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Tax-Cut Legislation: Applicable Budget Enforcement Procedures

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Abstract

Consideration of tax-cut legislation is subject to two different sets of budget enforcement procedures. First, under the Congressional Budget Act of 1974, the House and Senate are required to adopt an annual budget resolution, which is enforced by points of order when individual spending and revenue measures are considered. Second, under the Balanced Budget and Emergency Deficit Control Act of 1985, tax-cut legislation, as well as any other legislation affecting revenues or direct spending, is subject to a pay-as-you-go requirement tied to the sequestration process.

This report briefly assesses the application of these enforcement procedures to tax-cut legislation. It will be updated as developments warrant. (For additional reading, see *Manual on the Federal Budget Process*, CRS Report 98-720 GOV, 184 pages.)

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Summary

The House and Senate leadership have indicated that tax-cut legislation will be a high priority on the legislative agenda for the 106th Congress. Consideration of such legislation is subject to two different sets of budget enforcement procedures. First, under the Congressional Budget Act of 1974, as amended, the House and Senate are required to adopt an annual budget resolution. Budget resolution policies are enforced by points of order when individual spending and revenue measures are considered. The House and Senate may use various means to waive, or set aside, these points of order.

If the budget resolution adopted in 1999 does not recommend a tax cut, then revenue legislation implementing such a policy generally would be subject to a point of order; in the Senate, it would require 60 votes to waive such a point of order. In addition, the Senate has augmented its procedures with a special "pay-as-you-go" point of order that requires revenue and direct spending legislation to be deficit neutral over 10 years. Such a point of order also would require 60 votes to be waived.

The budget resolution may include optional reconciliation instructions, directing (among other things) that the House Ways and Means and Senate Finance Committees develop tax-cut legislation. Reconciliation legislation is considered under expedited procedures in the House and Senate. Any tax-cut legislation considered in the Senate outside of the reconciliation process is subject to a filibuster, and 60 votes would be needed to invoke cloture.

The second set of enforcement procedures was established under the Balanced Budget and Emergency Deficit Control Act of 1985, as amended. Under the 1985 act, tax-cut legislation, as well as any other legislation affecting revenues or direct spending, is subject to a "pay-as-you-go" (PAYGO) requirement. The net effect of all such legislation enacted during a session, as recorded on a PAYGO "scorecard," may not reduce the surplus (or increase the deficit), or else a sequester would automatically occur, reducing nonexempt direct spending programs by amounts sufficient to eliminate the violation.

In order to pass significant tax-cut legislation in the 106th Congress without incurring a PAYGO violation under current procedures, any revenue loss beyond the existing credits on the PAYGO scorecard would have to be offset by other revenue increases, reductions in direct spending, or a combination of the two. Two alternatives to this approach include: (1) by means of other legislation, changing the budget enforcement rules or eliminating them altogether; and (2) using a "directed scorekeeping" provision in the tax-cut legislation to instruct the director of the Office of Management and Budget not to record the revenue losses on the PAYGO scorecard. Such a provision, however, could require a waiver of the prohibition in Section 306 of the 1974 Congressional Budget Act against certain legislation changing the budget process; in the Senate, the waiver would require 60 votes.

Contents

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Background

The House and Senate considered significant tax-cut legislation during the 105th Congress but adjourned with unfinished business in this area. In 1997, the two houses passed the Taxpayer Relief Act of 1997 (P.L. 105-34; August 5, 1997; 111 *Stat*. 788-1103) in response to budget resolution policy calling for an $85 billion tax cut over FY1998-2002. In 1998, disagreements between President Clinton and Congress, and between the House and Senate, over the appropriateness of a tax cut and its size, coupled with the failure to adopt a budget resolution for FY1999, stymied action on tax-cut legislation. On September 26, the House passed the Taxpayer Relief Act of 1998 (H.R. 4579), a measure containing a five-year tax cut amounting to about $80 billion, but the Senate took no action on it before the 105th Congress adjourned. Instead, a scaled-down package of tax changes was included in the Omnibus Consolidated and Emergency Supplemental Appropriations Act for FY1999 (P.L. 105-277; October 21, 1998).

The House and Senate leadership have indicated that tax-cut legislation will be a high priority on the legislative agenda for the 106th Congress. The purpose of this report is to assess briefly the procedural context for action on such legislation.

