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Tax Plans Must Not Lose Revenue and Should Focus on Raising Working-Class Incomes

By Chuck Marr, Chye-Ching Huang, and Brendan Duke

Congress is expected to consider a 2018 budget resolution this fall that will set the rules for subsequent tax legislation by establishing the revenue targets that a tax bill must meet to qualify for the fast-track budget "reconciliation" process. At a minimum, the resolution should require that a tax bill be "revenue-neutral," meaning that the bill must fully offset the cost of any tax cuts by closing tax loopholes, scaling back exclusions and deductions, or enacting other revenue-raising provisions. That's because a revenue-losing tax bill would worsen the nation's long-term fiscal outlook and likely put key budget programs for low- and moderate-income Americans at risk, now or in the future. Beyond revenue neutrality, a tax bill should focus its benefits on low- and moderate-income working families because working-class wages have largely stagnated in recent decades, making a middle-class life harder for many to reach and maintain.

Congress should reject any budget resolution that would let lawmakers finance tax cuts, which almost certainly would disproportionately benefit the most well-off, with budget cuts, which would very likely come in large part from core assistance programs for low-income Americans, such as Medicaid, SNAP (food stamps), and Supplemental Security Income (SSI) for the elderly and disabled poor. Congress should also reject any resolution that paves the way for tax cuts that swell budget deficits. That would leave us with debt levels that are rising higher as a share of the economy, which would weaken the economy over time and could prompt policymakers down the road to enact large budget cuts to offset the cost of tax cuts. That, too, could mean large cuts to core assistance programs as well as to Medicare and to non-defense discretionary spending — the budget category that funds such key priorities as education, research, and infrastructure.

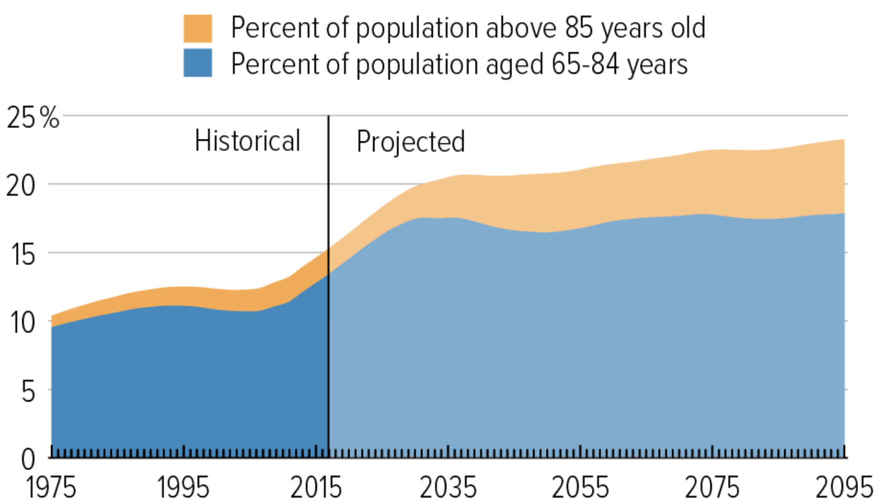
Unfortunately, recent tax and budget proposals from President Trump and congressional Republican leaders move in the wrong direction. They feature large tax cuts tilted to the most well-off without specific tax policies to fully offset the cost, alongside cuts to health coverage, nutrition assistance, education, and other priorities that are important to tens of millions of Americans. These budget cuts would fall mainly on low- and middle-income households, leaving them worse off while enriching the most well-off.

Revenue Neutrality Is Minimum Fiscal Requirement

The federal tax system should provide adequate revenue to finance national priorities and avoid spiraling long-run debt and interest burdens. With an aging population and rising health care costs pushing up costs for Social Security, Medicare, and Medicaid, and with national security challenges continuing, simply paying for existing federal commitments will require more revenues in the future — and that won't even cover the cost of needed additional investment in areas such as infrastructure and job training to strengthen prospects for long-term economic growth, help produce rising living standards, and foster more opportunity.[1] (See Figure 1.)

