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Tax Cut Bills in 2003: A Comparison

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Summary

Tax cuts were a major focus of the tax policy debate in the first part of 2003. Initially President Bush proposed a set of tax cuts for economic stimulus and released budget proposals calling for tax cuts totaling an estimated $1.57 trillion over fiscal years (FY) 2003-2013. The Administration characterized $726 billion of the cuts as "economic growth" measures, designed to stimulate the economy and improve its performance. On May 9, the House approved H.R. 2, the Jobs and Growth Tax Act. The bill proposed cutting taxes by an estimated $550 billion over FY2003-FY2013. Previously on May 8, the Senate Finance Committee approved its own tax bill (S. 2, later replaced by S. 1054). The bill included tax cuts estimated at $422 billion over FY2003-FY2013, fiscal assistance for the states of $20 billion, and revenue increases of $90 billion for a net revenue reduction/outlay increase of $350 billion. The full Senate approved a modified version of the bill on May 15 as H.R. 2 (amended). The House and Senate approved a conference committee report reconciling the differences between the two legislative versions on May 23. The final Act, (Jobs and Growth Tax Relief and Reconciliation Act of 2003, JGTRRA, P.L. 108-27), contained $350 billion in tax cuts (and spending increases) over FY2003-FY2013, as estimated by the Joint Committee on Taxation.

All four versions (the President's proposal, the House and Senate bills, and P.L. 108-27) proposed to accelerate the tax cuts for individuals scheduled for gradual phase-in by the 2001 tax cut act (Economic Growth and Tax Relief Reconciliation Act of 2001, or EGTRRA; P.L. 107-16), including a gradual reduction of tax rates, an increase in the child tax credit, tax cuts for married couples, and expansion of the lowest (10%) tax bracket.

The Senate, House and final version differed from the Administration proposal on the provisions for dividends and capital gains tax cuts. The Administration plan would have generally eliminated individual income taxes investors pay on dividends received from corporations and capital gains from the sale of corporate stock; the plan would have implemented a form of corporate "tax integration," and would have eliminated the double-taxation of corporate-sector equity income. The House proposal would have reduced (but not eliminated) taxes on corporate dividends and capital gains generally; the Senate bill would have temporarily eliminated the taxation of all dividends, without including the administrative features of the President's proposal designed to identify the portion of the dividends upon which taxes had already been paid. The final law was similar to the House version and expires in 2008.

The business expensing and depreciation provisions of the plans also contained several differences. In addition, the Senate's version included several revenue increasing provisions, which offset some of the tax cuts (and outlays). The final version did not include these measures. Finally, both the Senate version and the final version included a fund of $20 billion in outlays designed to assist state governments.

This report is no longer being maintained but remains available to Congress as a record of the progression of the tax reduction proposals in 2003.

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Tax cuts were a major focus of the tax policy debate in the first part of 2003. In January, President Bush proposed a set of tax cuts for economic stimulus and in February he released budget proposals calling for tax cuts totaling an estimated $1.57 trillion over fiscal years (FY) 2003-2013. The Administration characterized $726 billion of the tax cuts as "economic growth" measures, designed to provide economic stimulus and improve economic performance. On May 6, the House Committee on Ways and Means approved H.R. 2, the Jobs and Growth Tax Act of 2002. The Committee bill proposed cutting taxes by an estimated $550 billion over FY2003-FY2013. The full House approved the measure on May 9. On May 8, the Senate Finance Committee approved its own tax bill (S. 2). The bill included tax cuts amounting to an estimated $422 billion over FY2003-FY2013, fiscal assistance for the states of $20 billion, and revenue-raising measures offsetting the amounts in excess of $350 billion. On May 15, the full Senate approved a modified version of the Committee bill as H.R. 2 (amended). The final compromise version was agreed to by both the House and Senate on May 23. The Joint Committee on Taxation estimated the final law would reduce revenues (and increase outlays) by $350 billion.

This report provides a brief description of each proposal, including major proposals offered by the Democrats in both the House and the Senate. A discussion of the distributional affects of the proposals and potential effects on short and long term economic growth follows. A side-by-side detailed description of the various major proposals considered concludes the report as an appendix.

The President's Proposal

The President's tax cut plan released with his FY2004 budget proposal contained three broad elements: a set of tax cuts designed to provide economic stimulus and promote economic growth; a group of narrowly targeted tax incentives generally designed to encourage particular types of investment or activities; and extension of a number of expiring tax provisions. (Principal among these last provisions was a proposal to extend the tax cuts enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001, or EGTRRA, whose broad tax cuts are scheduled to expire after 2010.) Neither of the tax cut bills approved by the congressional tax-writing committees included the last two elements of the President's plan. Accordingly, the discussion here focuses on the "economic stimulus" part of the President's plan.[1]

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[1] For information on the President's full tax proposal, see CRS Report RS21420, *President Bush's 2003 Tax Cut Proposal: A Brief Overview*, by David L. (continued...)

