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## ADMINISTRATION'S TAX CUTTING AGENDA WOULD COST \$2.7 TRILLION THROUGH 2013

By Joel Friedman, Richard Kogan, and Denis Kadochnikov

The Administration's budget includes the tax cuts contained in the "growth package" released in early January, the proposal to make the 2001 tax cuts permanent, and a number of other tax-cut provisions. New estimates by the Joint Committee on Taxation, Congress's official scorekeeper of tax legislation, show that, taken together, these tax cuts would cost \$1.6 trillion through 2013.<sup>1</sup> This would *more than double* the amount of tax cuts enacted since the Administration took office.

But this \$1.6 trillion figure underestimates the dimensions of the Administration's tax-reduction agenda and its impact on the federal budget. First, the increase in interest payments on the debt that would result from these tax cuts is not included in the \$1.6 trillion figure. This cost must be taken into account. Tax cuts and spending increases result in larger deficits (or smaller surpluses) than otherwise would occur and thereby increase the size of the national debt. The larger the debt, the greater the cost of the interest payments that must be made on the debt. Under the standard method that CBO and OMB employ to estimate interest costs, the tax cuts in the Administration's new budget would result in \$371 billion in additional interest payments on the debt over the next ten years. That places the cost of the tax-cut proposals at \$1.95 trillion over this period.

**Table 1**

<b>Cost of Bush Administration Tax-Cut Agenda, 2003-2013 (in billions)</b>			
	<b>Revenue Loss</b>	<b>Interest</b>	<b>Total</b>
"Economic Growth" Package	\$726	\$268	\$994
Make 2001 Tax Cuts Permanent	\$624	\$48	\$672
All Other Bush Tax Proposals	\$225	\$55	\$280
Extend Alternative Minimum Tax Relief	\$658	\$111	\$769
<b>Total</b>	<b>\$2,233</b>	<b>\$483</b>	<b>\$2,716</b>

Even this \$1.95 trillion figure understates the magnitude of the Administration's tax reduction agenda. This figure omits the cost of preventing the Alternative Minimum Tax from exploding into the middle class in years after 2005. Unless changes in law are made, the number

<sup>1</sup> In this analysis, all estimates of the direct cost of tax proposals are from the Joint Committee on Taxation's analysis of the Bush FY 2004 budget. See JCT table JCX-15-03, March 4, 2003. The JCT estimates, like the equivalent Treasury estimates, include both the revenue effects and the outlay effects of the tax proposals. (Some of the proposals that would reduce tax liabilities also have the effect of increasing the amount of tax credits that are paid in a refundable form. Increases in refundable tax credit payments are classified as increases in "outlays.")

### **Total Cost — Including the 2001 Tax Cut — Equals \$4.6 Trillion Through 2013**

As noted, the cost of the tax cuts in the President's budget and extension of the AMT relief that the budget contains would cost \$2.7 trillion through 2013. These costs come on top of the original cost of the 2001 tax cut, which lasts through 2010. In total, the costs from 2001 through 2013 of the tax cuts enacted to date and the additional tax-cut agenda reflected in the new budget amount to \$4.6 trillion, including interest payments. In 2013, the combined revenue losses would constitute a larger share of the economy than did the Reagan tax cuts of the early 1980s.

of taxpayers who are subject to this tax will mushroom from two million today to nearly 40 million by the end of the decade. The Administration's budget provides AMT relief only through 2005; Administration officials have said they will wait until 2005 to propose addressing the AMT problem in the years after that. This delay enables the Administration to leave these costs out of its budget.

But these AMT costs clearly are coming. Taking the relief that the Administration proposes through 2005 and extending it through the rest of the decade adds approximately \$770 billion in cost through 2013, including the interest payments on the debt. This brings the overall cost of the Administration's tax cut path to \$2.7 trillion over ten years. (See Table 1.)

Moreover, the costs in decades after 2013 would be even larger, despite the fact that those are the decades in which the baby-boom generation will be retiring in large numbers and deficits already are projected to reach unmanageable levels. For example, the cost of estate tax repeal would be much higher in subsequent decades than through 2013 because estate tax repeal does not take effect until 2010. In addition, the dramatic changes that the budget proposes in the taxation of savings and retirement accounts are designed so they have no net cost over the first ten years but ultimately result in enormous revenue losses. The ultimate cost of the savings provisions would be far larger than the cost of the dividend proposal and possibly larger than the cost of estate tax repeal.

The ultimate cost of the emerging tax-cut agenda thus can only be described as massive. The remainder of this analysis examines in more detail the budgetary effects of the principal elements of the Administration's tax-reduction plans.

### **The "Economic Growth" Package**

The President announced his new "economic growth" package on January 7, 2003. The package includes \$726 billion of tax cuts, along with \$4 billion of new spending for personal re-employment accounts.<sup>2</sup> The centerpiece of the Administration's tax-cut package is a proposal to exempt from individual income taxes the corporate dividends that are paid out of corporate profits subject to the corporate income tax. The JCT estimates this tax cut would reduce revenues by \$396 billion through 2013.

