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TAX POLICY IN THE 1990s: ON THE ROAD TO NOWHERE

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In this article, Professor Pollack reviews the course of federal tax policy during the 1990s. The decade began with the president and Congress deadlocked over the budget and tax policy — and ended pretty much the same way. It is doubtful that the new millennium will usher in any new "Era of Good Feelings." Most likely, Pollack believes, the partisan conflict over tax policy that has prevailed during the past two decades will continue. The budget has become the focus of politics and the instrument through which the majority party governs, and the tax code is one of the most important tools of budgeting. As such, tax policy is highly partisan and expresses the fundamental cleavages that define the two major national political parties. If partisanship has weakened among voters at large, Pollack notes, it is no less intense in the halls of Congress where tax policy is made. Furthermore, so long as the American public persists in electing an executive from a political party different from that which controls Congress, the politics of deadlock will continue. In fact, the author concludes, deadlock over tax policy will likely continue even if one party or the other secures control of *both* the White House and Congress in the 2000 elections.

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Introduction

It has been said that the United States had "perpetual income tax legislation" in the 1980s.[1] No less than six major revenue bills were enacted during the decade, and Congress virtually re-wrote the tax code in 1986. On account of this great volume of tax legislation, economist Eugene Steuerle dubbed the 1980s the "Tax Decade."[2] Unfortunately, the 1990s proved to be no less exhausting for congressional tax policymakers — to say nothing of those who write about tax policy.

In many respects, tax policy was an even sorrier affair in the 1990s. At least in the 1980s, tax policymakers could claim the Tax Reform Act of 1986

[1]Daniel Shaviro, "Beyond Public Choice and Public Interest: A Study of the Legislative Process As Illustrated by Tax Legislation in the 1980s," 139 *U. Pa. L. Rev.* 1, 3 (1990).

[2]C. Eugene Steuerle, *The Tax Decade: How Taxes Came to Dominate the Public Agenda* (Washington, D.C.: Urban Institute Press, 1992), p. 3.

as their great success, even if the rest of the decade was marred by erratic and unstable policy. In the 1990s, tax policy was just as erratic and unstable, only without a single notable achievement to brag about. Republicans and Democrats in Congress engaged in a highly contentious and partisan politics that was often targeted at the tax code. Likewise, the legislative and executive branches were continually at odds over tax policy throughout the decade. However, if taxation was continuously on the policy agenda in the 1990s, little was actually accomplished or resolved. Indeed, the 1990s may be fondly remembered as the "Tax Deadlock Decade."

Ironically, neither party has been successful in claiming credit for the improvement in the federal government's financial position.

The decade began with congressional Democrats locking horns over the budget with a Republican president in the White House. With such short memories in Washington, the "Deficit" is but a faded memory today, but in those days it cast a dark shadow over all political discussions, with each political party blaming the other for the financial crisis of the national government. Were persistent deficits the fault of "tax-and-spend" Democrats or Republican supply-siders whose tax cuts decimated the Treasury coffers in 1981? There was more than enough blame to lay on both their doorsteps. With talks between the Democratic congressional leadership and the Bush administration stalemated over proposed tax increases, the deadline for approving the first budget of the new decade came and went, and the federal government was shut down in October 1990. (A more calamitous shutdown occurred in 1995.)

As the decade drew to a close, the tables were turned, with Republicans controlling Congress and a Democrat occupying the White House. Much the rest remained the same. The president and Congress were still deadlocked over the budget. The budget cycle has now pretty much become an all-year process that commands inordinate time from Congress and has subsumed a good deal of the politics that used to take place within the realm of the appropriations committees. As the late Aaron Wildavsky wily observed a decade ago: "Nowadays the State of the Union and the state of the budget have become essentially equivalent."[3] What Wildavsky forgot to mention is that this bodes well for neither the budget nor the State of the Union.

True, some things have changed for the better. Something called the "Surplus" now dominates the budget debate. Ironically, neither party has been successful in claiming credit for the improvement in the federal government's financial position. Republicans don't want to acknowledge that perhaps the president's 1993 tax rate increase was at least partially responsible for the increased revenue pouring into the Treasury — apparently without having had any serious detrimental effect on the booming economy. Conversely, Democrats don't want to even consider the possibility that trillions of dollars of surpluses (if they ever materialize) just might indicate that *some* kind of tax reduction is justified. And everyone is all too keenly aware of, and ultimately paralyzed by, the long-term financial insolvency of the nation's major domestic policy programs — social security and Medicare. The long-term deficit of the social security system (estimated by the General Accounting Office to amount to $3 trillion over the next 75 years[4]) is finally having an impact on the current budget process — which is a good thing! But even ignoring the unfunded long-term liabilities of social security, the short-term is not exactly an era of "easy finance." Notwithstanding predictions by the Congressional Budget Office (CBO) of a $2.9 trillion surplus over the next 10 years,[5] the numbers still don't add up for the current fiscal year. The protracted struggle over the fiscal year 2000 budget bears testimony to the difficulty of budgeting even in an era of surplus!

As Democrats in the White House and Republicans in Congress squabbled throughout 1999 over the fiscal year 2000 budget, the threat of another shutdown of the federal government loomed on the horizon as autumn leaves began to fall. Only some prolonged bargaining and a series of continuing resolutions kept the government running past the October 1 deadline. (Apparently, something was learned from the 1995 budget debacle.) A new budget was not approved until nearly two months into the fiscal year. Such delays in enacting a budget were commonplace in the 1990s. This suggests the possibility of a new "reform" budgeting procedure — one in which Congress waits until the *end* of a fiscal year before adopting a budget. That way, everyone can relax, see how things come out, and then draft a budget that actually conforms with the real numbers, thereby avoiding all the tough and nasty decisions, such as deciding *in advance* how to allocate the government's scarce resources. Perhaps "retroactive budgeting" will be the wave of the future in the new millennium!

Because the budget process has emerged as the focal point of our national politics, tax policy is extremely important today. The budget is the instrument through which the majority party now governs, and the tax code is one of the few tools for exercising control over the budget. (This is as much by default as anything else, as reducing expenditures, or even holding them to current levels, is virtually impossible for elected politicians.) The income tax is also the primary instrument of fiscal policy for those politicians who would manage the national economy — which includes most Republicans as well as all Democrats. To further compound the problem, Democrats would use the tax laws to achieve their distinctly egalitarian vision of social

[3]Aaron B. Wildavsky, *The New Politics of the Budgetary Process* (New York: Addison, Wesley, Longman, 3rd ed. 1997), p. xxiii.

[4]United States General Accounting Office, "Social Security: Different Approaches for Addressing Program Solvency," (GAO / HEHS-98-33) Washington, D.C.: U.S. General Accounting Office, July 1998.

[5]Congressional Budget Office, *The Economic and Budget Outlook: An Up-Date* (Washington, D.C.: July 1, 1999).

justice (i.e., "soak the rich"), while Republicans have their own singular uses for the "social tax code": stimulating investment, encouraging the accumulation of capital, and generally rewarding the rich for being wealthy.

Because of the deep-rooted ideological differences between the parties, tax policy is highly partisan and mired in the same politics of deadlock that has swamped the budgetary process. The result is not pretty. House Rules Committee Chairman David Drier, R-Calif., recently described the current budget process as "a disorganized patchwork of decades-old rules and laws" that simply do not work. He should try reading the tax code! Political conflict over tax policy, like that over the budget, expresses the same fundamental cleavages that define and divide the two major national political parties. If partisanship has weakened within the electorate at large, it is no less intense in the halls of Congress where tax policy is made. And that is where tax policy has reached the current impasse. While the cast of characters has changed over the years, the same play ran in the nation's capitol throughout the decade. As the French like to say: "Plus ça change, et plus ne change pas." It may be a tiresome cliche that the French repeat over and over without change — but they do have a point!

What follows is a brief chronicle of the major tax legislation and partisan battles over tax policy of the 1990s. Along the way, the current state of U.S. tax policy is assessed. While attempting to predict the course of future political events is highly perilous, and the wise commentator avoids saying anything too specific so as to avoid looking foolish in retrospect, some effort to forecast the direction of U.S. tax policy in the 21st century is expected in pieces such as this. To appease those who are looking for millennium predictions, some tepid observations are ventured. The main suggestion is that more of the same lies ahead.

The 1990 Budget (Dis)Agreement

While the 1980s were a period of economic prosperity compared to the stagflation and low growth rates experienced during the 1970s, the decade ended with the economy sliding into recession. For most of the postwar period, the federal government has operated in deficit, but the financial shortfalls became more dramatic and significant in the 1980s in the wake of the massive tax cuts implemented in 1981 by the Reagan administration. The severity of the deficits temporarily eased as the deficit as a percentage of GNP fell from a peak of 6.3 percent in 1983 to only 3.4 percent in 1988. However, the deficit rose again to 4.1 percent of GDP for fiscal year 1990, and early estimates were that it would approach 5 percent for the 1991 fiscal year.[6] The accumulated national debt was more than $3 trillion and the economy was faltering.

Coming to office in January 1989, George Bush inherited the Reagan fiscal year 1990 budget with an estimated $100 billion deficit — which in the end turned out to exceed $218 billion. The Bush administration generally stuck with the major outlines of the Reagan budget, and a particularly intense political battle was fought with the Democratic leadership of Congress over the terms of the fiscal year 1990 budget. Agreement was not reached until the end of November (almost two months into the new fiscal year), after a sequestration under Gramm-Rudman-Hollings.[7] As a result of the contentious partisan fight over the 1990 budget, the battle lines were already drawn for an even nastier squabble over the budget for fiscal year 1991.[8]

Introduced by President Bush in January 1990, the fiscal year 1991 budget included a modest $63 billion deficit. However, the mid-year budget report of the Office of Management and Budget (OMB) provided a much more realistic and depressing message. The mid-year report estimated that the fiscal 1991 deficit would be more in the range of $168 billion — $231 billion if the federal government's share of the savings and loan bailout was included, and nearly $300 billion if the social security surplus was not included. This was sobering news to all parties engaged in the budget process. With an emerging consensus that something had to be done about the uncontrolled deficits, the Democratic leadership of Congress commenced negotiations with the Republican administration.

As a solution to increasing deficits, the Bush administration urged spending reductions, while Democrats generally favored increasing taxes. During the summer of 1990, the administration team (led by OMB Director Richard Darman) and the congressional leadership came together at Andrews Air Force Base for a budget summit. Budget negotiators adopted a target of $40.1 billion in deficit reduction for fiscal year 1991 and a total of $500 billion in deficit reduction over five years. Whether deficit reduction would come from tax increases or spending reductions was the crucial question. Democrats argued for tax increases. The "No-New-Taxes" president waffled and tentatively agreed to limited tax increases. The administration's uncertain position allowed the congressional tax committees (controlled by Democrats) to maintain control over the negotiations, much to the president's detriment.[9] Ul-

[6]The figures are found in Steuerle, *Tax Decade,* note 2 *supra,* p. 173.

[7]The Balanced Budget and Emergency Deficit Control Act of 1985 (so-called Gramm-Rudman-Hollings). Pub. L. No. 99-171, 99 Stat. 1037, sec. 200 et seq.