The stimulus portion of the President's proposal consisted of the following elements.

- Acceleration, to 2003, of tax cuts phased in gradually under EGTRRA. The specific reductions are cuts in individual income tax rates (scheduled to be fully effective under EGTRRA in 2006); tax cuts for married couples (scheduled to be phased in over 2005-2010); and an increase in the child tax credit (also previously scheduled for 2005-2010).

- "Tax integration," or elimination of individual income tax on corporate-source equity income (dividends and capital gains). Under then existing law, corporate equity income was taxed twice: once under the corporate income tax and once when received by stockholders as dividends or capital gains. According to economic theory, the double taxation reduces economic efficiency by diverting capital from the corporate sector to other sectors of the economy (e.g., housing). The Administration proposed excluding dividends from individuals' taxable income, and eliminating (in effect) tax on capital gains by permitting stockholders to increase their "basis" deduction when calculating their capital gains tax.

- Expansion of the "expensing" allowance for business investment. Under prior law, firms were permitted to deduct in the year of purchase ("expense") up to $25,000 of equipment acquisitions. The proposal reduced the allowance for amounts for which investment exceeds $200,000, thus restricting its use to relatively small businesses. Expensing confers a tax benefit by speeding up tax deductions that firms would ordinarily have to spread over the life of the equipment as depreciation. The Administration proposed to increase the annual allowance to $75,000 and the beginning of the phase-out threshold to $325,000.

- A $4,000 increase in the individual alternative minimum tax (AMT) exemption for individuals. The increase would have expired after 2005.

Taken alone, the economic stimulus portion of the President's proposed tax cut was estimated by the Joint Committee on Taxation to reduce revenue by $726 billion over FY2003-FY2013.

The House Bill

On May 6, the House Committee on Ways and Means approved H.R. 2, the Jobs and Growth Tax Act of 2003 (H.Rept. 108-94); the full House approved the measure

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[1] (...continued)
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on May 9. The bill proposed a tax cut estimated at $550 billion over 10 years. It incorporated — with some differences — the principal elements of the economic stimulus tax-cut package proposed by President Bush in February. H.R. 2's principal provisions were to cut the tax rates applicable to dividends and capital gains; temporarily increase the "expensing" allowance for small business; temporarily provide a depreciation "bonus" for investment in machines and equipment; accelerate, to 2003, several phased-in tax cuts enacted under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16); and temporarily increase the alternative minimum tax (AMT) exemption for individuals.

A major difference between H.R. 2 and President's proposal was the treatment of capital gains and dividends. As described above, the President proposed complete elimination of individual income taxes on corporate-source capital gains and dividends; H.R. 2 proposed a reduction of rates rather than complete elimination of tax, and would have applied the reduced rates to most capital gains, not just those on corporate stock. Another difference between H.R. 2 and the President's proposal was that several of H.R. 2's accelerations of tax cuts were temporary and would have expired at the end of 2005, reverting to the phase-in schedule enacted by EGTRRA. These temporary provisions included widening of the 10% rate bracket, increasing the child credit, and doubling the standard deduction for married couples. Largely as a result of these differences, the proposed size of H.R. 2's tax cut was smaller over 10 years than the President's plan: $550 billion compared to the $726 billion proposed by the President.[2] In contrast, the bill's proposed tax cut was larger than either the total of $422 billion of tax cuts approved by the Senate Finance Committee on a gross basis, or the Finance bill's net tax cut of $350 billion, after subtracting the bill's revenue-raising offsets.

The bill's principal provisions were as follows.

- Acceleration, to 2003, of individual income tax cuts enacted but phased in under EGTRRA, including expansion of the 10% rate bracket, reduction of marginal tax rates, an increase in the child tax credit to $1,000, and the expanded standard deduction and 15% rate bracket for married couples. With the exception of the reduction in tax rates the House version of H.R. 2 proposed that each of these provisions would have expired at the end of 2005. The proposal reverted to the phase-in rules scheduled by EGTRRA after 2005.

- An increase in the exemption amount under the individual alternative minimum tax (AMT). Under temporary rules enacted by EGTRRA, the AMT exemption is $49,000 for couples and $35,750

[2] Along with tax cuts aimed at providing economic growth and stimulus, the President's budget proposal contained tax cuts targeted at specific activities and investments (tax "incentives") and would make the 2001 tax cuts — which are scheduled to expire in 2010 — permanent. According to Joint Tax Committee estimates, the President's $726 billion growth package, his proposed tax incentives, and elimination of the 2010 expiration would together reduce revenue by an estimated $1,575 billion over 10 years. Neither the proposed tax incentives nor provisions making the 2001 tax cut permanent were contained in H.R. 2.

for singles, but was scheduled to fall to $45,000 and $33,750, respectively, for tax years beginning in 2005 and thereafter. H.R. 2 proposed to increase the AMT exemption to $64,000 for couples and $43,250 for singles. The increased exemption would have applied to 2003, 2004, and 2005, but the amounts reverted to those scheduled under prior law in 2006 and thereafter.

