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TWO TAX CUTS THAT BENEFIT *ONLY* HIGH-INCOME HOUSEHOLDS — PRIMARILY MILLIONAIRES — SLATED TO START TAKING EFFECT IN 2006

Will These Tax Cuts be Implemented While Basic Programs for the Working Poor and Other Families are Cut?

by Robert Greenstein, Joel Friedman, and Isaac Shapiro

Summary

The President's budget contains reductions in an array of domestic programs, including programs in the education, health care, housing, veterans, and various other areas. The budget debate now moves to Capitol Hill. There has been no discussion, however, in the Administration or Congress of another potential way to reduce projected deficits — canceling or deferring two significant tax cuts enacted in 2001 that have not even yet started to take effect and that will benefit *only* households with high incomes.

- Under these two tax-cut measures, which are scheduled to phase in starting in 2006, a solid majority of the tax cuts — 54 percent of them — will go to the 0.2 percent of households with annual incomes *of more than $1 million a year*. The "millionaire" group will receive added tax cuts that average nearly $20,000 a year from these two tax-cut measures, once these tax cuts are fully in effect.

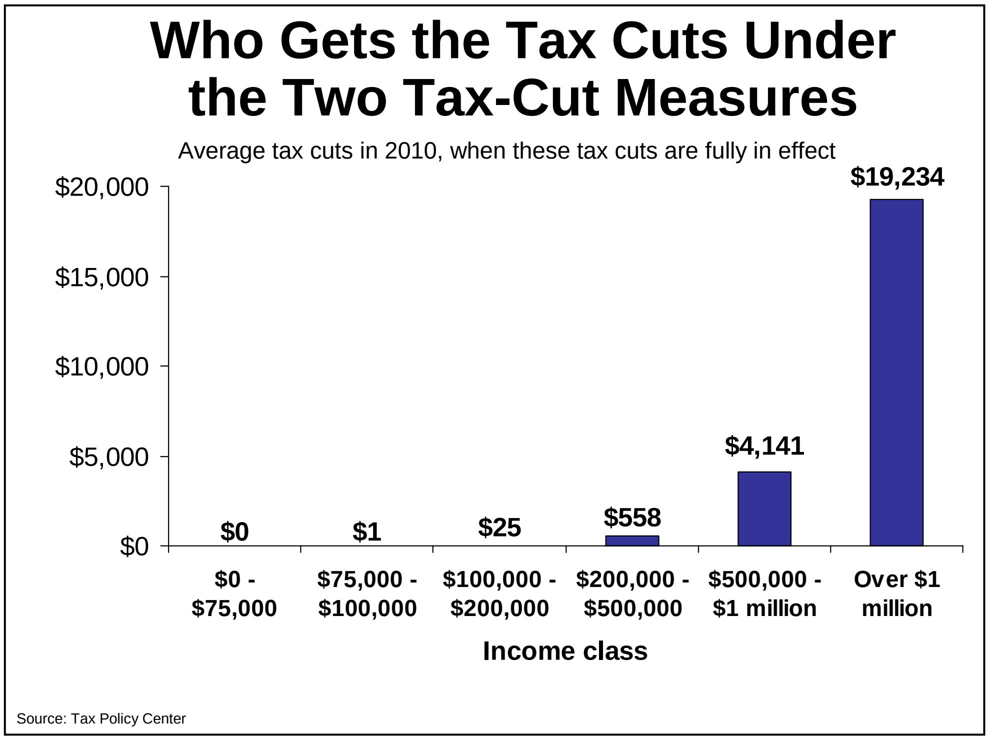
- Some 97 percent of the tax cuts will go to the four percent of households with incomes that exceed $200,000 a year.

- Virtually *none* of these tax cuts will go to families in the middle of the income spectrum.

- These provisions will only be fully effective in 2010. The Joint Committee on Taxation estimates that they will reduce revenues by $9 billion in 2010, rising to $16 billion in 2015. The ten-year cost of these provisions when they are fully in effect (2010 through 2019) would be $146 billion.[1] When the associated interest payments on the national debt of $51 billion are added in, the cost rises to $197 billion over this ten-year period.

- Note that these estimates significantly *understate* the cost of these two tax cuts, because they are based on Joint Tax Committee estimates that do not assume extension of relief from the Alternative Minimum Tax. As a result, the Joint Tax figures assume that a growing AMT would cancel out some of these tax-cut benefits. With AMT relief in place, these tax cuts would be even more costly.

[1] This assumes that the Joint Tax Committee estimate for 2015 continues to grow at the same rate as the economy in succeeding year.



