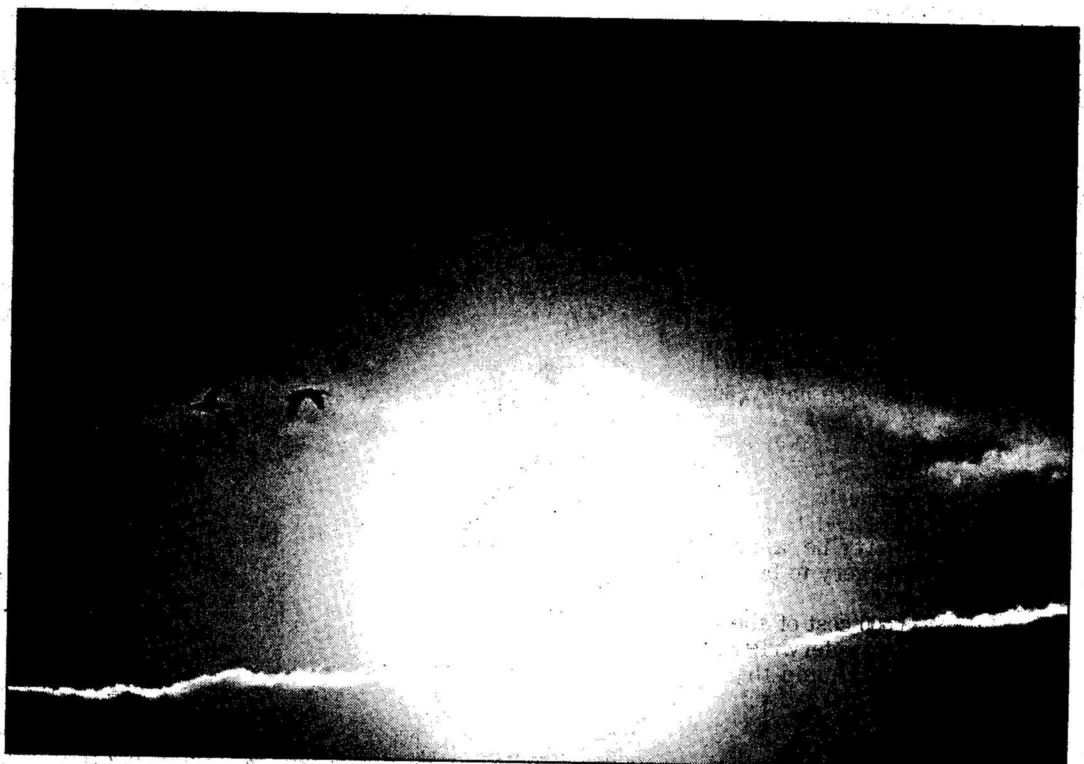
Perspective



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Stop the sunset

Tax provisions that expire make planning impossible

By SHELDON D. POLLACK

On May 28, President Bush signed into law the Jobs and Growth Tax Relief Reconciliation Act of 2003, which includes a hefty $330 billion tax cut. The bill cleared the House by a 231-200 vote and squeaked through the Senate by a razor-thin 51-50. None too surprisingly, voting in Congress was strictly along party lines, and despite squabbles within the ranks, congressional Republicans called the shots.

To be sure, Democrats placed a few of their own provisions in the bill. But make no mistake, this was a Republican tax bill, the third major tax cut since the president took office in 2001. This puts George W. Bush ahead of even that most celebrated warrior against federal taxes, Ronald Reagan.

Central to the latest tax cut is an increase in the child tax credit from $600 to $1,000, the acceleration of rate reductions previously enacted in 2001, and a significant reduction in the maximum tax rate imposed on dividends and capital gains. The latter is by far the most [illegible] gle item in the legislation, costing the Treasury an estimated $148 billion over the next 10 years.

The proposal to reduce the tax on dividends, the success of which surprised even seasoned observers of tax policy, appeared last February in the President's fiscal year 2004 budget. The idea was based on a plan drafted in the early 1990s by Columbia University economist Glenn Hubbard, then serving in the Treasury Department under President George H.W. Bush. Hubbard, now recently departed chairman of George W. Bush's Council of Economic Advisers, is a long-time proponent of eliminating the so-called double taxation of corporations.

The proposal called for a complete elimination of income tax on dividends received by shareholders, but with an additional proviso that the corporation itself must have paid corporate income tax on the earnings in order to qualify for tax-free treatment in the hands of the shareholders. No one gave that sensible, complicated, and very expensive proposal much chance of success, but a stripped-down version (costing about a third of the president's initiative) made it into the final legislation.

It will irk Democrats that they were unable to kill this tax preference for dividends (to say nothing of the entire bill), which in their familiar rhetoric is denounced for disproportionately benefiting the wealthiest taxpayers. Democrats in the Senate, with the assistance of three moderate Republicans, managed to impose a $350 billion cap on the president's tax cut, which was over twice as large in the original White House proposal. Because the total tax cut was limited to $350 billion over 10 years, Republicans had to make accommodations to keep the cost down.