[8]For an account of the partisan political battle between the new Bush administration and the Democratic Congress over the FY 1990 budget, see Howard E. Shuman, *Politics and the Budget: The Struggle Between the President and Congress* (Engelwood Cliffs, N.J.: Prentice Hall, 1992), pp. 304-11. Shuman argues that the antagonism arising from the president's mishandling of negotiations over the fiscal year 1990 budget led to the subsequent conflict over the 1991 budget.

[9]Much has been written of the political hay made by Democrats over the administration's many strategic blunders in the negotiations. *See, e.g.,* Alan Murray and Jackie Calmes, "How the Democrats, with Rare Cunning, Won the Budget War," *Wall St. J.,* November 5, 1990, A1; Donald F. Kettl, *Deficit Politics: Public Budgeting in Its Institutional and Historical Context* (New York: Macmillan, 1992), pp. 3-12; Steuerle, *The Tax Decade,* note 2 *supra,* pp. 173-84; Shuman, *Politics of the Budget,* pp. 314-17.

timately, Congress and the president failed to reach agreement by the October 1, 1990 deadline, and the federal government was shut down over the Columbus Day weekend.[10]

Soon after the government shutdown (which was mostly theatrics), negotiations were resumed, compromise was reached, and major tax legislation produced. The Omnibus Budget Reconciliation Act of 1990[11] raised some minor revenue through new user fees, a 10-cent increase in the gasoline tax, and increased excise taxes on liquor and cigarettes. Modest cuts in expenditures were included in the total package, and ultimately, virtually all deficit reduction was attributable to income tax rate increases. Budget negotiators slipped into the tax code several particularly odious provisions: a phase-out of personal exemptions, and new limitations on certain miscellaneous itemized deductions. These were nothing more than disguised increases in marginal tax rates.[12] Over the years, there has been much criticism of these provisions among tax professionals and academics.[13] Despite this, they remain in the tax code because under current budget rules, repealing them now would require policymakers to come up with new revenue — not an easy or attractive political option.

With the 1990 act, the decade began with tax policy adrift, headed down the road to nowhere. Neither Democrats nor Republicans were anxious to claim credit for the final bill, which resulted in only modest deficit reduction. The episode left the Bush administration in retreat on tax policy. Bush himself was eventually forced at the 1992 Republican National Convention in Houston to recant his political heresy of agreeing to raise taxes, but by then it was too late for him. Following the 1990 debacle, the commitment of Republicans in Congress against tax increases hardened and the groundwork was laid for a decade of deadlock.

1992: Bush's Revenge

After 1990, the Bush administration was without a tax policy of its own. The strategic political decision to repudiate the underlying premise of the 1990 budget agreement (accepting higher taxes in exchange for modest budget cuts) undercut the administration's own position. When initiatives commenced in Congress for a new tax bill in the spring of 1992, the White House was more an observer than an active participant. The result was a Democratic tax bill that passed the House on July 2, 1992. Imposing little in the way of budget cuts, the House bill offered up some $2.5 billion in new federal funding for social programs in the wake of the recent urban disturbances in Los Angeles. The Senate passed its own modified version of this urban aid tax package in September.

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During conference, Chairmen Dan Rostenkowski of Ways and Means and Lloyd Bentsen of the Finance Committee attempted to strip down the bill to render it more palatable to Bush. Nevertheless, Senate conferees retained the two odious revenue-raisers, making permanent the phaseout of personal exemptions and limits on itemized deductions enacted in 1990. The Senate bill was almost twice as costly as the House version. In October, the Conference Committee's bill (a $27 billion compromise) emerged from Congress, notwithstanding the president's open threat of a veto. The veto came on November 4, 1992 — one day after Bush was defeated in his bid for re-election. Lacking sufficient support for a veto override, the bill was laid to rest. Following Bush's stunning electoral defeat, the legacy of his administration in the area of tax policy was the repudiated 1990 budget agreement and the president's veto of the 1992 tax bill.

Clinton Soaks the Rich

With the election of a Democratic president in 1992, tax policy fell back into the familiar and financially destructive patterns that prevailed in the days when Democrats controlled Congress as well as the White House. During the 1992 presidential election campaign, candidate Clinton had asserted that the budget deficit would be one of his administration's highest priorities.[14] Following his election, the president-elect

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[10]The discussion of the 1990 and 1992 tax bills that follows relies on my own analysis in Sheldon D. Pollack, *The Failure of U.S. Tax Policy: Revenue and Politics* (University Park: Penn State Press, 1996), pp. 117-22.

[11]Pub. L. No. 101-508, 104 Stat. 1388-1400.

[12]Once a taxpayer crosses the threshold for the "phaseout" of personal exemptions, which in 1993 began at adjusted gross income (AGI) of $100,000 for a single taxpayer, as well as the threshold for the phased-in reduction in the enumerated deductions, which began at $150,000 for the same single taxpayer, the effective marginal tax rate was 34 percent, and not the statutory 31 percent.

[13]For a comprehensive and detailed analysis of how the phase-out of personal exemptions and itemized deductions impacts on marginal tax rates, see Elliot Manning and Laurence M. Andress, "The 1996 Marginal Federal Income Tax Rates: The Image and the Reality," *Tax Notes*, Dec. 30, 1996, p. 1585; *see also* Gene Steuerle, "The True Tax Rate Structure," *Tax Notes*, Oct. 16, 1995, p. 371 (benefit phaseouts as implicit tax rate hike); Gene Steuerle, "Bubbles, Bangles and Beads: Fixing Up the Top Rate," *Tax Notes*, Apr. 19, 1993, p. 425; Kay A. Thomas, "Phase Out the Phase-Outs," *Tax Notes*, Dec. 25, 1995, p. 1689 (urging replacing the phaseouts with higher marginal tax brackets).

[14]Budget expert Stanley Collender traces a heightened concern with the deficit to the 1992 elections. "[T]he 1992 elections produced the first recognizable change in budget politics in decades. Deficit reduction suddenly became a politically acceptable position for candidates for federal office . . ." Stanley E. Collender, *The Guide to the Federal Budget: Fiscal 1995* (Washington, D.C.: Urban Institute Press, 1994), p. xiii.

reiterated his campaign pledge, but also professed that his administration would lower taxes on the "middle class." Economic realities caught up with campaign rhetoric as new projections of an increasing deficit put an end to talk of tax cuts. The deficit shortfall would be addressed by the new Democratic administration through tax increases, rather than reductions in expenditures. Of course, the Republican administration departing from the White House had been unable to make any headway with spending cuts either — partly because the congressional legislative process was controlled by Democrats, but mostly because Congress as a political institution is overwhelmingly oriented toward spending increases. Just as higher tax rates were the cornerstone of the 1990 budget agreement, so too would they dominate White House budget proposals in 1993.

In his 1993 State of the Union address, President Clinton presented his "new" economic program to Congress. The package consisted of an assortment of recycled tax incentives, preferences, credits, and rate increases. The president reiterated his support for a traditional Democratic proposal: a so-called millionaires surtax. This was transformed into a 10 percent surtax imposed on taxable income in excess of $250,000. The "quarter-millionaires surtax" (along with other items in the president's package) expressed a class-based, soak-the-rich tax policy seldom heard in Washington since the 1930s. Directly targeting those who had benefited from the 1981 Reagan tax cuts, Clinton inflicted virtually the entire distribution of the 1993 tax increase on the wealthiest quintile. Republicans reacted bitterly. The result was an intensification of the level of political partisanship that persisted for the rest of the decade.

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The revenue raising provisions of the administration's budget mainly consisted of increasing tax rates for the wealthy. A new maximum tax bracket of 36 percent was created for individuals with income above $115,000, with the new 10 percent surtax applicable to taxable income above $250,000 (resulting in a top rate of 39.6 percent). The maximum tax rate on corporate income was increased to 35 percent, and the 55 percent maximum tax rate on gifts and estates (previously scheduled to decline to 50 percent) was retained. Other provisions proposed repeal or limitations on longstanding business deductions. While ideologically driven and largely aimed at business, these proposals were also motivated by a more pragmatic consideration — the search for revenue. It is just that the revenue was to come from the constituency of the Republican Party. To this end, the business deduction for meals and entertainment was reduced to 50 percent from 80 percent. Employee deductions for moving expenses were cut back, and business deductions were eliminated altogether for dues paid for membership in any social or athletic club and lobbying expenses. Corporate deductions for nonperformance-based executive compensation in excess of $1 million were disallowed.

Beginning in early 1993, Ways and Means took up consideration of the president's plan.[15] In a display of remarkable party coherence, Republicans opposed the entire package, ironically leaving it to Democrats to direct the course of the mark-up. In the end, the president's initiative was compromised in response to pressures from important regional interests capable of influencing congressional decision-making, as well as the institutional pressures and interests of Congress and its members. Much the same dynamics were evidenced in the Senate's consideration of that chamber's tax bill. In Conference Committee negotiations, the House bill prevailed on most significant issues. Floor voting on compromise legislation from Conference Committee followed strict party lines. The final vote in the Senate ended in a tie and was decided by Vice President Gore in his capacity as president of the Senate. That came one day after the House had passed the bill in a partisan vote by the narrow margin of 218-216. The Revenue Reconciliation Act of 1993[16] was signed into law by President Clinton on August 10, 1993.

In many respects, the politics surrounding the 1993 tax bill exemplified the same political trends that had characterized the 1990 bill. The budget crisis played a crucial role in orienting tax policy. Likewise, while executive initiatives served as the basis for tax legislation, congressional politics and interests dominated the policymaking process. Most significantly, the level of partisanship over tax policy intensified, with congressional voting following strict party lines. If Republicans had at least offered lukewarm support for bipartisan tax legislation in 1990, they would almost never again vote with Democrats on a tax bill for the rest of the decade. The redistributive tax policy underlying the 1993 Democratic tax legislation was highly divisive and provoked an equally partisan response by Republicans in the years that followed.

The New Republican Tax Agenda

The origins of the current stalemate in federal tax policy can be traced directly to the November 1994 elections in which the Republican Party gained concurrent control of both chambers of Congress for the first time in 40 years. This left government divided, with Democrats holding on to the White House and a particularly aggressive breed of Republicans in control of Congress. The "four-party" system that historian James

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[15]The president's tax proposals were introduced in the House on May 4, 1993, as H.R. 1960, and thereafter, subject to a mark-up by the Ways and Means Committee. The legislation was later passed by the House on May 27, 1993, as part of the Budget Reconciliation Bill of 1993 as H.R. 2264.

[16]Pub. L. No. 103-66, 107 Stat. 312.

MacGregor Burns has associated with the "deadlock of democracy" took a firm grip on Washington politics after 1994.[17] Tax policy did not escape its grasp.

During the November 1994 elections, House Republicans ran on a partisan platform set forth in the "Contract with America," which was chock full of proposed amendments to the tax code. The most significant tax provisions were proposals for the exclusion of 50 percent of capital gains, indexing of capital assets, a deduction for losses recognized on the sale of a principal residence, modifications to the Accelerated Cost Recovery System (ACRS), an increase in the $600,000 unified estate and gift tax lifetime credit, an increase in the section 179 annual expensing deduction to $25,000, expanded IRA coverage, reduction of the so-called marriage penalty, and a new $500-per-child credit.

The 'four-party' system that historian James MacGregor Burns has associated with the 'deadlock of democracy' took a firm grip on Washington politics after 1994. Tax policy did not escape its grasp.

