TAX POLICY CENTER AND CBPP ANALYSES SHOW THAT HOUSE TAX PLAN WOULD BE MORE TILTED TOWARD THE VERY WEALTHY — AND MORE EXPENSIVE — THAN BUSH PLAN

by Robert Greenstein, Richard Kogan, and Andrew Lee

Separate analyses by the Tax Policy Center and the Center on Budget and Policy Priorities show that the tax-cut plan agreed to by the House of Representatives on May 9 would:

• be more tilted toward the wealthiest people in the country — and give them somewhat larger tax cuts — than the original Bush plan, with taxpayers with incomes of more than $1 million receiving average tax cuts of $93,500 in 2003; and

• fit within the $550 billion ten-year target for that legislation only by using gimmicks that cloak its true cost. If the provisions scheduled to terminate before 2013 are extended — as Rep. Bill Thomas, Chairman of the House Ways and Means Committee, envisions and as Congress would be likely to do — the total cost of the plan would be between $865 billion and $1.1 trillion through 2013. In other words, if the provisions of the House plan are extended through 2013, the plan could be twice as costly as advertised.

The plan thus manages both to be more tilted to the very well-off and more expensive than the original Bush proposal, which would cost $726 billion through 2013. The House plan costs significantly more than the original Bush plan, once its gimmicks are taken into account, because it includes more tax cuts than the Bush plan. It adds two major business tax cuts not included in the Bush package.

As an additional gimmick, the House plan contains a pure timing shift, in which $13 billion in existing corporate estimated tax payments are shifted a few weeks, from fiscal 2003 into fiscal 2004. This timing shift makes the tax-cut package appear to fit within the revenue targets in the congressional budget plan. Those targets called for larger tax cuts in 2003 and smaller tax cuts in 2004 than the House tax-cut legislation actually provides.

Who Would Benefit From the House Plan?

The House plan replaces the Bush dividend proposal with a provision reducing the top tax rate on both dividends and capital gains to 15 percent. Analysis by the Urban Institute – Brookings Tax Policy Center shows that this provision is more heavily tilted toward the very well-off than even the Administration’s dividend proposal. This is because capital gains income is even more concentrated at the top of the income spectrum than dividend income is.
The analysis of the House plan by the Tax Policy Center finds that:

- Households with incomes of more than $1 million per year would get an average tax cut of $26,800 in 2003 from the Bush dividend proposal. They would get an average tax cut of $30,700 under the House capital gains/dividend proposal.

- The top five percent of households would receive 64 percent of the tax cut benefits from the Administration’s dividend tax cut but get 72 percent of the tax cut benefits from the House capital gains/dividend proposal.

The Tax Policy Center analysis also shows that:

- Households with incomes over $1 million would receive an average tax cut in 2003 of $93,500 under the House plan. Under the Bush plan, their average tax cut would be $89,500.

- The middle fifth of households would receive an average tax cut of just $217 under the House plan, slightly less than under the Bush plan.

**Cost**

The House plan officially costs $550 billion, but only because of reliance on a large gimmick — the artificial expiration of most of the plan’s provisions at the end of 2005, the business “expensing” provision at the end of 2007, and the capital gains / dividends tax preference at the end of 2012. Thus, for example, the child tax credit would rise to $1,000 in 2003 but then fall back to $700 in 2006. The *Los Angeles Times* reported on May 2, “Thomas acknowledged that the three-year limit on the politically popular family tax breaks was not intended to stand as policy. 'No one believes there will be any difficulty in extending them,' he said."

Indeed, no one expects that the various provisions of the House package would really be allowed to expire at the end of 2005 or 2007, or that the tax preferences for corporate dividends and capital gains would be allowed to expire at the end of 2012. Most likely, these provisions either would eventually be made permanent or would become part of the growing number of tax provisions that, every few years, are extended for several more years and never terminate.

A realistic estimate of the likely impact of the House plan on the Treasury should assume that its provisions will be extended and will not expire. That clearly is the intent of Rep. Thomas and the House leadership. Under such an estimate, the cost of the plan not only exceeds $550 billion but is greater than the $726 billion cost of the Bush plan.

- The likely cost would be between $865 billion and $1.1 trillion through 2013. (See below.)

