



FACT SHEET

Tax Reform Must Be at Least Revenue-Neutral and Avoid Gimmicks

By Seth Hanlon September 22, 2017

The Trump administration and congressional Republicans have proposed massive tax cuts that would go overwhelmingly to corporations and wealthy Americans and whose cost would threaten vital domestic priorities. This fact sheet explains why tax reform should at least be revenue-neutral; how Congress should ensure revenue neutrality in the budget resolution; and how Congress should avoid various gimmicks to hide the true cost of tax cuts.

Tax cuts would threaten domestic priorities

An aging population and the retirement of the Baby-Boom generation are putting increasing pressure on the federal budget. At the same time, the United States has underinvested in key priorities, such as child care, education, and infrastructure.¹ Budget cuts since 2011 have further strained domestic priorities, even as the United States faces new challenges, including the opioid crisis. Existing revenues are insufficient to pay for U.S. commitments to Social Security and Medicare over the long term. Given this context, the most important goal of tax reform should be to raise revenue to meet these challenges. At the very least, tax reform should not lose revenue.

Budget reconciliation instructions are critical to tax reform outcome

Congressional leaders have said that they will seek to enact tax reform through the two-step budget reconciliation process.² First, both houses of Congress have to approve a concurrent budget resolution for fiscal year 2018 containing reconciliation instructions. Then, tax reconciliation legislation that adheres to those instructions and follows the permanent ground rules for reconciliation bills would move through Congress under special procedures. Most importantly, such a bill could not be filibustered in the Senate and would therefore only need 51 votes in order to pass.

The reconciliation instructions in the budget resolution are therefore critical for shaping the ultimate outcome. They will determine whether any tax reconciliation bill can increase deficits within the budget window—which is typically 10 years—and, if so, by how much.³ Reports indicate that Senate Republicans are considering reconciliation instructions that would allow tax legislation to add up to \$1.5 trillion to deficits over the 10-year budget window.⁴

Under the Senate’s Byrd rule, reconciliation bills cannot increase deficits in years beyond the budget window. Reconciliation instructions will also determine whether tax cuts can be paid for with spending cuts or whether they must be paid for with tax code offsets such as eliminating tax deductions.

Tax reform must be revenue-neutral, not simply deficit-neutral

If the budget resolution requires that a subsequent tax bill be deficit-neutral, a reconciliation bill would be allowed to pay for tax cuts either with tax offsets or cuts to programs such as Medicare and potentially Medicaid, among others.⁵ For example, the budget resolution advanced by the House Budget Committee in July contains instructions for deficit-neutral tax reform on top of about \$200 billion in deficit reduction.⁶ However, if the budget resolution requires that a subsequent tax bill be revenue-neutral, then other tax offsets would have to pay for the tax cuts.

If Congress passes a budget with deficit-neutral instructions for tax legislation, it would set in motion a fast-track process whereby a bill that cuts taxes and pays for them with cuts to Medicare and potentially Medicaid could be enacted with 51 votes in the Senate. The House Republican budget proposes to cut Medicare, Medicaid, and other health programs by roughly \$2 trillion, including by transitioning Medicare to a voucher-based program and turning Medicaid into a capped block grant program. If the budget resolution allows tax cuts to be paid for by cutting these programs, then they must be considered at serious risk.⁷ In fact, even if reconciliation instructions allow higher deficits to pay for tax cuts—such as the reported Senate budget—they may also allow program cuts to pay for additional tax cuts. That is why reconciliation instructions for tax reform must require revenue neutrality, where tax cuts can only be paid for with tax offsets.

Gimmicks hide the true cost of tax cuts

Congress may also resort to various gimmicks to appear to meet the revenue or deficit target it sets out in the budget resolution. These gimmicks would hide the fact that tax cuts actually reduce revenues and therefore increase deficits—threatening key programs and investments down the road. Potential gimmicks fall into at least three categories.

1. The current policy loophole

Some members of Congress have advocated a budget sleight-of-hand that would make the cost of up to \$439 billion of tax cuts disappear.⁸ Under longstanding congressional procedure, the Joint Committee on Taxation (JCT)—Congress’s nonpartisan scorekeeper for tax bills—uses a current law baseline. For example, if Congress has written into the tax code that a certain tax break would expire in a future year, the JCT assumes that it will. Thus, extending that break beyond its expiration date is scored as losing revenue.