- Reduced rates for dividends and capital gains. Rather than eliminating individual taxes on corporate-source income, H.R. 2 proposed to reduce tax on corporate dividends as well as corporate and non-corporate capital gains. Under then existing law, capital gains were generally taxed at a maximum rate of 20% (10% for taxpayers in the 15% ordinary-income rate bracket). For capital gains, H.R. 2 proposed to reduce these rates to 15% and 5% respectively. The proposal treated dividends received from domestic corporations as capital gains for purposes of applying the rates.

- A temporary increase in the expensing benefit for small business investment to $100,000 from prior law's $25,000 and an increase in the provision's phase-out threshold to $400,000 from prior law's $200,000. The provision would have expired after 2007.

- A temporary depreciation "bonus" deduction equal to 50% of an asset's cost in its first year of service. The provision would have expired after 2005.

- Temporary extension of the net operating loss (NOL) carryback period for business losses as defined by the tax code to five years from then existing law's two years. The provision would have applied for losses incurred in 2003-2005.

The Senate Bill

On May 8, the Senate Committee on Finance approved S. 2 (later replaced by S. 1040), a bill containing a set of tax cuts broadly similar to those of the President and the House. Like the other two proposals, for example, the Committee bill proposed to accelerate many of the 2001 tax cuts including rate reductions, tax cuts for married couples, child credits, and expanded rate brackets. The bill also contained a tax cut for dividends, although it differed from the Administration and House proposals. Also in contrast to the other two proposals, the Finance bill contained a number of revenue-raising proposals, offsetting part of the revenue loss from the bill's tax cuts. According to estimates by the Joint Committee on Taxation for FY2003-FY2013, the bill contained $422 billion in tax cuts and other revenue reductions, $20 billion in fiscal relief to state and local governments and $90 billion of revenue-raising items. Its net revenue reduction/outlay increase was estimated at $350 billion over the period. On May 15, the full Senate approved a modified version of the bill as H.R. 2 (amended).

The bill's principal tax cut provisions were as follows.

- Acceleration of EGTRRA's phased-in tax cuts for individuals to 2003. As with the President's and the House proposal, these included the reduction in marginal tax rates, increase in the child credit, expansion of the 10% tax bracket, and expanded standard deduction and 15% bracket for married couples.

- An increase in the expensing benefit for small business investment from prior law's $25,000 to $100,000 and an increase in the provision's phase-out threshold to $400,000 from $200,000. The increases would have expired after 2007.

- An increase in the AMT exemption to $60,500 for couples and $41,500 for singles. The proposed amounts would have applied for 2003 - 2005. Under existing law during the debates, the exemptions were $49,000 and $35,750, but were scheduled to fall to $45,000 and $33,750 for 2005 and thereafter.

- A 50% reduction in taxes on dividends received by individuals from both foreign and domestic corporations in 2003. In 2004, 2005, and 2006, the proposal excluded 100% of the tax on dividends. The tax reduction would have expired in 2007.

The bill's principal revenue-raising items included a set of provisions aimed at restricting tax shelters generally, including a provision clarifying the "economic substance" doctrine that courts have applied to tax shelters. (This doctrine generally denies tax benefits with respect to transactions that do not change a taxpayer's economic position in a substantive way.) The bill's largest single revenue-raising item was a proposed repeal of the foreign earned income exclusion provided by section 911 of the tax code. Under existing law at the time of consideration, U.S. citizens residing abroad were permitted to exclude up to $80,000 of non-government source income from foreign employment along with a certain amount of housing costs. The Senate bill proposed to repeal the exclusion.

Final Bill, P.L. 108-27

On May 23, the House and Senate agreed to the conference report for H.R. 2, reconciling the differences between the House and Senate versions of the Jobs and Growth Tax Act. According to the Joint Committee on Taxation, the package was estimated to result in $350 billion in reduced revenues (and increased outlays) from FY2003 through FY2013. In contrast to the Senate provision, which had the same net cost, the final bill did not include revenue raising measures or "offsets." The principal outlay in the package established a $20 billion fund to provide relief to state governments. The principal components of the tax package include:

- acceleration, to 2003, of the individual income tax cuts enacted and phased-in under EGTRRA. Specifically, income tax rates above

15%, scheduled to decline in 2004 and 2006, are accelerated to their 2006 levels in 2003. The application of the 10% tax bracket, scheduled to increase in 2008, is accelerated to 2003 and 2004;

