

# Issue Brief for Congress

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## Major Tax Issues in the 108<sup>th</sup> Congress

Updated April 17, 2003

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# CONTENTS

SUMMARY

MOST RECENT DEVELOPMENTS

BACKGROUND AND ANALYSIS

The Economic Context

    The State of the Economy

    The Federal Budget

    The Federal Tax Burden

Selected Issues

    Expiration of the 2001 Tax Act

    Tax Cuts for Economic Stimulus

    International Taxation

    Other Possible Tax Issues

        Fundamental Tax Reform

        Business Taxation

        Small Business Taxation

        Family Tax Issues

        Estate Tax

        Individual Alternative Minimum Tax (AMT)

        Expiring Tax Provisions

        Energy Taxation

        Pension Tax Policy

        Tax Policy and Health Insurance

        Internet Taxation

        Internal Revenue Service (IRS) Oversight

        Charitable Contributions

    The President's Proposal

    House Democratic Proposal

    The Daschle Proposal

## Major Tax Issues in the 108<sup>th</sup> Congress

### SUMMARY

Tax policy received considerable attention throughout the 107<sup>th</sup> Congress, but the context of the policy debate changed substantially over 2001-2002. At the outset of 2001, the federal budget situation was favorable, with surpluses projected to occur. Politically, both chambers of Congress had Republican majorities. And newly elected President George W. Bush had made a proposed large tax cut an important part of his election campaign. Tax-cut supporters argued that a part of projected budget surpluses should be returned to taxpayers as a tax cut and would also help steer the slowing economy away from recession. Tax cut opponents argued that long-run budgetary considerations and the looming retirement of the baby-boom generation made a large tax cut imprudent and maintained that the particular type of tax cut that was actively considered would favor high-income taxpayers.

In May 2001, Congress passed a sizeable 10-year tax cut as the \$1.35 trillion Economic Growth and Tax Relief Reconciliation Act (EGTRRA; P.L. 107-16, H.R. 1836). The Act's principal provisions reduced individual income tax rates, phased out the estate tax, provided tax cuts for married couples, and increased the per-child tax credit. To comply with Senate budget rules, the tax cuts were scheduled to expire at the end of 2010.

By the fall of 2001, the context of the tax debate had changed markedly. Politically, Democrats had assumed control of the Senate. Economically, a recession was recognized as having begun, and the weakened economy – along with EGTRRA's tax cuts – diminished budget surplus projections. The attacks of September 11 added to uncertainty about the economy. The new atmosphere led some policymakers to call for new tax cuts that

would provide economic stimulus, and the House passed tax-cut bills in both October and December. However, the measures' opponents objected to the cuts' size and composition, and the bills were not passed by the Senate. The stimulus measure that was ultimately enacted in March 2002 (the Job Creation and Worker Assistance Act; P.L. 107-147, H.R. 3090), was smaller than those initially passed by the House. Its principal elements were temporary expensing and depreciation benefits for business, more favorable treatment of business losses, tax incentives to develop areas damaged by terrorism, and extension of a set of temporary tax benefits.

The March stimulus bill was the last broad tax measure approved by the 107<sup>th</sup> Congress, but the tax policy debate continued throughout the year on a number of fronts, providing a glimpse of the tax issues Congress may address in 2003: the possibility of a new stimulus package; elimination of the 2001 tax cut's sunset provisions; business and investment benefits; international tax reform, pension reform, and measures aimed at suppressing tax shelters. More long term issues may include addressing the looming increase in the number of persons subject to the minimum tax; long-term budget pressures; and the possibility of fundamental tax reform.

In January, President Bush proposed a set of tax cuts for economic stimulus and later released budget proposals containing \$1.57 trillion in tax cuts over fiscal years 2003-2013, including the stimulus plan, some additional cuts, and permanent extension of the 2001 tax cut. House Democratic leaders proposed a smaller stimulus package, estimated at \$100 billion over 10 years. Senator Daschle proposed a one-year, \$141 billion plan.