Some members of Congress want to depart from this practice and switch to a so-called current policy baseline for tax cuts. Several tax breaks are currently scheduled to expire or phase out in coming years; extending them would cost \$304 billion over the next 10 years.⁹ An additional slew of tax breaks already expired at the end of 2016, and reviving and extending them would cost about \$135 billion. Therefore, if Congress measures its new tax cuts against a baseline that assumes the expired and expiring tax provisions are extended, those tax cuts would appear to cost as much as \$439 billion less than they would otherwise.

A current policy baseline is inappropriate for several reasons. First, it would mean that the cost of up to \$439 billion in tax cuts would never be accounted for, which would allow that amount to be added to the national debt. Second, it would disregard Congress’s clear intent when it enacted a law in 2015 to make certain tax breaks permanent while letting others expire or phase out.¹⁰ Furthermore, the largest tax break currently set to expire—bonus depreciation—was always expressly intended as a temporary policy.¹¹ Finally, a current policy baseline would make a mockery of the self-imposed rules that Congress has relied on for decades to enforce budget discipline. Accounting for only one year’s cost, Congress could pass enormous tax cuts lasting only that one year. Making those tax cuts permanent would be scored as having no cost in following years. That is a formula for more gimmickry and irresponsible policymaking in the future.

2. Unreliable scoring methods or magic asterisks

When the JCT estimates the revenue effects of a tax bill, it takes into account the direct effect of tax changes—such as changes in rates—and anticipates how people and businesses would adjust to new tax rules.¹² However, as with the Congressional Budget Office, the JCT traditionally does not incorporate the more uncertain macroeconomic effects into its scores. In other words, its scores would not reflect the tax rules’ estimated effects on the economy as a whole. However, in 2015, House Republicans changed the rules to require such dynamic scoring of major legislation, despite warnings from budget experts that such a change would open the door to political manipulation of estimates.¹³ Senate rules currently require a dynamic estimate for informational purposes only.¹⁴ Because such estimates are inherently uncertain and susceptible to political manipulation, Congress should not rely on dynamic scoring.

The Trump administration and congressional Republicans recently illustrated how dynamic scoring can be abused. President Donald Trump's budget included a \$2 trillion magic asterisk—a made-up number inserted into its budget totals. Despite all evidence to the contrary, the administration asserted that its trickle-down policies—including an unwritten tax plan—would raise incomes so much that an additional \$2 trillion of revenue would flow into the U.S. Treasury.¹⁵ Senate Republicans are reportedly considering justifying up to \$1.5 trillion in unpaid-for tax cuts by unrealistically assuming that their tax plan would stimulate enough economic growth to offset the deficit impact, even though the tax bill has yet to be written, let alone analyzed by nonpartisan scorekeepers.¹⁶ Congress should not use such phony gimmicks to cover up the true cost of tax cuts.

3. Timing gimmicks or sunsets

Proponents of large tax cuts may also try to hide their true fiscal costs by using timing gimmicks or sunseting tax cuts.

Timing gimmicks can be used to make a tax cut revenue neutral within a budget window even if it would lose substantial revenue over time. If Congress enacts large, long-lasting tax cuts and pays for them with provisions that create a one-time revenue surge, the overall package could be revenue-neutral within a 10-year budget window even if it loses revenue in the long term.

Two timing gimmicks to watch out for are Rothification of retirement accounts and deemed repatriation of overseas earnings. Under mandatory Rothification, retirement savers would be required to pay taxes up-front on income in their savings accounts—such as individual retirement accounts and 401(k)s—instead of when they make withdrawals. Rothification would bring in more revenue for the government early on, but less in the long term. Furthermore, Congress should not rely on the one-time revenue from enacting a deemed repatriation of corporate earnings. U.S. multinational corporations currently hold an estimated \$2.6 trillion of earnings in foreign subsidiaries in order to delay taxes on those earnings. If Congress changes the international tax system, the transition will likely involve accelerating the payment of taxes on those earnings. However, Congress should not then rely on that one-time revenue surge to pay for permanent tax cuts.¹⁷

