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TEMPORARY PROVISIONS IN THE CORPORATE TAX BILL MASK ITS LIKELY LONG-TERM IMPACT ON THE DEFICIT

by Joel Friedman

The conference committee chaired by House Ways and Means Chair Bill Thomas completed work on the corporate tax bill on October 6, and the House and Senate are expected to vote on the measure before adjourning this week. The bill would take the positive step of repealing an export subsidy that has been declared illegal by the World Trade Organization and closing a number of corporate tax shelters. Unfortunately, the bill uses the revenues raised by these provisions to finance a raft of new corporate tax cuts. Many are narrowly focused, special-interest tax breaks that offer no benefit to the economy as a whole. These tax cuts only serve to erode the corporate tax base at a time when corporate tax revenues have fallen to historically low levels and evidence of corporations engaging in tax-avoidance schemes is abundant.

The bill misses an important opportunity to make progress in addressing the nation's fiscal problems by dedicating the revenues raised by repealing the export subsidy and closing loopholes to deficit reduction. In fact, despite an official cost estimate that shows the bill to be deficit neutral, the measure is likely to lead to higher deficits in the future. The bill includes a number of temporary tax cuts, many of which are candidates for inclusion in the growing list of "extenders" — those temporary tax cuts that are routinely extended. If these new tax breaks are extended in coming years without being paid for — a likely scenario in the absence of pay-as-you-go rules that require the cost of such tax to cuts be offset — the result will be higher deficits.

Official Cost Estimate Likely To Understate Full Cost of Bill

This short analysis examines one issue — how much is this corporate tax bill likely to cost? According to the official cost estimate prepared by the Joint Committee on Taxation, the measure is essentially budget neutral over the ten-year period, 2005 through 2014. But the accuracy of this estimate relies on the crucial assumption that all of the provisions in the bill that expire before 2014 will in fact be allowed to expire. If instead new tax cuts not really intended to be temporary are extended, the bill's deficit neutrality will evaporate unless the

Temporary Tax Cuts in the Corporate Tax Bill That Are Likely to be Extended (in billions of dollars, 2005-2014)

	Additional cost if tax cuts are extended
Small business expensing	$-32.7
Deduction for state & local sales taxes	-29.8
Alcohol fuels income tax credit	-5.7
Other expiring tax cuts*	-11.3
Total, temporary tax-cut provisions	**-79.5**

*Does not include the transition assistance for ETI repeal, the tax break for repatriated funds, or the bonus depreciation provisions.

costs of extending these provisions are offset. If these costs are not offset, extending these provisions would reduce revenues by *nearly $80 billion* through 2014.

How valid is the assumption that these temporary tax cuts will *not* add to the deficit in future years? Based on the actions of Congress since 2001, there is little reason to think this assumption will prove accurate over the long run:

- It seems evident that there will be significant pressure to extend a number of the tax breaks that the bill establishes but also schedules for expiration. As one example, the small business "expensing" tax break (section 179 expensing) was initially enacted in 2003 on a temporary basis supposedly to stimulate a weak economy, but it was always clear that strong efforts would be made to extend it. Extending it through 2007, as the corporate tax bill would do, makes clear that the provision is no longer linked to the economic slowdown and that the intent is to make it a regular feature of the tax code.

  Similarly, the deduction for state and local sales taxes would be in place only for 2004 and 2005, but given the ease with which it was attached to this corporate tax bill (despite the irrelevance of this deduction to the issues the corporate tax bill addresses), it is difficult to believe this tax cut will not be routinely extended. Extending these two provisions alone would cost an additional $63 billion in cost through 2014. In fact, except for the bill's deduction for domestic manufacturers, these two provisions would be the most costly tax breaks in the entire bill had the bill continued them through 2014.

- If these temporary provisions are extended, there are no pay-as-you-go rules in place that would compel Congress to offset the cost of their extension. The pay-as-you-go rules expired in 2002. There are no budget rules that require Congress to pay for tax cuts (or entitlement expansions) and no automatic across-the-board program cuts to enforce fiscal discipline if Congress acts again to increase the deficit.

- Moreover, in the absence of pay-as-you-go rules, the Congressional leadership has shown readiness to disregard commitments to hold the line on costly tax cuts. The use of budget gimmicks to hide the true cost of 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. Just 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. 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 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 those tax cuts to expire or paying for their extension could last year's promise that the cost of the 2003 tax-cut package was limited to $350 billion be upheld.

What Happened to the "Extenders"?

Both the House- and Senate-passed corporate tax bills included short-term extensions for about two dozen tax cuts, mostly for corporations. These popular tax breaks are known as "extenders" because they have been written into the law on a temporary basis but are routinely extended. Although these extensions were part of both the House- and Senate-passed corporate tax bills, they are not included in the conference agreement. Rather they were shifted to the package of "middle class" tax cuts signed into law October 4, where they accounted for $13 billion of that bill's $146 billion cost through 2014. Once shifted to the "middle class" package, these tax-cut extensions were not offset.

Shifting these extensions from the corporate tax bill to the "middle class" tax bill made it easier for the corporate bill to achieve its official deficit-neutral "score." But that maneuver still results in higher deficits. It is little more than a shell game, with the costs being shifted from one bill to another. Further, the long-term costs are potentially much higher than the official $13 billion estimate. If these corporate tax "extenders" are continually extended without the cost being offset — a likely scenario for these popular provisions, as evidenced by their treatment in the "middle class" bill — revenues will be reduced by another $117 billion through 2014.

As noted, extending the temporary provisions in the bill would reduce revenues by about $80 billion through 2014. This estimate does *not* include the impact of extending all of the temporary provisions in the bill. Rather, it assumes that some of these provisions — such as the general transitional assistance for companies affected by the repeal of the export subsidy, an expansion of bonus depreciation provisions enacted in 2002 to cover certain aircraft, and the tax holiday for the repatriation of foreign earnings — will, in fact, be allowed to expire. This assumption may be too optimistic. For instance, concerns have been raised that the tax holiday for repatriated funds may be viewed as a precedent, with pressure to repeat the tax holiday at some point in the future. If these tax cuts, as well, are extended or repeated without their costs being offset, the revenue losses would be higher than the $80 billion figure cited here.

Conclusion

The corporate tax package should not be viewed in isolation. It should be seen in the context of the "middle class" package signed into law on October 4. The tax cuts in that legislation cost $146 billion through 2014, with none of the costs being offset. The revenue-raising provisions in the corporate tax bill could have been used to offset nearly all of those costs. In other words, Congress could have extended those popular "middle-class" tax cuts without damaging the budget. Instead, Congress chose a far more fiscally irresponsible approach. It used the revenue raised from repealing an illegal export subsidy and closing corporate tax shelters to pay for a dizzying array of new, mostly corporate tax breaks, while using deficit-financing for the "middle-class" bill. And, if some of the temporary tax breaks in the corporate bill are extended without offsets, as seems likely to occur in the absence of a pay-as-you-go rule, the bill will add further to the deficit over the long term. With the retirement of the baby-boom generation looming, the nation can ill-afford such blatant disregard for fiscal responsibility.