Revenues and Revenue Legislation. Most of the revenues of the federal government arise automatically each year under permanent law. *Revenues*—also called *receipts*—are income derived principally from the government's exercise of its sovereign powers. They consist mainly of individual and corporate income taxes and social insurance taxes, such as the Social Security payroll tax. In addition, revenues include excise taxes; customs duties and tariffs; certain fines, fees, and user charges; gifts and donations; and certain other income.[1]

Although the majority of revenue laws are permanent, each Congress typically considers many different measures affecting revenues. The purposes behind these measures may range from routine extensions of expiring provisions and minor technical modifications in current law, to major policy changes involving redistribution of the tax burden. While most revenue legislation considered during a session has modest, or even negligible, effects on the federal budget, the House and Senate usually consider at least one or two measures that have a significant revenue impact.

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[1] Some funds received by accounts in the federal budget are treated as *offsetting collections*, which are deducted from spending instead of being counted as revenue; they involve business-like or market-oriented activities, or payments from one federal account to another.

Measures with a significant revenue impact usually involve changes in income, social insurance, or excise taxes rather than changes in fees, tariffs, and other forms of income. Some measures, such as the Economic Recovery Tax Act of 1981, make deep tax cuts; others, such as the Tax Equity and Fiscal Responsibility Act of 1982, provide large tax increases; and still others, such as the Tax Reform Act of 1986, are intended to be revenue-neutral over a multi-year period, but may change revenues markedly in any given year.

Jurisdiction and Procedure. In the House, jurisdiction over "revenue matters generally" and other specific revenue matters is vested in the Ways and Means Committee by Clause (1)(s) of Rule X. Similarly, in the Senate, Paragraph (1)(i) of Rule XXV assigns jurisdiction over "revenue matters generally" and other specific revenue matters to the Finance Committee. Both committees also have jurisdiction over a considerable portion of direct spending (*i.e.*, spending that is controlled outside of the annual appropriations process), which includes such programs as Social Security and Medicare.

Revenue measures often are constrained in their scope solely to revenue matters; such measures may range from the imposition or waiver of a single tariff to extensive changes in the Internal Revenue Code. Sometimes, omnibus measures dealing with direct spending programs may include one or more revenue titles along with titles containing direct spending and other legislative provisions. For example, legislation pertaining to Social Security or Medicare may contain provisions dealing with payroll taxes and other revenue features pertinent to the program, as well as provisions dealing with the program's eligibility criteria and benefit payments. In some instances, such as for highway and aviation spending, the Ways and Means Committee and Finance Committee develop the revenue portion (*i.e.*, excise taxes) of the legislation, while other House and Senate committees develop the spending portion. During the 1980s and 1990s, the Ways and Means Committee and the Finance Committee also have developed revenue reconciliation bills in response to reconciliation directives in the annual budget resolution.

The Constitution, in Article I, Section 7, requires that revenue measures originate in the House. (By custom, the annual appropriations acts originate in the House as well.)

In the House, the jurisdiction of the Ways and Means Committee, as well as the prerogative of the House to originate revenue measures, is protected by Rule XXI. Clause 5(b) of the rule effectively bars other House committees from reporting legislation containing any "tax or tariff measure" and prohibits such amendments from being offered to other committees' legislation. Similarly, the clause bars House consideration of revenue provisions added by the Senate to a House-passed measure not reported by the Ways and Means Committee. The Senate has no comparable rule specifically to protect the Finance Committee's jurisdiction, but its jurisdiction is protected in the same manner as the jurisdictions of the other committees under Senate rules and practices generally.

In addition, the House changed Rule XXI in the 104th Congress to require a three-fifths vote to pass legislation containing an increase in federal income tax rates and to bar retroactive increases in federal income tax rates.

Framework for Budgetary Enforcement

Two separate sets of enforcement procedures have a bearing on the consideration of tax-cut legislation. First, the Congressional Budget Act of 1974, as amended, established points of order that can be raised against legislation in violation of budget resolution policies. Second, the Balanced Budget and Emergency Deficit Control Act of 1985 (as amended by the Budget Enforcement Act of 1990, the Budget Enforcement Act of 1997, and other laws) established the sequestration process to enforce discretionary spending limits and a pay-as-you-go requirement. Sequestration involves automatic, across-the-board reductions in spending if certain budgetary goals are not met.

