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GIMMICKS MASK TRUE COST OF REVISED THOMAS CORPORATE TAX-CUT PACKAGE

by Joel Friedman

The House Ways and Means Committee is scheduled to consider a package of corporate tax cuts on October 28. According to Joint Committee on Taxation estimates, the package includes tax cuts totaling $128 billion, about one third less than the $200 billion cost of the tax cuts in the original corporate-tax package that Ways and Means Committee Chairman Bill Thomas introduced in August. The new Ways and Means package also includes revenue-raising provisions, which reduce its overall ten-year cost to $60 billion (as compared to $128 billion for the original Thomas proposal). In developing the revised package, Chairman Thomas dropped several costly provisions that were included in his original bill.

Nevertheless, the $60 billion ten-year cost of the revised package substantially understates the measure’s true long-term cost. The package relies heavily on budget gimmicks to mask the costs of its tax-cut provisions.

In fact, a distinguishing feature of the revised package is that few of its tax cuts take full effect immediately. They either would not begin to be implemented until some time after 2004 or would phase in over several years and not take full effect until later in the decade. In the case of the rate reduction for domestic manufacturing, which becomes fully effective in 2007, the delay is arguably timed to coincide with the phase out of the export subsidies that are repealed in 2007 under the bill. But in other cases these delays are used as a gimmick, reducing the number of years within the ten-year budget period in which the tax cuts would be in full effect and thereby artificially shrinking the official cost of the package.

The ten-year cost estimate is thus a poor indicator of the package’s true impact on the budget over the long term. Yet it is in the long term — the years beyond the current ten-year budget window — when the nation faces severe budget challenges, with a large and growing mismatch between projected revenues and projected expenditures.

- As a result of the delayed implementation of numerous tax cuts — for instance, two of the major tax cuts in the package would not become effective until 2009, and the rate cut for small businesses would only become fully effective in 2012 — the revenue losses in the package as a whole (including offsets) are concentrated in the latter part of the decade. *More than half of the revenue losses would occur in the last three years of the ten-year period*. In 2013 alone, the revenue loss in almost $12 billion, or one-fifth of the ten-year total.

- If all of the provisions in the bill took effect immediately, without delays, then the ten-year cost of the measure would likely be about *60 percent higher* than the official $60 billion cost. Further, some provisions in the package are slated to expire before 2013; if they are assumed to be extended, the ten-year cost rises higher. In fact, if all the tax cuts in the bill were fully in effect throughout the ten years covered by the cost estimate — as they likely would be in subsequent ten-year periods — the cost through 2013 would be *more than double* the official $60 billion price tag.

- The long-term budgetary impact of the package is likely to be even more troublesome than these higher ten-year estimates indicate, because some of the offsets used in the package are slated to expire at the end of 2013, while all of the tax cuts in the package that would be in effect in 2013 would be permanent. This is yet another gimmick. Under the bill, the Customs Service and IRS user fees — which together represent over 20 percent of all of the offsets in the bill in 2013 — would expire after 2013, but the tax cuts whose costs these fees would partially offset would be permanent. This means that in 2014, the Customs Service and IRS user fees could be extended again, with the "savings" used to offset a new set of tax cuts on top of the corporate tax cuts in the Thomas bill.

The magnitude of the budgetary game-playing in the revised Thomas package is large. Putting aside the manufacturing rate cut — which accounts for $61 billion of the $128 billion in tax cuts before the offsets have been applied[1] — more than 95 percent of the cost of the remaining tax cuts in the package reflect the cost of provisions that either (1) do not start to take effect until after 2004, (2) phase in over an extended period of time and do not become fully effective until later years, or (3) sunset artificially before the end of the ten-year period. All three such maneuvers shrink the ten-year cost estimate. A ten-year cost estimate can provide a credible indicator of a tax cut's true ongoing cost only if the tax cut takes effect promptly and does not expire prematurely.[2]

New Tax Cuts Dubious Given Worsening Budget Outlook

If the official cost estimate of $60 billion for the next ten years were an accurate reflection of the ongoing cost of the tax-cuts in the revised Thomas corporate tax-cut package, that cost still would be unwarranted, given the dismal fiscal outlook. A joint analysis by the Center on Budget and Policy Priorities, the Concord Coalition, and the Committee for Economic Development projects deficits totaling $5 trillion through 2013 and rising to much higher levels

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[1] Some press reports have stated that the tax cuts in the revised Thomas plan total about $140 billion, rather than the $128 billion figure used here. The $140 billion figure counts as a new tax cut the $12 billion cost of continuing a portion of an existing export subsidy before the subsidy is eliminated entirely. Under that accounting, the revenue raised by repealing the remaining portion of the export subsidy also is counted as being a $12 billion larger offset, so the net cost of the bill remains at $60 billion. We view the cost of continuing the portion of the export subsidy as reducing the savings associated with repealing the subsidy, rather than as a new tax cut. In any event, these are simply two different ways of counting the costs and the offsetting savings in the bill, both of which result in the same net cost for the bill as a whole.

[2] Even if one were to assume there were legitimate policy reasons for delaying implementation of these tax cuts for two years — until after 2005 — the picture would change little. More than three-quarters of the official, ten-year cost estimate excluding the manufacturing rate cut would still reflect provisions that would not become fully effective until after 2005 or would sunset before the end of the ten-year period.