## **MOST RECENT DEVELOPMENTS**

Congress closed out 2002 amidst debate over whether to approve tax cuts for economic stimulus and whether the 2001 tax cut should be allowed to expire after 10 years, as provided in the original 2001 legislation. These same issues appear to be prominent on the congressional tax agenda in first part of the 108<sup>th</sup> Congress. On February 3, the Administration released a detailed set of tax cut proposals with its budget documents. According to Joint Committee on Taxation estimates, the proposals would reduce taxes by \$1.57 trillion from FY2003 through FY2013. The proposals include a stimulus package, some additional tax cuts, and permanent extension of the 2001 tax cut. On March 21, the House passed a budget resolution (H.Con.Res. 95) that incorporates revenue reductions, amounting to \$726 billion over ten years, that are consistent with the President's economic stimulus proposal. However, on March 26, the Senate approved a budget resolution (S.Con.Res. 23) containing a smaller tax cut, amounting to \$350 billion. On April 11, both chambers approved a conference agreement on a budget resolution (H.Con.Res. 95) calling for reconciliation legislation containing up to \$550 billion in tax cuts over ten years. Indications are, however, that procedural rules in the Senate may complicate enactment of tax cut legislation exceeding \$350 billion.

## **BACKGROUND AND ANALYSIS**

### **The Economic Context**

Tax policy is frequently considered by policymakers as a tool for boosting economic performance in various ways, and the likely economic effects of tax policy are often hotly debated. A brief overview of the current economic context is thus a good starting point for looking at tax issues facing the current Congress. The overview of major tax issues begins by describing three aspects of the economic context in which the tax policy debate during the 108<sup>th</sup> Congress is likely to occur: the general state of the U.S. economy; the position of the federal budget; and the level of taxes in the United States.

### **The State of the Economy**

At the outset of 2001, the U.S. economy had recorded nine consecutive years of continuous expansion. Thus, consideration of tax policy as a counter-cyclical device to stimulate the economy out of recession had not occurred in recent years. However, in late 2000 the economy began to show signs of weakness, and fiscal stimulus was one of the arguments the Bush Administration advanced in support of the large tax cut that was enacted in June 2001.<sup>1</sup> As 2001 progressed, there were increasing signs of economic weakness, and in November, the National Bureau of Economic Research (NBER; the organization that tracks business cycles) determined that a recession had begun in March of that year.

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<sup>1</sup> Mark Felstenthal, "Bush Cites Economic Concerns As Justification for Tax Cut Plans," *BNA Daily Tax Report*, Dec. 18, 2000, p. G-4.

Economic data now show that the economy contracted during the first three quarters of 2001 before registering positive growth again in the fourth quarter of that year and in all four quarters of 2002. (See NBER's January 13 press release, available on the NBER Web site at [<http://nber.org/cycles/recessions.html>].) However, employment continues to decline and the NBER has not yet announced an ending date for the recession. If the recession that began in 2001 has indeed ended, it will have been of about average severity and duration for economic recessions of the post-World War II era.<sup>2</sup>

The economy registered positive growth in all four quarters of 2002. In November congressional testimony Federal Reserve Chairman Alan Greenspan termed the U.S. economy "remarkably resilient" and characterized U.S. economic growth over the first part of the year as "well maintained" and "respectable." Nonetheless, he observed several forces placing a drag on the economy: a long adjustment in capital spending; the "fallout" from revelations of corporate malfeasance; declines in the stock market; and increased "geopolitical risks." Mr. Greenspan further stated that evidence suggested the economy had hit what he termed a "soft patch" as a likely result of these factors. In February 2003 testimony before the Senate Committee on Banking, Housing, and Urban Affairs, Chairman Greenspan observed that economic growth slowed markedly in the last quarter of 2002 and termed the pattern "choppy." (Testimony available on the Federal Reserve Web site at [<http://www.federalreserve.gov/boarddocs/testimony/2002/20021113/default.htm>].) For his part, President Bush in November 2002, stated that he is not satisfied with the economy's performance, and has characterized it as merely "bumping along."<sup>3</sup>

For further reading, see CRS Report RL31237, *The Current Economic Recession: How Long, How Deep, and How Different from the Past*, by Marc Labonte and Gail Makenin.

## The Federal Budget

After decades of continuous deficits, the federal budget moved into a state of surplus in fiscal years 1998 through 2001 – a development that was the result of both deliberate deficit-reducing policies and a long period of economic growth that helped boost tax receipts. At the outset of the 107<sup>th</sup> Congress in January 2001, the budget outlook was bright despite mounting evidence of an economic slowdown. The Congressional Budget Office (CBO) predicted large and growing budget surpluses for the next 10 years.<sup>4</sup>

As the 107<sup>th</sup> Congress progressed, however, the budget picture changed markedly. Indeed, the budget situation worsened with almost each successive budget report. In August, 2001, CBO reduced its surplus projections as a result of the tax cut enacted in June of that

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<sup>2</sup> CRS Report RL31237, *The Current Economic Recession: How Long, How Deep, and How Different from the Past*, by Marc Labonte and Gail Makenin, p. 29.