- increase in the child tax credit previously scheduled to be $600 for 2003 and 2004 to $1,000 and for 2003 and 2004. For 2003, the increase will be paid in advance to qualifying taxpayers;

- for 2003 and 2004 only, expansion of the standard deduction and 15% tax bracket for married taxpayers to twice that of singles. Beginning in 2005, these provisions will revert to prior law, which provides for a phased-in increase to the levels of twice that of singles over several years;

- increase of alternative minimum tax exemption amount by $9,000 for married couples and $4,500 for singles for 2003 and 2004;

- temporary increase in maximum allowable business expensing from $25,000 to $100,000 for 2003, 2004, and 2005 for small businesses. The provision's phase-out threshold was increased from $200,000 to $400,000 over the same time period;

- temporary increase in "bonus" depreciation allowance. Originally passed in March of 2002, this bonus depreciation is increased and extended to allow for a 50% first year deduction (up from 30%) for the period between May 5, 2003 and December 31, 2004; and

- reduction of rate on both dividends and capital gains to 15% for taxpayers in the higher tax brackets and 5% for those in the lower tax brackets for 2003 through 2008. (The tax rate for those in the lower tax brackets will be 0% in 2008.) The dividend provision applies to both domestic and foreign corporations.

Other Proposals

The Daschle Proposal. On May 6, Senate Minority Leader Daschle announced a tax cut proposal as an update to a plan he proposed in January. The anticipated total cost of the plan was $125 billion in 2003 and $152 billion over 11 years. The proposal included the following:

- an immediate $300 tax cut for each adult and up to two children per family;

- expanded standard deduction for married couples and earned income tax credit;

- an increase in the child tax credit (an additional $100 in 2003, for a total of $700 and another $100 in 2004, for a total of $800);

- an increase in the equipment depreciation allowance from 30% to 50% in 2003;
- an increase the amount of equipment that can be expensed for small businesses from $25,000 to $75,000; and
- tax credits for health insurance premiums for small businesses and for Internet infrastructure.

In addition to these tax-related components, the plan proposed to provide $40 billion in assistance to state and local governments and extend unemployment benefits.

The House Democratic Proposal. On May 7, House Democratic leaders outlined a tax cut proposal they stated would reduce taxes by $58 billion in 2003 and 2004 and by $106 billion over 11 years.[3] Some of the components were similar to the provisions offered by Senator Daschle. Among the plan's principal elements were the following:

- an increase in the child tax credit to $800 per child (under prior law the child tax credit was $600 per child for 2001 through 2004);
- acceleration of the expansion of the 10% tax rate bracket and the marriage penalty relief (expansion of the 15% rate bracket for married couples filing jointly and an increase in the basic standard deduction amount for joint returns);
- 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. 107-147). Under the 2002 Act, firms could claim a first-year depreciation deduction equal to 30% of the cost of new equipment investments made in 2002-2004. The House Democratic proposal would have increased the depreciation bonus to 50% for the next 12 months before returning to 30% for the balance of 2004; and
- an increase in the expensing benefit to $75,000, from the prior law's $25,000, for equipment investment made by small businesses through 2004.

Further, the proposal included $177 billion in revenue offsets during FY2003 through FY2013 in order to pay for the proposed tax reductions previously outlined. Offsets specifically included closing tax shelters and freezing the top-bracket rates, which were scheduled to decline.

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[3] The proposal is described on the Democratic side of the House Budget Committee website: [http://www.house.gov/budget_democrats/analyses/econ_stimulus/dem_jobs_plan_may03.pdf].

Non-tax elements of the proposal included an extension of unemployment benefits for 26 weeks and a $44 billion package of assistance to state and local governments, $18 billion of which was directed to address areas including Medicaid.

Economic Stimulus and Growth Effects

Proponents of a major tax cut have based their support on various factors — including, for example, a general philosophical belief in lower taxes. The particular tax cut enacted in May, 2003, however, has been supported by some as a means to stimulate a lagging economy, and proponents have argued that a properly designed tax cut would also spur long-run economic growth. According to Chairman Grassley of the Senate Finance Committee, the tax act is designed to provide "a balanced package of consumption and investment incentives that will provide short-term stimulus and the building blocks for meaningful future economic growth."[4]

The possibility of tax cuts to stimulate the economy occupied the attention of policymakers in Congress and elsewhere for several years. In 2001, signs of a sluggish economy were one reason for enactment of the sizeable tax cut contained in the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) that was passed in June of that year, and economic data now show that a recession was indeed underway: the economy contracted during the first three quarters of 2001. Since then, the economy in general returned to positive economic growth, with real output growing in the fourth quarter of 2001 and each quarter of 2002. Preliminary indications suggest that the economy also grew in the first quarter of 2003.