FIGURE 1

More Federal Revenue Required to Address Aging of the Population



Source: Social Security Administration

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Ideally, then, any major tax bill should raise revenues, as virtually all bipartisan deficit-reduction commissions of recent years have urged. At a minimum, it should not lose revenue. To be sure, House Speaker Paul Ryan, Senate Majority Leader Mitch McConnell, and other key Republicans have said at various times this year that tax legislation will be revenue-neutral.[2] But, with the House and Senate likely to consider a fiscal year 2018 budget resolution this fall, the question is whether GOP leaders will follow through.

[1] Paul N. Van de Water, "Tax Reform Must Not Lose Revenues — and Should Increase Them," CBPP, April 20, 2017, https://www.cbpp.org/research/federal-tax/tax-reform-must-not-lose-revenues-and-should-increase-them

[2] House Speaker Paul Ryan said, "[W]e're planning revenue-neutral tax reform, which means you have to take away loopholes and special interest deductions if you're going to lower tax rates." See Jonathan Chait, "Tax Reform Is Hard. Tax Cuts Are Easy," *New York Magazine*, March 30, 2017, http://nymag.com/daily/intelligencer/2017/03/tax-reform-is-hard-tax-cuts-are-easy.html. Senate Majority Leader Mitch McConnell made a similar statement around the same time. See "Politico Playbook: Interview with Mitch McConnell," *Politico*, March 9, 2017, www.pgpf.org/multimedia/politico-playbook-interview-with-mitch-mcconnell.

The issue will come to a head in the coming weeks. Republican leaders say they plan to use the budget reconciliation process to pass tax legislation in the months ahead. Reconciliation bills can pass the Senate with a simple majority — that is, with only Republican votes. But to use reconciliation, Congress must first approve a budget resolution that creates a "reconciliation instruction" for tax legislation, setting out deficit or revenue targets for the legislation over the budget period.

Any reconciliation instruction for tax legislation should require that it be revenue-neutral. And Congress should both enforce revenue neutrality and measure it honestly. That means:

1. **Measuring revenue neutrality against a "current-law" baseline.** Some Republican lawmakers are reportedly considering using a "*current-policy*" baseline to evaluate tax policy changes, instead of the standard "*current-law*" baseline. That would constitute a large budget gimmick, paving the way for $439 billion in unfinanced tax cuts over ten years. That figure is the cost of extending through the next decade the dozens of "temporary" corporate and individual tax breaks that have recently expired or are scheduled to expire in the coming years under current law. Unlike the *current-law* baseline, which assumes that current law will be honored and hence that these time-limited tax breaks will expire on schedule, a *current-policy* baseline assumes that these measures will remain in effect despite their scheduled expiration. Thus, under a current-policy baseline, proposals to extend these tax breaks are portrayed as having *no cost*. And proposals to let these tax breaks expire on schedule are treated as raising *new revenue* that lawmakers could then use to "pay for" new tax cuts.[3]

2. **Using standard Joint Committee on Taxation (JCT) scoring.** The non-partisan JCT should estimate the impacts of any tax legislation, using its traditional revenue estimates rather than estimates altered by "dynamic scoring." Dynamic scoring incorporates highly uncertain estimates of the supposed impact of tax policy changes on future economic growth. Given the country's fiscal pressures and the high degree of uncertainty surrounding dynamic scoring, lawmakers should not use it to try to make the cost of a tax-cut bill appear smaller.[4]

3. **Avoiding other gimmicks**. Lawmakers also shouldn't use other gimmicks to hide the cost of tax cuts, such as by making them *temporary* (for, say, ten years) even though policymakers fully intend to make them permanent later, or by using timing shifts (in, for instance, the tax treatment of retirement accounts) in order to accelerate revenue from future decades into the coming decade and thereby make a tax cut appear less costly than it will be over the long run.[5]

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[3] Chye-Ching Huang and Brandon DeBot, "'Current Policy' Baseline Would Hide $439 Billion in Tax Cuts Worth at Least $40,000 a Year for the Top 0.1 Percent," CBPP, August 16, 2017, https://www.cbpp.org/research/federal-tax/current-policy-baseline-would-hide-439-billion-in-tax-cuts-worth-at-least-40000.