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<sup>2</sup> The Treasury estimates a cost of \$695 billion through 2013 for the "growth" package, of which \$388 billion is for the dividend proposal. The Joint Committee on Taxation estimates a cost of \$396 billion for the dividend provision, and (as noted) a cost of \$726 billion for the entire "growth" package.

### **The Popular Misimpression About Why the Tax Cuts Expire in 2010**

It often is mistakenly said that the framers of the 2001 tax-cut legislation had to make the 2001 tax cuts expire in 2010 in order to comply with Senate rules. In fact, compliance with Senate rules would have required the tax cuts to expire in 2011, not 2010. The framers of the legislation chose to have the tax cuts expire in 2010 because the earlier expiration made the multi-year price tag of each provision smaller. That enabled them to shoe-horn more tax-cutting provisions into the legislation.

The other major component of the package is a proposal to accelerate four tax cuts enacted in 2001. The four provisions include: reductions in the top four income-tax rates; an increase in the amount of taxable income that is subject to the 10 percent tax rate; an increase in the child tax credit to \$1,000; and increases for married couples in both the standard deduction and the amount of taxable income subject to the 15 percent tax rate. Under current law, these provisions become fully effective at various points between 2006 and 2010. The Administration proposes to make them all fully effective in 2003.

### **Making the 2001 Tax Cuts Permanent**

The large package of tax cuts that was enacted in 2001 is scheduled to expire at the end of 2010. According to the JCT, making the tax cuts that expire in 2010 permanent would cost \$624 billion through 2013. More than one-quarter of these costs would come from the repeal of the estate tax.

### **Additional Tax Proposals in the President's Budget**

The Administration's budget also includes other tax-cut proposals. The measures with the largest costs over the next ten years include a refundable tax credit for the purchase of health insurance in the individual health insurance market, the permanent extension of the research and experimentation tax credit, and a new deduction for the purchase of long-term care insurance. Similar or identical proposals were included in the Administration's first two budgets.

In addition, the Administration is proposing dramatic changes in the tax treatment of savings and retirement accounts. Under these proposals, most of the interest, dividend, and capital gains income in the nation eventually would be sheltered from taxation. The JCT shows these sweeping proposals as having net costs of only \$5 billion over the next ten years, largely because these tax cuts are structured in such a way as to "backload" their costs heavily into subsequent decades. While there would be almost no net revenue loss in the initial years, the losses would then mount with each passing year and eventually become extremely large.<sup>3</sup> A recent analysis by the co-directors of the Urban Institute-Brookings Institution Tax Policy Center estimated that the annual revenue loss could be on the order of 0.5 percent of GDP after 25 years, the equivalent of more than \$50 billion per year today. The authors concluded that "there is a

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<sup>3</sup> Robert Greenstein and Joel Friedman, "Proposed "Savings Incentives Would Cause Revenue Hemorrhage In Future Decades," Center on Budget and Policy Priorities, February 5, 2003.

great potential for erosion of the revenue base over the long term from this provision alone” and that the backloading amounted to “mortgaging future revenues ... at very unfavorable terms for the government.”<sup>4</sup>

The JCT estimates that, taken together, the dozens of proposed tax cuts that are outside the growth package (and are not part of the proposal to make the 2001 tax cut permanent) would cost \$225 billion through 2013.

## **The Alternative Minimum Tax**

The Administration includes measures in this year’s budget to protect taxpayers from the swelling Alternative Minimum Tax — but only through 2005. The *New York Times* recently quoted Pamela Olson, Assistant Secretary of the Treasury for Tax Policy, as stating that the Administration plans to propose a long-term solution to the AMT, but not until President Bush’s second term. The article reported, “The target date [for a longer-term AMT proposal] is 2005, she said. ‘We are working on it,’ Ms. Olson said.”<sup>5</sup> But although addressing the AMT problem is clearly part of the Administration’s plans, the costs of doing so beyond 2005 are not included in its budget.

### **Source of the AMT Problem**

The Alternative Minimum Tax is a parallel tax system originally designed to ensure that tax filers with high incomes could not avoid paying taxes altogether by aggressively using available deductions, exemptions, and tax shelters. Such taxpayers calculate their tax liability according to both the regular income tax and the AMT and pay whichever amount is higher.

Unlike the regular income tax code, however, the key components of the AMT are not indexed for inflation. As a result, as incomes rise over time to reflect the effects of inflation, more taxpayers become subject to the AMT. This problem was exacerbated by the tax cuts enacted in 2001, which reduced tax liabilities under the regular income tax code, particularly for those with high incomes, without making corresponding adjustments in the AMT.

About two million taxpayers are currently subject to the AMT. The Treasury Department estimates that the number of taxpayers subject to the AMT will soar to 39 million by 2012, assuming that the 2001 tax cuts are made permanent. The AMT would hit one of every three taxpayers in the nation by that year, with many middle-class families finding themselves subject to it and its complexities. By that time, the AMT would be “taking back” a goodly share of the 2001 tax cut from many of these families. It is inconceivable the President or the Congressional leadership of either party will allow the AMT to mushroom in this manner.