Despite the growth, however, business spending has remained weak and employment has not grown. The continued sluggish performance has been attributed to various causes: the decline in the stock market; the September 11 terrorist attacks; revelations of corporate malfeasance; and uncertainty induced by the wars in Afghanistan and Iraq. In the face of the continued weakness, the National Bureau of Economic Research — the organization that tracks business cycles — was unwilling to pronounce whether the recession that began in 2001 has ended. In this context, Congress in March, 2002, enacted a modest tax cut intended to provide additional fiscal stimulus. And in early 2003, President Bush proposed an "economic growth" package that would reduce taxes by an estimated $746 billion over 10 years. (The economic growth provisions were part of a larger tax cut proposed by the President that amounted to an estimated $1.6 trillion.) This package was designed to stimulate the economy both in the near term and to boost long-run growth. And the according to the Administration, the need for fiscal stimulus had become "more urgent" by the time the tax cut was enacted in May.[5]

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[4] Senator Charles Grassley, statement before the Senate Finance Committee at the committee's mark-up of H.R. 2, May 8, 2003. Posted on the committee's web site at [http://finance.senate.gov/hearings/statements/050803cg.pdf].

[5] Executive Office of the President, Office of Management and Budget, *Statement of Administration Policy, H.R. 2 Growth and Jobs Tax Act of 2003*, May 9, 2003.

As noted in other sections of this report, the tax-cut bills Congress took up in the spring of 2003 were broadly similar to the economic growth components of the President's plan, including, for example, versions of the acceleration of EGTRRA's tax cuts that the President proposed as well as tax cuts for dividends and an increased expensing benefit for business investment. Leading congressional supporters of the tax cut bills likewise emphasized the need for economic stimulus as a leading purpose of the measures.

Will the tax cut improve economic performance, as intended? Economic analyses of the tax-cut generally approach the question by distinguishing between a tax cut's possible effects on long-term growth and its efficacy as a short-term economic stimulus — that is, by distinguishing between a tax cut's impact on the growth of the U.S. economy long after concerns about its present sluggishness pass, and the effect of the measure in helping the economy recover more quickly from the recent recession. We first look more closely at the long run. According to economic theory, a tax cut could conceivably boost long run growth by increasing basic components of the economy that contribute to growth — specifically, labor supply and saving (the supply of capital). In principle, a cut in the tax rates applicable to labor income might induce individuals to provide more labor. And — again, in principle — a tax cut might encourage individuals to save more because saving bears a higher return, after taxes.

Economic analysis, however, suggests several reasons for doubt as to the impact of a tax cut on long-term growth. To begin, economic theory is uncertain as to whether a tax cut actually increases private saving or labor supply because of two offsetting effects. In the case of saving, for example, a tax cut might induce individuals to increase their saving because the after-tax return it produces is higher; on the other hand, if a saver's goal is accumulate a particular sum, a tax cut will enable him to do so at a lower level of saving. Theory predicts similar conflicting effects on labor supply. Economic theory, in short, is not useful for assessing whether tax cuts increase or reduce saving and labor supply. Given the ambiguity of theory, a firm conclusion would need to rely on empirical evidence. Most evidence does not suggest a large savings response from a tax cut.[6]

But whether or not a tax cut increases private saving or labor supply may be moot because of a revenue reduction's budgetary effects. A tax cut that is not matched by reductions in government spending increases the government's budget deficit above what would otherwise occur, and thus boosts the government's borrowing requirements. As a consequence, real interest rates faced by private investors may increase, "crowd out" private investment and more than offset any increase in investment resulting from an increase in private saving. Another way of looking at this effect is to recognize that total, national saving consists of private saving minus government borrowing. A tax cut will thus probably reduce national saving and may therefore reduce long-run growth.

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[6] CRS Report RL31824, *Dividend Tax Relief: Effects on Economic Recovery, Long-Term Growth, and the Stock Market*, by Jane G. Gravelle.

Shifting to short-run considerations, could a tax cut similar to those considered stimulate the economy out of its sluggish performance? In recent decades, economists have grown more doubtful of the efficacy of tax cuts as a short-run stimulative tool, especially compared to monetary policy, its counter-cyclical alternative. There are several reasons for this skepticism. First, the modern world economy has become more open, and — via mechanisms such as capital flows and exchange rate adjustments — much of the stimulative force of tax cuts is thought by economists to be dissipated in the larger world economy. Beyond this consideration, monetary policy is thought to have an advantage over fiscal policy because changes in monetary policy can be implemented with more alacrity than those of fiscal policy; monetary authorities can recognize the need for stimulus and implement money-supply changes more quickly than tax-cut or spending legislation can work its way through Congress. Given that the tax cut at hand has been passed, the implications of this point for the current situation is not clear. However, it might raise the question of whether additional economic stimulus is, at this time, necessary, given the recent tax cuts and interest-rate reductions by the Federal Reserve. For example, Federal Reserve Board chairman Alan Greenspan, in April 2003 congressional testimony, suggested that a stimulus fiscal-policy package was not needed.[7]