<sup>3</sup> Nancy Ognanovich and Brett Ferguson, "Bush Reiterates Interest in Stimulus To Address Sluggish U.S. Economy," *BNA Daily Tax Report*, Nov. 14, 2002, p. G-9.

<sup>4</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002-2011* (Washington: GPO, 2001), p. 51.

year and as a result of economic weakness.<sup>5</sup> In January 2002, CBO reduced its projected 10-year surpluses further and predicted that the federal budget would move into deficit in FY2002 and FY2003 before returning to surplus.<sup>6</sup> And in August, CBO again revised its projections downwards, predicting deficits in FY2002 - FY2005 and reducing estimates of surpluses in the out years.<sup>7</sup> The changed projections were the result of enacted legislation, changed economic conditions, and changes in the make-up of aggregate income. In its January 2003 report, CBO revised its budget projections slightly downwards again.

The longer-term budget situation is a concern to many policymakers, chiefly because of demographic pressures posed by an aging population that will begin with the retirement of the “baby boom” generation and that will continue afterwards. Because of the expected growing ratio of retirees to wage earners, the gap between Social Security and Medicare revenues and outlays will increase substantially in future years under current tax and entitlement laws. The Congressional Budget Office has estimated that beginning in 2010, outlays under the Social Security and Medicare programs will exceed the programs’ tax revenues and Medicare premiums. (This estimate excludes trust fund revenues consisting of transfers from other Treasury Department accounts.) By 2040, outlays under the programs are projected to reach 12.1% of gross domestic product (GDP) while revenues are expected to be about 7%.<sup>8</sup>

The war in Iraq adds uncertainty to the budgetary outlook: how much will it cost and how much will it add to the budget deficit. The war will certainly have an impact on outlays by increasing defense expenditures, although the cost appears uncertain. The Administration has asked Congress for \$74.7 billion to finance the war. In addition, the war could affect the budget indirectly by affecting economic performance.

For additional information, see CRS Report RL31784, *The Budget for Fiscal Year 2004*, by Philip D. Winters, CRS Report RL31778, *The Size and Scope of Government: Past, Present, and Projected Government Revenues and Expenditures*, by Don C. Richards, and CRS Report RL31176: *Financing Issues and Economic Effects of Past American Wars*, by Mark Labonte.

## The Federal Tax Burden<sup>9</sup>

At the outset of the preceding (107<sup>th</sup>) Congress, some pointed to the historically high aggregate level of federal taxes compared to the economy as evidence of the desirability of

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<sup>5</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (Washington: GPO, Aug. 2001), p. ix.

<sup>6</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2003-2012* (Washington: GPO, 2002), p. xiv.

<sup>7</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (Washington: GPO, Aug. 2002), p. x.

<sup>8</sup> U.S. Congressional Budget Office, *The Impact of Social Security and Medicare on the Federal Budget*, (Washington: November 14, 2002). Posted on the Congressional Budget Office’s Web site at [<http://www.cbo.gov/showdoc.cfm?index=3982&sequence=0>].

<sup>9</sup> Authored by Gregg A. Esenwein, Specialist in Public Finance, Government and Finance Division.

a tax cut. As a percentage of GDP, federal taxes were at their highest level since the end of World War II in FY2000, at 20.8%, before falling to 19.8% in FY2001 and 18.0% in FY2002. These levels are not a dramatic departure from the past; since the mid-1950s, federal taxes as a percentage of GDP have remained within a range of between 17% and just below 20% of GDP. According to CBO, the increased level of tax revenues prior to FY2002 was due to economic growth, an increase in capital gains realizations (for example, from sales of appreciated stock) and increases in real incomes. The decline in FY2002 revenues was due to slower economic growth, declines in capital gains realizations, and slower growth of very high incomes.

Although there have been some fluctuations in the distribution of the federal tax burden over the last 20 years, the fluctuations have been concentrated at the ends of the income spectrum. During the 1980s, the federal tax burden increased for lower-income families and decreased for upper-income families. This trend was reversed in the 1990s with tax reductions at the lower end of the income spectrum and tax increases at the upper end of the income spectrum. Families in the middle-income brackets, however, experienced very little change in their federal tax burdens over this period, despite legislated tax cuts.