- The cost exceeds the cost of the Bush plan because of the inclusion in the House plan of two major business tax breaks that are not part of the Bush plan. These tax breaks — the bonus depreciation provision and the carryback of net operating losses — are discussed below.
The Cost of the House Tax Plan

According to the Joint Committee on Taxation, the House-passed tax cut plan costs $550 billion through 2013, as required by the congressional budget plan adopted in April, which is less than the $726 billion cost of the President’s so-called “growth” tax cuts package.

But the House tax-cut plan does not really reduce the costs of the President’s tax cut package; it very likely increases them. Eight of the nine tax cuts in the House plan are set to expire before 2013 and upon their expiration, tax rates would increase or tax credits or deductions would shrink. The President and others want most or all of these expiring provisions to be permanent tax policy. It is better, therefore, to view the package as if its provisions were permanent law. We estimate that if all the provisions of the House plan except relief from the Alternative Minimum Tax were permanent, the plan would cost more than $1.1 trillion through 2013, as shown below.

Comparison of the Cost of Tax-Cut Packages

2003-2013 totals in billions of dollars; House expiration dates in [brackets]

<table>
<thead>
<tr>
<th></th>
<th>Bush package</th>
<th>House package</th>
<th>House if tax cuts are extended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends and capital gains [expires 2012]</td>
<td>396</td>
<td>277</td>
<td>296</td>
</tr>
<tr>
<td>Top-bracket rate reductions, effective 2003</td>
<td>74</td>
<td>74</td>
<td>74</td>
</tr>
<tr>
<td>Child tax credit increases, effective 2003 [expires 2005]</td>
<td>90</td>
<td>45</td>
<td>90</td>
</tr>
<tr>
<td>Widen 10% bracket, effective 2003 [expires 2005]</td>
<td>45</td>
<td>19</td>
<td>45</td>
</tr>
<tr>
<td>Tax breaks for married couples [expires 2005]</td>
<td>55</td>
<td>43</td>
<td>55</td>
</tr>
<tr>
<td>Expand §179 business expensing [expires 2007]</td>
<td>29</td>
<td>3</td>
<td>35</td>
</tr>
<tr>
<td>Increase AMT exemption [expires 2005]</td>
<td>37</td>
<td>53</td>
<td>53</td>
</tr>
<tr>
<td>Expand/extend bonus depreciation [expires 2005]</td>
<td>n.a.</td>
<td>21</td>
<td>400</td>
</tr>
<tr>
<td>Extend write-offs for net operating losses [expires 2005]</td>
<td>n.a.</td>
<td>15</td>
<td>75</td>
</tr>
<tr>
<td>TOTAL</td>
<td>726</td>
<td>550</td>
<td>1,123</td>
</tr>
</tbody>
</table>

Source: Joint Committee on Taxation, except for estimates in italics, which are derived by the Center on Budget and Policy Priorities. See the text for a discussion of issues related to the estimates for the bonus depreciation provision. Note that this table treats both the Bush and the House AMT provisions as temporary, for comparability.

Depreciation Provision and Provision for Operating Losses Could Lead to Substantial Added Costs

The March 2002 stimulus legislation established a temporary provision (known as “bonus depreciation”) under which, until September 2004, businesses can deduct 30 percent of the cost of new investments in equipment and facilities. The House plan both increases this deduction and extends the provision from September 2004 through December 2005. The extension of this provision into 2005 is cause for significant concern from a fiscal responsibility standpoint.

Extending the provision into 2005 will reduce its impact in boosting the economy and result in somewhat fewer jobs being created now than if the provision ended in September 2004, as currently scheduled. The Congressional Budget Office, in a January 2002 report, warned that extending the period for such a provision undermines efforts to boost the economy now.

“[T]he stimulus provided by some tax cuts for business investment can be increased by making them temporary. Firms may view them as one-time opportunities for saving, which may induce them to move up some of their future investment plans to the present. They might not take that step if they knew that the tax advantage would remain in place and be available to them later.”
“Extending the period during which such expensing could be used would reduce the bang for the buck because it would decrease businesses’ incentive to invest in the first year and increase the total revenue cost.”

In other words, to provide near-term economic stimulus, business tax provisions must induce immediate business investment. Lengthening the effective period of this provision has the opposite effect — it allows firms to delay investment decisions until after the economy has recovered to a much greater degree while still taking advantage of the tax break. Why should a firm accelerate investments at a time when the economy is weak and not as many customers may purchase its products if it knows it can get the same tax break if it waits to see what the economy looks like a couple of years from now and delays the investment?