Beyond these general considerations, several aspects of the particular tax-cuts under consideration lead some observers to conclude that their design was not particularly well suited to provide short-run economic stimulus. In general, a tax cut has a larger stimulative effect in the short run if more of it is spent by individuals on consumption rather than saved. (Note the difference here from the long-run, where increases in economic growth depends, in part, on a tax cut eliciting an increase in saving.) For the most recent tax cuts, upper income individuals were estimated to receive a larger tax cut under the bills that were being considered than were lower-income persons. Given that upper-income persons tend to save a higher proportion of additions to their income than do lower-income individuals, this distributional character likely reduces stimulative effects. In addition, the temporary character of several of the particular tax cuts may reduce their stimulative efficacy, again because of saving and consumption decisions among taxpayers. In particular, certain aspects of economic theory suggest that individuals save much of what they regard as temporary, windfall increases in their income and spend them only over a period of time.[8]

In accordance with House of Representatives rules, the Joint Committee on Taxation conducted a macroeconomic analysis of the effects of House-passed version of the May tax cut bill.[9] The analysis focused on both the short run, stimulative impact of the measure and its likely impact on long-run growth; it used a variety of assumptions and models in its assessment. The study's conclusions reflect the

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[7] Brett Ferguson, "Greenspan Warns Against Higher Deficits, Remains Unconvinced of Need for Tax Cuts," BNA *Daily Tax Report*, May 1, 2003, p. G-11.

[8] CRS Report RS21126, *Tax Cuts and Economic Stimulus: How Effective are the Alternatives?*, by Jane G. Gravelle.

[9] The report was inserted in the *Congressional Record* by Chairman William Thomas of the House Committee on Ways and Means: Rep. William Thomas, remarks in the House, *Congressional Record*, daily edition, May 8, 2003, pp. H3829-H3832.

divergent impact tax cuts can have on short-run and long-run economic performance. In the short run — here, over 2003-2008 — the analysis projected the bill would increase real Gross Domestic Product (GDP) growth by 0.2% - 0.9%, depending on the particular assumptions and model used. In the long run, all but one of analysis' five scenarios predicted the bill would reduce long-run growth with estimates ranging from -0.1% to -0.2; the remaining estimate predicted no change.

Distributional Effects

There are a number of ways in which distributional analyses of tax changes are presented and published. The interests, computational traditions, and perspectives of the authors and conveyors of such analyses likely shape the choice and presentation of the conclusions. Subtle, yet important, differences in the questions being asked can significantly alter the presentation of the information. Complicating the issue, there is not a consensus among economists or practitioners about the methodologies associated with distributional analyses. The politically sensitive nature of the conclusions further fuel the controversy when evaluating public policy options. The following discussion attempts to describe a variety of distributional impacts of P.L. 108-27 and related proposals.[10] Several specific limitations and caveats are noted. Nonetheless, omissions and objections may remain: few, if any, analyses consider inter-generational issues and potential modifications in taxpayer behavior following a change in tax policy. Further, popular distributional analyses are generally limited to taxes and do not incorporate a discussion of the impact government expenditures may have on an individual's economic well-being. Notwithstanding these objections, a broad discussion of the distributional impacts as a result of P.L. 108-27 and related proposals can be informative.[11]

Distributional analyses are often used by economists to assess a measure's fairness among individuals, households, or taxpayers within tax systems. This discussion begins with H.R. 2, as passed by the House on May 9, and is based on analysis originally prepared by the Joint Committee on Taxation. The Committee has not released estimates of the distributional effects of either the President's proposal, the Senate's version of H.R. 2, or P.L. 108-27. However, as shown later, the

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[10] The discussion relies most heavily upon CRS calculations of an analysis prepared by the Joint Committee on Taxation for the Ways and Means Committee of H.R. 2, as passed by the House on May 9, and distributional analyses of all legislative versions prepared by the Urban-Brookings Tax Policy Center, a non-government research organization. The Urban-Brookings Tax Policy Center analyses are posted on its Web site at [http://www.taxpolicycenter.org/commentary/revenue.cfm]. In addition, the Department of the Treasury has prepared a distributional analysis of P.L. 108-27. It is available on the Department of the Treasury Web site: [http://www.ustreas.gov/press/releases/js409.htm]. However, the Department of the Treasury's distributional table does not include comparable information on percentage of after-tax changes nor does it include the necessary information to make comparable calculations.

[11] For more information on assessing the distribution of tax changes, see CRS Report RL30779, *Across the Board Tax Cuts: Economic Issues*, by Jane G. Gravelle.

distributional effects, at least in the first year, appear to be relatively similar among the different proposals.