That is why there is still some taxation of dividend income, at a maximum rate of 15 percent. Most important, Republicans were forced to put an expiration date on the dividend tax cut, just as they did for tax cuts enacted in May 2001. As it now stands, the preferential tax rate for dividends expires at midnight on December 31, 2008. In fact, virtually all of the tax cuts enacted in 2003 and 2001 expire (in tax parlance, "sunset") sometime before the end of the decade.

Temporary gains

So this was only a temporary victory for antitax Republicans. The same political battles must be fought again in Congress in the coming years or else the tax code will revert to pre-2001 law — which means tax rates will go right back to where they stood when Bill Clinton occupied the White House. If that happens, Bush's reputation as a Republican antitax warrior will crash like a statute of Saddam Hussein in Iraq.

If Democrats were unsuccessful in blocking the Republican tax cut, it hasn't stopped them from resisting. Lately Democratic opponents of the Republican tax legislation, led in the Senate by minority leader Tom Daschle, have adopted a new strategy: denouncing the plan as costing more than the $350 billion official price tag. That official estimate comes from the Congressional Budget Office, a nonpartisan office created in 1974 to provide Congress with information regarding the budget. Comparable estimates come from the Joint Committee on Taxation.

But critics argue that because Republicans will never let the tax cuts expire, the legislation really will cost much more. Based on this logic, the Center for Budget and Policy Priorities asserts the cuts will cost more than twice as much.

The problem is they are dead wrong — and hypocrites to boot. Under current law, the tax cuts enacted in 2001 and 2003 definitely will expire. That is precisely why this package of tax cuts will cost less than comparable tax cuts that don't expire. That's how Republicans kept the package at $350 billion. If Republicans cannot muster majorities in both houses of Congress and retain control of the White House in 2004, they surely will fail to re-enact these tax cuts.

Are Democrats conceding the 2004 election to Bush? Have they given up on regaining control of the House or Senate? If so, Republicans probably will be able to make the tax cuts permanent. But the more likely scenario is that any such effort will be hotly contested. It surely won't be a slam dunk for the GOP.

Second, whatever Congress may do over the rest of the decade is irrelevant to current estimates of the cost of the tax cuts. This is because the CBO revenue scorers are required under budget rules written by Congress to base their 10-year revenue estimates on current law, not make predictions about what Congress may do [illegible] will be some changes to the tax code in the next decade, but budget and revenue forecasting must disregard this. This is to take guessing about the future out of the budget process, and presumably, eliminate any political pressure that surely would be exerted on budget staffers.

Democrats who object to this rule are hypocrites because they wrote the rules.

Keeping score

In addition, Democrats have repeatedly denounced Republican efforts to manipulate the scoring of tax proposals by taking into account future economic or political developments. For example, Republicans have traditionally complained that revenue scorers in the CBO do not use "dynamic scoring," which would take into account the vast economic growth and expansion that supposedly will result from the tax cuts themselves. Proponents of supply-side economics claim that an expanded economy will generate additional tax revenue for the government — thereby reducing (if not fully off-setting) the cost of tax cuts.

Democrats have denounced this as "voodoo economics" in forecasting. On this point, they are on solid ground. The staff of the JCT (which incidentally works for the Republican congressional leadership) recently studied the question and found little support for dynamic scoring. Similar conclusions were reached by the CBO under director Douglas Holtz-Eakin, a former economic adviser to President Bush. So the issue has been quietly dropped.

Democrats who would similarly manipulate the budget scoring rules to produce partisan revenue estimates also should back off.

In the end, there are plenty of good reasons to avoid tax cuts that sunset. Right now, there are some 56 provisions in the tax code slated to expire at various times. It's not just tax cuts but a whole slew of credits and deductions. Indeed, the gift and estate tax is scheduled for repeal in 2010, but the provision that repeals the tax itself expires the next year, bringing back the gift and estate tax at the same old onerous rates.

Provisions come and go, making planning for business and individuals extremely difficult. Estate lawyers advise their clients, tongue firmly in check, that if they must die, they should do so in 2010 when the estate tax is temporarily repealed, rather than before repeal in 2009, or later in 2011 when the tax returns with a vengeance.

Is this any way to run a tax system?

Critics should oppose use of sunset provisions because they distort the tax code and create economic uncertainty, rather than raise bogus issues about what tax cuts really cost.

And Republicans should shoot for more modest tax cuts that are permanent, rather than pass big tax cuts that expire after only a few years. Do we really need to fight these battles over and over in Congress, changing the tax laws virtually every year in a political game that never ends?

Taxpayers deserve some certainty about what the tax laws will look like next year. They also deserve better than the rhetoric thrown around by Democrats who raise misleading charges about the hidden cost of Republican tax cuts. The truth is bad enough.

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