With the electoral triumph of the Republican party in 1994, the odds of these Contract tax provisions making their way into the tax code seemed promising. The new chairman of the House Ways and Means Committee, Representative Bill Archer of Texas, along with new majority leader Richard K. Armey (also of Texas) looked like just the right guys to lead the campaign in the House. Early in 1995, a new tax bill (H.R. 1215) containing the Contract provisions breezed through the House.[18] As promised, the bill repealed a 1993 provision that increased the taxable portion of social security benefits, provided for the indexing of basis in capital assets, and included a 50 percent exclusion for capital gains and the $500 child credit. Remarkably, the House bill fully repealed the corporate alternative minimum tax for tax years beginning after the year 2000. Predictably, each of these provisions produced a strong partisan howl from Democrats — who, during their long tenure in control of the tax committees, had crafted the very tax regime now under attack.

The Senate did not turn to the House bill until late in the spring of 1995, and even then, proceeded at its own leisurely pace. Having neither signed a Contract nor made promises to cut taxes, Senate leadership felt itself in no way bound by the frantic 100-day schedule of House Republicans. The House tax cuts were put on hold as the Senate took up consideration of budget reduction plans. Finance Committee Chairman Packwood and other Senate Republican leaders viewed cutting taxes as secondary to deficit reduction, and negotiations between Senate and House Republicans stalled.[19] But by the end of June, Senate Republicans agreed to accept as much as $245 billion of tax cuts spread over seven years (up from their initial commitment to $170 billion contingent on fiscal savings realized through expenditure cuts). A nonbinding budget resolution adopted by both chambers on June 29 assumed that the $245 billion of tax cuts would be funded by a $170 billion "fiscal dividend" (purportedly to be derived from interest savings attributable to the balanced budget itself) and $75 billion of additional spending cuts to be determined at a later date. House Republicans stuck to their plan for a $500 child tax credit for taxpayers with incomes up to $200,000, provoking a split with Senate Republicans, who wanted a much lower cap on the credit.

The outcome on these issues, as with all other Contract tax provisions, remained up in the air throughout the summer of 1995 as congressional Republicans struggled to reach agreement among themselves. With the forced resignation of Packwood from the Senate in September, William Roth, R-Del., took over as chairman of the Finance Committee. More strongly committed to tax reduction than Packwood, Roth also turned out to be surprisingly adept in leading the Finance Committee. Within the framework of the previously agreed figure of $245 billion in total net tax reductions over seven years, the House and Senate tax committees began drafting a new tax bill.

The starting point in the House was the Contract tax bill adopted in January. The largest single item in the new House tax bill (H.R. 2491) once again was the nonrefundable $500-per-child tax credit. This "pro-family" credit was a nonnegotiable item pursued by the aggressive, highly partisan, and unified block of freshman House Republicans. At their instigation, the new tax bill also included a refundable credit of $5,000 for expenses relating to the adoption of a child and a non-refundable credit of $1,000 for care of a dependent parent. The Senate was lukewarm toward the $500 child credit, with moderate Republicans opposed to enacting such a significant revenue loser in the midst of the effort to balance the budget. The $500 child credit was scored by the Joint Tax Committee at some $147

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[17]James MacGregor Burns, *The Deadlock of Democracy; Four-Party Politics in America* (Englewood Cliffs, N.J.: Prentice Hall, 1963). The reference to a "four-party" system reflects Burns's notion that there are two national political parties that contest for seats in Congress and two other national political parties that vie for control of the White House. Hence, even when Democrats have controlled both branches, the different constituencies of the two Democratic coalitions (one centered around the legislature and the other around the executive) have produced political conflict, rather than a harmony of interests. Witness the presidency of Jimmy Carter and the death of his tax legislative initiatives at the hands of a Democratic Congress.

[18]The account of the 1995 Contract tax bill that follows is drawn from *The Failure of U.S. Tax Policy,* note 10 *supra,* pp. 133-50.

[19]*See* Jackie Calmes and Rick Wartzman, "GOP Weighs $245 Billion Tax-Cut Compromise," *Wall St. J.,* June 22, 1995, A6; Christopher Georges and David Rogers, "House and Senate Republicans Split Over Details of $245 Billion Tax Cut," *Wall St. J.,* June 27, 1995, A18.

billion over seven years.[20] This amounted to 60 percent of the total $245 billion in proposed tax cuts. Finance Committee Chairman Roth's markup of the House bill included the $500 child credit, but provided for a phaseout for taxpayers in the income range of $75,000 to $95,000. The House adhered to a phaseout in the range of $200,000 to $250,000.

The second most significant item in the House tax bill was the preference for long-term capital gains. For individual taxpayers, there would be an exclusion for 50 percent of long-term capitals gains (other than that realized on "collectibles" such as artwork and jewels); for corporate taxpayers the maximum capital gains tax would be capped at 25 percent. This preference was scored by the Joint Committee on Taxation as costing $35 billion over seven years. The Senate generally followed the House, except the top corporate rate was fixed at 28 percent and indexing of capital assets was left out altogether. Likewise, a House provision allowing a deduction for losses realized on the sale or exchange of a principal residence (an otherwise nondeductible personal loss) was dropped by the Finance Committee. These changes reduced the seven-year revenue loss by more than $12 billion.

The bill that emerged from the Finance Committee also left out several highly publicized provisions from the House bill. The Senate taxwriters opposed the outright repeal of the corporate alternative minimum tax (AMT), proposing instead a more modest reform — eliminating the onerous requirement that corporate taxpayers use a different depreciation schedule for purposes of computing tentative taxable income under the AMT. Senator Roth used the power of his new position to advance his favorite cause: expanding IRA coverage. Senate modifications to the House bill included a more generous expansion of the eligibility requirements for existing individual retirement accounts (IRAs), including new allowances for tax-free withdrawals for qualified expenses. Both the House and Senate bills provided for new "medical spending accounts" modeled on IRA accounts.

Both tax committees finished their work late in the month. On October 26, the House passed the Ways and Means Committee bill by a 227-203 margin, with voting following partisan divisions. The Finance Committee approved the chairman's bill by an 11-9 vote that followed strict party lines. The full Senate then passed the Finance Committee bill on October 28 by a 52-47 vote, with all Democrats voting against the bill and all Republicans save for William Cohen of Maine voting in favor of the tax reduction bill. House and Senate tax conferees convened only days later to commence the delicate process of crafting a compromise bill suitable to Republicans in both chambers. The conferees largely followed the House on key issues, although Senate conferees prevailed in lowering the phase-out threshold for the $500 child credit and in retaining the corporate AMT. The 50 percent deduction for long-term capital gains was adopted, retroactive to December 31, 1994, and indexing of capital assets would be phased-in by the year 2002. Other Contract tax provisions adopted in the final bill included the deduction for capital losses realized on the sale of a principal residence, increasing the $600,000 gift and estate tax exemption to $750,000, increasing the annual expensing allowance for small businesses, expanding the coverage of IRAs, and reducing the marriage penalty. The final bill also included a major effort to simplify provisions governing pension plans and the taxation of Subchapter S corporations.

Balanced Budget and Tax Reduction in 1995

The Conference Committee's tax bill was included in, and in many respects submerged by the Republicans' massive legislative effort to reform Medicaid and Medicare and balance the federal budget by the year 2002. In many ways, this typified how tax policy was engulfed in the broader debate over the budget in the 1990s. The omnibus revenue and budget bill reported out by the Budget Committees passed the House by a vote of 237 to 189 on November 17, 1995. The Senate followed suit later that same day. The Seven-Year Balanced Budget Reconciliation Act of 1995 was presented to President Clinton on November 30, 1995. Clinton followed through with his oft-repeated promise and vetoed the legislation on December 6.

The president specifically attributed his action to the $270 billion reduction in Medicare spending and $163 billion reduction in Medicaid spending over seven years. In his veto message, Clinton declared: "I am returning herewith without my approval H.R. 2491, the budget reconciliation bill adopted by the Republican majority, which seeks to make extreme cuts and other unacceptable changes in Medicare and Medicaid, and to raise taxes on millions of working Americans. . . . While making such devastating cuts in Medicare, Medicaid, and other vital programs, this bill would provide huge tax cuts for those who are already the most well-off."[21]

Still, Clinton expressed willingness to compromise on at least some of the major issues included in the Republican bill. Specifically, the president accepted the idea of balancing the budget over seven years (down from his prior commitment to a 10-year timetable), some form of a child credit, a new $5,000 deduction for educational tuition, a higher income phase-out range for existing IRA saving accounts, and new IRA-styled savings accounts with penalty-free "back-end" withdrawals for qualified expenses. The Democratic president also now accepted in principle deeper cuts in discretionary spending. The White House called for reducing Medicare spending by $124 billion over seven years, compared to the $270 billion reduction in the Republican plan.

[20] Joint Committee on Taxation, "Estimated Budget Effects of Revenue Reconciliation and Tax Simplification Provision of H.R. 2491," (JCX- 53-95), November 16, 1995.

[21] President Clinton's Statement to House of Representatives on Veto of Budget Reconciliation Bill (H.R. 2491) (December 6, 1995), *Doc 95-10958 (2 pages), 95 TNT 239-27.*

Overall, the president was willing to accept a plan for $105 billion in gross tax cuts over seven years, offset by $35 billion in additional revenues to be raised over the same period. This demonstrated just how far House Republicans had come in shifting the framework for the political debate. Still, the White House held firm on other issues, rejecting entirely any preference for capital gains, increases in estate tax exemptions, and changes to the corporate AMT — perhaps to gain some additional bargaining room in the forthcoming negotiations. The White House plan embraced several GOP revenue-raisers. The administration also proposed several new provisions aimed at corporate taxpayers that would raise $20 billion over seven years.[22]

The disagreement between the White House and congressional Republicans extended to the economic assumptions which supported the party's respective plans for balancing the budget. Congressional Republicans relied upon the relatively conservative economic forecast of CBO, which predicted a slightly lower rate of annual growth for the economy than did OMB, which itself was more conservative than most Wall Street economists. The White House used OMB projections forecasting a 2.5 percent annual growth rate, while congressional Republicans relied upon the 2.3 percent rate from CBO. This seemingly minor 0.2 percent difference between the CBO and OMB economic forecasts required $400 billion in extra cuts under the congressional plan to bring the budget into balance by the year 2002. The impasse was bridged when CBO revised its economic assumptions in a new December report.[23] CBO's more rosy economic forecast meant that there was an extra $135 billion in revenue to play with, thereby closing the gap between congressional Republicans and the Democratic White House to only $300 billion over seven years. This extra revenue would help achieve a balanced budget, even while accepting the reduced cuts to Medicaid and Medicare spending demanded by Democrats.

Attempts to reach agreement between Congress and the White House on an overall balanced budget plan continued throughout the second week of December. The federal government had already been partially shut down for six days starting November 14, with some 800,000 "nonessential" federal workers kept off the job. A temporary spending measure had been adopted by Democrats and Republicans to bring federal employees back on the job and avert a default on federal debt obligations, but this authorization lasted only until December 15.[24] In the end, even the threat of another shutdown could not push the parties to compromise. Negotiations ended abruptly with the federal government shutting down following the expiration of the temporary spending measure at midnight on December 15.

