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NEW GAMBIT TO PASS TAX CUT EXTENSIONS WITHOUT PAYING FOR THEM REPRESENTS UNSOUND POLICY

by Robert Greenstein and Isaac Shapiro

Spurred by a White House meeting on July 7, Republican leaders in Congress are reportedly planning to use an unusual strategy to extend certain tax cuts without paying for them. The strategy is to adopt these policies by reviving a moribund conference committee on a largely unrelated bill and attaching the tax-cut extensions to a "conference report" on that bill, thereby bypassing normal consideration in the Senate Finance Committee and on the Senate floor of whether the tax-cut extensions should be paid for. This gambit is designed to force a single up-or-down vote on a conference report that would consist primarily of tax-cut extensions the Senate has not previously considered. Those who vote against the conference report would likely be attacked as favoring "tax increases" on middle-class families, despite the fact that nearly all Senators and Congressmen who voted "no" would favor legislation to extend these tax cuts and offset the costs of doing so.

The Republican Congressional leadership has not yet announced the details regarding how it plans to proceed, but key elements of the plan are known. The leadership would use a dormant conference committee on a bill passed over a year ago in response to embarrassing publicity generated by an unsavory aspect of the 2003 tax-cut legislation — the last-minute deletion from that legislation of a Senate provision accelerating (from 2005 to 2003) a child tax credit expansion for low-income families. The leadership would take this bill, pare back its low-income provisions (by accelerating the low-income child tax credit provision just to 2004, since 2003 is past), and add to the bill a multi-year extension of three "middle-class" tax provisions scheduled to expire at the end of 2004, as well as a one-year extension of relief from the Alternative Minimum Tax. (The three "middle-class" provisions in question are provisions enacted in 2003 to accelerate full implementation of the 10-percent tax bracket, the increase in the child tax credit to $1,000 per child, and tax cuts for married families.)

This would mark a sharp departure from the Senate child tax-credit bill for low-income working families that was passed and sent to conference last year. The Senate bill had a modest cost, *all* of which was offset so the bill would not increase the deficit. The new bill would cost vastly more than last year's Senate bill — the price tag would be about $120 billion if, as reported in some quarters, the "middle-class" tax-cut provisions are extended for five years.[1] This cost apparently would *not* be offset.

[1] These costs do not take into account the increased interest payments that would result. They also do not reflect the reality that the AMT fix will surely continue beyond 2005.

A modest $1.8 billion of this $120 billion cost — or *1.5 percent* of it — would come from the acceleration to 2004 of the low-income child tax credit provision. More than 98 percent of the cost would come from other provisions that the leadership would add to the bill, even though many of those provisions apparently would be outside the "scope" of the conference.

In this manner, a bill to benefit low-income working families without enlarging the deficit would be turned into a bill primarily to benefit other families, including high-income families, and to add substantially to the deficit.

Proposed Legislation Would Make a Mockery of $350 Billion Cost Estimate for the 2003 Tax-cut Law

The 2003 tax-cut legislation was supposed to cost $350 billion over 10 years. The $350 billion limit was established because of serious concerns in the Senate over the effects of larger tax cuts on the long-term deficit. To hold the bill's cost to $350 billion, the bill's designers crafted provisions of the bill accelerating the phase-in of three "middle-class" tax cuts enacted in 2001 (the 10-percent tax bracket, increase in the child tax credit, and marriage-penalty relief) so these accelerations would be in effect only in 2003 and 2004. The accelerations are scheduled to expire on December 31, 2004.

If the accelerations of these tax cuts are now extended *without* the cost of these extensions being offset, the 2003 tax cut will turn out to have rested upon an egregious budget gimmick — and policymakers who supported and defended the 2003 legislation on the grounds that its costs were limited to $350 billion will turn out either to have been disingenuous or to have been deceived. (Some policymakers were honest about the 2003 bill when it was enacted and openly acknowledged that the ultimate cost would be far larger, but many did not.)

It should be noted that the deficit outlook has deteriorated even further since the 2003 legislation was enacted. The projection of the cumulative deficit for the period from 2004-2013 is now more than *$2 trillion* larger than it was when the 2003 tax cuts were enacted a year ago.[2] (In August, CBO is expected to lower its deficit projection for 2004 somewhat, but the mid-term and long-term deficit projections are not expected to change markedly, and the deficit picture will still look much worse than when the 2003 tax cuts were enacted.)

Potential Offsets Are Available to Pay for Tax-cut Extensions

Adding to the problematic nature of the approach that the White House and Congressional leadership appear to be taking is the fact that potential offsets are available. One suitable candidate would be the package of offsets, most of which close corporate tax shelters, that is included in the corporate tax bills the Senate and House have recently adopted. The

[2] 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.