Enforcement under the 1974 Congressional Budget Act applies to individual measures as they are considered by the House and Senate. The 1985 Balanced Budget Act is enforced by the executive (in strict conformance with statutory requirements) at the end of a session, after congressional action has ceased, on the basis of the net effect of all enacted legislation.

Neither set of enforcement procedures is absolutely binding. The House and Senate sometimes waive provisions of the 1974 act during the consideration of legislation. On a few occasions, Congress and the President have enacted legislation suspending, canceling, or modifying a sequester that had taken effect. (There have been no sequesters in recent years.)

Congressional Budget Process

The congressional budget process entails consideration each year by the House and Senate of a budget resolution that establishes congressional budget policies over a multi-year period (covering five or more fiscal years). The budget resolution focuses on budget policies at an aggregate level; specific program decisions are left to the committees with jurisdiction over revenue and spending programs. In some years, the House and Senate use an optional reconciliation process to implement key budget resolution policies.

Congressional Budget Resolution. Under established budget resolution practices, any significant tax-cut policy should be reflected in the regular, annual budget resolution considered by the House and Senate if procedural difficulties are to be avoided. As required by Section 301(a) of the 1974 act, the tax-cut policy would be reflected in the budget resolution primarily in: (1) the aggregate revenue levels; and (2) the amounts by which the aggregate revenue levels should be changed (in this case, reduced).

The aggregate revenue levels for the first fiscal year and the sum of all the fiscal years covered by the budget resolution are enforced by a point of order in Section 311(a) of the 1974 act. Under this approach, the aggregate revenue levels for these two time periods serve as floors. Any legislation that would cause the estimated levels of total revenues to fall below the floors would be subject to a point of order.

Failure to provide for a tax cut in the initial budget resolution generally would make legislation providing such a tax cut subject to a point of order. In the Senate, it would require 60 votes to waive such a point of order.[2] Aside from waiving the point of order, the only way to avoid it would be to adopt a second budget resolution reflecting a tax-cut policy.[3] During the early 1980s, however, Congress abandoned the practice of adopting more than one budget resolution in a year due to the difficulty of doing so.

Several years ago, the Senate adopted a "pay-as-you-go" rule, as part of a budget resolution, to augment statutory procedures (discussed below) applicable to direct spending and revenue legislation.[4] The rule requires that direct spending and revenue legislation be deficit neutral, but it differs from the statutory requirement in two respects. First, the test of deficit neutrality applies solely to the measure under consideration at the time (not to the net effect of all legislation enacted during the session). Second, the rule covers a longer time frame—not just to the first year and the sum of the five years covered by the budget resolution, but to an additional five years as well. The Senate's 10-year "pay-as-you-go" rule remains in effect through FY2002, unless the Senate chooses to extend it. In order to waive the rule, 60 votes are required.

Reconciliation Legislation. Beginning in 1980, the House and Senate have regularly used the reconciliation process to enact major components of budget resolution policy. Reconciliation is an optional process authorized by Section 310 of the 1974 act under which legislation implementing budget resolution policies is considered in an expedited fashion, with significant time limitations and restrictions on amendments.

Reconciliation involves two separate steps. In the first step, reconciliation directives are included in the budget resolution. In the case of tax cuts, for example, reconciliation directives could instruct the House Ways and Means Committee and the Senate Finance Committee to reduce revenues by specified amounts over the period covered by the budget resolution.

In the second step, the instructed committees submit legislative recommendations to their respective Budget Committees. The Budget Committees then combine the legislative recommendations (usually in a single, omnibus bill), without any substantive revision. The reported reconciliation bill usually is modified significantly during initial floor action and subsequent conference proceedings.

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[2] This waiver, as well as similar Senate waivers, requires the affirmative vote of "three-fifths of the Members, duly chosen and sworn" *(i.e.*, 60 of the 100 Senators). In instances when some Senate seats are vacant, the required number of votes for a waiver could be less than 60.

[3] The point of order would not apply if a declaration of war was in effect.

