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Tax-Cut Legislation: The Economic Growth and Tax Relief Act of 2001 (H.R. 3)

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Summary

On March 8, 2001, the House of Representatives approved H.R. 3, the Economic Growth and Tax Relief Act of 2001. The bill provides a gradual reduction in the statutory tax rates that apply to taxable income under the individual income tax. It also provides that current law's refundable child credit and earned income tax credits will not be reduced by an individual's alternative minimum tax (AMT). H.R. 3's tax rate cut is almost identical to that proposed by President Bush during the 2000 presidential campaign and as sent to Congress in February, 2001. One difference, however, is retroactivity: H.R. 3's initial cut in current law's 15% rate would begin January 1, 2001, and withholding tables would be adjusted accordingly. President Bush has stated he is willing to accept a retroactive tax cut. This report will be updated as legislative developments occur.

The principal feature of H.R. 3's tax cut is its reduction in marginal tax rates, which would account for over 98% of the bill's estimated $958 billion 10-year revenue reduction.[1] In broad terms, the bill would cut rates applicable to most brackets and consolidate the number of brackets. It would separate the lowest bracket into two parts, with a 10% rate applying to the first $12,000 for joint returns ($6,000 for singles) and retaining a 15% rate for the rest of the bracket. The plan would consolidate the next four brackets into two, with a single 25% rate replacing current law's 28% and 31% rates, and a single 33% rate applying to current law's 36% and 39.6% brackets. The rate reductions would become effective gradually over the period 2001 – 2006. The initial reduction in the 15% rate to 12% would be the only part of the proposal to be retroactive; the remaining phased-in reductions would begin in 2002. The table at the end of this report presents the rates and brackets for current law and those under H.R. 3's fully phased-in provisions.

[1] The revenue estimates are from: U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of H.R. 3* (Washington: Feb. 28, 2001). For a description of H.R. 3, see: U.S. Congress, Joint Committee on Taxation, *Description of the Economic Growth and Tax Relief Act of 2001*, JCX-03-01 (Washington: Feb. 27, 2001), 7 pp.

H.R. 3's AMT provision applies to the interaction of the AMT and refundable tax credits: the child tax credit for families with three or more children; and the earned income tax credit (EITC). In broad terms, the AMT generally requires individuals to pay either their regular tax or their AMT, whichever is higher. Under current law, a taxpayer's regular-tax refundable EITC is reduced by the amount by which the AMT exceeds the taxpayer's regular tax; the same holds for the refundable credit for families with three or more children, beginning in 2002. H.R. 3 would repeal the provisions of current law that offset the refundable credits by the amount of the AMT. President Bush's tax plan also includes a proposal that addresses the interaction of tax credits and the AMT. However, details on how the Bush proposal compares with H.R. 3 are not available.

Democrats on the Ways and Means Committee set forth an alternative proposal that was not adopted. The alternative would have created a new 12% tax-rate bracket, increased the standard deduction for married couples to twice that of singles, and expanded the earned income tax credit. According to the Joint Committee on Taxation, the proposal would reduce revenue by $585.5 billion over 10 years.[2]

The merits of the size and nature of a tax cut has been one of the principal policy issues before Congress in the first months of 2001. The debate over a tax cut has included issues such as: fairness; its size; its impact on the budget; and whether a cut is needed to stimulate the economy. These issues are beyond the scope of this report, but are discussed in the following CRS products:

- CRS Report RS20819, *President Bush's Tax Proposal: A Brief Overview*;
- CRS Report RL30779, *Across-the-Board Tax Cuts: Economic Issues*; and
- CRS Report RL30839, *Income Tax Cuts, the Business Cycle, and Economic Growth: A Macroeconomic Analysis.*

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[2] Information on the Democratic alternative is based on material in the BNA *Daily Tax Report*, Mar. 2, 2001, p. GG-2.

Statutory Marginal Tax Rates Under Current Law and H.R. 3 (Income Brackets Applicable to 2001)								
Singles			Heads of Households			Married Couples		
Taxable Income Bracket (Tax Year 2001)	Current Law	H.R. 3	Taxable Income Bracket (Tax Year 2001)	Current Law	H.R. 3	Taxable Income Bracket (Tax Year 2001)	Current Law	H.R. 3
$0 – $6,000	15%	10%	$0 – $10,000	15%	10%	$0 – $12,000	15%	10%
$6,000 – $27,050	15%	15%	$10,000 – $36,250	15%	15%	$12,000 – $45,200	15%	15%
$27,050 – $65,550	28%	25%	$36,250 – $93,650	28%	25%	$45,200 – $109,250	28%	25%
$65,550 – $136,750	31%	25%	$93,650 – $151,650	31%	25%	$109,250 – $166,500	31%	25%
$136,750 – $297,350	36%	33%	$151,650 – $297,350	36%	33%	$166,500 – $297,350	36%	33%
$297,350 –	39.6%	33%	$297,350 –	39.6%	33%	$297,350 –	39.6%	33%

Note that the tax rates in the table are *marginal rates* – that is, they apply to increments of income a taxpayer earns within the corresponding income bracket. Increments of a taxpayer's income corresponding to lower brackets are taxed at lower marginal rates; increments corresponding to higher brackets are taxed at higher rates. For example, if single taxpayer earns $70,000 of taxable income under current law, $27,050 of his income would be taxed at 15%, $38,500 (i.e., $65,500 minus $27,050) would be taxed at 28%, and $4,450 would be taxed at 31%. Note also that for ease of comparison with current law, the table presents income brackets set forth by the tax code for 2001. Because the tax brackets are changed annually to reflect inflation, the tax brackets that will be applicable in 2006 when H.R. 3 is fully effective are not those presented above for either current law or for H.R. 3's rates.