Senate bill raises about $130 billion over the next ten years, primarily by cracking down on tax shelters. (This amount is in addition to the $50 billion that would be saved by repealing an export subsidy the World Trade Organization has ruled to be illegal.)

Both the Senate and House bills use these revenues to pay for new corporate tax breaks. Since Congress seems intent on extending the "middle-class" tax cuts, it would be better policy to use these revenues to offset the costs of these extensions, rather than to finance these extensions by running up larger deficits and then to use the savings from the corporate loophole closings to create a new array of corporate tax breaks.

If the revenues that could be secured from closing corporate tax breaks were not sufficient to pay for the middle-class tax-cut extensions in full, Congress could modestly scale back the very generous upper-income tax cuts adopted in 2001 and 2003 to make up the difference. The Urban Institute-Brookings Institution Tax Policy Center reports that households with incomes exceeding $1 million are receiving an average tax cut this year of $123,600.

Are Middle-income Families the Prime Beneficiaries of These Tax Cuts?

The tax-cut extensions would benefit the broad middle class. They also would benefit high-income households.

The 10-percent bracket offers the same tax-cut benefit to a family with an income of $400,000, or of $4 million, as it does to a family with $40,000 of earnings. The tax breaks for married couples are worth somewhat *more* to upper-income married couples than to couples in the middle of the income spectrum.[3] Only the child tax credit phases out for those with incomes above a certain level.

Overall, data from the Tax Policy Center show that the middle fifth of households is receiving an average tax cut of $547 in 2004 from the three "middle-class" provision that would be extended. The highest-income fifth of households is receiving an average tax cut of $1,558 from these provisions.[4]

High-income Families May Receive a Large New Child Tax Credit Expansion

Moreover, the biggest winners from the new package could be certain higher-income families. One unknown aspect of the package is whether it will contain a *new* tax-cut provision to extend the child tax credit to substantial numbers of families with incomes too high to qualify for the credit under current law.

[3] When the three tax-cut provisions for married couples are fully in effect, nearly two-thirds of their annual cost results from the one provision that *only* benefits higher-income couples. This provision widens the 15 percent bracket, which benefits only families with incomes above the income level at which the old 15 percent bracket ends. About one-third of married couples have incomes this high. The two-thirds of married couples who are in the 15 percent bracket or lower tax brackets do not benefit from this provision.

[4] Isaac Shapiro and Joel Friedman, *Tax Returns: A Comprehensive Assessment of the Bush Administration Tax Cuts*, Center on Budget and Policy Priorities, pages 20-22.

The day after the 2003 tax bill was signed, the *New York Times* ran a front-page story calling attention to the failure of the bill to accelerate a child tax credit provision targeted on lower-income families. In the wake of embarrassing publicity on the deletion of this provision from the 2003 tax-cut bill, the Senate and House passed bills last year to accelerate the lower-income child-tax-cut provision as well, so it would take full effect in 2003 rather than 2005.

The price of securing the agreement of the Republican Congressional leadership to move these bills in the Senate and House last year was the inclusion in the bills of a major increase in the child tax credit for higher-income families. Both the Senate and House bills raised the income level at which the child credit starts to phase down from $110,000 (for married couples) to $150,000. This would make married families in the $110,000 – $150,000 range, who now receive a partial child tax credit, eligible for a full credit of $1,000 per child. Last year's bills also would extend a partial child tax credit to many families in the $150,000 – $190,000 range and, in the case of families with three or more children, to some families with incomes exceeding $200,000. Moreover, the House went further this year and passed legislation to raise the income level up to which the full child tax credit would be provided to $250,000 for married couples and to provide a partial child tax credit to many families in the $250,000 – $300,000 range.

It is unclear whether the "conference report" that the leadership plans to bring to the House and Senate floors will raise the income level for the child tax credit and use still more deficit financing to do so. It bears noting that families at these income levels do not need government subsidies to raise their children.

The Ultimate Irony: Low-income Children Would Likely be Made Worse Off

What began over a year ago as an effort to benefit working-poor families with children and to remedy an inequity in the 2003 tax-cut law — which accelerated tax cuts for the richest households but refused to accelerate tax cuts for the working poor — may thus end up providing a vehicle that is used to enact legislation which may further impoverish poor families over time. The legislation would provide modest benefits to low-income families with children, but those benefits would be heavily outweighed by the effects of adding up to $120 billion to deficits. By swelling the deficit, the proposed legislation would likely lead at some point to larger budget cuts, much of which would be likely to come from domestic programs, including programs that serve low-income families and children. (Indeed, such programs are more likely to be cut than, say, programs such as Medicare or the defense budget.) With the modest benefit that the legislation would provide to low-income families constituting but a tiny fraction of the amount by which the deficit would be increased, the likelihood is high that enactment of this legislation would ultimately make poor families and children worse off.