While the overall level of federal taxes has been relatively stable, its composition has shifted. In particular, the share of federal receipts made up by corporate income taxes and excise taxes has declined, falling from 30% and 18%, respectively, of total receipts in FY1946 to 10.4% and 3.4% in FY2002. The share comprised of Social Security taxes has increased over the same years from 7.9% to 36.4%, and is now the second largest source of federal revenues after individual income taxes.

For further information, see CRS Report RS20087, *The Level of Taxes in the United States, 1940-2002*, by David L. Brumbaugh and Don C. Richards.

## **Selected Issues**

Although predicting a likely tax agenda is full of uncertainty, the following issues have been mentioned by policymakers and analysts as likely legislative topics in 2003 tax agenda.

### **Expiration of the 2001 Tax Act**

The Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA) provided a substantial tax cut that is scheduled to be phased in over the 10 years following its enactment. The Act's most prominent provisions are a reduction in individual income tax rates, tax cuts for married couples, phase-out of the estate tax, a larger per-child tax credit, education tax benefits, and tax cuts for Individual Retirement Accounts and pensions. The estimated size of the scheduled tax cut is \$1.35 trillion over fiscal years 2001 - 2011.

However, a Senate procedural rule – the so-called “Byrd rule” – provides that a point of order can be raised against any provision of budget reconciliation bill that is “extraneous” to the budget reconciliation legislation. Included among the several types of provisions the Byrd rule defines as extraneous are those that would increase the budget deficit (or reduce the budget surplus) for a fiscal year beyond that covered by the reconciliation measure being

considered. To avoid application of the Byrd rule, EGTRRA contains language providing for the expiration of its provisions at the end of calendar year 2010.

During 2002, the House passed a number of bills that would have made some or all of EGTRRA's tax cuts permanent. H.R. 586, approved by the House in April, would have repealed all of EGTRRA's sunset provisions. H.R. 2143, H.R. 4019, and H.R. 4931 were passed in June and would have (respectively) made EGTRRA's estate tax repeal, marriage penalty benefits, and retirement and pension tax cuts permanent. The Senate did not adopt the bills.

## Tax Cuts for Economic Stimulus

Consideration of a tax cut designed to stimulate the economy has occupied the attention of policymakers in Congress and elsewhere for more than a year. Following the terrorist attacks of September 11 – and amid signs of continued economic weakness – the House passed a tax cut bill (H.R. 3090) in October 2001, whose stated goal was economic stimulus. The bill would have reduced revenue by an estimated \$99.5 trillion in FY2002 and consisted of a mix of business tax cuts and tax reductions for individuals. The Senate, however, did not approve the tax cut, and the House in December passed a scaled-back version of the proposal as H.R. 3529. The Senate again did not approve the House-passed tax cut, and in early March 2002, both chambers adopted a stimulus tax-cut (the Job Creation and Worker Assistance Act; P.L. 107-147) as a substantially pared-down version of H.R. 3090. The bill was estimated to reduce tax revenue by \$51 billion in FY2002 and by \$94 billion over its first 5 years. Its principal elements are an “expensing” benefit for business investment that expires after 3 years; more favorable treatment of business losses (as measured by the tax code; so called “net operating losses”); a package of tax incentives designed to stimulate development in areas subject to terrorist attacks; extension of a set of temporary tax benefits; and a 13-week extension of unemployment benefits.

A tax cut for economic stimulus appears likely to be high on the congressional tax agenda in 2003. As described more fully below, President Bush proposed a stimulus package in January 2003, while some Democratic members of Congress have proposed smaller, temporary cuts. Some policymakers, however, remain skeptical of the need for a stimulative tax cut. Federal Reserve Board chairman Alan Greenspan, in February 2003 congressional testimony, suggested that a stimulus fiscal-policy package is not needed (BNA *Daily Tax Report*, Feb. 12, 2003, p. G-8). In addition, many economists question the efficacy of stimulative tax cuts in general, believing that time lags and adjustments in the international economy dilute much of their impact. Opponents of tax cuts also emphasize the risk such cuts pose to the federal budget, which (as described above) already faces severe long-term pressures.<sup>10</sup>

Proponents of the need for additional stimulus have generally focused on the economy's sluggish employment performance. The Administration's “fact sheet” on the President's January 2003 stimulus proposal states that “this economy is not creating enough jobs” [<http://www.whitehouse.gov/infocus/economy/index.html>]. Proponents of a stimulus

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<sup>10</sup> Patti Mohr, “Policy Wonks Form Basis for Tax Cut vs. Deficit Debate,” *Tax Notes*, Dec. 23, 2002, p. 1505.



package have also minimized the deleterious impact of larger budget deficits on the arguing, for example, that integrated world capital market reduces the impact of the budget deficit on interest rates.<sup>11</sup>

For further reading see CRS Report RS21126, *Tax Cuts and Economic Stimulus: How Effective Are the Alternatives?*, by Jane G. Gravelle and CRS Report RL30839, *Tax Cuts, the Business Cycle, and Economic Growth: A Macroeconomic Analysis*, by Marc Labonte and Gail Makinen.