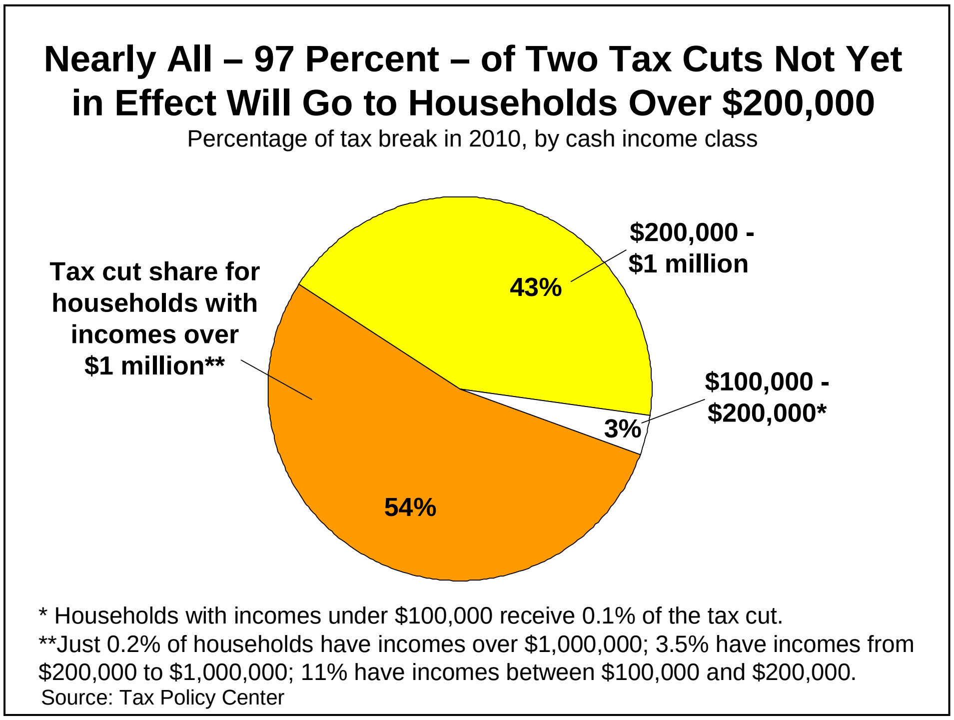
Will Today's Policymakers Have the Courage of Ronald Reagan and the first President Bush?

When substantial budget deficits emerged in 1982, President Ronald Reagan agreed to undo a significant share of the tax cuts he had signed the previous year. In 1990, facing large deficits, President George H. W. Bush had the courage to change his position on taxes and to play a leadership role in developing a major bipartisan deficit reduction package that both raised revenues and cut spending. Today, with deficits looming as far as the eye can see, the question arises as to whether President George W. Bush and Congressional leaders will at least consider forgoing these two extremely regressive tax cuts, which were enacted at a time when large surpluses were thought to exist and which have not even begun to take effect yet.

This question takes on particular poignancy because the two tax cuts in question are simply measures that repeal two key revenue-raising measures that the first President Bush negotiated and signed into law in 1990 to help address troubling budget deficits. Furthermore, the two tax cuts in question were *not* proposed by the current President Bush in 2001; they were added on Capitol Hill. Forgoing these tax cuts could both advance the cause of deficit reduction and serve as an alternative to some troubling budget cuts that President Bush may propose or Congress otherwise may consider that could harm some of the most needy and vulnerable members of our society.

The Two Tax Cuts that Have Not Yet Begun to Take Effect

Both of these tax cuts were enacted in 2001. One of these tax cut measures repeals a provision of law enacted in 1990 that scales back the magnitude of itemized deductions that high-income taxpayers can take. The other tax-cut measure repeals another provision enacted in



1990, under which the personal exemption is phased out for households with very high incomes. (See the box on page 5 for a fuller description of the two provisions of law that are to be repealed.) Under the 2001 tax cut legislation, these two current provisions of law are to start being phased out in 2006 and to be eliminated entirely in 2010.

If Tax Cuts Take Effect, They Would Constitute Some of the Most Regressive on Record

The highly respected Tax Policy Center of the Urban Institute and the Brookings Institution has conducted a new analysis of these two tax-cut measures. The Tax Policy Center found:

- A majority of these tax cuts — 54 percent — will go to households with incomes of more than $1 million a year, the top 0.2 percent of households.[2,3]
- Another 43 percent of the tax-cut benefits go to the 3.5 percent of households with incomes between $200,000 and $1 million. Thus 97 percent of the benefit of repealing these two provisions will go to the 3.7 percent of households with incomes over $200,000.

[2] In its analyses, the Tax Policy Center examines the effects of the tax cuts on different "tax units." These "tax units" include individuals and married couples who file income tax returns, as well as those who do not file (primarily because their incomes are below the minimum threshold for filing). As shorthand, this report uses the term "households" instead of "tax units."

[3] These TPC distribution estimates reflect the assumption that provisions expiring before 2010, such as the capital gains and dividend tax cuts and relief from the Alternative Minimum Tax, will be extended through 2010. Without this assumption, the degree to which these tax cuts are concentrated on those with the highest incomes would be *even greater*.