> ***What went wrong for Republicans in 1995? Essentially, House Republicans refused to follow the most basic rule of postwar tax policymaking. When you want to pass a tax bill, you must provide some benefits to everyone.***

The December shutdown was more limited than that in November, as 9 of the 13 required appropriations bills were actually in place. Still a number of "minor" Cabinet departments (including Interior, Labor, and Health and Human Services, as well as independent agencies such as the EPA and NASA) were forced to close down operations. Negotiations peaked and ebbed the week before Christmas. But in the wake of a threatened revolt by House Republican freshmen against their more "moderate" leadership, positions hardened. Republicans declared that budget talks could not continue until the president negotiated in "good faith" — meaning on their terms. Negotiations reached deadlock. The December recess came, the government remained shut down, and the first session of the 104th Congress ended with neither a budget in place for fiscal year 1996 nor the enactment of any tax reduction legislation.[25]

1995: A Lesson for the GOP?

So what then went wrong for Republicans in 1995? Essentially, House Republicans refused to follow the most basic rule of postwar tax policymaking. When you actually want to pass a tax bill, rather than just grandstand, you must provide some benefits to *everyone* — including the minority party. Logrolling is the essence of the politics of the federal income tax. It is not sufficient to offer benefits only to those among the party faithful. With every provision in the tax bill

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[22]These included limiting the carryback of net operating losses to one year (down from the current three), restricting the use of so-called "captive insurance companies," reducing the "dividends received" deduction (available to corporations owning less than 20 percent of the stock of another corporation) from 70 percent to 50 percent, and phasing out one major component of the section 936 possessions tax credit. For a description of the White House tax proposals, see John Godfrey, "Clinton Keeps Individual Tax Cuts, Targets More Corporate Provisions," *Tax Notes,* Dec. 11, 1995, p. 1303.

[23]Congressional Budget Office, "The Economic and Budget Outlook: December 1995 Update," Washington, D.C., December 11, 1995. For a discussion of the political implications of the economic assumptions in the CBO report, see Christopher Georges, "New Estimates Help Shrink Deficit Gap, But Budget Gap Talks Still Have Far To Go," *Wall St. J.,* December 12, 1995, A2, A8.

[24]H.R. 2586, approved by the House Ways and Means Committee on November 7, 1995, increased the statutory limit on the public debt to $4.95 trillion for debt outstanding before December 13, 1995. This was less than the increase to $5.5 trillion included in the Republican's budget reconciliation bill (H.R. 2491), but provided a few weeks breathing room for negotiations between the White House and Congress.

[25]Congress and the administration did not reach agreement on the 1996 budget until six months into the fiscal year. The fiscal 1996 omnibus appropriations bill (H.R. 3019) was signed by President Clinton on April 26, 1996.

targeted at either the conservative Republicans or their pro-business, pro-family constituents, there was simply nothing in it for the Democrats. In the short run, moderate Republicans had no place to go, so they stayed with their more conservative GOP leadership. But with no inducements for Democrats to join the coalition, the highly partisan House tax bill went as far as it could go — to a losing showdown with the Democratic president. With little offered by way of compromise, anything short of a presidential veto would have alienated the president with the rank and file of his own party. And so veto he did!

The 1995 tax bill also reminds us of another feature of contemporary tax policymaking. Any tax bill of such magnitude is sure to include a host of special interest provisions buried deep in the muck and mire. No single individual or committee can maintain control over the legislative process where a bill touches on so many sections of the tax code. With the tax bill itself submerged within the confines of a massive budget bill that would abolish entire cabinet departments and rewrite programs such as Medicare and Medicaid, it was impossible to keep centralized control of the legislative initiative. This allows members of the tax committees, as well as party leadership (both Republicans and Democrats), to slip in provisions to aid constituents. For better or worse, this is how tax legislation is made. Mostly, it is for the worse.

A Quiet Year for Taxes: 1996

While 1996 is generally considered an "off year" for tax legislation, several major domestic policy bills were enacted that included substantial amendments to the tax code. House GOP leaders opened the year by attempting to attach a limited tax package to a bill to raise the national debt limit. Purportedly, the GOP package was to include items off the failed 1995 Contract tax bill.[26] Later in February, the Republican leadership unveiled its plan, which included a capital gains tax cut, a child tax credit, pension protection, and a constitutional amendment to limit tax increases. A separate bill introduced in the House by James M. Talent, R-Mo., and J.C. Watts Jr., R-Okla., proposed creating new "renewal communities" in low-income areas. While Speaker Newt Gingrich, R-Ga., endorsed this plan for a new version of empowerment zones, the bill never made it through the House.[27]

Legislation to increase the debt ceiling to $5.5 trillion passed the House on March 28 by a vote of 328 to 91. The bill did *not* include the GOP mini-Contract tax package, but it did include a line-item veto measure granting the president authority to veto certain tax provisions. The line-item veto was subsequently removed from the legislation, passed by Congress on March 28 as a separate bill (S. 4), and sent to the president for his signature.[28] On April 9, President Clinton signed the Line Item Veto Act, which granted the president veto power (subject to congressional approval) over any revenue-losing measure that provides a federal tax deduction, credit, exclusion, or preference to 100 or fewer taxpayers — a targeted tax benefit.[29] Clinton first used the line-item veto power in 1997 to strike two provisions from the Taxpayer Relief Act of 1997. However, the legislation was immediately challenged in the federal courts and subsequently ruled unconstitutional by the Supreme Court.[30]

In April and May, congressional Republicans began consideration of legislation to reform health care insurance. The legislation stalled in the Senate due to opposition to a provision in the House bill (H.R. 3103) creating medical spending accounts. In June, the Senate Finance Committee also began markup of another bill (H.R. 3448) offering tax relief to small businesses. At the same time, the health insurance reform bill emerged from the Conference Committee after negotiators reached agreement on medical savings accounts. In late August, the president signed into law the Health Insurance Portability and Accounting Act of 1996. At the same time, Clinton signed the Small Business Job Protection Act of 1996 (SBJPA), a 10-year $20.5 billion package of provisions granting tax relief to small businesses. That month, Republicans also sent up to the president a sweeping welfare reform bill (H.R. 3734), which he also signed in the same blitz of domestic policy legislation. The welfare reform bill, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, also included some tax provisions, most prominently $3.2 billion in earned income tax credit reforms.

Of the three major bills enacted in August 1996, the Small Business Job Protection Act included the most significant amendments to the income tax. The legislation contained numerous provisions affecting businesses, simplifying pension rules, expanding contributions to IRAs, and extending expired tax provisions. Among the many tax provisions in SBJPA was a measure that increased the deduction for health insurance for self-employed persons from 50 percent to 80 percent over 10 years. The legislation also increased the section 179 expense deduction from $17,500 to $25,000 over seven years and enacted a tax credit for up to $5,000 of expenses incurred in adopting a child. Under a reform proposal introduced by the administration, the

[26]*See* John Godfrey, "Chances Dim for Tax Plan to Ride on Debt Limit Bill," *Tax Notes*, Mar. 4, 1996, p. 1303.

[27]*See* Heidi Glenn, "GOP Moves To Limit Contract, 'Renew' Distressed Cities," *Tax Notes*, Mar. 4, 1996, p. 1309.

[28]*See* Heidi Glenn, "Congress Passes Debt Limit Bill, Limited Line-Item Veto," *Tax Notes*, Apr. 1, 1996, p. 7.

[29]P.L. 104-130, 110 Stat. 1200; 2 U.S.C. section 691 *et seq.*

[30]Judicial challenges to the line-item veto quickly left the legal status of the measure in limbo. On February 12, 1998, a U.S. district court declared the Line Item Veto Act unconstitutional as a violation of Article I, Section 7 of the U.S. Constitution, as well as the "separation of powers" doctrine. After granting expedited review, the Supreme Court held the line-item veto unconstitutional in a 6-3 decision. *William J. Clinton, et al. v. New York, et al.*, No. 97-1374, 81 AFTR2d Par. 98-837, *Doc 98-20687 (45 pages), 98 TNT 123-9* (U.S. Sup. Ct. June 25, 1998).

deduction for company-owned life insurance (COLI) was limited. The law established that the exclusion from gross income for amounts received as damages for personal injury or sickness applies only to damages for a *physical* injury or sickness. The legislation also included a provision that was previously introduced as a stand-alone bill. That proposal created an entirely new "pass through" entity, the Financial Asset Securitization Investment Trust (FASIT). The new entity was a gift to the financial community, which decided that it needed a new tax-favored vehicle for the securitization of general debt obligations, such as credit card receivables, home equity loans, and automobile loans. Wall Street asketh and Congress giveth!

The Taxpayer Relief Act of 1997 reads like a Christmas list of special tax provisions targeted at constituents of the Republican Party.

The Small Business Job Protection Act included a major overhaul of subchapter S of the Internal Revenue Code, dealing with so-called S corporations. For many years, proposals were introduced to modify and modernize the law governing S corporations. These efforts finally bore fruit in 1996. Under the new legislation, which was supported by the tax bar and accounting profession, the limit on the number of shareholders for an S corporation was raised from 35 to 75. In addition, under revised subchapter S, an S corporation is permitted to be a member of an "affiliated group," and hence, can own 80 percent or more of a C corporation, as well as have a wholly owned subsidiary that itself is an S corporation. Another significant change allowed some tax-exempt organizations to become shareholders of S corporations.

Republicans got a few of the more modest tax provisions on their wish list, but none of the really big ticket items. In October 1996, House Ways and Means Committee Chairman Bill Archer announced that a capital gains tax cut and a $500 child credit would be at the top of the committee's agenda for the following year. Whether congressional Republicans would succeed in their effort appeared dependent on whether Bob Dole would capture the White House — which turned out not to be the case. After announcing in August a much anticipated tax plan (calling for the incredibly novel idea of a 15 percent across-the-board tax cut), the Dole campaign fizzled. Notwithstanding heavy doses of what we now know to be the drug Viagra, the Dole candidacy went limp and the GOP's hope of passing the Contract tax bill was dashed. Bill Clinton's reelection and Democratic gains in the House and Senate suggested that 1997 would be another year of tax deadlock. Or would it?

Cutting Taxes in 1997

The year 1997 began with congressional Republicans picking up right where they left off the prior year — proposing tax-reduction legislation. On January 8, Senate Majority Leader Trent Lott, R-Miss., expressed his hope that Congress and President Clinton could agree to tax cuts in the order of $125 billion to $150 billion.[31] To get the ball rolling, on the very first day of the 105th Congress, 14 bills were introduced in the House to revise the tax code. Tax reduction was again on the Republican agenda. As Congress turned to the new budget, tax provisions crowded the legislative docket. Budget proposals offered by both Senate Republicans and Democrats included tax incentives for education, expanded IRAs, reduction in the tax on capital gains, and relief from the estate and gift tax. Indeed, President Clinton's own 1998 budget package provided $100 billion in tax cuts over five years. Republicans accepted that as a good start, but urged an overhaul of the IRS and the entire tax code as well.[32]

In January, Senate Republicans released a package of their 10 most desired tax items, including some $200 billion in tax reduction over five years. Senate Democrats released their own alternative package, with a more modest goal of $90 billion in tax cuts. The first week of March, House Republicans announced their agenda. The plan included reducing, or eliminating altogether the taxation of capital gains, as well as repeal of the estate tax. They also proposed expanded access to IRAs, pension plans, and medical spending accounts. The plan reiterated support for tax simplification and a desire to "audit the IRS" and review alleged IRS abuses.[33]

By May, Republicans were willing to accept the president's budget proposals for tax incentives for education in exchange for the White House's commitment to meaningful tax reduction. By June, budget negotiators approved a five-year budget resolution even while the chairman of the Ways and Means Committee began marking up a new tax bill. Soon after, the Finance Committee reported its own tax bill that included $85 billion of tax cuts over five years and $250 billion over ten years. Similar to the proposal that emerged from Ways and Means, the Senate bill included, none too surprisingly, Chairman Roth's favorite proposal: expanded coverage for IRAs.