## International Taxation

The U.S. economy is increasingly open, in terms of both trade and investment flows; the openness has helped make international tax issues among the most prominent tax questions Congress has faced in recent years. Specific international tax issues are numerous and include whether to reform the U.S. system by moving to a “territorial” system that exempts foreign-source income from U.S. tax; whether to adopt more incremental tax cuts for U.S. firms in order to help them compete internationally; how to resolve the export tax benefit controversy with the European Union (EU) over the U.S. extraterritorial income (ETI) tax benefit for exports; whether to adopt measures designed to curb corporate “expatriations” or “inversions” where firms reincorporate abroad to save taxes; whether and to what extent to cooperate with foreign governments in reducing international tax evasion and avoidance; and how the Internal Revenue Service should proceed in reducing U.S. tax evaders that use offshore tax havens.

At least one of these issues – the ETI controversy – is time sensitive. The EU has been authorized by the World Trade Organization (WTO) to impose retaliatory tariffs on U.S. products. Thus, ETI will likely be considered during the 108<sup>th</sup> Congress and may be the occasion for a broader policy debate on international taxation in general. The origins of the ETI controversy stretch back more than 30 years to enactment in 1971 of the Domestic International Sales Corporation (DISC) export tax benefit. European countries complained that DISC was an export subsidy, and as such, it violated the General Agreement on Tariffs and Trade (GATT, the WTO’s predecessor). In 1984, the United States attempted to remedy the situation by replacing DISC with a new export tax benefit, the Foreign Sales Corporation (FSC) provisions. However, in 1997, the European Union began proceedings against FSC under the new WTO agreements. Several WTO panel rulings concluded that FSC – like DISC before it – was a prohibited export subsidy. In 2000, the United States again attempted to revamp its export tax benefit with a WTO-compatible provision – in this case, ETI. However, WTO panels again supported the EU position, and in 2002, the WTO ruled that the EU can impose up to \$4 billion in retaliatory tariffs against U.S. products. EU officials have stated that the tariffs will not be imposed as long as the United States is seen to be making progress on making its export tax provisions WTO-compatible.

In July 2002, Chairman Thomas of the House Ways and Means Committee introduced H.R. 5095, a broad international tax bill that addressed the ETI controversy by proposing repeal of the export benefit. The bill also proposed to promote U.S. competitiveness by cutting taxes on U.S. multinational firms in a variety of other ways. Congress did not take

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<sup>11</sup> Mohr, “Policy Wonks Form Basis for Tax Cut vs. Deficit Debate,” p. 1505.

action on the measure before it adjourned – in part due to opposition from policymakers who favor attempting to negotiate with the EU.

For further information, see CRS Report RS20746, *Export Tax Benefits and the WTO: Foreign Sales Corporations and the Extraterritorial Replacement Provisions*, by David L. Brumbaugh and CRS Report RL31717, *U.S. Taxation of Overseas Investment and Income: Background and Issues in 2003*, by David L. Brumbaugh.

## Other Possible Tax Issues

Other particular tax issues that might become prominent in the 108<sup>th</sup> Congress include the following items.

**Fundamental Tax Reform.** Congress actively considered fundamental tax reform – for example, shifting from an income to a consumption tax – in the mid-1990s, but such legislation never progressed beyond the committee level. Administration officials have recently indicated they are considering fundamental tax reform as a proposal for long-run tax policy, although it would be proposed apart from any stimulus package. In past Congresses, a number of Members introduced legislation that would adopt fundamental tax reform, suggesting congressional interest in the topic. For further information, see CRS Issue Brief IB95060, *Flat Tax Proposals and Fundamental Tax Reform: An Overview*, by James Bickley.