Distribution of the Two Tax Cuts, 2010

Income Group (thousands of 2003 dollars)	Share of Households	Share of the Tax Cuts	Average Tax Cut
$0-75	77.1%	0.0%	$0
75-100	8.3	0.1	1
100-200	10.9	3.2	25
200-500	3.0	19.1	558
500-1,000	0.5	24.0	4,141
More than $1 million	0.2	53.5	19,234

Source: Urban-Brookings Tax Policy Center.

- That leaves only 3 percent of the benefits for the 96 percent of households with income below $200,000. Essentially none of the benefits will flow to families with incomes of under $100,000 (see table).

- Further, high-income households already will receive huge tax cuts even without these two new tax cuts. For instance, households with incomes of more than $1 million will receive tax cuts averaging $108,000 in 2010 from the other *income*-tax provisions of the 2001 and 2003 tax cuts. Including the effects of repeal of the estate tax, those in this very high income group will receive average tax cuts of $133,000 in 2010 from the other provisions of the 2001 and 2003 tax cuts. Adding in the repeal of the two tax provisions discussed here brings the total average tax cut for those whose incomes exceed $1 million to $152,000 in 2010. (These figures are in 2010 dollars.)

The Role of the Two Presidents Bush

These two provisions of the tax code were adopted on a bipartisan basis in 1990, as part of the deficit reduction package enacted that year, in no small part because of the leadership of the first President Bush. These measures were part of a large, balanced, highly effective deficit reduction package that featured shared sacrifice. The package included both substantial program reductions and substantial tax increases. These two revenue-raising provisions were included in the package to direct more of the revenue increases to those who could most readily afford them.

President George W. Bush did not propose the elimination of these two provisions in 2001; it was added during the Congressional process. Nonetheless, the President has since supported making these tax cuts permanent.

A More Balanced Approach to Deficit Reduction

The President's budget targets a broad range of programs and services (primarily domestic "discretionary" programs) for cuts. But the President and Congressional leaders have declared that taxes are "off the table" when it comes to deficit reduction. That decision

Tax Cuts Would Repeal Two Tax Provisions Enacted in 1990 Deficit-Reduction Effort

The two provisions in question were enacted as part of the 1990 deficit-reduction package (and made permanent in the 1993 deficit-reduction package). Under the 2001 tax-cut law, both would be phased-out starting in 2006 and repealed entirely in 2010.

The first provision phases out the personal exemption for those at high income levels; it is known as the "personal exemption phase-out," or "PEP" for short. The tax code provides for a personal exemption that taxpayers can use to shield some income from taxation. The personal exemption is set at $3,200 in 2005. The personal exemption phase-out provision reduces a tax filer's total personal exemption amount by two percent for each $2,500 by which the tax filer's income exceeds $218,950 for married couples in 2005 (or exceeds $145,950 for individuals).

The second provision limits the value of itemized deductions for taxpayers with high incomes. (This is sometimes referred to as the "Pease" provision, after the late Rep. Don Pease, who originally designed it.) The tax code allows taxpayers to reduce their taxable income either by the standard deduction or by an amount equal to the sum of an array of itemized deductions. About two-thirds of taxpayers use the standard deduction, while one-third — typically those with higher incomes — itemize deductions. Under this provision, certain itemized deductions are reduced for high-income taxpayers; the value of these deductions is reduced by an amount equal to three percent of the amount by which a taxpayer's income exceeds $145,950 in 2005. Thus, a taxpayer with income of $245,950 would reduce his or her itemized deductions by $3,000 ($100,000 x 3 percent). If such an individual were in the 33 percent bracket, the provision would cause the individual's tax liability to be $990 higher ($3,000 x 33 percent) than if this provision did not exist.[a]

[a] Note: Itemized deductions affected by the limit cannot be reduced by more than 80 percent under this provision.

apparently applies, as well, to these two tax-cut provisions that have not yet begun to take effect and that will be of benefit almost exclusively to high-income households.

If these two tax cuts were to be cancelled in light of the marked worsening of the fiscal outlook in the years since their enactment in 2001, proposals to cut important services — including assistance to working-poor families with children — could be moderated. Congress and the President could avert cuts in areas like health care, child care, housing assistance, and food stamp assistance for low-income working families.

What Other Recent Republican Presidents Have Done

Faced with a need to address unanticipated deficits, other recent Republican Presidents have moderated their stances on taxes and opted for a more balanced approach; they have led, even when some of their supporters staunchly opposed such a policy change. As noted, Ronald Reagan agreed to scale back his tax cuts in 1982 when the fiscal situation deteriorated. President George H.W. Bush altered his position on taxes in 1990 in the face of difficult fiscal realities. A question now is whether President George W. Bush would be willing to opt for even the very modest step of forgoing these two tax cuts for the affluent that have not yet taken effect, a step that still would leave those with incomes over $1 million with average tax cuts of more than $100,000 a year, or whether the President and Congressional leaders will rule out consideration of such a step while seeking to force cuts in an array of programs on which millions of less fortunate American families rely.