Since extending the period during which the depreciation provision would remain in effect would reduce its immediate impact on economic growth and jobs, the most likely reason for inclusion of an extension in the House plan appears to be to enhance the provision’s chances of becoming an ongoing part of the tax code that never actually expires. Under the House plan, the Child Tax Credit increase, the accelerated marriage penalty relief, the widening of the 10 percent tax bracket, and the depreciation provision all would expire at exactly the same time — December 31, 2005. This sets up the depreciation provision to be extended in 2005 as part of a package with all of the other expiring provisions.

The cost of the depreciation provision, if it is extended and does not expire, is roughly $400 billion through 2013. This is much greater than the “official” cost of $21 billion that the House plan shows for this provision. The House plan shows only a small cost for the provision because if the provision really were allowed to terminate at the end of 2005, most of the tax breaks it would provide through the end of 2005 would simply represent an acceleration of tax deductions that otherwise would have been taken in subsequent years. This provision is relatively inexpensive if it really is temporary and very costly if it continues to be extended and never expires.

In estimating a $400 billion cost for the House proposal for bonus depreciation, we have measured the cost of 50-percent bonus depreciation extended through 2013 relative to existing law, which provides 30-percent bonus depreciation expiring September 2004. An argument may be made that the current 30-percent bonus depreciation provision may ultimately end up being extended regardless of whether Congress acts now to extend the depreciation provision through December 2005. From this point of view, the added cost that is likely to result from passage of the House plan should be seen as the difference between the cost of extending the current 30-percent depreciation provision through 2013 and the cost of extending the 50-percent level that the House plan contains. The Congressional Budget Office has estimated the cost of extending the current depreciation provision at $256 billion through 2013; thus, under this approach to estimating the plan’s impact on the budget, $256 billion of the $400 billion in costs from extending the depreciation provision through 2013 is assumed even in the absence of the House plan, and the plan’s likely additional cost through 2013 would be approximately $865 billion rather than $1.1 trillion.

This lower figure of $865 billion still significantly exceeds the $726 billion cost of the Bush plan and the official budget target of $550 billion. Moreover, there is a reasonable basis for using the approach that yields the $1.1 trillion estimate: enacting legislation now to extend the depreciation provision through December 2005 represents a substantial step toward retaining this provision in the tax code on an ongoing basis — there really is no other good reason for extending the depreciation provision through 2005 — and will make it likely that the depreciation provision will be included in the much larger package of tax-cut extensions that will become inevitable in 2005 if the House plan is enacted.

The House plan also provides for a five-year carryback of “net operating losses” by businesses. Like the bonus depreciation provision, this proposal is also set to expire at the end of 2005; here, too, this expiration date will make it likely that the provision will be included in the much larger package of tax-cut extensions that will become inevitable in 2005 if the House plan becomes law. If the carryback provision is extended, its costs will be likely be noticeably larger than the $15 billion shown for a temporary provision.2

---

2 Under current law, business operating losses in the current year can generally be “carried back” two years, to previous years in which the business earned profits and therefore paid income taxes. This carryback feature allows a business that is running at a loss in the current year to net that loss against profits it earned in either of the two prior years. When the profits it actually earned in those prior years is recalculated to be a lower figure (because the current operating loss is attributed to those prior years), the business is then allowed to recapture some or all the taxes it paid in those prior years — the business gets a refund from the Treasury. By expanding the carryback period to five years, businesses may be able to recapture more taxes, which is why the House provision loses revenues.

If the House provision is temporary, it will allow some businesses to recapture prior taxes for a few years. However, when those businesses carry back their current operating losses to recapture prior taxes, they lose the opportunity (which also exists in the tax code) to carry those losses forward and reduce future taxes. Thus, the House provision, as designed, will reduces revenues for a few years as businesses recapture more old taxes, but increase revenues after the provision expires, as businesses have less ability to offset future income and thereby to reduce future taxes. The increase in revenues generated by the House provision after it expires in 2005 explains the relatively low net cost of the proposal through 2013.

However, if the House provision were extended through 2013, the provision would lose revenues in all years, rather than losing them for a few years and then gaining revenues in subsequent years. The provision would become a permanent windfall for businesses because it would permanently increase the total amount of previously paid business taxes that could be recaptured.