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The Jobs and Growth Tax Act (H.R. 2): A Brief Overview of the House Tax-Cut Bill

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David L. Brumbaugh
Specialist in Public Finance
Government and Finance Division

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Summary

On May 6, the House Committee on Ways and Means approved H.R. 2, the Jobs and Growth Tax Act of 2003; the measure was approved by the full House on May 9. The bill proposes a tax cut estimated at $550 billion over fiscal years (FY) 2003 - 2013. The bill is similar in many respects to the tax cut proposed by President Bush with his FY2004 budget, although the total size of the Committee's tax cut is smaller — a difference arising principally from H.R. 2's partial rather than full elimination of individual taxes on corporate dividends and capital gains and the expiration of several of the bill's tax cuts at the end of 2005. In contrast, H.R. 2's total tax cut is larger than the $350 billion tax cut in reconciliation instructions given to the Senate Finance Committee by the FY2004 budget resolution (H.Con.Res. 95). The principal provisions of H.R. 2 are:

- reduction of the tax rate for capital gains and dividends to 15% or 5%, depending on a taxpayer's income level;
- an acceleration to 2003 of several tax cuts scheduled to be phased in under the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16), including the scheduled reduction in marginal tax rates, the tax cut for married couples, the widening of the 10% tax-rate bracket, and the increase in the child tax credit;
- a temporary increase to $100,000 from $25,000 of the "expensing" benefit for small business investment;
- temporary allowance of a 50% depreciation "bonus" for business investment in machines and equipment;
- extension to losses occurring in 2003, 2004, and 2005 of the five-year loss carryback provision enacted in 2002; and
- a $7,500 ($15,000 for couples) increase in the alternative minimum tax (AMT) exemption amount.

On May 7, House Democratic leaders outlined an alternative tax and outlay package that would cut taxes and increase selected outlays by an estimated $177 billion over 10 years. The plan also contains revenue-raising proposals that would offset the budget effects of the tax cuts and outlay increases. The proposed tax cuts include acceleration of several of the tax cuts scheduled under the 2001 tax act as well as a temporary increase in the expensing allowance for business investment and a temporary depreciation bonus. The plan would also phase out the extraterritorial income (ETI) tax benefit for exports and replace it with a tax benefit for domestic production.

This report will not be updated. For information on the bill in the Senate and conference, see CRS Report RL31907, *Tax Cut Bills in 2003: A Comparison*.

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On May 6, the House Committee on Ways and Means approved H.R. 2, the Jobs and Growth Tax Act of 2003. The bill proposes a tax cut estimated at $550 billion over 10 years. It incorporates — with some differences — the principal elements of the economic stimulus tax-cut package proposed by President Bush in February with his fiscal year (FY) 2004 budget plan. H.R. 2's principal provisions are a cut in the tax rates applicable to dividends and capital gains; a temporary increase in the "expensing" allowance for small business; a temporary depreciation bonus for investment in machines and equipment; an acceleration to 2003 of several phased-in tax cuts enacted under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16); and a temporary increase in the alternative minimum tax (AMT) exemption for individuals.

A major difference between H.R. 2 and President's proposal is the treatment of capital gains and dividends. The President proposed complete elimination of individual income taxes on corporate-source capital gains and dividends; H.R. 2 proposes a reduction of rates rather than elimination of tax and would apply to most capital gains, not just those on corporate stock. Another difference between H.R. 2 and the President's proposal is that several of H.R. 2's accelerations of tax cuts are temporary and would expire at the end of 2005, reverting to the phase-in schedule enacted by EGTRRA. These temporary provisions include the widening of the 10% rate bracket, the increase in the child credit, and the doubling of the standard deduction for married couples. Largely as a result of these differences, the proposed size of H.R. 2's tax cut is smaller over 10 years than the President's plan: $550 billion compared to the $726 proposed by the President.[1] In contrast, the bill's proposed tax cut is larger than the $350 billion tax cut contained in the budget reconciliation instructions given to the Senate Finance Committee in the fiscal year 2004 budget resolution (H.Con.Res. 95).

For further information on the President's tax proposal, see CRS Report RS21420, *President Bush's 2003 Tax Cut Proposal: A Brief Overview*, by David L. Brumbaugh.

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[1] Along with tax cuts aimed at providing economic growth and stimulus, the President's budget proposal contained tax cuts targeted at specific activities and investments (tax "incentives") and would make the 2001 tax cuts — which are scheduled to expire in 2010 — permanent. According to Joint Tax Committee estimates, the President's $726 growth package, his proposed tax incentives, and elimination of the 2010 expiration would together reduce revenue by an estimated $1,575 billion over 10 years. Neither the proposed tax incentives nor provisions making the 2001 tax cut permanent are contained in H.R. 2.

