

CRS Report for Congress

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Extending the 2001, 2003, and 2004 Tax Cuts

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Summary

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) reduced marginal income tax rates, created a new 10% income tax bracket, provided marriage tax penalty relief, and increased the child tax credit. Many of the EGTRRA provisions were originally scheduled to be phased in over the 2001 to 2010 time period. All of the act's provisions are scheduled to sunset (revert to prior law levels) at the end of 2010. The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) accelerated the implementation of certain tax reductions originally enacted in the 2001 act. Several of these JGTRRA provisions were temporary and were scheduled to expire at the end of 2004. JGTRRA also reduced the tax rate on dividend and long-term capital gains income. The dividend and capital gains tax relief is scheduled to expire after 2008. The Working Family Tax Relief Act of 2004 (WFTRA), extended many of the JGTRRA tax provisions scheduled to expire at the end of 2004 (it did not, however, extend the capital gains/dividend tax reductions). The WFTRA tax reductions, however, are still scheduled to sunset after 2010 as per the original EGTRRA legislation required.

Since all of the tax reductions provisions of all three of these acts expire at some point in the future, Congress faces the issue of whether to extend and/or make the reductions permanent. Extending these tax reductions, however, is likely to significantly reduce federal revenues in the future. This report will be updated as legislative action warrants or when new cost estimates become available.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) reduced marginal income tax rates, created a new 10% income tax bracket, provided marriage tax penalty relief, increased the child tax credit, and increased the alternative minimum tax (AMT) exemption. These changes were scheduled to phase in over a period of several years.

All of the changes in EGTRRA (including the tax rate changes) will expire (sunset) after 2010. Congress included the sunset in EGTRRA to avoid a Byrd rule (Section 313 of the 1974 Congressional Budget Act, as amended) violation in the Senate. The Byrd

rule prohibits “extraneous matter” in reconciliation legislation.¹ Under the rule, extraneous matter includes, among other things, language that would cause an increase in the budget deficit (or reduce budget surpluses) in a fiscal year beyond those covered by the reconciliation legislation. As a result of the Byrd rule, EGTRRA contained language providing for the expiration of all of its provisions at the end of calendar year 2010, since the years after 2010 were outside the reconciliation budget window.

In 2003, in an effort to stimulate the economy, Congress passed the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA; P.L.108-27). JGTRRA accelerated the implementation of certain tax reductions originally enacted as part of EGTRRA. These included marriage tax penalty relief, expansion of the 10% tax bracket, an increase in the child tax credit to \$1,000, and an increase in the AMT exemption. These changes were temporary and were scheduled to be in effect for two years, 2003 and 2004.

In addition, JGTRRA lowered the maximum tax rate on qualified dividend income and long-term capital gain income (gains on assets held longer than 12 months) to 5% (0% for 2008) for taxpayers in the 10% and 15% marginal income tax brackets. The maximum dividend and capital gains tax rate was reduced to 15% for taxpayers in marginal income tax brackets exceeding 15%. These changes were effective for assets sold or exchanged on or after May 6, 2003, and before January 1, 2009.

In September 2004, Congress passed the Working Families Tax Relief Act of 2004 (WFTRA; P.L. 108-311). WFTRA extended several tax provisions that were scheduled to expire at the end of 2004. These expiring tax reductions were enacted under JGTRRA, which had accelerated implementation of tax reductions originally enacted in 2001 under EGTRRA.

WFTRA extended the \$1,000 child tax credit through 2009 (for 2010, the EGTRRA provisions apply and the child tax credit will remain at \$1,000). In addition, WFTRA accelerated, to 2004, the increase in the refundability of the child tax credit. For 2004 through 2010, the child tax credit will be refundable to 15% of a taxpayer’s earned income in excess of the applicable threshold. The 2004 Act also contained a provision including combat pay in earned income for purposes of computing child tax credit refundability.²

WFTRA also extended marriage penalty relief (standard deduction and 15% tax bracket for joint returns set at twice the level as those for single returns) through 2008. (In 2009 and 2010, EGTRRA provisions apply which will maintain the level of the standard deduction and 15% tax bracket for joint returns). The 2004 act also extended the increase in the 10% income tax bracket through 2010.

WFTRA included a one-year extension in the increase in the basic exemption for the alternative minimum tax (AMT) originally enacted under JGTRRA. (EGTRRA also included a temporary increase in the AMT exemption which was then superseded by the JGTRRA increases.) The AMT exemption for 2005 will be \$58,000 for joint returns and

¹ CRS Report RL30862, *Budget Reconciliation Process: The Senate’s “Byrd Rule,”* by Robert Keith.

² See CRS Report RS21860, *The Child Tax Credit*, by Gregg Esenwein.

\$40,250 for unmarried taxpayers. In 2006, the AMT exemption would revert to its prior law levels of \$45,000 for joint returns and \$33,750 for unmarried taxpayers.

These temporary increases in the basic exemption for the AMT have been enacted as a means of mitigating the interaction between the reductions in the regular income tax and the AMT. Extending or otherwise modifying the AMT is probably the most pressing individual income tax issue facing the 109th Congress. It is estimated that, if the reductions in the individual income tax are extended beyond 2010, then the number of taxpayers subject to the AMT will increase from about 1.8 million in 2001 to over 18 million in 2006, and then to over 41 million in 2013.³

Absent congressional action, the AMT will “take back” most of the tax relief granted through the income tax.⁴ Hence, Congress faces not only the issue of whether or not to extend and/or make permanent the reductions in the regular income tax, but more urgently, it must face the issue of how to repair the individual AMT.

Counterbalancing congressional desire to provide continued tax relief is concern over the current and projected size of the federal budget deficit. The revenue effects of extending and/or making permanent the 2001 and 2003 tax reductions are substantial. Moreover, once the costs of fixing the AMT are included, the revenue costs associated with maintaining the current level of tax relief increase considerably.

For instance, the following table presents some order of magnitude estimates of the cost of extending the EGTRRA/JGTRRA tax reductions and reforming the AMT. It should be noted that if these policy options are deficit financed (that is, there are no offsetting tax increases or spending reductions), then there will be additional revenue losses associated with servicing the increase in the public debt that these policy options engender. The table presents estimates of both the direct and indirect costs of these tax policy options.

As shown in the table, as a rough estimate, the total cost (both direct and indirect) of extending the EGTRRA/JGTRRA tax cuts and reforming the AMT will be more than \$2 trillion over the FY2006 through 2015 period. As an alternative measure, an order of magnitude estimate indicates that the out year per annum cost (including debt servicing) of these tax policy options will be slightly larger than 2% of gross domestic product (GDP). The cost will increase as a percentage of GDP as time progresses.

³ For more information see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Gregg Esenwein.

⁴ For more information on the “take back” effect see CRS Report, *The Alternative Minimum Tax (AMT): Income Entry Points and “Take Back” Effects*, by Gregg Esenwein.

Table 1. Order of Magnitude Estimates of the Revenue Costs Associated with Extension of EGTRRA/JGTRRA and Reform of the AMT

FY2006 through FY2015 (Billions of dollars)	
Extend EGTRRA/JGTRRA:	\$1,321
Reform the AMT: (Extension of increased AMT exemption and indexation of AMT exemption and tax brackets.)	\$642
Debt Service:	\$327
Total:	\$2,290

Source: Congressional Budget Office. *The Budget and Economic Outlook: Fiscal Years 2006 to 2015*. Table 1.3. January 2004. Calculations by CRS.