[4] Paul N. Van de Water, "Budget and Tax Plans Should Not Rely on 'Dynamic Scoring,'" CBPP, November 17, 2014, https://www.cbpp.org/research/budget-and-tax-plans-should-not-rely-on-dynamic-scoring.

[5] For examples of timing gimmicks considered in prior tax debates, see: Chye-Ching Huang, Chuck Marr, and Nathaniel Frentz, "Timing Gimmicks Pose Threat to Fiscally Responsible Corporate Tax Reform," CBPP, January 13, 2014, https://www.cbpp.org/research/timing-gimmicks-pose-threat-to-fiscally-responsible-corporate-tax-reform; Nathaniel Frentz and Chye-Ching Huang, "Four Timing Gimmicks That Could Disguise Fiscally Irresponsible Individual Tax Reform," CBPP, October 30, 2013, https://www.cbpp.org/research/four-timing-gimmicks-that-could-disguise-fiscally-irresponsible-individual-tax-reform.

Revenue-Losing Tax Bill Would Put Key Programs at Risk, Now or in Future

Congress may be tempted to adopt a budget resolution that allows a tax reconciliation bill to be "*deficit*-neutral" rather than "*revenue*-neutral." That would allow revenue-losing tax proposals to be financed by cuts in entitlement programs. Since entitlements mainly benefit middle- and lower-income families while the GOP tax-cut proposals unveiled to date heavily favor high-income households and large corporations, legislation that finances large tax cuts with big entitlement cuts would represent a Robin Hood-in-reverse measure.[6]

Congress also may be tempted to permit, through the budget resolution, revenue-losing tax legislation, which would increase budget deficits. That, however, would likely only kick the budget cuts down the road, as policymakers must pay for tax cuts sooner or later. Here, too, low- and middle-income families would likely end up worse off once lawmakers cut programs that help families afford basic needs and domestic investments that can strengthen long-term economic growth. Medicare and Medicaid would be particularly vulnerable to future budget cuts, given their substantial cost and share of non-defense spending.[7] In addition, if a revenue-losing tax cut significantly worsened the outlook for deficits and debt, those who favor substantial cuts in Social Security would likely cite that as a justification.

The Tax Policy Center (TPC) recently analyzed the most recent Trump tax proposal's net effect on households across the income distribution, offering three hypothetical ways of paying for its tax cuts. Under the financing option most closely reflecting the budget priorities of the Administration and Republican Congress, virtually every household in the bottom two-fifths of the income spectrum — those earning below $48,600 a year — would lose more than it gained, losing an average of more than $2,000 a year in after-tax income once the offsetting budget cuts are taken into account.[8] Most households in the middle fifth — those earning between $48,600 and $86,100 — would also be net losers, losing an average of $1,500. (See Figure 2.)

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[6] Brandon DeBot, "Harsh Trade-off at Core of GOP Health Bill: Keep Medicaid Expansion or Cut Taxes for Wealthy?," CBPP, June 21, 2017, https://www.cbpp.org/research/health/harsh-tradeoff-at-core-of-gop-health-bill-keep-medicaid-expansion-or-cut-taxes-for; Brandon DeBot, "Wealthy, Corporations Still Win Big Under Senate GOP Health Bill Even With Possible Change," CBPP, June 30, 2017, https://www.cbpp.org/blog/wealthy-corporations-still-win-big-under-senate-gop-health-bill-even-with-possible-change.