Acceleration of the 2001 Tax Cuts

EGTRRA contained a number of broad tax cuts that it scheduled to be phased in gradually over the period 2001 - 2010. Among the phased-in cuts were a three percentage-point reduction in marginal tax rates scheduled to be phased in over 2001 - 2006; an expansion of the lowest tax bracket, effective in 2008; a gradual increase in the per-child tax credit over 2001 - 2010, to $1,000 from prior law's $600; a gradual increase in the standard deduction for married couples to twice that of singles over the period 2005 - 2009; and an increase over 2005 - 2008 of the width of the 15% tax bracket for married couples to twice the width of that for singles.

In general, H.R. 2 would move up the point at which EGTRRA's reductions are effective, applying each of the full reductions in 2003. To illustrate, EGTRRA set marginal tax rates at 10%, 15%, 27%, 35%, and 38.6% for 2001 - 2003; at 10%, 15%, 26%, 34%, and 37.6% for 2004 - 2005; and at 10%, 15%, 25%, 33%, and 35% for 2006 until EGTRRA's general expiration in 2010. H.R. 2 would apply the 2006 rates in 2003. Table 1, below, presents a schematic view of the effective years for the various tax cuts scheduled for phase in under EGTRRA and accelerated by H.R. 2.

H.R. 2 would not accelerate all the tax cuts scheduled to be phased by EGTRRA; the 2001 Act's phase-out of the estate tax would not be accelerated by H.R. 2, nor would EGTRRA's phase-outs of the limitation on itemized deductions (the "Pease" limitation) or the personal exemption reduction.

Table 1. Schedule of Tax Cuts Under EGTRRA and H.R. 2

<table>
<tr><th colspan="9">Marginal Tax Rates</th></tr>
<tr><th></th><th>2003</th><th>2004</th><th>2005</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th></tr>
<tr><td>EGTRRA</td><td>10% 30%
15% 35%
27% 38.6</td><td colspan="2">10% 29%
15% 34%
26% 37.6%</td><td colspan="5">10% 28%
15% 33%
25% 35%</td></tr>
<tr><td>H.R. 2</td><td colspan="8">10% 28%
15% 33%
25% 35%</td></tr>
<tr><th colspan="9">Width of 10% Bracket</th></tr>
<tr><th></th><th>2003</th><th>2004</th><th>2005</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th></tr>
<tr><td>EGTRRA</td><td colspan="5">$0 -$6,000
singles
$0 - $12,000
couples</td><td colspan="3">$0 - $7,000
singles
$0 - $14,000
couples</td></tr>
<tr><td>H.R. 2</td><td colspan="3">$0 - $7,000
singles
$0 - $14,000
couples</td><td colspan="2">$0 -$6,000
singles
$0 - $12,000
couples</td><td colspan="3">$0 -$7,000
singles
$0 - $14,000
couples</td></tr>
</table>

<table>
<tr><th colspan="9">Child Tax Credit</th></tr>
<tr><th></th><th>2003</th><th>2004</th><th>2005</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th></tr>
<tr><td>EGTRRA</td><td colspan="2">$600</td><td colspan="4">$700</td><td>$800</td><td>$1,000</td></tr>
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<tr><td>EGTRRA</td><td colspan="2">couples’ deduction 167% of singles’</td><td>couples’ 174% of singles’</td><td>couples’ 184% of singles’</td><td>couples’ 187% of singles’</td><td>couples 190% of singles’</td><td colspan="2">couples’ 200% of singles’</td></tr>
<tr><td>H.R. 2</td><td colspan="3">couples’ 200% of singles’</td><td>couples’ 184% of singles’</td><td>couples’ 187% of singles’</td><td>couples 190% of singles’</td><td colspan="2">couples’ 200% of singles’</td></tr>
<tr><th colspan="9">Broadened 15% Rate Bracket for Married Couples</th></tr>
<tr><th></th><th>2003</th><th>2004</th><th>2005</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th></tr>
<tr><td>EGTRRA</td><td colspan="2">End of couples’ bracket 167% of singles’</td><td>End of couples’ bracket 180% of singles’</td><td>End of couples’ bracket 187% of singles’</td><td>End of couples’ bracket 193% of singles’</td><td colspan="3">End of couples’ bracket 200% of singles’</td></tr>
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<tr><th colspan="9">Alternative Minimum Tax Exemption</th></tr>
<tr><th></th><th>2003</th><th>2004</th><th>2005</th><th>2006</th><th>2007</th><th>2008</th><th>2009</th><th>2010</th></tr>
<tr><td>EGTRRA</td><td colspan="2">$49,000 for couples
$35,750 for singles</td><td colspan="6">$45,000 for couples
$33,750 for singles</td></tr>
<tr><td>H.R. 2</td><td colspan="3">$64,000 for couples
$43,250 for singles</td><td colspan="5">$45,000 for couples
$33,750 for singles</td></tr>
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Dividend Exclusion