[4] In its current form, the Senate rule is Section 202 of the FY1996 budget resolution (H.Con.Res. 67; 104th Congress; 109 *Stat*. 1019-1021).

In some cases, the House and Senate have pursued revenue changes under reconciliation separately from spending changes, choosing not to incorporate both types of changes into a single, omnibus bill. For example, in the 1982 reconciliation process, revenue changes were included in the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) while spending changes were included in the Omnibus Budget Reconciliation Act of 1982 (P.L. 97-253). Similarly, the 1997 reconciliation process led to the enactment of the Balanced Budget Act of 1997 (P.L. 105-33) as well as the Taxpayer Relief Act of 1997.

Reconciliation directives may even provide for the possibility of action on more than one reconciliation bill containing significant revenue provisions. In 1996, for example, the reconciliation directives in the budget resolution for FY1997 (H.Con.Res. 178; 104th Congress) anticipated the possibility of three separate reconciliation bills. Section 201(a), which pertained to reconciliation directives to House committees, identified separate submissions for: (1) "Welfare and Medicaid Reform and Tax Relief"; (2) "Medicare Preservation"; and (3) "Tax and Miscellaneous Direct Spending Reforms." The three-stage, interdependent reconciliation procedure was intended to allow for consideration of a tax-cut bill in concert with reconciliation bills achieving savings in Medicare, Medicaid, welfare, and other direct spending programs. As the joint explanatory statement accompanying the conference report on H.Con.Res. 178 indicated:

> The House conferees note that the multi-reconciliation process provides maximum flexibility to achieve the changes in spending and the tax relief assumed in this conference report. For example, any of the spending or revenue changes assumed in the first bill could—if not enacted—be achieved in the third bill. Moreover, the reconciliation committees are permitted to exceed the savings assumed in each of the reconciliation bills. Nevertheless, the process still requires reconciled committees ultimately to meet their targets whether incrementally through the separate reconciliation bills or solely through the third bill.[5]

One option available under this approach was to consider tax-cut legislation after the cuts had been "paid for" by the enactment of spending reductions.

In the Senate, the "Byrd rule" (Section 313 of the 1974 Congressional Budget Act) bars the inclusion of extraneous matter in reconciliation measures.[6] Legislation providing a tax cut for the years covered by the budget resolution is accommodated by the Byrd rule (so long as the estimated revenue effects of the legislation are consistent with the amounts of the reconciliation directives), but tax cuts extending beyond this period would be considered extraneous under Section 313(b)(1)(E).

In most major tax bills, revenue changes generally are permanent in nature. Accordingly, this portion of the Byrd rule potentially threatens major tax-cut legislation in the Senate unless it is circumvented in some fashion (waivers of the Byrd

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[5] See page 81 of the conference report, H.Rept. 104-612 (June 7, 1996).

[6] For more information on the rule, see: *The Senate's Byrd Rule Against Extraneous Matter in Reconciliation Measures*, by Robert Keith, CRS Report 97-688 GOV, updated September 9, 1998, 30 pages.

rule require 60 votes). With regard to consideration of the Taxpayer Relief Act of 1997, the Senate considered the bill under a unanimous consent agreement that required the tax-cut effects of the bill to be considered in conjunction with the direct spending savings of the other reconciliation bill.[7] The savings in the other reconciliation bill, the Balanced Budget Act of 1997, were largely permanent in nature too and "offset" the tax cuts; therefore, a point of order under the Byrd rule was avoided.

Major revenue legislation also has been enacted since 1980 outside of the reconciliation process. For example, the Social Security Amendments of 1983, intended to raise revenue, and the Tax Reform Act of 1986, intended to be deficit neutral over a multi-year period, were not reconciliation bills. Any tax-cut legislation considered in the Senate outside of the reconciliation process, however, is subject to a filibuster, and 60 votes would be needed to invoke cloture.

Pay-As-You-Go Procedures

Section 252 of the 1985 Balanced Budget Act, as amended, imposes a pay-as-you-go (PAYGO) requirement on revenue and direct spending legislation considered through FY2002.[8] When PAYGO legislation is enacted, its effects on the deficit or surplus are registered by the director of the Office of Management and Budget (OMB) on a multi-year PAYGO "scorecard." Under the PAYGO process, revenues and direct spending for a fiscal year from new laws, when combined with the balance on the PAYGO scorecard for that year from prior laws, must not result in a net increase in the deficit or a net reduction in the surplus.[9] Revenue reductions or direct spending increases are allowed so long as they are offset by the carryover balances or other new PAYGO laws.