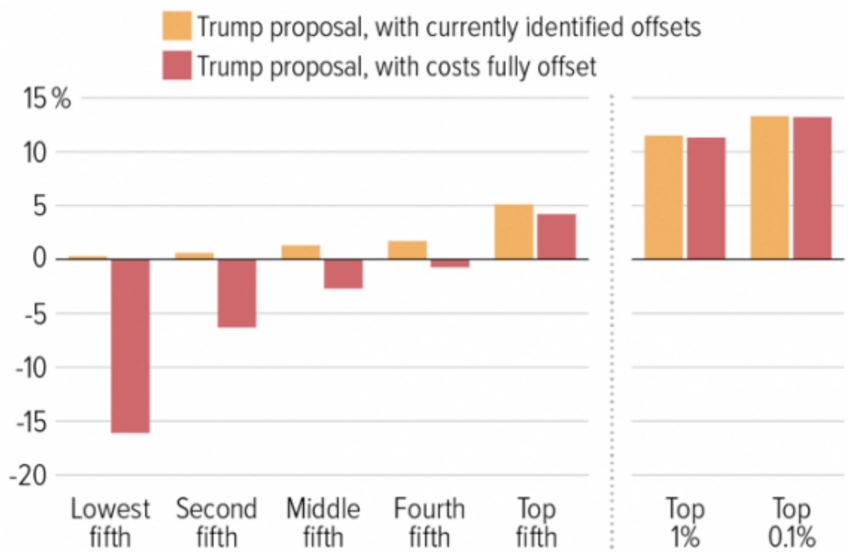
[7] Paul N. Van de Water, "Federal Spending and Revenues Will Need to Grow in Coming Years, Not Shrink," CBPP, September 6, 2017, https://www.cbpp.org/research/federal-budget/federal-spending-and-revenues-will-need-to-grow-in-coming-years-not-shrink; Robert Greenstein, "Commentary: House Moving to Fast-Track Both Low-Income Program Cuts and Tax Cuts for Wealthy," CBPP, June 26, 2017, https://www.cbpp.org/federal-budget/commentary-house-moving-to-fast-track-both-low-income-program-cuts-and-tax-cuts-for; Isaac Shapiro, Richard Kogan, and Chloe Cho, "House GOP Budget Cuts Programs Aiding Low- and Moderate-Income People by $2.9 Trillion Over Decade," CBPP, August 3, 2017, https://www.cbpp.org/research/federal-budget/house-gop-budget-cuts-programs-aiding-low-and-moderate-income-people-by-29.

[8] Isaac Shapiro and Chye-Ching Huang, "Vast Majority of Americans Would Likely Lose From Trump Tax Cuts, Once They're Paid For," CBPP, August 17, 2017, https://www.cbpp.org/research/federal-tax/vast-majority-of-americans-would-likely-lose-from-trump-tax-cuts-once-theyre.

FIGURE 2

Bottom Four-Fifths of Households Would Lose Under Trump Tax Approach, Once Fully Financed

Percent change in after-tax income by income group, 2018



Note: the tax plan proposed by the Trump Administration does not fully offset the costs of its proposed tax cuts with revenue-raising provisions. The Tax Policy Center analysis considers three scenarios for fully offsetting the tax cuts, including the scenario shown here, "equal dollar financing," which means that each household pays an equal dollar amount each year to finance the tax cut.

Source: Tax Policy Center

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To minimize threats to programs that help people afford basic needs, including Medicare and Social Security — and to restore some of the recent cuts in defense and non-defense discretionary spending while leaving room for needed initiatives — tax legislation should raise revenue, and certainly not lose it.

Tax Policy Changes Should Focus Help on Working Families

While establishing how tax legislation can affect the budget, the budget resolution will not delineate the specific tax changes that Congress should adopt. When that phase of the debate begins, policymakers should concentrate on tax policies that aid low- and moderate-income working families — a racially, ethnically, and geographically diverse group that has been hit hard by the economic trends of recent decades.[9]

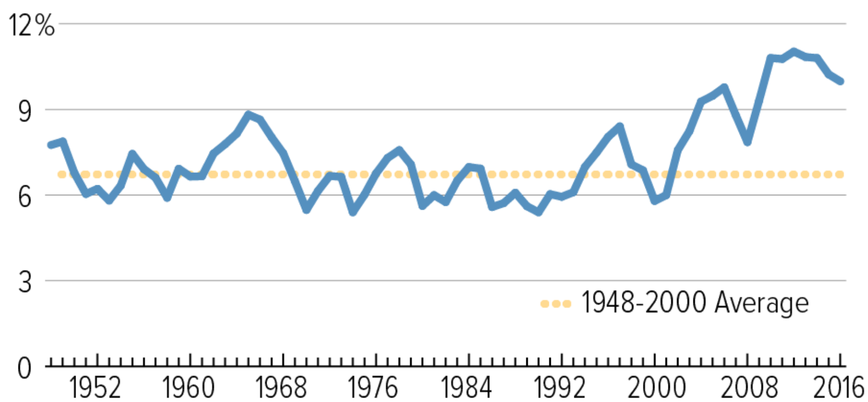
[9] Isaac Shapiro, Danilo Trisi, and Raheem Chaudhry, "Poverty Reduction Programs Help Adults Lacking College Degrees the Most," CBPP, February 16, 2017, https://www.cbpp.org/research/poverty-and-inequality/poverty-reduction-programs-help-adults-lacking-college-degrees-the.