**Business Taxation.** The stimulus tax cut that Congress approved in March 2002 contained several tax cuts for business. However, these were temporary and scaled-back from the business tax cuts passed by the House (but not the Senate) in earlier versions of the stimulus package. In addition, participants in President Bush's August 2002 economic summit proposed eliminating the double-taxation of corporate dividends as a desirable reform for business taxation, a type of reform known among tax professionals as tax integration. It therefore is likely that Congress will address business taxation in the 108<sup>th</sup> Congress. The issue may be debated as part of an economic stimulus package. For further information, see CRS Report RL31597, *The Taxation of Dividend Income: An Overview and Economic Analysis of the Issues*, by Gregg Esenwein and Jane Gravelle and CRS Report RL31782, *The Effect of the President's Dividend Relief Proposal on Corporate Tax Subsidies*, by Gregg Esenwein and Jane Gravelle.

**Small Business Taxation.** Taxation of small business is a continuing concern to Congress, and it is not likely that the 108<sup>th</sup> Congress will be an exception. Possible topics for consideration may be tax simplification, reform of the Subchapter S rules for taxing closely-held businesses, and enactment of investment incentives. For further information, see CRS Report RL31052, *Small Business Tax Relief: Selected Economic Policy Issues for the 107th Congress*, by Gary Guenther.

**Family Tax Issues.** Several family tax issues may be debated in the 108<sup>th</sup> Congress. For example, the earned income tax credit for low-income families has been suggested as a focus of simplification efforts and the individual alternative minimum tax's impact on families has been a focus of concern. In addition, several prominent family-oriented tax provisions were part of the EGTRRA's tax cut, including benefits for married couples and the child tax credit. Thus, it appears likely that family tax issues will be an important part

of the debate over making EGTRRA's tax cuts permanent. For further information, see CRS Report RS20988, *The Child Tax Credit After the Economic Growth and Tax Relief Reconciliation Act of 2001*, by Gregg Esenwein.

**Estate Tax.** One of the largest and most debated aspects of EGTRRA was its phase-out and repeal of the estate tax. Given the liveliness of the estate tax debate, and in view of its place as a fundamental part of the tax structure (albeit a small one), the estate tax may become a prominent part of the tax policy debate, apart from its place in the debate over making EGTRRA permanent. For further information, see CRS Report RL30600, *Estate and Gift Taxes: Economic Issues*, by Jane Gravelle.

**Individual Alternative Minimum Tax (AMT).** Under current law, an individual pays either the regular tax or AMT, whichever is larger. (The two will ordinarily differ because the AMT has lower rates but fewer and smaller tax benefits than the regular tax.) The individual alternative minimum tax presents a looming tax issue because key provisions of the AMT are not indexed for inflation, and an increasing number of individuals will find themselves subject to the AMT. In addition, tax benefits enacted by EGTRRA and other acts have placed an increased number of persons at or near AMT status. The March 2002 stimulus package included a provision allowing personal credits to offset a person's AMT, but that provision is scheduled to expire at the end of 2003, adding to the time-sensitive nature of the AMT issue and increasing the possibility that Congress will address it as an issue in the coming year.

**Expiring Tax Provisions.** The 2002 stimulus package extended a number of temporary tax provisions but extended many of the most prominent and popular of these "extenders" only through 2003. Some examples are the AMT treatment of personal tax credits (see the above issue), the work incentive tax credit, the welfare to work credit, and suspension of a limit on percentage depletion for oil wells. Given the time-sensitive nature of these provisions, Congress may address them in 2003, although it has allowed them to expire for brief periods in the past before retroactively extending the provisions.

**Energy Taxation.** In 2002, both the House and Senate passed legislation (H.R. 4) containing tax benefits related to energy, primarily tax benefits for particular categories of energy producers and consumers. Although a conference committee convened, the 107<sup>th</sup> Congress adjourned without acting on the bill. Both the House and Senate returned to energy tax issues in 2003. During the first week in April, both the Senate Finance Committee and the House Ways and Means Committee approved energy-related tax legislation (S. 597 and H.R. 1531, respectively). For further information, see CRS Issue Brief IB10054, *Energy Tax Policy*, by Salvatore Lazzari.

**Pension Tax Policy.** Both the House and Senate passed pension bills in 2002, but legislation was not enacted. In the 108<sup>th</sup> Congress, H.R. 1000, the Pension Security Act of 2003 was introduced, which – in the wake of the Enron controversy – proposes to mandate employee diversification rights in 401(k) plans. Additional pension issues that could be considered include a revision of tax rules to protect employee pensions from abuse and relaxation of rules relating to taxation of IRA withdrawals after retirement. For further information, see CRS Report RS20629, *Pension Reform: The Economic Growth and Tax Relief Reconciliation Act of 2001*, by Patrick Purcell.