Gimmicks Seen and Unseen in the Revised Thomas Plan

As this analysis explains, the revised package of corporate tax cuts that the House Ways and Means Committee will consider on October 28 is rife with budget gimmicks that artificially reduce its official ten-year cost. Ways and Means Committee Chairman Thomas has relied on delaying the implementation of most of the major tax cuts so they do not become effective for several years or phase in slowly over the decade.

Chairman Thomas reportedly is relying on another gimmick as well. Provisions of the original Thomas bill that were dropped in the revised bill but are included in the Senate Finance Committee version of the legislation can be added back in conference committee. A recent article in *Tax Notes* reports: "According to a Ways and Means aide, any duplicate tax pieces pared from the House bill can be added during a potential tax conference — a procedural sidestep allowing Thomas to cut costs while promising future action on any discarded provisions. 'The point is to get a bill that can get through committee,' the GOP aide said." (Warren Rojas, "Thomas Prepares to Lighten ETI Proposal," *Tax Notes*, October 16, 2003.)

after that. A recent analysis by Brookings economists reaches a nearly identical conclusion, while Goldman Sachs projects deficits totaling $5.5 trillion over the next ten years.[3]

Furthermore, corporate income tax revenues declined in 2003 to their lowest levels in six decades, both as a share of the economy and as a share of total revenues, except for the exceptionally low levels reached in 1983. The current very low level of corporate tax revenues reflects not only the effects of a weak economy, but also recent tax cuts and aggressive tax sheltering by corporations. The Congressional Budget Office projects that corporate revenues will remain at historically low levels throughout the decade, even after the economy has recovered and even if all corporate tax breaks enacted in 2002 and 2003 are allowed to expire on schedule, which may not happen.[4] Corporate tax-cut proposals such as those featured in the revised Thomas bill would serve to erode further an already diminished corporate tax base, while making the corporate income tax still more complicated and creating additional opportunities for tax sheltering.

Comparison of the Original and Revised Thomas Proposals

An examination of both the original corporate tax-cut package that Chairman Thomas introduced and his revised proposal indicates that Mr. Thomas has essentially traded one set of budget gimmicks for another. Both the original and the revised Thomas bills contain a profusion of timing gimmicks to make the bills' price tags look lower than they really are. But the specific gimmicks used in the two bills differ.

[3] For an analysis of the budget outlook, see Center on Budget and Policy Priorities, Committee for Economic Development, and Concord Coalition, "Mid-term and Long-term Deficit Projections," September, 29, 2003. Goldman Sachs, "The Federal Deficit: A $5.5 Trillion Read Elephant," U.S. Daily Financial Market Comment, September 9, 2003. A Brookings analysis by William Gale and Peter Orszag projects deficits of $4.6 trillion not counting a prescription drug benefit. This is equivalent to the CBPP-Concord-CED projection of a $5 trillion surplus with a drug benefit.

[4] Joel Friedman "The Decline in Corporate Revenues," Center on Budget and Policy Priorities, October 24, 2003.

In his original bill, a number of costly provisions would have been temporary, expiring artificially before the end of the ten-year budget period. If these tax breaks were assumed to be permanent — and there surely would have been significant pressure to extend them — their cost would have been shown to be significantly higher. In the revised Thomas package, a number of these temporary tax cuts are dropped. But they have been replaced by tax cuts that do not take full effect immediately either because the tax cuts do not start until later in the decade or because they are phased in over a number of years. Because of the differences in the timing gimmicks used, the costs of the original Thomas bill were concentrated in the first part of the ten-year period, while the costs of the revised bill are concentrated in the latter part of the decade.

- The new Thomas corporate package is estimated by the Joint Tax Committee to cost $60 billion (including offsets). This is $68 billion less than the $128 billion net cost of the original package. All of the reduction in cost, however, occurs in the first five years, 2004 through 2008. In the second five years, 2009 through 2013, the new Thomas bill actually costs $26 billion *more* than the original bill.

- In 2013, the new Thomas bill — including its revenue-raising offsets — would have a net cost of $12 billion. This is $4 billion more than the cost of the original Thomas bill in 2013. In other words, the revenue loss in 2013 would be 50 percent greater under the new, supposedly scaled-back bill than under the original bill.

Senate Finance Committee Bill Also Backloaded and *Not* Revenue-Neutral Over the Long Term

The Senate Finance Committee adopted a corporate tax-cut measure on October 1 that has many of the same characteristics as the revised Thomas package. The Senate Finance package includes tax cuts that would cost $102.1 billion over ten years, offset by revenue-raising provisions that total $102.7 billion. Thus, the official estimate shows the package as being deficit neutral over ten years. But just as the official cost of the Thomas plan is understated because of the bill’s reliance on backloaded tax cuts, so is the Senate Finance bill’s appearance of revenue neutrality an illusion that rests upon timing gimmicks.

As under the Thomas plan, several of the Senate Finance Committee tax cuts would not become fully effective until late in the decade. This makes their cost in the ten-year budget window much smaller than the cost of maintaining these tax cuts after that. The Finance Committee bill would produce a serious mismatch over time between the revenue that the “offsets” in the bill would raise and the revenue that its tax cuts would lose.

This can be seen in the Joint Tax Committee cost estimate for the bill, which shows the Finance Committee bill would lose more than $4 billion in 2013 alone. Over the long run, the bill is not close to being deficit neutral and would produce sizeable revenue losses, although not as large as those that would result from the Thomas plan, which shows a revenue loss of nearly $12 billion in 2013.