Executive pay, corporate profits, and stock-market values have all risen in recent decades, while working-class wages have largely stagnated and a middle-class life has become harder for many to reach and sustain. (See Figure 3.)[10] Income inequality has grown substantially in recent decades, and a tax bill that could reallocate trillions of dollars of income over the next decade should take that into account.

FIGURE 3

Corporate Profits Are at an All Time High

After-tax corporate profits as a share of national income



Source: Bureau of Economic Analysis

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President Trump has frequently alluded to a central economic challenge — to boost the incomes of working-class people. "These are the forgotten men and women of America," he said while running for President. "People who work hard but don't have a voice. . . . Too many of our leaders have forgotten that it's their duty to protect the jobs, wages and well-being of American workers before any other consideration."[11] In his inaugural address, he vowed to make "every decision" on taxes "to benefit American workers and American families."[12]

Similarly, Treasury Secretary Steven Mnuchin promised in February that "any reductions we have in upper-income taxes will be offset by less deductions, so there will be no absolute tax cut for the upper class."[13] That standard, sometimes called the "Mnuchin rule," recognizes that there is no need

[10] Figure 3 displays after-tax profits as a share of national income. After-tax profits as a share of domestic income and after-tax profits as a share of gross domestic product display similar patterns.

[11] Tessa Berenson, "Read Donald Trump's Speech on Jobs and the Economy," *Time,* September 15, 2017, http://www.time.com/4495507/donald-trump-economy-speech-transcript/.

[12] The White House, "Remarks of President Donald J. Trump — As Prepared for Delivery," August 20, 2017, https://www.whitehouse.gov/inaugural-address.

[13] Patricia Cohen, "Treasury Nominee Vows No Tax Cut for Rich. Math Says the Opposite," *New York Times,* February 9, 2017, https://www.nytimes.com/2017/02/09/business/economy/mnuchin-rule-tax-cut.html?mcubz=0; Max Ehrenfreund, "The Trump administration says it's not pushing a tax cut for the rich. They almost certainly are,"

to cut the taxes of hedge fund managers, corporate CEOs, and the like whose incomes have risen sharply in recent decades. Any tax legislation should adhere to it.

A major tax package should respond to stagnant working-class wages and rising inequality — and so reflect the statements of the President and Secretary Mnuchin. Unfortunately, the specific tax policies that the Administration has unveiled and the "Better Way" tax plan that House Republicans issued in 2016 have strayed far from these goals.[14] So do the GOP bills to "repeal and replace" the Affordable Care Act.[15]

The House GOP "Better Way" plan was tilted so heavily to the *highest*-income people that TPC estimated that by 2025, an overwhelming 96 percent of its tax cuts would go to households with incomes above $1 million. Those households would receive annual tax cuts averaging $302,000 by that year, boosting their after-tax incomes by more than 11 percent, TPC estimated (see Figure 4).[16] (The "Better Way" plan also is far from revenue-neutral, losing $3.1 trillion over ten years, according to TPC.)

The Trump tax plan is even more expensive and also highly regressive, TPC found.[17] It would give the largest tax cuts (both in dollars and as a share of their income) to people making over $1 million a year, while doing little for most working- and middle-class families.

Washington Post, April 27, 2017, https://www.washingtonpost.com/news/wonk/wp/2017/04/27/the-trump-administration-says-its-not-pushing-a-tax-cut-for-the-rich-they-almost-certainly-are/?utm_term=.5ea45e82b419.

