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President Bush's 2003 Tax Cut Proposal: A Brief Overview

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Summary

On January 7, 2003, President Bush announced the elements of a new tax cut plan intended to provide a fiscal stimulus to the economy by encouraging consumer spending and promoting investment. As initially announced, the stimulus package contained an estimated $670 billion in tax cuts over 10 years, and included acceleration to 2003 of tax cuts scheduled to be gradually phased in under the tax cut enacted in 2001; elimination of individual income taxes on corporate-source dividends and capital gains; and an increase in the "expensing" tax benefit for business investment. On February 3, the Administration released fiscal year (FY) 2004 budget documents providing a more comprehensive outline of the President's tax proposals. The budget proposes tax cuts totaling an estimated $1.46 trillion over 10 years. This amount includes the already-proposed stimulus package, a set of additional tax cut proposals characterized as "tax incentives," and a proposal to make the expiring provisions of the 2001 tax cut permanent.[1] Congress began consideration of tax cut legislation similar to the President's proposal in April and May 2003. For information on congressional tax-cut legislation, see CRS Report RL31907, *Tax Cut Bills in 2003: A Comparison*, by David L. Brumbaugh and Don C. Richards. This report will be updated as events warrant.

The Proposal's Size

The Administration estimates that the tax-cut proposals in its budget will reduce federal revenue by $1.46 trillion over 10 years and by $493.4 billion over its first five years. Based on Congressional Budget Office (CBO) estimates for total revenue and gross domestic product (GDP) otherwise expected over the period, the 10-year revenue loss amounts to 5.2% of federal revenue and 1.0% of GDP.

[1] A detailed description of the proposals has been published by the Treasury Department in its *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* (Washington: Feb. 2003). See [http://www.treas.gov/offices/tax-policy/library/bluebk03.pdf].

The revenue impact of the proposal, however, is better seen by separating the proposal into its likely long-run, permanent effects, and its more near-term transitory effects. In the near-term, much of the proposal's revenue cost consists of acceleration of the cuts that were previously enacted under the Economic Growth Tax Relief and Reconciliation Act (EGTRRA; P.L. 107-16) but that were scheduled to be phased in over a number of years. According to the Administration's estimates for the plan's first 5 years, the combined elements of the proposal would reduce revenue by 4.2% of otherwise expected revenues and 0.8% of GDP. Between one-third and one-half of this (41%) consists of revenue reductions from acceleration of EGTRRA's tax cuts.

The long-run picture is different. First, to comply with procedural rules in the Senate, EGTRRA contained a provision repealing all of its tax cuts at the end of calendar year 2010. Accordingly, the President's proposal to make those cuts permanent will not register its full revenue effect until after the expiration is scheduled to take place in fiscal year 2012 and beyond. Second, the provisions of the current proposal that would accelerate EGTRRA's tax cuts do not impose additional costs in the long run; the cost of the acceleration is confined to the first six to eight years of the plan. For these reasons, the long-run, permanent revenue effect of the President's proposal is best seen by looking at the revenue estimates for the plan's "out years." According to the Administration's estimates, the revenue loss in FY2013 would be $299.1 billion, or – again using CBO projections to scale the estimated loss – 8.1% of otherwise expected revenues and 1.7% of GDP. In FY2013, $203.5 billion of the revenue loss would be from extension of EGTRRA's tax cut. In terms of its long-run general revenue effect, the proposal can thus be summarized as reducing tax revenue by 5.5% so as to make EGTRRA's tax cuts permanent, plus providing roughly half again as much in new tax cuts.

Components of the Plan

Table 1 presents the Administration's estimates of the revenue cost of the plan's major components for its first 5 years, its first 10 years, and – in keeping with the considerations outlined above – for FY2013. The table listings can be separated into three groups: the "economic growth" or stimulus package; extension of EGTRRA's tax cuts; the plan's tax incentives and other tax cuts. On the basis of the numbers in the table, the stimulus package would account for most (about two-thirds) of the plan's revenue cost in the proposal's early years but falls to less than one-quarter by 2013. The cancelling of EGTRRA's expiration, on the other hand, accounts for a very small part of the plan's cost in its first 5 years, but rises to over two-thirds by 2013. Among the other provisions, the largest are generally extension of a set of expiring tax benefits that are not a part of EGTRRA (the so-called "extenders"), tax benefits for health care, and tax benefits related to charitable giving. The provisions are described in more detail in the following sections.

