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THE ANTICIPATED CORPORATE TAX PACKAGE: WATCH OUT FOR GIMMICKS AND GIVEAWAYS

By Joel Friedman

A Congressional conference committee, chaired by House Ways and Means Chairman Bill Thomas, is scheduled to meet late on October 4 to finalize a package of corporate tax changes. The package will raise revenue primarily by repealing an export subsidy that the World Trade Organization has ruled to be illegal, closing some corporate tax shelters, and extending expiring user fees. It will use these savings not to reduce the deficit or to address other national priorities, but to provide a raft of new tax breaks, primarily for corporations.

Chairman Thomas has indicated that the final package will be "revenue neutral." The Senate deserves credit for pushing the House to agree to this goal, as the House-passed package would have explicitly increased the deficit. The key issue, however, is whether this goal will be achieved without resorting to budgetary sleight of hand. Those assessing the package emerging from conference should be on the look-out for various gimmicks and maneuvers that are likely to be employed to produce an official "score" of budget neutrality, but that could obscure the package's real long-term impact on the budget. Since 2001, the Congressional leadership has consistently employed budget gimmicks to hide the true cost of tax cuts, thwarting the efforts of those seeking to impose some degree of fiscal restraint in response to a worsening fiscal outlook.

True Cost of Bill May Be Higher Than the "Official" Cost

A "revenue neutral" tax bill is one that does not increase the deficit. In most cases, the shorthand test of whether a bill is revenue neutral is if the Joint Committee on Taxation "scores" the cost of the tax reductions in the bill as being offset over the ten years from 2005 through 2014 by savings from revenue-raising provisions in the bill. Unfortunately, the integrity of these official estimates and their value as a shorthand test can be severely undermined by budget gimmicks that mask the true cost of tax packages. With such devices, a measure that appears to be "revenue neutral" over ten years, according to the official Joint Tax Committee "score," may result in large increases in the deficit when all of the provisions in the bill are fully in effect, particularly in the years beyond 2014.

- One tactic is to slowly phase in tax cuts over the ten-year period covered by the official cost estimate. This has the effect of showing a lower cost for a tax cut in the first part of the decade, when it is not yet fully in effect. But it is the higher cost later in the decade, when the tax cut *is* fully in effect, that will be continued into the future and that is the best gauge of the tax cut's long-term impact on the budget. When this maneuver is used for provisions in a tax-cut package, the official cost estimate of the package usually shows revenue losses in the tenth year, indicating that there will be on-going revenue losses in years after that and

over the long term, despite the bill's officially being scored as "revenue neutral" over the first ten years.

- The "discussion draft" of the corporate tax bill that Chairman Thomas circulated last week already makes use of the tactic of slowly phasing in tax cuts. The draft shows the largest tax cut in the package — a deduction for domestic manufacturers — would be phased in slowly and not become fully effective until 2010. Because of the slow phase-in, about one-third of the provision's estimated $80 billion ten-year cost would be concentrated in the final two years.

- Another device that could be employed in the conference agreement involves having tax cuts expire before the end of the ten-year period, even when the intention is to extend these tax cuts so they remain in effect on an ongoing basis. Defenders of such temporary provisions may argue that the cost of extending these tax cuts will be paid for at the time the tax cuts are extended. But such promises are not reassuring, given recent Congressional actions.

  Last month, Congress failed to cover any of the cost of extending the so-called "middle-class" tax cuts enacted in 2003 and other expiring provisions, despite their $146 billion price tag. Calls by some members, such as Senator Max Baucus, the Finance Committee's ranking member, to offset these costs were rejected by the Congressional leadership and the White House.

  Failure to pay for these tax cuts made a mockery of claims that Congress, by making the "middle class" tax cuts temporary in 2003, had really limited the cost of that package to $350 billion. A cost of $350 billion was the maximum that the tax cuts could carry last year and still pass the Senate. Only by allowing the tax cuts to expire or paying for their extension could the promise made last year that the cost of the 2003 package was limited to $350 billion be upheld. Despite the fact that CBO estimates that the ten-year deficit has worsened by more than $2 trillion since enactment of the 2003 tax-cut legislation, these expiring tax-cut measures were extended last month with no offsets whatsoever.[1]

- One maneuver that helps make the corporate tax package deficit-neutral has already been put into effect: nearly two dozen expiring, mostly corporate, tax-cuts extensions were stripped out of the House and Senate corporate tax bills and inserted into the just-passed "middle-class" tax bill instead. Once part of that bill, the cost of these provisions did not have to be offset. This shift makes it easier for Congressional tax-writers to present the corporate bill as revenue-neutral, but it results in higher deficits just the same.