[14] Chye-Ching Huang and Chuck Marr, "ACA Repeal, Trump Tax Plan, and Ryan's 'Better Way' Tax Plan All Fail Mnuchin Test," CBPP, January 18, 2017, https://www.cbpp.org/research/federal-tax/aca-repeal-trump-tax-plan-and-ryans-better-way-tax-plan-all-fail-mnuchin-test.

[15] Brandon DeBot, "Harsh Tradeoff at Core of GOP Health Bill: Keep Medicaid Expansion or Cut Taxes for Wealthy?," CBPP, June 21, 2017, https://www.cbpp.org/research/health/harsh-tradeoff-at-core-of-gop-health-bill-keep-medicaid-expansion-or-cut-taxes-for.

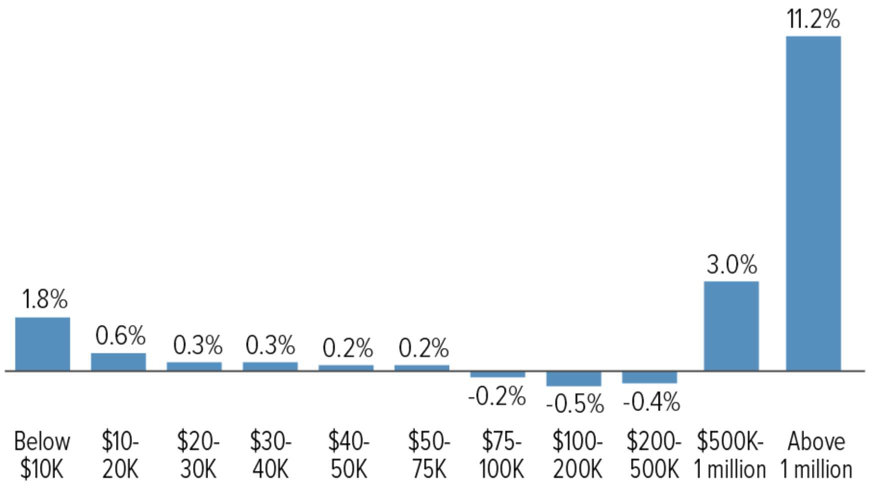
[16] Tax Policy Center, T16-0198 — House GOP Tax Plan, Distribution of Federal Tax Change by Expanded Cash Income Level, 2025, September 6, 2016, www.taxpolicycenter.org/model-estimates/house-gop-tax-plan-sep-2016/t16-0198-house-gop-tax-plan-distribution-federal-tax.

[17] Tax Policy Center, "The Implications of What We Know And We Don't Know about President Trump's Tax Plan," July 12, 2017, http://www.taxpolicycenter.org/sites/default/files/publication/142616/2001405-the-implications-of-what-we-know-and-dont-know-about-president-trumps-plan_1.pdf. The TPC analysis estimates that the tax cuts that have been discussed by the Trump Administration or campaign would cost $7.8 trillion over the coming decade. It also finds that even when all the revenue-raising measures mentioned during President Trump's campaign and by the Trump Administration — including many that the campaign and Administration have embraced inconsistently — are counted, the Trump tax plan presented so far would still have a net cost of $3.5 trillion over ten years.

FIGURE 4

House Republican "Better Way" Tax Plan Gives Big Tax Cut to the Top

Percent change in after-tax income by income group, 2025



Source:Tax Policy Center, table T16-0198

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Conclusion

Given stagnant wages for many workers, soaring incomes for those at the top, and strong corporate profits — as well as future fiscal pressures stemming from the aging of the population and rising health care costs — tax reform should adhere to these core principles: strict revenue neutrality, no net tax cuts for the most well-to-do, and a focus on ordinary working families. The rhetoric of President Trump, senior Administration officials, and Republican congressional leaders has often reflected these principles. But their proposals to date have run in the opposite direction.

The upcoming debate over the budget resolution will show whether Republicans intend to shift their policies to match their rhetoric. A tax reconciliation instruction that is revenue-neutral, as Republican leaders have promised, would ensure that tax legislation does not create pressure for cuts to programs that help families meet basic needs or that can strengthen the economy over time. But if Congress instead fast-tracks a tax package that either adds to the deficit or is financed with cuts to programs that help families afford basic needs, that will leave the most well-to-do even better off and most others holding the bag.