Table 1. Estimated Reductions in Tax Revenue Under the President's Proposal
(dollars in billions)

	5-Year Reduction (FY2004-2008)		10-Year Reduction (FY2004-2013)		Long-Run Single Year (FY2013)	
	$	% of Total	$	% of Total	$	% of Total
Total, All Provisions	**$493.4**	**100%**	**$1,460.6**	**100%**	**$299.1**	**100%**
Economic Growth Package	390.4	79.1	664.9	45.5	57.6	19.3
Acceleration of EGTRRA Tax Cuts	203.5	41.2	239.1	16.4	3.3	1.1
Dividend Exemption	152.7	30.9	385.4	26.4	53.0	17.7
Expensing for Business Investment	8.4	1.7	14.6	1.0	1.3	0.4
Minimum Tax Reductions	25.8	5.2	25.8	1.8	0.0	0.0
Tax Incentives						
Charitable Giving	9.0	1.8	19.5	1.3	2.3	0.8
Education	4.3	0.9	6.2	0.4	0.3	0.0
Health Care	47.8	9.7	135.4	9.3	19.5	6.5
Telecommuting	0.2	0.0	0.6	0.0	0.1	0.0
Housing	3.5	0.7	17.5	1.2	3.2	1.1
Environment	1.4	0.3	2.8	0.2	0.3	0.1
Energy	5.2	1.1	8.0	0.5	0.6	0.2
Trade, Tax Administration and Unemployment Insurance	4.4	0.9	3.3	0.2	(1.6)[a]	(0.5)[a]
Tax Simplification and Other Proposals	(13.2)[a]	(2.7)[a]	1.6	0.1	3.4	1.1
Make EGTRRA Cuts Permanent	5.8	1.2	523.0	35.8	203.5	68.0
Extend Other Expiring Provisions	34.5	7.0	77.8	5.3	10.0	3.3

Source: *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* (Washington: Feb. 2003), p. 151.
[a]Estimated net revenue gain.

Economic Growth (Stimulus) Package

The President's budget calls for Congress "to pass an economic growth package quickly that will reinvigorate the economic recovery and provide new jobs, reduce tax burdens, and strengthen investor confidence."[2] EGTRRA's tax cut in June 2001was also enacted, in part, to provide economic stimulus. Data now show that a recession was in

[2] U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2004. Analytical Perspectives* (Washington: GPO, 2004), p. 66.

progress at the time, with the economy contracting during the first three quarters of 2001. Since then, the economy has registered positive rates of growth, and the Administration has acknowledged that the economy "continues to recover and long-run fundamentals are solid, with low inflation and strong productivity growth."[3] Nonetheless, the Administration has stated that the recovery is slow, with businesses expanding production slowly and "too few jobs being created." Outside the Administration, economists also viewed the pace of the recovery in 2002 as disappointing, but generally expect economic growth to gather momentum over the course of 2003, despite lingering uncertainties.[4] (As described below in the report's last section, however, not all analysts have concluded a tax cut is the appropriate economic remedy.)

The stimulus portion of the President's proposal consists of the following elements:

- Acceleration to 2003 tax cuts phased in gradually under EGTRRA. The specific reductions are cuts in individual income tax rates (scheduled to be fully effective under EGTRRA in 2006); tax cuts for married couples (scheduled to be phased in over 2005-2010); and an increase in the child tax credit (also currently scheduled for 2005-2010).

- "Tax integration," or elimination of individual income tax on corporate-source equity income (dividends and capital gains.) Under current law, corporate equity income is taxed twice: once under the corporate income tax and once when received by stockholders as dividends or capital gains. According to economic theory, the double taxation reduces economic efficiency by diverting capital from the corporate sector to other sectors of the economy (e.g., housing). The Administration would exclude dividends from individuals' taxable income, and would (in effect) eliminate tax on capital gains by permitting stockholders to increase their "basis" deduction when they calculate their capital gains tax.

- Increase in the "expensing" allowance for business investment. Under current law, firms are permitted to deduct in the year of purchase ("expense") up to $25,000 of equipment acquisitions. The allowance is reduced for amounts by which investment exceeds $200,000, thus restricting its use to relatively small businesses. Expensing confers a tax benefit by speeding up tax deductions that firms would ordinarily have to spread over the life of the equipment as depreciation. The Administration proposes to increase the annual allowance to $75,000 and the beginning of the phase-out threshold to $325,000.

- A $4,000 increase in the individual alternative minimum tax (AMT) exemption for individuals. The increase would expire after 2005.

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[3] U.S. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals*, p. 3.

[4] *Blue Chip Economic Indicators*, Jan. 10, 2003, p. 1.