In July, the president unveiled his own package of tax cuts, which included reduction of capital gains tax, the gift and estate tax relief for farms and small businesses, expansion of IRAs, a modest child tax credit, and tax credits for college tuition. During the summer, negotiations stalled in the Conference Committee that was trying to work out a compromise over differences between the House and Senate bills. But by the end of the month, Congress passed legislation that would cut taxes by more than $400 billion over 10 years. The tax bill (H.R. 2014) passed the House by a vote of 389-93 and the Senate by 92-8. On August 5, even while expressing reservations about its content, President Clin-

[31] *See* John Godfrey, "Senate Takes Policy Lead As Congressional Session Begins," *Tax Notes,* Jan. 13, 1997, p. 111.

[32] *See* John Godfrey, "GOP Leaders Seek White House Tax Reform Proposal," *Tax Notes,* Feb. 17, 1997, p. 826.

[33] *See* John Godfrey, "House GOP Unveils Agenda; Tax Plans Remain Murky," *Tax Notes,* Mar. 10, 1997, p. 1227.

ton signed into law the Taxpayer Relief Act of 1997.[34] Thus, two and a half years after taking control of Congress, Republicans finally had their tax bill.

The Taxpayer Relief Act of 1997 reads like a Christmas list of special tax provisions targeted at constituents of the Republican Party. The legislation finally reduced the maximum tax on capital gains for individuals to 20 percent (a perennial goal of Republicans since the preferential rate for capital gains was repealed in 1986), lessened the burden of the corporate alternative minimum tax, and eliminated it altogether for small business corporations. The 1997 act also increased (over 10 years) the exemption to federal gift and estate tax from $600,000 to $1 million — as well as creating an entirely new $700,000 exemption for owners of small businesses and farms. The Republican legislation also included provisions expanding the availability of Individual Retirement Accounts (IRAs) and creating a new "Roth IRA" (named after Finance Committee Chairman Roth, who has the dubious honor of being the only individual having a section of the tax code named after him).

Because any tax bill requires a broad nonpartisan coalition behind it, Republicans were forced to make concessions to Democrats. The Clinton administration was behind several new education tax credits, a new exemption for $250,000 of gain ($500,000 for married couples) recognized on the sale of a residence, and a number of proposals to shut down "abusive" financial transactions designed by Wall Street investment firms to allow clients to defer gain realized on stock and securities. These provisions had been originally proposed by the Clinton administration in 1995 in response to the GOP's Contract tax bill, and were included in the 1997 act as a compromise to secure the president's support (or at least, tacit acceptance) for the bill.

Opinions of the Tax Reform Act of 1997 range from enthusiastic (Republicans), to lukewarm (Democrats), to highly negative (tax professionals). From the perspective of the administration of the tax system, the 1997 act was a disaster! Not only was the tax code not made any simpler, but a good deal of unnecessary complexity was introduced. Specifically, the treatment of capital gains on Schedule D became a nightmare. During the final stages of negotiations over the 1997 bill, at the insistence of Treasury Secretary Robert Rubin, the holding period for the new preferential 20 percent rate for long-term capital gains was raised from 12 months to 18 months. This created a complicated three-tier system under which gains were taxed at three different rates, depending on the applicable holding period, as well as the classification of the underlying capital asset itself. The apparently simple job of determining a taxpayer's tax liability for the sale of a capital asset now required a separate worksheet and a much more complicated tax form.

Likewise, the $700,000 exemption from estate tax for owners of small businesses and farms just introduced a new and complicated tax shelter available to very few taxpayers. By creating yet another tax-deferred entity (the new Roth IRA), the 1997 act further complicated strategies and decisions for retirement savings. Several new education tax credits (none of them worth very much) were also introduced to clutter up the tax code. Only the new exemption for gain realized on the sale of a personal residence contributed to simplification of the tax laws. With such a generous exemption, most sales will not likely be subject to tax, and thus, the burden of recordkeeping was eased for most taxpayers. Of course, the same generous exemption also creates a strong economic incentive for overinvestment in residential real estate, thereby creating an inefficiency in the allocation of resources. Even still, the new statute makes a whole lot more sense than the old two-year rollover provision and the one-time $125,000 exemption for those over 55 years of age.

GOP Antitax Policy: 1997-1998

In 1997, congressional Republicans turned their attention to the agency charged with administering the tax laws — the Internal Revenue Service. Tapping what they (rightly or wrongly) perceive to be a strong undercurrent of antitax sentiment among the electorate, Republican leaders focused popular discontent with the tax laws on the IRS. Out on the campaign trail, Republican politicians took to blaming the IRS for the excessive complexity of the tax laws (which many of them persisted in calling the "IRS Code") and the burden of taxation itself — conveniently ignoring that it is Congress that writes the tax laws, and not the administrative agency. In September 1997, Senate Finance Committee Chairman Roth conducted televised committee hearings investigating alleged abuses of taxpayers by the Internal Revenue Service. In dramatic testimony, IRS agents (some wearing hoods to conceal their identities) testified before the Finance Committee on the alleged abusive conduct of the agency in its collection activities. The hearings were a great public relations success for antitax Republicans, who viewed the publicity as the first step in a full-scale assault on the income tax itself.[35]

Soon after the hearings, the Ways and Means Committee approved a bill proposing new safeguards for taxpayers litigating with the IRS and restructuring the Internal Revenue Service (by putting the agency under the control of an independent supervisory board made up of non-governmental executives). The bill sailed through the House in early November 1997 by a vote of 426 to 4, but then was held up in the Finance Committee by Roth — who promised that the Senate would adopt an even tougher version in 1998. In the spring

[34] P.L. 105-34, 111 Stat. 788.

[35] The following account of the 1997 campaign against the IRS draws upon my essay, "The Politics of Taxation" in *Handbook of Government Budgeting*, Roy T. Meyers, ed. (San Francisco: Jossey-Bass Publishers, 1999), pp. 332-54; *see also* Sheldon D. Pollack, "The Politics of Taxation: Who Pays What, When, How," unpublished paper presented to Annual Meeting of the American Political Science Association, Boston, Massachusetts, September 3-6, 1998.

of 1998, Roth again held Finance Committee hearings investigating alleged abuses of taxpayers by the IRS, but this time there was a much less enthusiastic response from the media and public. Soon thereafter, the GOP proposal to restructure the IRS was adopted in the Internal Revenue Service Restructuring and Reform Act of 1998.[36]

While still only a minority within their own party, members of the antitax wing of the Republican Party have attracted much attention for their cause and tried to organize a viable national political movement against the income tax. Back in 1998, Ways and Means Committee Chairman Archer went off on speaking engagements across the country to "educate" the public on the need to replace the income tax (whether with the flat consumption-based tax favored by Dick Armey and Steve Forbes or a national sales tax, championed by Rep. Billy Tauzin of Louisiana and Senator Orrin Hatch of Utah). The antitax message of the Republican Party has dominated the party's policy agenda in the 1990s. In one particularly amazing act of political grandstanding in June 1998, the House voted 219-209 in favor of the Tax Code Termination Act, which would "sunset" the federal income tax by July 4, 2002. The bill (H.R. 3097, sponsored by Rep. Steve Largent of Oklahoma and co-sponsored in the Senate by Majority Leader Lott) left completely unanswered the rather important question of how to replace the $1 trillion of revenue raised annually under the income tax. Apparently, the House leadership counted on the integrity of the Senate to deal with such matters as fiscal responsibility and kill the measure — which it did. The point of adopting such a bill in the first place (knowing full well that the Senate would defeat it) was simply to promote the GOP campaign for "fundamental tax reform."[37] This all may have backfired on the Republicans, as the Washington press corps reacted with a good deal of cynicism, and the public with considerable indifference, to this overtly political use of the legislative power.

The antitax rhetoric of the GOP imposes significant restraints on all policymakers — even Democrats who might otherwise be tempted to raise taxes for the federal government. Indeed, there has been enormous political pressure on all politicians in the United States to reduce taxes even in the face of the significant budget shortfalls experienced in the 1980s and 1990s — a lesson learned all too well by Bill Clinton. After only a few years, the president sheepishly disavowed his own 1993 tax increase and accepted a proposal from congressional Republicans for $95 billion of net tax cut over five years. These were included in the Taxpayer Relief Act of 1997 and the Balanced Budget Act of 1997, both signed into law by Clinton. That budget legislation included the caps on discretionary domestic spending that so severely constrained the budgetary process for fiscal year 2000.

The persistence of the deep-rooted antitax ideology expressed by Republicans has also had a significant long-term impact on the development of U.S. tax policy. Ironically, while broad-based tax reduction is a fundamental tenet of the Republican Party, and cutting marginal tax rates is dogma to the pro-investment supply-side wing of the GOP, all such tax cuts run counter to what is most advantageous to congressional policymakers *qua* politicians — namely, tax cuts targeted to constituents. As much as Republican politicians like cutting taxes in general, they (and their Democratic colleagues) have a greater interest in granting tax relief to constituents in their home districts and those organized interests and groups that comprise their respective party coalitions. This helps explain why, for all the antitax rhetoric, the 1995 Republican tax bill (vetoed by President Clinton) and the tax reduction legislation enacted in 1997 included so many special tax preferences benefiting constituents of *both* political parties.

In one particularly amazing act of political grandstanding in June 1998, the House voted 219-209 in favor of the Tax Code Termination Act, which would 'sunset' the federal income tax by July 4, 2002.

The Internal Revenue Service Restructuring and Reform Act of 1998 expressed partisan rhetoric *and* bipartisan constituency service. The initiative emerged from committee as typical grab-bag tax legislation as Republicans succeeded in turning the IRS restructuring measure into an omnibus tax bill.[38] The central feature of the reorganization plan was a new organizational structure for the IRS based upon classifications of taxpayers (individuals, corporations, tax-exempt entities, etc., rather than the old geographic, regional organization in place since 1952) and the creation of a new independent oversight board. The IRS oversight board is comprised of nine individuals: (1) six "private-life" members who are not federal employees or federal officials, and who are appointed by the president, (2) the Treasury secretary, (3) the IRS commissioner, and (4) a full-time federal employee appointed by the president with the advice and consent of the Senate. The authority of the board is limited to administrative and management issues, and is expressly barred from participating in the development or formulation of federal tax policy.

The legislation also included several new taxpayer protections (i.e., provisions expressing the wrath of the

[36]The House passed the Conference Committee report to H.R. 2676 on June 25 by a vote of 402 to 8, and the Senate followed on July 9, by a vote of 96 to 2. President Clinton signed the bill into law on July 22, 1998.

[37]For an account of the politics behind the provision to repeal the tax code, see Ryan J. Donmoyer, "In Election-Year Gambit, House Votes to Scrap Code," *Tax Notes*, June 22, 1998, pp. 1533.