Violations of the PAYGO requirement, as determined in a sequestration report prepared by the OMB director, trigger a PAYGO sequester at the end of a congressional session. Under such a sequester, automatic reductions would be made in direct spending programs sufficient to eliminate any estimated net increase in the deficit or net reduction in the surplus. Although all direct spending is taken into account in determining whether a PAYGO sequester is necessary,[10] only a small subset of direct spending programs would be subject to the required spending

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[7] See the remarks of Senator Domenici in the *Congressional Record* of May 21, 1997, at page S4873.

[8] The PAYGO procedures remain in effect for four additional years (through FY2006) to deal with the out-year effects of legislation considered through FY2002.

[9] The PAYGO procedures exclude the off-budget Social Security trust funds (and the Postal Service Fund). Although the total federal budget incurred a surplus in FY1998 ($70 billion), for the first time in 29 years, and surpluses in the total federal budget are projected well into the future, the on-budget portion of the federal budget remains in deficit. Some argue that the PAYGO procedures would cease to apply if the on-budget portion of the federal budget moved to surplus.

[10] Social security spending, interest on the public debt, and certain other mandatory spending is not considered to be direct spending for these purposes.

reductions. Reductions for the largest direct spending program subject to a PAYGO sequester, Medicare, are limited to four percent by the 1985 act.

In addition to controlling revenue and direct spending legislation through PAYGO procedures, the 1985 act also sets statutory limits on discretionary spending *(i.e.*, spending controlled through the annual appropriations process). The enforcement procedures for the PAYGO requirement, on the one hand, and the discretionary spending limits, on the other, are separated by a "firewall." Savings made on one side of the firewall cannot be used to the advantage of programs on the other side. For example, the cost of tax-cut legislation could not be offset by reductions in annual appropriations acts in order to avoid a PAYGO sequester.

At the beginning of each session, the President issues (as part of his annual budget submission) preliminary sequestration reports covering both the PAYGO requirement and the discretionary spending limits. These reports provide an early warning regarding the possibility of sequesters at the end of the session and the potential magnitude of any actions that might be necessary to avoid them. An update report is required to be issued in August and the final report is required to be issued within 15 days after Congress adjourns.

The most currently available information, obtained from the OMB final sequestration report for FY1999, shows a PAYGO credit of about $3 billion for FY2000, with smaller credits for each of the following years. Consequently, the current PAYGO scorecard would allow tax-cut legislation (or legislation increasing direct spending) to be enacted without triggering a sequester, but such legislation would have to be quite modest in its impact.

In order to pass significant tax-cut legislation in the 106th Congress without incurring a PAYGO violation under current procedures, any revenue loss beyond the existing credits on the PAYGO scorecard would have to be offset by other revenue increases, reductions in direct spending, or a combination of the two.

As an alternative to this approach, some Members favor changing the budget enforcement rules so that reductions in discretionary spending could be used to offset revenue losses from a tax cut, or eliminating the PAYGO requirement altogether, so long as surpluses are projected.

Finally, the House and Senate could avail themselves of the approach used by the House in the Taxpayer Relief Act of 1998 (H.R. 4579). Section 607 of the bill, as passed by the House on September 26, 1998, simply instructed the OMB director "not to make any estimates of changes in receipts" on the PAYGO scorecard from the enactment of H.R. 4579. Under Section 607, had the measure been enacted into law, the tax cuts would have taken effect and no PAYGO sequester would have occurred.

Any legislation that directly or indirectly changes the budget process is prohibited by Section 306 of the 1974 Congressional Budget Act, unless it was reported by the House or Senate Budget Committee, as appropriate (or unless the committee was discharged from further consideration). This prohibition, therefore, needed to be waived so that the House could consider the "directed scorekeeping" provision in Section 607 of H.R. 4579 (the House did so by adopting a special rule, H.Res. 552, that waived all points of order against consideration of the bill). In the Senate, 60 votes are required to waive points of order under Section 306