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<sup>4</sup> Leonard E. Burman, William G. Gale, and Peter R. Orszag, “The Administration’s New Tax-Free Savings Proposals: a Preliminary Analysis,” Tax Notes, March 3, 2003.

<sup>5</sup> David Cay Johnston, “Alternative Tax Looms Large Despite Plans for Other Cuts,” *The New York Times*, January 10, 2003.

## High Cost of AMT Relief

Preventing the individual Alternative Minimum Tax from exploding in size and encroaching heavily upon middle-class taxpayers in the years to come will be costly. Because the Administration currently is proposing AMT relief only through 2005, however, the estimated cost of making the 2001 tax cuts permanent is kept down, since the estimate rests upon the unrealistic assumption that AMT relief will end after 2005, the number of taxpayers subject to the AMT will explode after that year as a result, and the swollen AMT will cancel out a sizeable share of the tax cuts. This enables the Administration to show the cost of making the tax cut permanent as being much lower than that cost actually will be.

In reality, of course, AMT relief will be continued beyond 2005. The Bush Administration clearly intends to propose that such relief be maintained.<sup>6</sup> The cost of extending AMT relief beyond 2005 thus is essentially an "off-book liability" that must be considered part of the long-term cost of the Administration's proposal to make the tax cut permanent and to enact new tax cuts.<sup>7</sup> It is necessary to include the cost of addressing the AMT problem when assessing the long-term cost implications of the Administration's tax-cut proposals.

The Urban Institute-Brookings Institution Tax Policy Center has undertaken the most thorough review of the AMT issue to date.<sup>8</sup> Based on the Tax Policy Center analysis, extending beyond 2005 the AMT relief that the Administration is now proposing would reduce revenues by about \$660 billion through 2013, and result in a total cost of about \$770 billion when the increased interest payments on the debt are taken into account.<sup>9</sup> This may be a conservative

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<sup>6</sup> The Administration's temporary AMT relief builds on a similar provision in the 2001 tax-cut package that provided AMT relief through 2004. The cost of providing permanent AMT relief would have driven the cost of the 2001 tax-cut package well above what the fiscal year 2002 Congressional budget resolution allowed unless other elements of that package were scaled back. The framers of the tax cut consequently resorted to the gimmick of letting the AMT relief sunset at the end of 2004, knowing that Congress would have no choice but to extend AMT relief before the provision expired.

<sup>7</sup> The Administration has provided no indication that it would countenance scaling back parts of the enacted tax-cut package or raising other taxes to pay for the cost of the inevitable AMT relief or redirecting the AMT in a cost-neutral manner that would free large numbers of middle-class taxpayers from the AMT but expand its applicability to those at the highest income levels, whom the AMT leaves largely untouched.

<sup>8</sup> Leonard Burman, William Gale, Jeffery Rohaly, and Benjamin Harris, "The Individual AMT: Problems and Potential Solutions," Urban-Brookings Tax Policy Center Discussion Paper No. 5, September 2002.

<sup>9</sup> This AMT option would index the AMT exemption, tax-bracket thresholds, and exemption phase-out threshold for inflation beginning in 2002. These indexed levels would become effective starting in 2006, after the temporary relief proposed by the Administration has expired. This option is used here to illustrate the likely cost of the Administration's agenda because indexing the AMT parameters at 2002 levels produces an exemption amount in 2005 very similar to the Administration's proposal for that year (2005 is the final year of AMT relief under the Administration's new plan). The cost of AMT relief shown in this analysis is greater than the cost shown by the Tax Policy Center for two reasons. First, this analysis extends through 2013, and the cost of AMT increase grows dramatically each year. Second, this analysis also includes that assumed permanent extension of EGTRRA while the Tax Policy Center assumed EGTRRA would expire in 2010. As noted, EGTRRA substantially increases the number of tax filers subject to the AMT and therefore the cost of AMT relief. Finally, it should be noted that the Tax Policy Center analysis also includes a cost-neutral AMT relief option that shields most middle-income tax filers

estimate, as such AMT relief would still leave 10 million tax filers subject to the AMT by the end of the decade.

## **Conclusion**

The Administration's "economic growth" package represents but a portion of the Administration's tax-cutting plans. The Administration also is proposing to make permanent the tax cuts enacted in 2001 and to enact a wide variety of other new tax-cut measures. Furthermore, to ensure that these tax cuts do not dramatically increase the number of tax filers subject to the Alternative Minimum Tax, the Administration has indicated it will propose further AMT relief after 2005, when the temporary relief in its current budget would expire.

Taken together, these tax proposals (including the extension of AMT relief) would reduce revenues by more than \$2.2 trillion through 2013. This loss of revenues would lead to a higher debt and an increase in interest payments totaling more than \$480 billion through 2013. When these two costs are combined, the overall impact of the Administration's tax-cut plans on the budget reaches \$2.7 trillion through 2013 (and much more in subsequent decades). Finally, when these costs are added to the costs of the tax cuts that were enacted in 2001, the total cost of tax reductions from 2001 through 2013 mounts to \$4.6 trillion.

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from the AMT and offsets the cost by reforming the AMT so it applies to taxpayers at very high income levels. (See Burman *et al.*, footnote 8.)