**Tax Policy and Health Insurance.** The 107<sup>th</sup> Congress evinced interest in enacting additional tax benefits related to health insurance. For example, the House passed a patients' protection bill (H.R. 2563) that included provisions making tax-favored Medical Savings Accounts a permanent rather than temporary part of the tax code, a tax credit for small employers, and expansion of tax benefits for the self-employed. The 108<sup>th</sup> Congress may take up health tax policy again. For further information, see CRS Issue Brief IB98037, *Tax Benefits for Health Insurance: Current Legislation*, by Bob Lyke and Christopher Sroka.

**Internet Taxation.** The growth of the Internet has placed pressure on the states' sales and use tax systems, raising questions such as: How should use of the Internet be taxed? and How should commerce conducted via the Internet be taxed? The federal government has a role in regulating Internet taxation by virtue of the Constitution's Commerce Clause, and in 2001 a moratorium was enacted prohibiting new taxes on Internet access and multiple or discriminatory taxes on Internet commerce. The moratorium, however, expires on November 1, 2003, suggesting that Congress may take up the issue of Internet taxation again in 2003. For further information, see CRS Report RL31177, *Extending the Internet Tax Moratorium and Related Issues*, by Nonna Noto.

**Internal Revenue Service (IRS) Oversight.** Oversight of the IRS may be an issue Congress addresses in 2003. The IRS Restructuring and Reform Act of 1998 mandated significant changes in the way the IRS operates along with a change in its "culture"; Congress may examine the extent to which the IRS has accomplished the Act's goals. In addition, the apparent growth of tax shelters has been of increasing concern to some policymakers; an issue before Congress may be the effectiveness of IRS efforts to restrain abusive tax shelters.

**Charitable Contributions.** As a component of President Bush's faith based initiative, the House passed H.R. 7 in the 107th Congress. This legislation would have expanded benefits for charitable giving and charities. In the 108th Congress, similar legislation has already been revisited. Key tax-related issues are likely to include providing charitable deductions for nonitemizers, allowing tax-free distributions from individual retirement accounts for charitable purposes, and extending the deduction for food inventory to all businesses. For further information, see the CRS Electronic Briefing Book, *Taxation*, "Charitable Contributions" by Jane G. Gravelle, available online only from the CRS Web site at [<http://www.congress.gov/brbk/html/ebt xr80.html>].

## Major Tax Cut Proposals

### The President's Proposal

On January 7, 2003, President Bush announced the details of a new tax cut proposal intended to provide a stimulus to the economy ([<http://www.treas.gov/press/taxes.html>]). According to estimates prepared by the Joint Committee on Taxation, the stimulus portion of the plan would reduce revenues by an estimated \$726 billion from FY2003-FY2013 and \$114 billion in the first full fiscal year (FY2004). On February 3, the Administration released FY2004 budget documents containing a more detailed explanation of the stimulus package, a set of additional tax cut proposals characterized as "tax incentives," and a

proposal to make the expiring provisions of the 2001 tax cut permanent [<http://www.whitehouse.gov/omb/budget/fy2004/index.html>]. According to Joint Committee on Taxation estimates, the total revenue reduction from the combined elements of the plan would be \$1.575 trillion for FY2003-FY2013 and \$118 billion for FY2004, its first full year. Based on CBO baseline budget projections of revenues, this amounts to a reduction in revenues of about 5.3% over that period. However, the revenue losses estimated for last few years in the “estimating window” under the Administration’s current proposal are substantially larger than for the first few years – a reflection of the impact of making EGTRRA permanent instead of allowing it to expire after 2010. The tax cut over the last five years of the “estimating window” (i.e., over FY2009-FY2013) would be an estimated \$1.046 trillion, or 6.5% of anticipated revenue.