  This group of expiring corporate tax breaks is popularly known as the "extenders" because they are routinely extended whenever they are scheduled to expire

[1] CBO's baseline deficit projection has increased by about $3 trillion (not including the increase attributable to the 2003 tax cut itself), but the CBO baseline mechanically assumes the repetition of costs in Iraq and Afghanistan each year over the coming decade. After adjustment to remove much of those costs, the increase in the projected deficit falls below $3 trillion but remains well in excess of $2 trillion.

(frequently without their costs being offset, as the "middle-class" tax-cut bill shows). To the extent that a tax cut is made "temporary" in the corporate tax bill, one can assume that its supporters will work hard to ensure that it joins the ranks of these "extenders" in the future, as membership in this club virtually guarantees that it will not be allowed to lapse and possibly without regard to whether the cost of extending it is offset.

Overall, the commitment to "revenue neutrality" should be applauded, but only if it is upheld honestly. Unfortunately, the Congressional leadership has shown a willingness to run roughshod over positions that call for more fiscally responsible proposals. The use of budget gimmicks, especially with regard to tax cuts, has reached unprecedented heights with the enactment of the 2001, 2003, and 2004 tax-cut packages. Each step of the way, Congress has taken credit for scaling back tax-cut packages in the name of fiscal restraint, only to turn around and undo that restraint in subsequent tax bills. In the absence of meaningful budget rules, such as pay-as-you-go requirements that apply to both tax cuts and entitlement increases, there is little evidence to suggest that those in Congress seeking fiscal responsibility can prevail upon the leadership to pay for future tax cuts or extensions of existing tax cuts.

More New Corporate Tax Breaks

The House- and Senate-passed corporate tax bills — and thus presumably the conference agreement that will emerge — would raise substantial revenues. The revenue-raising provisions, such as repealing the FSC-ETI export subsidy and curbing corporate tax shelters, generally represent positive steps and sound policy. Unfortunately, these savings are not being used to reduce the deficit or meet other pressing priorities, but rather are being plowed back into more tax breaks mostly for corporations. This comes at a time when corporate revenues are at historically low levels, and evidence of tax-avoidance schemes by corporations is abundant.

- Corporate income tax revenues are projected to total just 1.6 percent of the Gross Domestic Product in 2004, according to the Congressional Budget Office, *lower than the average level in every decade from the 1940s to the present*. Moreover, CBO projects that corporate tax receipts will remain low in coming years in historical terms and will equal only about 1.5 percent of GDP in 2014.

- A new study by the Institute on Taxation and Economic Policy of 275 of the nation's largest corporations shows that over the three-year period from 2001 through 2003, they paid just 18 percent of their profits in tax — or only about half the statutory rate of 35 percent. Over these three years, 82 of these companies paid no taxes or received a tax refund in at least one year, even though all of these companies were profitable.

- Some of the companies that pay little or nothing in taxes stand to benefit from the tax breaks likely to be included in the corporate tax package. The *Washington Post* has reported, for example, that General Electric has strongly influenced this legislation and may end up gaining new tax advantages from it.[2] Yet according to

[2] Jeffery H. Birnbaum and Jonathan Weisman, "GE Lobbyists Mold Tax Bill," *Washington Post*, July 13, 2004.

the ITEP study, of the 275 companies examined, GE was the single largest recipient of tax breaks between 2001 and 2003. GE received $9.5 billion in tax breaks over this period, which lowered its effective tax rate over the period to a meager 9 percent. In 2001, GE paid no taxes at all, even though it earned profits of $12 billion in that year.

- Another study, by former Treasury Department economist and tax expert Martin Sullivan, shows that U.S. companies have been shifting more of their profits to tax-haven countries, such as Bermuda, to avoid paying U.S. taxes.[3] The study finds that "the profit shifting appears to reflect an aggressive use — or abuse — of the nation's tax laws," resulting in revenue losses to the Treasury of "at least $10 billion and perhaps as much as $20 billion annually." Sullivan points out that while U.S. companies have shifted profits to these tax haven countries, they have not shifted equipment and jobs — that is, real economic activity — to these countries. This is a sign that the profit-shifting represents an abusive tax-avoidance strategy.

Given the bleak fiscal outlook, particularly once the baby-boom generation begins to retire in large numbers, policymakers should be taking steps to bolster the corporate tax base, not to erode it further by doling out more tax breaks to corporations, particularly corporations that have been aggressive in avoiding paying U.S. taxes.

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[3] Martin Sullivan, "Profit Shift Out of U.S. Grows, Costing Treasury $10 Billion or More," *Tax Notes*, September 28, 2004.