[38]*See* Greg Hitt, "Lawmakers Strike Deal on IRS Overhaul," *Wall St. J.*, June 24, 1998, A2.

GOP for the IRS): provisions to shift the legal burden of proof to the IRS in civil litigation, impose limitations on the power of the IRS to levy a taxpayer's principal residence, provide a more favorable computation of the amount of interest owed by taxpayers on unpaid tax liabilities, and limit the liability of an "innocent spouse" for taxes owed by their spouse on a joint tax return. The bill also created a new privilege for accountants representing taxpayers in tax matters.[39] The Conference Committee subsequently modified this privilege, limiting its scope to client representation in civil tax matters before the IRS (but not other government agencies, such as the SEC) and expressly holding that privilege shall not apply in written communications with the taxpayer concerning "corporate tax shelters." As the wording of the bill originally seemed to also apply to the privilege of lawyers representing their clients, the American Bar Association joined the American Institute of Certified Public Accountants in lobbying against the measure. Thereafter, the Conference Committee inserted language making clear that the lawyer-client privilege was not affected by the provision.[40]

In a provision added at the last minute in Conference Committee, the 1998 legislation altered the three-tiered holding period for long-term capital gains that had been adopted only the year before in the 1997 tax act.[41] Tax professionals and taxpayers alike found the system a nightmare of complexity on 1997 returns. Ways and Means Committee chairman Bill Archer had promised to repeal the 18-month holding period, and he kept his word in the 1998 legislation. Repeal of the 18-month holding period carried a cost of $2 billion over 10 years.[42] Archer also attracted attention when he blocked inclusion of a "technical correction" to the 1997 tax act. The drafters of that legislation had inadvertently altered the tax rate structure for the federal estate tax, and thereby reduced the tax burden for those few wealthy individuals with estates greater than $20 million. Archer rejected the technical correction on the grounds that it would implement a "tax increase" and hence, had no place in the bill. Democrats in Congress were apoplectic. House Minority Leader Richard Gephardt, D-Mo., denounced Archer's maneuvering to kill the technical correction an "abomination," and Senate Minority Leader Thomas Daschle, D-S.D., fumed. But in the end, silence from the White House left congressional Democrats dangling and undercut Democratic opposition in the Conference Committee. The "inadvertent" estate tax cut stood.[43]

The 1998 tax act was notable for several other provisions that did not make it into the final legislation. The influence of special interest is often evidenced as much by those provisions that are excluded from a tax bill as by those that are included in the legislation for their benefit. For example, the White House had proposed a revenue-raising provision that would have changed the way life insurance companies calculate reserves, regulated the use of family limited partnerships in reducing federal gift and estate tax liabilities, and eliminated the use of so-called *Crummey* powers in planning for the gift and estate taxes. All of these reform measures, which had their origins in the Treasury Department, faced strong opposition from well organized business interests — most particularly, the insurance industry. Congressional Republicans succeeded in excluding all three proposals from the final bill. In addition, a proposal to expand the IRS's electronic filing program via the dissemination of software for tax return preparation was squashed by lobbying efforts from industry giants Intuit Inc. and H&R Block Inc. — which market their own highly profitable software programs for tax return preparation. In another provision, issuers of tax-exempt bonds challenged by the IRS were given added protections and a new appeals procedures in an amendment introduced by Senator Orrin Hatch, R-Utah, for the benefit of a school district in his state that had its bonds challenged by the IRS.[44]

A Treasury proposal to tax employer-provided meals was opposed by lobbyists for the gaming and hospitality industries, and a greatly watered-down version was substituted (at a cost of $316 million over 10 years, as estimated by the JCT). In fact, the final version of the bill actually provided more favorable tax treatment of employer-provided meals than that afforded under pre-1998 law.[45] Finally, it was notable that the 1998 bill failed to include even modest relief from the marriage penalty.[46] Separate legislation was introduced

[39]These provisions are described in detail in Robert Manning and David F. Windish, "The IRS Restructuring And Reform Act: An Explanation," *Tax Notes,* July 6, 1998, p. 83.

[40]The political bargaining in the Conference Committee over the 1998 tax bill is described in Ryan J. Donmoyer, "Loaded-Up IRS Restructuring Bill Awaits Senate Approval," *Tax Notes,* June 29, 1998, p. 1663; Sheryl Stratton, "Accountant-Client Privilege: Unclear From the Start," *Tax Notes,* July 6, 1998, p. 7.

[41]For an account of how the reduction of the holding period for capital gains was included in the IRS restructuring bill, see Richard W. Stevenson, "Break in Capital Gains Tax Is Added to I.R.S. Overhaul," *N.Y. Times,* June 24, 1998, A1.

[42]Joint Committee on Taxation, "Estimated Budget Effects of Internal Revenue Service Restructuring and Reform Act of 1998," June 24, 1998 (JCX-51-98).

[43]The story of Archer's opposition to this technical correction is found in David E. Rosenbaum, "A Mistake Prevails, as Certainly as Death and Taxes," *N.Y. Times,* June 24, 1998, A21.

[44]*See* Greg Hitt, "IRS Bill, Poised for Senate Approval, Also Has Benefits for Special Interests," *Wall St. J.,* July 9, 1998, A20.

[45]House Ways and Means Committee member John Ensign, R-Nev., was successful in slipping into the IRS restructuring bill a proposal that he had introduced in the House in May. That bill, the Worker Meal Fairness Act of 1998, was co-sponsored in the Senate by Speaker Newt Gingrich, R-Ga. For an account of Ensign's lobbying, as well as the impact of the provision, see Amy Hamilton, "IRS Reform's Flying Circus — Tales of One Last-Minute Change," *Tax Notes,* July 13, 1998, p. 145.

[46]This issue became a central theme of social conservatives who were enraged to discover that some married couples would pay greater income tax filing on a joint tax return than they would if they were unmarried individuals with the same incomes filing separately. The reason for this result is the progressive tax rate structure that puts the joint taxpayers into a higher marginal tax bracket. For a comprehensive explanation and historical account of the marriage penalty, see Michael J. Graetz, *The Decline [and Fall?] of the Income Tax* (New York: W.W. Norton, 1997), pp. 29-40, 282-83.

later in 1998 to take on the marriage penalty, but never made it to the floor. This bogus issue has haunted tax policy since 1994, when Republicans committed to this Contract "reform," but soon discovered they cannot come up with the revenue to pay for any meaningful change.

Funding for the many revenue losers included in the 1998 tax act (which the Joint Tax Committee scored as costing $13 billion over 10 years) was achieved largely through two measures. The first liberalized the rules for converting a traditional IRA into a new Roth IRA. (The conversion raises revenue in the short-run because tax is triggered on the withdrawal of savings out of the traditional IRA; however, in the long-run, the conversion costs the Treasury as the funds reinvested in a Roth IRA are afforded a more favorable tax treatment. Conveniently, the long-term cost of the conversion shows up outside the 10-year framework of federal budgeting.) The second major revenue raiser overturned the much criticized decision of the U.S. Tax Court in *Schmidt Baking Co. Inc.*[47] In that case, the tax court had allowed the company to deduct more than $2 million of accrued (but unpaid) vacation and severance compensation that was secured by a standby letter of credit. Legislative repeal of *Schmidt Baking* was projected to raise some $3.2 billion over five years.[48]

In a separate legislative initiative during the spring of 1998, the Education Savings and School Excellence Act of 1998 (H.R. 2646), congressional Republicans proposed expanding tax-free IRA withdrawals for qualified educational expenses — including tuition for private elementary and secondary schools. The bill passed both houses and went to Conference Committee in June. However, President Clinton threatened to veto the bill (despite having sponsored the educational tax credits included in the 1997 tax act), and as the Republican leadership lacked the requisite votes to override such a veto, the measure subsequently died a quiet death. The GOP was willing to rest, content with its success in restructuring the IRS.

1999: Another Year of Tax Deadlock

Starting back in 1996, the Congressional Budget Office began tracking a new trend in the government's financial condition. CBO was soon suggesting that budget deficits would not be nearly as severe as previously estimated. Slowly, predictions of budget deficits gave way to predictions of surpluses only a few years down the line. As the economy boomed and tax receipts continued to flood into the Treasury, the whole game changed dramatically. In January 1999, CBO predicted a cumulative *surplus* of $2.6 trillion for fiscal years 2000-2009. Suddenly, after years of dire forecasts of ballooning deficits, CBO was predicting decades of surpluses. The era of the Surplus had begun!

Based on CBO's rosy forecast in January, President Clinton proposed in his 1999 State of the Union address "dedicating" some 62 percent of the projected surplus to social security. The president also proposed an expensive plan for new retirement savings accounts — Universal Savings Accounts. The new "U.S.A. Accounts" would be funded by the government, using an additional 11 percent of the surplus (over the next 15 years) to match the contributions made by an estimated 100 million participants. The president's plan relied on some shoddy accounting gimmicks, and was justly criticized for "double counting" that portion of the surplus dedicated to the trust funds.[49] But any way you whack it up, an extra trillion dollars or so goes a long way in bailing out the bankrupt social security system — which is why politicians of all stripes were so anxious that CBO improve on its earlier economic prediction. Good news is just what they got!

Not only did CBO not disappoint, but it was even more optimistic than OMB.

First, in late June the Office of Management of Budget, the White House's budget agency, issued a 15-year forecast predicting an extra $1 trillion on top of the $4.9 trillion surplus that OMB had previously projected for the period. As soon as OMB came out with its revised forecast, President Clinton proposed additional measures to bolster social security, as well as expand Medicare by adding new prescription drug coverage for the elderly (the latter, at an estimated cost of $118 billion over 10 years). However, while the administration commonly relies on OMB forecasts for new program initiatives, as well as in preparing the annual budget, CBO's figures are authoritative for the legislative process. Thus, it was important that CBO issue numbers at least as favorable in its July report.

Not only did CBO not disappoint, but it was even more optimistic than OMB. According to the July report, the budget surplus for the current fiscal year would reach $120 billion — some $9 billion more than what it had predicted only last April, and pretty close to the actual figure of $123 billion for 1999.[50] In addition, CBO was now predicting that the cumulative

[47]*Schmidt Baking Co. Inc.*, 107 T.C. 271, *Doc 96-30060 (19 pages), 96 TNT 223-13* (1996).

[48]Joint Committee on Taxation, "Estimated Budget Effects of Internal Revenue Service Restructuring and Reform Act of 1998," June 24, 1998 (JCX-51-98).

[49]For a critique of the president's accounting, see Martin Feldstein, "Clinton's Social Security Sham," *Wall St. J.*, February 1, 1999, A20; *see also* Matthew Miller, "Slick: Saving Social Security with a Pencil," *New Republic*, February 15, 1999, p. 14; Gene Steuerle, "'Spending' the Surplus: Counting the Ways," *Tax Notes*, Feb. 1, 1999, p. 715; *but cf.* Henry J. Aaron, "The Phony Issue of Double-Counting," *Tax Notes*, Feb. 1, 1999, p. 717.

[50]Congressional Budget Office, "Monthly Budget Review Fiscal Year 1999," Washington, D.C., November 10, 1999.

surplus over the next 10 years would be nearly $2.9 trillion. Even more significant, the revised CBO figures showed an "on-budget" surplus of $14 billion for fiscal year 2000 and a cumulative on-budget surplus of $996 billion for fiscal years 2000-2009. This on-budget surplus was what got the tax-cutting wing of the Republican Party giddy all over!