Table 1, below, shows an estimated distribution of the tax cut for calendar year 2003 only. The principal provisions of H.R. 2 would have resulted in an apparent larger increase in after-tax income, in absolute and relative terms, for higher income groups than for lower income groups. The percent change in after-tax income is used by economists since it reflects a measure of the change in an individual's annual economic well-being, or standard of living. Specifically, taxpayers with incomes less than $20,000 were anticipated to experience an estimated increase in after-tax income of 0.1% or less. In contrast, the analysis suggests taxpayers with incomes in excess of $200,000 would benefit from an estimated 3.3% increase in their after-tax incomes in 2003. Although this presentation indicates that, on average, taxpayers in all income categories would benefit from the proposed tax reductions of H.R. 2, higher income taxpayers were expected to receive a larger percent change in after-tax income - thus, in a relative sense income would likely be distributed more heavily to the to those with higher incomes.[12]

Table 1 shows only the tax cuts' impact in 2003. However, given the scheduled effective and expiration dates included in H.R. 2 and previously adopted tax cuts in 2001 (EGTRRA; P.L. 107-16), the results of a distributional analysis fluctuate depending upon the year assessed. For example, **Table 2** illustrates the Joint Committee on Taxation's distributional estimates for 2008. Given the expiration of the temporary acceleration of specific provisions as well as the interaction with prior law, which included phased-in tax reductions in future years, **Table 2** shows the effective tax rate changes would be quite small for all but the highest income categories. Unlike the reductions in the marginal tax rates, the reduced tax on dividends and capital gains would be less affected by these interactions. Therefore, the proposal, composed mainly of tax cuts on dividends and capital gains in future years, was expected to benefit higher income taxpayers even more prominently in future years. Nonetheless, such an estimate of the distribution over time should not suggest the same taxpayers would necessarily benefit over a span of time. Taxpayers' incomes can and do fluctuate for a variety of factors, most directly due to entering and exiting the workforce.

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[12] It should be noted here that this conclusion is based upon the estimates of the Joint Committee on Taxation data, which rely upon statistical estimates of income data, particular definitions of "income" and "taxes," assumptions of economic incidence, and the level of significant digits when comparing effectively small percentage changes. Further, economic theory offers little guidance of the desired degree of relative distribution, which is inherently a value judgement.

Table 1. Distributional Effects of H.R. 2, as Passed by the House Calendar Year 2003[a]

Income Category[b]	Changes in Federal Taxes[c]		Effective Tax Rate[d]		Change in After-tax Income
			Present Law	Proposal	
	Millions	Percent	Percent	Percent	Percent
Less than $10,000	-$16	-0.3%	7.2%	7.2%	0.0%
10,000 to 20,000	-$334	-1.4%	6.0%	5.9%	0.1%
20,000 to 30,000	-$1,611	-3.1%	10.2%	9.9%	0.3%
30,000 to 40,000	-$2,906	-3.5%	13.8%	13.3%	0.6%
40,000 to 50,000	-$3,856	-4.3%	15.8%	15.1%	0.8%
50,000 to 75,000	-$11,088	-4.4%	17.5%	16.7%	0.9%
75,000 to 100,000	-$13,023	-5.5%	19.9%	18.8%	1.4%
100,000 to 200,000	-$28,292	-7.0%	23.5%	21.8%	2.1%
200,000 and over	-$41,254	-8.4%	28.3%	25.6%	3.3%
Total, All Taxpayers	-$102,430	-6.3%	19.9%	18.5%	1.6%

Source: Joint Committee on Taxation in addition to CRS calculations.

Notes:

a. Includes acceleration of the EGTRRA provisions concerning the child credit, the marriage penalty in the 15% tax bracket and standard deduction, marginal rates, and the 10% tax bracket, an increase in the AMT exemption and a 15%/5% rate on dividends and capital gains.

b. The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: (1) tax-exempt interest, (2) employer contributions for health plans and life insurance, (3) employer share of FICA tax, (4) worker's compensation, (5) nontaxable social security benefits, (6) insurance value of Medicare benefits, (7) alternative minimum tax preference items, and (8) excluded income of U.S. citizens living abroad. Categories are measured at 2003 levels.

c. Federal taxes are equal to individual income tax (including the outlay portion of the EIC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of the other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

d. The effective tax rate is equal to federal taxes described in note 3, divided by: income described in note 2 plus additional income attributable to the proposal.