Making EGTRRA's Tax Cuts Permanent

A Senate procedural rule – the "Byrd rule" – provides that a point of order can be raised against any provision of a budget reconciliation bill that is "extraneous" to the budget reconciliation legislation. Included among the several types of provisions the Byrd rule defines as extraneous are those that would increase the budget deficit (or reduce the budget surplus) for a fiscal year beyond that covered by the reconciliation measure being considered. To avoid application of the Byrd rule, EGTRRA contained language providing for the expiration of its provisions at the end of calendar year 2010. Over the course of 2002, the House passed several bills that would have made some or all of EGTRRA's cuts permanent, but the Senate did not act on them. The President's proposal would rescind the expiration of all of EGTRRA's tax cuts.

Other Provisions

The remaining elements of the President's proposal fall into the following categories: "tax incentives;" trade, tax administration and unemployment insurance; tax simplification and other proposals; and extension of expiring provisions not included in EGTRRA. The principal tax incentives are as follows:

- Tax benefits for charitable giving. In terms of revenue cost, the largest of these would be a deduction allowable to non-itemizers (an "above-the-line" deduction) for charitable donations and tax-free withdrawal for charitable donations from IRAs;

- Tax cuts for education, including a refundable tax credit for the costs of switching attendance from a failing public school, and an above-the-line deduction for certain out-of-pocket expenses of teachers;

- Tax benefits related to health care, including a refundable tax credit for the costs of purchasing health insurance, and an above-the-line deduction for the cost of long-term care insurance;

- Exclusion from income for the cost of an employer-provided home computer (intended to promote telecommuting);

- Tax credit for developers of low income housing;

- Tax benefits related to the environment, including permanent extension of the benefit for environmental remediation expenses;

- Tax benefits for energy production and conservation. Prominent among these are a tax credit for production of gas from landfills; a tax credit for the purchase of hybrid and fuel cell vehicles; and a tax credit for residential solar energy systems.

Among the remaining proposals, the most prominent "simplification" measure is a structuring of the tax code's individual retirement account (IRA) tax-favored savings benefit. Under the plan, IRAs would be replaced with two sorts of tax-favored accounts:

lifetime savings accounts, which could be used for any type of saving; and retirement savings accounts, which would be restricted to retirement saving. Contribution limits would be $7,500 per year for each type of account.

The administrative portions of the proposal would increase rather than reduce revenues, and include changes to the 1998 IRS restructuring legislation, tighter restrictions on the deductibility of interest payments to related firms ("earnings stripping"), and an increase in restrictions on tax shelters. The proposal would also extend or make permanent a number of tax benefits (not included in EGTRRA) that are scheduled to expire at various times. Prominent among the extended provisions are the research and experimentation tax credit (which the plan would make permanent), the work opportunity tax credit and welfare-to-work tax credit (which the plan would also modify) and certain AMT relief for individuals.

Other Proposals

The President's tax proposals have been criticized by some congressional Democrats and others on three general grounds: that the plan will disproportionately favor upper-income individuals; that it is overly costly in terms of lost tax revenues and will expand the federal budget deficit; and that its economic stimulus elements will be ineffective in boosting economic growth.[5]

On January 6, House Democratic leaders proposed a smaller stimulus package amounting to an estimated $87 billion in 2003 and $59 billion over 10 years.[6] The plan's principal tax provisions are a refundable tax rebate in 2003 of $300 per person; an increase in the depreciation "bonus" for businesses previously enacted in March, 2002, and an increase to $50,000 of the expensing benefit for business investment. On January 24, Senate Minority Leader Thomas Daschle outlined a one-year economic stimulus proposal containing tax-cut and spending elements that would total an estimated $141 billion over the year it is in effect.[7] For the year the plan is in effect, the tax elements of the plan include a $300 per-person tax credit; an increase in the depreciation bonus; an increase to $75,000 in the expensing allowance for business investment; a tax credit for health insurance outlays of small businesses; and a 20% credit for business investment in broadband Internet infrastructure.

[5] See, for example, the views reported in Katherine M. Stimmel and Nancy Ognanovich, "Senate Democratic Moderates' Opposition Puts Fate of White House Plan in Flux," BNA *Daily Tax Report*, Jan. 9, 2003, p. GG-1.

[6] The proposal is described on the Democrats' side of the House Budget Committee's Web site: [http://www.house.gov/budget_democrats/analyses/house_dem_stimulus.htm]. The estimated revenue loss over 10 years is smaller than the projected loss in 2003, and is likely the result of the plan's depreciation component, which shifts deductions to 2003 from future years.

[7] The proposal is described on Senator Daschle's web site at [http://daschle.senate.gov/pdf/democraticplan.pdf].