As every Washington politician knows (although it is often conveniently ignored), CBO's predictions of budget surpluses are based on the *consolidated* budget, which these days includes an extra $125 billion to $150 billion or so generated annually by the social security wage tax. But even so, CBO was now predicting that a tiny "on-budget" surplus would be realized for FY 1999 — nine years earlier than CBO had been predicting only one year before. The political significance of on-budget surpluses, no matter how modest, was hardly lost on politicians in Washington, especially among the antitax wing of the Republican Party. Predictions of "off-budget" surpluses never helped their cause very much as any excess cash-flow currently generated by the social security wage tax is invested in special U.S. Treasury notes that must be repaid one day. While Congress has always been quite willing to use the temporary social security surplus to finance current government spending, everyone knows that this is money that is owed to the social security trust fund, and must be repaid in the near future. (Of course, politicians seldom worry about the "near future," as the "present" usually offers more than enough problems to wrestle with.) On the other hand, the newly projected trillion-dollar on-budget surplus represents a real economic windfall for the federal government — at least, somewhere down the road when, and if, it actually materializes. These funds don't have to be paid back! Even moderate Republicans are willing to use a projected on-budget surplus to finance a major tax cut. And so the momentum for another Republican tax-cut bill mounted.

During the spring of 1999, House Republican leaders worked to craft a new tax bill that would use most of the projected $996 billion cumulative on-budget surplus to dole out a wide range of tax benefits to woo voters in advance of the coming 2000 elections. The GOP House bill, released on July 10, differed in significant respects from that released by the Senate only the day before. The House bill, which provided for $850 billion of tax cuts over 10 years, was largely the handiwork of Ways and Means Committee Chairman Archer. Archer recognized that this would be his last chance to deliver on long promised tax proposals, as the powerful Texas Republican had already announced that he would not seek re-election when his current term expires. The House bill included provisions that would grant relief to high-income, two-earner married couples from the marriage penalty (by increasing the standard deduction for married couples to $8,600 from $7,200), further reduce the preferential tax rate for capital gains for individuals (capping the maximum rate at 15 percent), entirely phase out the federal gift and estate tax (over nine years), and ease the burden on individual and corporate taxpayers from the alternative minimum tax. House Republicans also proposed several new "targeted" tax cuts — tax credits and expanded IRA-like savings accounts for educational expenses, including private school tuition, and tax credits for those who care for an elderly relative at home. The latter was the only item likely to appeal to President Clinton.

Archer's original mark included a provision that would reduce the top capital gains rate for corporations from 35 percent to 25 percent — a tax cut long favored by the Republican from Texas. That item was quickly scraped in an effort led by House Speaker Dennis Hastert, R-Ill., to build support for the tax bill among moderate Republicans. The exclusion of Archer's provision allowed Hastert to include several other items also designed to broaden appeal for the bill. These include expanding existing tax credits for low-income housing and hiring low-income workers. Most prominently, a new deduction was created for the cost of Medicare prescription drug insurance coverage. The latter was contingent on reaching agreement between the White House and congressional Republicans on a broader plan to overhaul the Medicare program.

But the centerpiece of the House bill was an expensive 10 percent across-the-board tax cut — costing an estimated $400 billion over 10 years. The proposal reduced the top tax bracket from 39.6 percent to 35.6 percent, decreased the 28 percent bracket to 25.2 percent, and dropped the 15 percent bracket to 13.5 percent starting January 1, 2001. In the past, this kind of proposal left Republicans vulnerable to criticism that the main beneficiaries of their tax cuts are the wealthy. Indeed, almost as if on cue, Robert McIntyre, director of Citizens for Tax Justice, denounced the House proposal as "unfair" for favoring the wealthy over middle- and lower-income taxpayers. In contrast, the bill that Senator Roth presented to the Finance Committee intentionally targeted lower- and middle-income taxpayers, proposing a reduction of the 15 percent tax bracket (which currently applies to taxable income up to $25,350 for single taxpayers) to 14 percent for tax years beginning January 1, 2001, and gradually raising over eight years the income level for the new 14 percent bracket.

The Roth tax bill was estimated to cost *only* $792 billion over 10 years. It preserved the capital gains tax rate at current levels — offering instead increased contribution limits for IRAs and 401(k) tax-preferred savings accounts. The Senate bill also offered no new relief from the federal estate tax. Because of this, the more moderate Senate bill was less appealing to the hard core constituency within the GOP that favors more radical tax cuts, although it had greater bipartisan support. All along the While House indicated that while the president would accept moderate tax cuts (something the order of $250 billion over 10 years), he would not support the Republican bill in its present form. Appearing on NBC television's "Meet The Press" on July 11, Treasury Secretary Lawrence Summers indicated that the president would veto either version of the Republican bill, insisting that the bulk of the surplus must be used to bolster Medicare and social security, and not fund tax cuts.

In many respects, the 1999 campaign for tax cuts became a "make or break" issue for the GOP. For the past five years, Republicans in Congress failed to enact their most favored tax policies. In September 1998, GOP House leaders were unable to push through even a modest tax bill that would have provided $80 billion of targeted tax cuts over five years. And remember the Republican response to President Clinton's 1999 State of the Union address? That too called for a 10 percent across-the-board tax cut — which would have been the largest tax cut since the Economic Recovery and Taxpayer Relief Act of 1981 (ERTA). The proposal fell flat and was dropped like a hot potato. Suddenly, in July, with the CBO predicting huge surpluses, it reappeared as the centerpiece of the new Republican tax bill!

The Conference Committee met to reconcile the Senate and House versions. As it turned out, this required remarkably little effort. Indeed, the conferees threw in several new proposals that were not in either the original House bill or its Senate counterpart. On August 4, the Conference Committee reported its compromise bill. Surprising even its most enthusiastic supporters, the GOP tax bill sailed through the House and Senate in record time. The very next day, the House passed the Taxpayer Refund and Relief Act of 1999 by a 221 to 206 vote that followed strict party lines, and the Senate followed suit by a vote of 50 to 49.

The 1999 act was never serious legislation. Because the GOP refused to scale back the magnitude of the tax cuts (the final bill was estimated to cost $792 billion over 10 years[51]), a veto by President Clinton was a certainty. Ironically, the president's threatened veto pumped up congressional Republicans, who seized the opportunity to load up the bill with virtually every tax preference and reform proposal ever advanced by the GOP in the postwar era. The bill became a laundry list of everything the GOP would do to the federal tax system — if only there was no opposition in the White House or Democrats in the Congress. Of course, if George W. Bush is elected president in 2000, they just may get their chance. On December 1, 1999, candidate Bush announced his tax plan.[52] Imposing some $483 billion of tax cuts over five years, the Bush plan is actually twice as costly over 10 years as the Taxpayer Refund and Relief Act of 1999.[53] Bush would cut all tax rates, benefiting not only the wealthiest taxpayers, but also the "working poor" and the middle class. The child credit would be doubled and made available to taxpayers with income up to $200,000. Nonitemizers would be allowed a deduction for charitable contributions. Tax deferred educational accounts would be expanded, the marriage penalty reduced (by restoring the $3,000 two-earner deduction previously repealed in 1986), and the estate and gift tax phased out by 2009. Amazingly, compared to the antitax candidates Steve Forbes, Gary Bauer, Alan Keyes, and even Orrin Hatch, George Bush is the *moderate* among GOP presidential contenders!

Instead of sending the Taxpayer Refund and Relief Act of 1999 directly to the White House for the president's signature (which everyone knew was not forthcoming), congressional Republicans made a tactical decision to sit on the bill. With that, Congress recessed for the summer and Republican members went off to the hinterlands to drum up support for the tax cut among their constituents. What they quickly discovered was that the voters were not particularly keen on tax reduction at all, preferring other uses for the $2.9 trillion surplus that CBO was now predicting. Polls revealed that voters (including Republicans) generally preferred using surplus funds to bolster the Social Security Trust Fund and public schools.[54] After failing to generate any noticeable public interest for their tax-reduction legislation (let alone the groundswell of support that they needed to overcome the president's promised veto), Congress finally sent the Taxpayer Refund and Relief Act of 1999 to the White House on September 15, 1999.

> ***This final specimen of tax legislation from the 20th century perfectly illustrates how Congress has rendered the tax code a mangled mess of conflicting, confusing, and complicated provisions.***

After waiting so many weeks to receive the bill, Clinton was in no rush to act. Instead, the Democratic president savored the moment and took full advantage of the opportunity to reiterate his opposition to a tax cut of such magnitude, attempting to tarnish the Republican tax cut by contrasting it with other possible uses for the projected surplus funds — most prominently, his own plan to "save" the under-funded social security and Medicare programs. Waiting to the last moment for dramatic effect, the president made good on his promise and vetoed the legislation on September 23. Once again, Clinton stopped a Republican tax bill dead in its tracks. During his tenure in office, President Clinton has already vetoed more Republican tax bills

[51]Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 2488," (JCX-61-99R), August 5, 1999.

[52]The Bush tax plan is described in Jay Root, "Bush Talks up Tax Plan," *Phila. Inquirer,* December 2, 1999, A28; Ryan J. Donmoyer and Heidi Glenn, "Something for Everyone? Bush Proposes $483 Billion Cut," *Tax Notes,* Dec. 6, 1999, p. 1223.

[53]While there has been no official scoring of the Bush plan yet, estimates of its 10-year cost range from $1.3 to $1.7 trillion. The Bush camp scored the plan relying upon a projected economic growth rate of 2.7 percent, as opposed to the more conservative 2.3 percent forecast of CBO.

[54]A June 1999 *Wall Street Journal* / NBC News poll found that only 9 percent of voters thought that tax cuts should be the highest priority of the government. Improving public education, shoring up social security, and promoting strong moral values all topped tax cuts as issues with significant voter appeal. For a summary of the pollsters' findings, see Bruce Bartlett, "The Trouble With Tax Cuts," *Tax Notes,* Dec. 13, 1999, p. 1457.

than any Democrat, including Harry Truman.[55] And remember, he still has another year in office to try to extend his own record!

In the end, the Republican tax bill was only the sideshow in 1999. The real battle was over the FY 2000 budget, and here too, the Republicans took a mild beating from the president. By the time the new fiscal year began on October 1, only a few of the 13 appropriations bills that provide authorization for government spending were in place. In dribs and drabs, Congress sent up to the president additional bills. Because nearly two-thirds of the $1.7 trillion federal budget goes toward nondiscretionary spending (mostly, the so-called entitlement programs of social security and Medicare, along with military pensions), the only politically feasible method of reigning in federal spending is cutting back funding for everything else. This puts the squeeze on spending for domestic policy programs, as well as the military.[56] In addition, the spending caps on discretionary spending adopted under the 1997 budget agreement imposed even more pressure on negotiators trying to put together a budget. As a result, the struggle over the FY 2000 budget devolved into a partisan struggle over funding that one-third of the budget that is reachable by elected politicians. To this end, Republicans initially proposed a 1 percent across-the-board cut in spending for all programs, but Democrats rejected that out of hand. The struggle over the budget then disintegrated into a discussion over such petty issues as the optimal number of students per teacher in the classroom (the education bill) and the milk price support system in the Midwest (the agriculture bill).