The principal tax proposals in the President’s budget are:

- acceleration of several tax cuts for individuals that were enacted by EGTRRA in 2001 but that were scheduled to be phased in gradually. Specifically, the proposals would make the reduction in statutory tax rates for individuals fully effective on January 1, 2003; the rate reductions were initially scheduled to be phased in over the period 2001-2006. The proposal would also accelerate a broadening of the 10% rate bracket that is currently not scheduled to occur until 2008. Another part of the proposal would move up EGTRRA’s scheduled tax cuts for married couples to 2003; under current law, the tax cuts are not scheduled to be fully effective until 2009. The President’s proposal would also increase the per-child tax credit to \$1,000 from \$600 in 2003. The full increase is not scheduled to occur until 2010 under EGTRRA’s initial provisions.
- The proposal would move towards “integration” of the taxation of corporate-source income by eliminating individual income taxes on dividends and by permitting a “step up in basis” for capital gains resulting from retained earnings.
- The proposal would increase the so-called “expensing” allowance for business investment in equipment to \$75,000 from current law’s \$25,000 and would index the amount for inflation.

Each of these proposals were included in the stimulus package the President outlined in January. Prominent among the additional tax cuts proposed with the February budget – aside from making EGTRRA’s tax cut’s permanent – are the following items:

- two new tax-favored savings vehicles that would replace Individual Retirement Accounts (IRAs) and that would have less binding restrictions than current law’s IRAs;
- a set of new tax incentives for charitable giving, including a deduction for non-itemizers;
- a number of tax benefits related to health care, including a long-term care insurance deduction for non-itemizers;

- a set of tax benefits related to energy production and conservation; and
- permanent extension of current law's temporary research and experimentation tax credit.

According to Joint Committee on Taxation estimates, the acceleration of EGTRRA's tax cuts would reduce revenue by \$263.9 billion over FY2003-FY2013, accounting for 17% of the total estimated tax cut over that period. The estimated revenue loss from the tax exclusion for dividends is \$395.8 billion, or 25% of the total tax cut. The estimated revenue loss from rescinding EGTRRA's expiration is \$624.2 billion, or 40% of the total.

On February 27, legislation was introduced in Congress containing the economic stimulus parts of the President's tax plan, but not the tax incentives or rescission of the EGTRRA's sunset provisions. The bills are H.R. 2 (Representative Thomas) and S. 2 (Senator Nickles).

## House Democratic Proposal

On January 6, House Democratic leaders outlined a tax cut proposal they stated would reduce taxes by \$87 billion in 2003 and by \$59 billion over 10 years.<sup>12</sup> The plan's principal elements are:

- a refundable tax rebate in 2003 of \$300 per person (\$600 for couples) for individuals with earned income;
- an increase in the depreciation "bonus" provided by the tax stimulus package enacted in March 2002 with the Job Creation and Worker Assistance Act of 2002 (P.L. 107-16). Under the 2002 Act, firms can claim a first-year depreciation deduction equal to 30% of the cost of new equipment investments made in 2002-2004. The Democratic proposal would increase the depreciation bonus to 50% for 2003 but would reduce the bonus to 10% in 2004.
- For equipment investment made in 2003, the proposal would increase the expensing benefit to \$50,000 from current law's \$25,000.

Non-tax elements of the proposal included a retroactive extension of unemployment benefits for 26 weeks and a \$31 billion package of assistance to state and local governments. The total amount of spending increases and tax reductions would be an estimated \$136 billion in 2003 and \$100 billion over 2003 - 2013.

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<sup>12</sup> The proposal is described on the Democrat's side of the House Budget Committee's Web site: [[http://www.house.gov/budget\\_democrats/analyses/econ\\_stimulus/house\\_dem\\_stimulus\\_plan.pdf](http://www.house.gov/budget_democrats/analyses/econ_stimulus/house_dem_stimulus_plan.pdf)]. The estimated revenue loss over 10 years is smaller than the projected loss in 2003, and is likely the result of the plan's depreciation component, which shifts deductions to 2003 from future years.

## The Daschle Proposal

On January 24, Senate Minority Leader Thomas Daschle outlined a one-year economic stimulus proposal containing tax-cut and spending elements that would total an estimated \$141 billion over the year it is in effect.<sup>13</sup> For the year the plan is in effect, the tax cut elements of the plan are as follows:

- a \$300 tax credit for each adult taxpayer and an additional \$300 for up to two children;
- an increase in the depreciation bonus to 50%;
- an increase in the expensing allowance for business investment to \$75,000 from current law's \$25,000;
- a tax credit for health insurance outlays of small businesses; and
- a 20% credit for business investment in broadband internet infrastructure.

The non-tax elements of the plan would include an extension of unemployment benefits and aid to state and local governments.

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<sup>13</sup> The proposal is described on Senator Daschle's Web site, available at [<http://daschle.senate.gov/pdf/democraticplan.pdf>].