The mother of all timing gimmicks is sunseting tax cuts—in other words, providing that these cuts expire after 10 or more years so that their long-term cost would not be accounted for. The Bush tax cuts, for example, sunset after 10 years in order to hide their long-term fiscal cost. Sunseting allowed them to technically comply with the Senate Byrd rule requirement that legislation cannot increase deficits in any year beyond the budget window. Though the Bush tax cuts were originally estimated to have

no long-term cost, Congress made the bulk of the cuts permanent at the end of 2012, including a substantial portion of the tax cuts for high-income earners.¹⁸ According to an estimate by the Center on Budget and Policy Priorities, the Bush tax cuts will be responsible for roughly one-third of the federal debt by next year.¹⁹ The Bush tax cuts failed to boost the economy or create jobs. Congress should not repeat their mistake.²⁰

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Endnotes

- 1 See for example, Katie Hamm and Julie Kashen, "A Blueprint for Child Care Reform" (Washington: Center for American Progress, 2017), available at <https://www.americanprogress.org/issues/early-childhood/reports/2017/09/07/438428/blueprint-child-care-reform/>; Simon Workman and Jessica Troe, "Early Learning in the United States: 2017" (Washington: Center for American Progress, 2017), available at <https://www.americanprogress.org/issues/early-childhood/reports/2017/07/20/436169/early-learning-united-states-2017/>; Kevin DeGood and others, "An Infrastructure Plan for America" (Washington: Center for American Progress, 2016), available at <https://www.americanprogress.org/issues/economy/reports/2016/07/14/141157/an-infrastructure-plan-for-america/>.
- 2 Ashley Killough and others, "Republicans promise tax overhaul but still have no plan," CNN, August 30, 2017, available at <http://www.cnn.com/2017/08/30/politics/congress-tax-reform/index.html>.
- 3 The Senate's current PAYGO rule also creates a point of order that would also pose an obstacle to a deficit-increasing tax bill, but it is possible that the budget resolution will amend or waive the PAYGO rule. If Congress enacted legislation increasing deficits, the statutory version of PAYGO would apply, leading to automatic spending cuts known as sequesters if not waived. However, in the past, after passing deficit-increasing legislation such as the Bush tax cuts, Congress has attached provisions preventing sequesters to must-pass bills. For these reasons, the terms of the budget resolution are critical for determining whether a reconciliation bill can increase deficits within the budget window. For further discussion, see Alan Cohen, "The Potential Impact of PAYGO Rules on Tax Legislation" (Washington: Center for American Progress, 2017), available at <https://www.americanprogress.org/issues/economy/reports/2017/08/28/437873/potential-impact-paygo-rules-tax-legislation/>.
- 4 Richard Rubin and Siobhan Hughes, "Senate Republicans Consider a Trillion-Dollar-Plus Tax Cut for Budget," *The Wall Street Journal*, September 18, 2017, available at <https://www.wsj.com/articles/senate-republicans-consider-a-trillion-dollar-plus-tax-cut-for-budget-1505786253>.
- 5 Under the House budget's instructions, any spending cuts used to finance tax cuts would have to come from programs within the Ways and Means Committee's purview, which includes Medicare, unemployment insurance, Temporary Assistance for Needy Families, and various other programs. In the Senate, the tax-writing Finance Committee also has jurisdiction over Medicaid, so it too could be at risk under a deficit-neutral instruction. In fact, the so-called Trumpcare bill—which provided massive tax cuts paid for with massive cuts to Medicaid and health insurance subsidies—that passed in the House and nearly passed in the Senate in July 2017 was facilitated by a deficit-neutral reconciliation instruction in the fiscal year 2017 budget. Technically, it required each of the relevant committees to report legislative changes reducing deficits by \$1 billion over ten years. See *A concurrent resolution setting forth the congressional budget for the United States Government for fiscal year 2017 and setting forth the appropriate budgetary levels for fiscal years 2018 through 2026*, S. Con. Res. 3, 115 Cong. 1 sess. (Government Printing Office, 2017).