One of the largest parts of President Bush's tax-cut plan is its proposed elimination of individual income taxes on income investors earn on their corporate-sector assets, including removing taxes on capital gains earned on corporate stock and on dividends paid by corporations. The Administration's proposed tax exclusion for such income would amount to an estimated $395.8 billion over FY2003-2013. This would constitute over half (54.5%) of the total revenue cost of the economic growth portion of the President's proposal. The plan would institute a form of what economists term "integration" of taxes on corporate income. Under current law, much of corporate equity income is taxed twice: once under the federal corporate income tax, and once under the individual income tax when stockholders sell their stock or receive dividends. The Administration's proposal to exclude both dividends and capital gains from tax would eliminate one of the two levels of tax.

Rather than eliminating individual taxes on corporate-source income, H.R. 2 proposes to reduce tax on corporate dividends and non-corporate as well as corporate-source capital gains. Under current law, capital gains are generally taxed at a maximum rate of 20% (10% for taxpayers in the 15% ordinary-income rate bracket). For capital gains, H.R. 2 would reduce these rates to 15% and 5% respectively. The proposal would treat dividends received from domestic corporations as capital gains for purposes of applying the rates.

Alternative Minimum Tax Exemption

Under current law, an individual generally pays either his or her alternative minimum tax (AMT) or regular tax, whichever is larger. The two liabilities ordinarily differ because taxable income is defined differently under the AMT and different tax rates are applied to taxable income. AMT tax rates are generally lower than those of the regular tax. In addition, taxable income is generally defined more broadly under the AMT; it contains more items of income and provides fewer benefits. Rather than providing the same itemized or standardized deduction or personal exemptions as the regular tax, the AMT applies to AMT taxable income in excess of an exemption amount that is phased out at higher income levels.

Under temporary rules enacted by EGTRRA, the AMT exemption is $49,000 for couples and $35,750 for singles, but is scheduled to fall to $45,000 and $33,750, respectively, for tax years beginning in 2005 and thereafter. H.R. 2 proposes to increase the AMT exemption to $64,000 for couples and $43,250 for singles. The increased exemption would apply to 2003, 2004, and 2005, but the amounts would revert to those scheduled under current law in 2006 and thereafter.

Increased "Expensing" Benefit for Small Business Investment

In broad terms, the tax code does not permit businesses to deduct the entire cost of investments in the year they are acquired. Investment outlays, in tax parlance, are not permitted to be treated as expenses ("expensed") such as wages, which are deducted in the year the outlays are made. For example, when a firm buys a new machine, it is not incurring a cost, but simply trading one asset (cash) for another of equal value (the machine). Instead, businesses are generally required to gradually deduct the costs of tangible assets (broadly, machines, equipment, and structures) over a period of years as the gradual decline in the assets' value does impose a cost. The tax rules generally specify how rapidly a tangible asset can be depreciated; from the point of view of a firm, the more quickly depreciation deductions can be claimed, the better, since the sooner a deduction is claimed the sooner the savings it represents can be invested and earn a return. In general, if an asset is permitted to be deducted more rapidly than it actually loses value, a tax benefit is conferred. If the entire acquisition price of an asset is deducted in the year of purchase (i.e., if the asset is "expensed") the value of the benefit is the equivalent of exempting the asset's return from tax.

Notwithstanding the tax code's general depreciation rules, section 179 of the tax code permits firms to deduct immediately (expense) up to $25,000 annually of outlays for machines and equipment (but not structures). The benefit is linked to small business by a phase-out provision; under its terms the expensing limit is reduced on a dollar-for-dollar basis by the amount qualified investment in a year exceeds $200,000. (Thus, for example, a firm that invests $210,000 in a year could expense only $15,000.) H.R. 2 would increase the expensing limit to $100,000 for property placed in service in 2003-2007; the increase would expire for 2008 and thereafter. The plan would also increase the beginning of the phase-out range to $400,000, also for 2003-2007.