As the Thanksgiving holiday drew near and members of Congress looked forward to recessing for the year, a compromise was finally reached. A package of the five final appropriations bills was accepted by Republicans anxious to get a budget in place and head home to lick their wounds. Under the compromise, more than $3.2 billion in spending was pushed into next year's budget by delaying government paychecks to military and civilian personnel until after October 1, 2000. To appease the White House, an additional $1.3 billion (over seven years) was included in the education bill to hire new teachers, $926 million was earmarked to pay down the government's debt to the United Nations, and $1.8 billion was provided to implement the Wye River Middle East peace plan brokered by the president. To appease their Republican colleagues, Democrats agreed to a modest 0.38 percent across-the-board spending cut (amounting to some $1.3 billion). The Federal Reserve Board did its part by agreeing to a one-time transfer of $3.5 billion to the Treasury to help close the gap.[57] Democratic Senator Herbert Kohl of Wisconsin mercifully dropped his quixotic campaign on behalf of Midwest dairy farmers that threatened to tie up the agriculture appropriations bill. In the end, Republicans were forced to use the modest on-budget surplus that CBO predicted for FY 2000 to finance increased domestic discretionary spending. And the spending caps were blown to bits! GOP presidential contender John McCain later criticized his congressional colleagues (including fellow Republicans) for inserting some $1.9 billion in the final package for "special interest giveaways and pork-barrel spending."[58] Accusing members of Congress of slipping pork-barrel spending into the federal budget is a bit like denouncing a hog for excessive piggishness — it's not very astute as far as observations go. Of course, the Senator from Arizona has spent considerable time in Iowa and New Hampshire of late, and perhaps he hasn't had a chance to look over any of the other federal budgets adopted in the 1990s. FY 2000 surely was no aberration.

On November 18, the House passed the $391 billion omnibus appropriations bill by a 296-135 vote, and the Senate followed suit on November 19 by a 74-24 margin. With this, Congress wrapped up the budget of the federal government for FY 2000, providing for $617 billion in total discretionary spending — $36 billion more than last year (a 6 percent increase) and $17 billion beyond the "mandatory" spending caps agreed to in 1997 ($36 billion if you count "emergency" outlays not subject to the budget caps, including spending for such emergencies as the census, disaster relief, and national defense). According to CBO's year-end wrap-up, the $14 billion on-budget surplus predicted for 2000, together with the $37.5 billion on-budget surplus predicted for FY 2001, is now history, and if current spending remains constant, as much as $17 billion of the $147 billion social security surplus will be needed to fund the rest of the government's operations this fiscal year.[59] That translates into a $17 billion on-budget *deficit*. So much for the Age of the Surplus! Complicating matters for future budgeters is the $11 billion of spending that was deferred into FY 2001 to reach the FY 2000 budget compromise. But who worries about what might happen a year from now? Certainly not Congress, which sent the budget package to the president and recessed for the year. Clinton signed the measure on November 29, and the federal government finally had its budget.

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[55]After the GOP took control of Congress in 1946, Truman vetoed the *same* Republican tax bill three times — a dubious distinction even Clinton has never achieved. The final time the Republican tax bill was passed by Congress, Truman's veto was overridden by a coalition of Republicans and Southern Democrats, resulting in the Revenue Act of 1948, which lowered the maximum individual income tax rate to 77 percent.

[56]According to Robert Reischauer of the Brookings Institution, discretionary spending since 1992 has actually shrunk as a share of GDP from 3.5 percent to 3.2 percent.

[57]The Fed's action is explained in "Treasury to Receive $3.5 Billion From Fed, Balancing Budget," *Wall St. J.*, November 19, 1999, A22.

[58]McCain was quoted in Jeffrey Taylor, "McCain Criticizes Budget Deal's 'Pork' in Latest Attack," *Wall St. J.*, November 23, 1999, A24.

[59]Congressional Budget Office, "The Budget for Fiscal Year 2000: An End-of-Session Summary," Washington, D.C., December 2, 1999.

More amazing, in the waning days of the first session of the 106th Congress, a $21.4 billion package of "extenders" for expiring tax credits was passed by the House.[60] The extenders tax package (H.R. 1180) passed the House on November 18 by an overwhelming 418-2 vote, and the Senate gave its approval the following day. The president signed the measure into law on December 17, 1999. In the end, this was the only tax legislation that the Republican Congress could get by the Democratic president the entire year. (Of course, the president did not fare so well either, failing to secure a hike in the minimum wage or prescription drug coverage under Medicare, or even get an increase in cigarette taxes.) While there would be no tax cuts in 1999, at least American business got to keep its sacred tax credits. By one estimate, some 76 percent of the total package consists of benefits for corporate / business taxpayers.[61] The most important item in the bill extended the section 41 research tax credit for five years (instead of the usual one year), thereby giving some measure of certainty to business planning. In addition, the credit was expanded to cover research conducted in Puerto Rico. Whether the tax credit actually stimulates research and development is another question.[62] Much to the delight of Delaware chicken farmers, Finance Committee Chairman Roth managed to include a provision in the extenders bill that modifies the section 45 tax credit (also extended through 2001) to include "poultry waste" as an alternative energy source for the production of electricity. That should keep the lights burning all winter in Delaware, where chickens are big business and Roth faces a tough opponent next November in his bid for another term in the Senate.[63]

Finally, the extenders bill included three years of relief for the middle class from the alternative minimum tax. Horrified by the prospect of millions of taxpayers losing the $500 child credit (enacted in 1997) on account of the AMT, Republicans opted to excuse the middle-class from the onerous alternative tax regime. As Bill Archer more generously put it: "Middle-income taxpayers can breathe easier now knowing they won't be hit with an unexpected tax bill."[64] So now the "back-up" tax system that was designed by Congress to limit the tax benefits derived from the countless, mindless tax preferences inserted into the tax code by the same politicians trying to curry favor with special economic and social interests has been limited by a complicated special interest provision intended to give relief to middle-class taxpayers (e.g., voters) who might otherwise lose the benefit of one particularly silly $500 tax credit inserted into the tax code to appease the social conservative wing of the Republican Party. Just what we need! This final specimen of tax legislation from the 20th century perfectly illustrates how Congress has rendered the tax code a mangled mess of conflicting, confusing, and complicated provisions. We will surely see more of this kind of abuse of the tax laws in the coming millennium, although if we are lucky, it will be a few decades before we see its equal. Mercifully, the Tax Deadlock Decade has come to an end!

Conclusion

Tax policy was chaotic throughout the 1990s, with little of lasting importance accomplished. Constant battling between the two major parties resulted in a decade of deadlock over the budget and tax policy. The 1990s began with George Bush wrestling with a Democratic Congress over the direction of tax policy and the budget. Stalemate was reached in 1992 when the Republican president vetoed the Democratic tax bill. In 1993, with Bush out of the White House, Democrats enjoyed a single year of political dominance, and they made the most of it — socking it to the constituency of the GOP. There are Republicans who still cannot sleep at night because of nightmares over the 1993 tax act. But with the ascendancy of the GOP in Congress in 1994, the Democrats lost control over the legislative process and tax deadlock resulted. For the balance of the decade, the Republican controlled Congress would contest the Clinton administration on everything related to tax policy and the budget. However, even impeachment by the House and a close encounter with removal by the Senate did not weaken the president's determination to veto yet another Republican tax bill. And veto he did! But rather than a mark of distinction, President Clinton's recurring veto of Republican tax bills is but the sad symbol of the deadlock that gripped tax policy in the 1990s. Ironically, the possible election of another George Bush to the White House and return of Democratic control of Congress forebodes that the 2000s will experience much the same stalemate that gripped Washington in the early 1990s. I repeat: "Plus ça change . . . ."

The very structure of the American political system creates this deadlock over tax policy and the budget. Our political institutions are needlessly divided; excess checks and balances are the precondition for political stalemate. Congress checks the White House; the House checks the Senate; Democrats check Republicans; interest groups check policymakers. When any legislation is actually passed, it includes something for everyone, and thus, lacks principle and coherence. The result is the tax code gets mugged. Our political institutions impose conflicting demands on congressional policymakers — requiring them to raise

[60]Joint Committee on Taxation, "Estimated Budget Effects of the Revenue Provisions Included in the Conference Agreement for H.R. 1180," (JCX-86-99), November 18, 1999.

[61]Ryan J. Donmoyer, "Businesses Feed on the Surplus as Extenders are Completed," *Tax Notes,* Nov. 22, 1999, 975; *see also* Joint Committee on Taxation, "Estimated Budget Effects of Conference Agreement on H.R. 1180 Relating to Expiring Tax Provisions and Other Revenue Provisions," (JCX-86-99), November 18, 1999.

[62]The credit is evaluated in Martin Sullivan, "The Research Credit: A Perfect Example of an Imperfect Code," *Tax Notes,* Oct. 11, 1999, p. 128.

[63]For an account of how Roth's provision found its way into the legislation, see Herman P. Ayayo, "APA Secrecy, Poultry Waste Credit Survive Legislative Endgame," *Tax Notes,* Nov. 29, 1999, p. 1120. Roth is expected to run in November against the current Democratic governor, Tom Carper.

[64]Quoted in Jeffrey Taylor and Laurie McGinley, "House Approves Tax-Break Extension," *Wall St. J.,* November 19, 1999, A4.

revenue through the income tax, and at the same time, motivating them to enact special tax provisions to implement their partisan policies, as well as cultivate relations with constituents. When the income tax is used by policymakers to implement public policies and give benefits to constituents, the Treasury is inevitably deprived of revenue. That is the origin of budget deficits. To complicate matters, a strong antitax ideology pervades American politics, most typically given voice by the Republican Party. At various moments during the 1990s, this antitax rhetoric prevailed in the tax legislative process, thereby shifting the direction of tax policy. But even those politicians who rant and rave most against the income tax find it irresistible to use for their own political purposes. Many of the same politicians who voted in June 1998 to "sunset" the income tax also voted that very same month for a host of new tax preferences, including education tax credits and preferential treatment for capital gains. This is an expression of the schizophrenia that pervades Republican tax policy — in contrast with the mere pathology that informs Democratic tax policy.

The possible election of another George Bush and return of Democratic control of Congress forebodes that the 2000s will experience much the same stalemate that gripped Washington in the early 1990s.

Notwithstanding all the rhetoric and bluster of the antitax wing of the GOP, the income tax will be around in the 21st century, continuing to serve as the primary source of revenue of the federal government. Undoubtedly, Congress will also continue to enact tax legislation that expresses all the worst features of tax legislation from the 1990s. The first omnibus tax bill of the 21st century will surely include provisions that raise revenue, as well as those that would give it away for no justifiable reason. Some tax preferences will be targeted at distinct and separate economic or political interests in the home district of powerful members of Congress; others will implement broad national public policies. Democrats will oppose Republican provisions, and vice-versa. That is the nature of contemporary tax legislation. And unfortunately, it is a prescription for continued deadlock over tax policy. If deadlock meant that nothing ever gets done, we could live with the result. Unfortunately, even the deadlocked legislative process generates a major tax bill every so often. Mostly the result is incoherent, erratic and unprincipled legislation. There is no silver lining here, and no breakthrough for the legislative logjam is in sight for the new millennium. And mark my words, when Senator Clinton of New York is elected president and Congressman Largent becomes chairman of the Ways and Means Committee sometime in the next millennium, things will only go downhill!