- 6 *Establishing the congressional budget for the United States Government for fiscal year 2018 and setting forth the appropriate budgetary levels for fiscal years 2019 through 2027*, H. Con. Res. 71, 115 Cong. 1 sess. (Government Printing Office, 2017).
- 7 See Center for American Progress, "8 Ways the House Republicans' Budget Will Harm Working Families to Pay for Millionaire Tax Cuts" (2017), available at <https://www.americanprogress.org/issues/economy/news/2017/07/18/435981/8-ways-house-republicans-budget-will-harm-working-families-pay-millionaire-tax-cuts/>.
- 8 David van den Berg, "Brady Says Talks Continue on Budget Baseline After Committee Vote," Tax Analysts, July 21, 2017, available at <http://www.taxanalysts.org/content/brady-says-talks-continue-budget-baseline-after-committee-vote>.
- 9 Congressional Budget Office, "51138-2017-06-revenueprojections," available at <https://www.cbo.gov/sites/default/files/recurringdata/51138-2017-06-revenueprojections.xlsx> (last accessed September 2017). Totals do not include certain Affordable Care Act-related tax provisions.
- 10 See Harry Stein and Alex Rowell, "Using the Current Policy Loophole to Hide Tax Cuts Is Dishonest Math—Just Ask Congressional Republicans" (Washington: Center for American Progress, 2017), available at <https://www.americanprogress.org/issues/economy/news/2017/09/06/438420/using-current-policy-loophole-hide-tax-cuts-dishonest-math-just-ask-congressional-republicans/>.
- 11 Jane G. Gravelle, "Bonus Depreciation: Economic and Budgetary Issues" (Washington: Congressional Research Service, 2014), available at <https://fas.org/sgp/crs/misc/R43432.pdf>.
- 12 For example, if a bill lowers taxes on one form of business entity, JCT might anticipate that more businesses will choose to take advantage of that form.
- 13 See, for example, John L. Buckley, "Dynamic Scoring: Will S&P Have Company?," Tax Analysts, March 2, 2012, available at <http://www.taxhistory.org/www/features.nsf/Articles/43736B49FCB019E3852579B5006E1933?OpenDocument>.
- 14 *Concurrent Resolution on the Budget for Fiscal Year 2016*, H. Rept. 114-96, 114 Cong. 1 sess. (Government Printing Office, 2015), pp. 168–169.
- 15 See Seth Hanlon and Alexandra Thornton, "Trickle-Down Tax Cuts Don't Create Jobs" (Washington: Center for American Progress, 2017), available at <https://www.americanprogress.org/issues/economy/reports/2017/08/24/437625/trickle-tax-cuts-dont-create-jobs/>; Chad Stone, "In Forthcoming Trump Budget, Rosy Forecasts of Economic Growth Likely to Produce Highly Unrealistic Budget Estimates" (Washington: Center on Budget and Policy Proposals, 2017), available at <https://www.cbpp.org/research/federal-budget/in-forthcoming-trump-budget-rosy-forecasts-of-economic-growth-likely-to>. The administration also committed a basic math error by double-counting that \$2 trillion; see Lawrence H. Summers, "Trump's Budget is Simply Ludicrous," *The Washington Post* Wonkblog, May 23, 2017, available at https://www.washingtonpost.com/news/wonk/wp/2017/05/23/larry-summers-trumps-budget-is-simply-ludicrous/?utm_term=.5a80a2f5dc02.
- 16 See Alan Rappeport and Thomas Kaplan, "Senate Republicans Embrace Plan for \$1.5 Trillion Tax Cut," *The New York Times*, September 19, 2017, available at <https://www.nytimes.com/2017/09/19/us/politics/senate-republicans-tax-cut.html?mcubz=0>.
- 17 There is also no reason for Congress to provide a deeply discounted tax rate on unrepatriated earnings. Congress must not repeat the failed repatriation holiday experiment of 2004, when it provided a special tax holiday for foreign earnings without reforming the underlying system. See Alexandra Thornton, "Repatriation Holiday: It's Time to Drop It for Good" (Washington: Center for American Progress, 2014), available at <https://www.americanprogress.org/issues/economy/news/2014/07/07/93257/repatriation-holiday-its-time-to-drop-it-for-good/>.
- 18 Chye-Ching Huang, "Budget Deal Makes Permanent 82 Percent of President Bush's Tax Cuts" (Washington: Center on Budget and Policy Proposals, 2013), available at <https://www.cbpp.org/research/budget-deal-makes-permanent-82-percent-of-president-bushs-tax-cuts?fa=view&id=3880>.
- 19 Kathy Ruffing and Joel Friedman, "Economic Downturn and Legacy of Bush Policies Continue to Drive Large Deficits" (Center on Budget and Policy Priorities, 2013), available at <https://www.cbpp.org/research/economic-downturn-and-legacy-of-bush-policies-continue-to-drive-large-deficits>.
- 20 Hanlon and Thornton, "Trickle-Down Tax Cuts Don't Create Jobs."