Enhanced Depreciation Allowance

As noted above, the tax code generally requires firms to depreciate their tangible business property over a period of years. The tax code governs how rapidly the cost of an asset can be depreciated by specifying the number of years over which deductions must be spread (the "recovery period") and the portion of the asset's total cost that can be deducted in each year of the recovery period. Notwithstanding these rules — and also as described above — section 179 of the tax code permits firms to deduct ("expense") a certain amount of investment outlays in first year an asset is placed in service. In addition, the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147) enacted on a temporary basis a special depreciation "bonus," under which 30% of the cost of qualifying business property — generally machines and equipment, but not structures — can be deducted in the year of purchase. The provision applies to property purchased during the three-year period from September 11, 2001 to September 10, 2004 and placed in service before 2005.

H.R. 2 would provide a new temporary first-year allowance under which firms are permitted to deduct 50% of the cost of machines and equipment in their first year. The allowance would cover property acquired after May 5, 2003 and before January 1, 2006, a period spanning roughly two years and eight months.

Net Operating Losses

Firms are generally subject to federal tax on their taxable income, that is, their gross revenues, as defined by the tax code, minus allowable deductions. If a firm's deductions in a given year exceed its taxable revenues, it incurs a loss for tax purposes, a "net operating loss" or NOL. Firms incurring an NOL in a particular year are permitted to "carry back" the NOL and deduct it from taxable income earned in the preceding two years. If a firm possesses positive taxable income in either of the two carryback years, it receives a tax refund for the deductions generated by the NOL. If some or all of the firm's NOL remains after deducting it from taxable income in the carryback years — if the NOL is larger than the sum of taxable income in the carryback years — any remaining NOL can be "carried forward" up to 20 years and deducted from taxable income in the future. In general, an NOL that is carried back and used to generate a tax refund is more valuable to a firm that an NOL carryforward of the same amount because of discounting, the idea that firms and other economic actors value resources they have in the present more than the same resources received at some point in the future. To illustrate, the sooner a firm obtains the tax savings from a deduction, the sooner it can invest the savings and begin to earn a return on them.

The 2002 Act temporarily increased the NOL carryback period to five years from two. The extended period is applicable for NOLs arising in 2001 and 2002. H.R. 2 would extend the period for which the five-year carryback is available to NOLs incurred in 2003, 2004, and 2005.

The House Democratic Proposal

On May 7, House Democratic leaders announced the outlines of an alternative tax and outlay package that would cut taxes and increase selected outlays by an estimated $177 billion over 10 years.[2] (Of that total, the proposed tax cuts would reduce revenue by an estimated $106 billion over 10 years.) The plan also contains revenue "offsets": revenue-raising tax increases that are designed to offset the cost of the tax cuts so that there would be no net change in revenues over 10 years.

For individuals, the plan would accelerate to 2003 part of the scheduled increase in the per-child tax credit. The plan would increase the credit to $800; as described above in table 1, the credit is currently $600 and is scheduled to increase to $800 in 2009 and to $1,000 in 2010. The proposal would also accelerate to 2003 the expansion of the 10% tax-rate bracket that EGTRRA scheduled for 2008, as well as unspecified tax cuts for married couples.

For businesses, the proposal would increase the expensing benefit for small business investment undertaken in 2003 to $75,000 from current law's $25,000. The plan would also provide a 50% first-year depreciation "bonus" for 2003 and a 10% bonus for 2004.

The proposal would also implement the provisions of H.R. 1769 (Rep. Crane), a bill that addresses the controversy between the United States and the European

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[2] An outline of the plan is posted on the Bureau of National Affairs website, at [http://ippubs.bna.com]. The outlay portions of the plan also propose $44 billion in increased outlays over 10 years that are not included in the $177 billion "jobs creation" part of the proposal.

Union (EU) over the U.S. extraterritorial income (ETI) tax benefit for exporters. The EU has charged — and World Trade Organization (WTO) panels have agreed — that the ETI provisions violate WTO strictures against export subsidies; the EU has received authorization from the WTO to implement retaliatory tariffs if the United States does not bring its tax laws into WTO-compliance. H.R. 1769 would repeal ETI and implement a tax deduction for domestic U.S. producers that would apply to both exported goods and goods that are not exported. The bill's provisions contrast with the approach to ETI taken by H.R. 5095 (Rep. Thomas) in the 107th Congress, which proposed to eliminate ETI while adopting a range of tax cuts for the overseas operations of U.S. firms.[3]

The outlay portions of the proposal include extension and expansion of unemployment benefits and fiscal assistance to the states. The precise nature of the revenue-raising provisions have not been specified beyond identifying tax shelters and the freezing of scheduled rate-reductions for the top income brackets as targeted areas.

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[3] For more information on the ETI controversy, see CRS Report RS20746, *Export Tax Benefits and the WTO: Foreign Sales Corporations and the Extraterritorial Replacement Provisions*, by David L. Brumbaugh; and CRS Report RS21143, *Policy Options for U.S. Export Taxation*, by David L. Brumbaugh.