Table 2. Distributional Effects of H.R. 2, as Passed by the House Calendar Year 2008[a]

Income Category[b]	Changes in Federal Taxes[c]		Effective Tax Rate[d]		Change in After- Tax Income
			Present Law	Proposal	
	Millions	Percent	Percent	Percent	Percent
Less than $10,000	-$1	less than -0.05%	6.0%	6.0%	0.0%
10,000 to 20,000	-$31	-0.1%	5.8%	5.8%	0.0%
20,000 to 30,000	-$95	-0.2%	9.8%	9.8%	0.0%
30,000 to 40,000	-$221	-0.2%	13.3%	13.3%	0.0%
40,000 to 50,000	-$471	-0.4%	15.2%	15.1%	0.1%
50,000 to 75,000	-$1,483	-0.5%	17.5%	17.3%	0.1%
75,000 to 100,000	-$1,883	-0.6%	19.3%	19.1%	0.2%
100,000 to 200,000	-$5,013	-0.8%	22.7%	22.5%	0.2%
200,000 and over	-$19,599	-2.7%	27.1%	26.0%	1.0%
Total, All Taxpayers	-$28,798	-1.3%	20.1%	19.7%	0.3%

Source: Joint Committee on Taxation in addition to CRS calculations.

Notes:
a. Includes acceleration of the EGTRRA provisions concerning the child credit, the marriage penalty in the 15% tax bracket and standard deduction, marginal rates, and the 10% tax bracket, an increase in the AMT exemption and a 15%/5% rate on dividends and capital gains.
b. The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: (1) tax-exempt interest, (2) employer contributions for health plans and life insurance, (3) employer share of FICA tax, (4) worker's compensation, (5) nontaxable social security benefits, (6) insurance value of Medicare benefits, (7) alternative minimum tax preference items, and (8) excluded income of U.S. citizens living abroad. Categories are measured at 2003 levels.
c. Federal taxes are equal to individual income tax (including the outlay portion of the EIC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of the other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.
d. The effective tax rate is equal to federal taxes described in note 3, divided by: income described in note 2 plus additional income attributable to the proposal.

Beyond differences in the distributional analysis over time, organizations apply a variety of methodologies to develop the comparisons. Differing definitions of income, units of analyses, breadth of taxes considered, preferences in statistics for presentation, and a variety of additional assumptions can result in different conclusions. **Table 4** presents the CRS computed change in after-tax income from data released by the Joint Committee on Taxation and compares it to an identical statistic computed by the Urban-Brookings Tax Policy Center for the House version of H.R. 2 for 2003 based on its internal estimation model. The two methodologies yield relatively similar results. Most important, the same conclusions can be drawn from both calculations: the proposal was anticipated to have generally increased the after-tax incomes for all income cohorts and would have shifted after-tax income shares to those with higher incomes.[13]

From an economic perspective, distributional analyses using income as a basic category ideally include an economic definition of income, rather than a more restrictive accounting or tax-based definition of income. Accordingly, the Joint Committee on Taxation's analysis expanded the legal definition of income used for tax purposes to include several other forms of income not included in the tax term, "adjusted gross income." The analysis prepared by Urban-Brookings Tax Policy Center applies a more restrictive definition of income, which may provide a partial explanation of why the two organizations' models result in different after-tax income changes, as a percent. In short, a narrower definition of income will result in a larger change in after-tax income from a tax reduction. While most of the major provisions included in H.R. 2 were incorporated into the distributional estimates, the tax reductions on businesses, specifically, the temporarily increased allowable business expensing, bonus depreciation, and carryback of net operating losses were not included in either analysis.

Since the various proposals differed both in the magnitude and design of the immediate tax reductions, the distributional analysis of the four proposals (Administration, House, Senate, and P.L. 108-27) also differs. **Table 4** provides a side-by-side illustration of the distributional effects of each package, as estimated by the Urban-Brookings Tax Policy Center. One of the most significant differences is the variety of proposals for reducing the tax on dividends. Consequently, the distributional analyses among the plans, while quite similar for low and middle rate taxpayers, varies most for higher income cohorts as this group tends to benefit most from such proposals. Specifically, the House package and final version appear the most beneficial, and the Senate package the least beneficial, for the highest income groups.

One approach for reducing the limitations on the various definitions of income is to illustrate the distribution of the changes in after-tax income by percentile of

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[13] Note the analysis here stops short of making a determination of the relative changes the proposals would make in the progressivity of the tax system. Succinctly, there is not one agreed upon definition of how to measure relative levels of progressivity. For further information on this topic, see Donald W. Kiefer, "Progressivity, measures of," in Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle, eds., *The Encyclopedia of Taxation and Tax Policy* (Washington, D.C.: Urban Institute Press, 1999), pp. 285-287.

income class: quartile, quintile, etc. **Table 5** reflects a distributional analysis prepared by the Urban-Brookings Tax Policy Center for each of the major legislative proposals by income percentiles. In this depiction, the strict definitions of income became less important since it is likely that the same taxpayers are expected to generally fall into similar broad percentile categories, regardless of measures of income.

Table 3. Comparison of the Percentage Change in After-Tax Income from H.R. 2: Joint Committee on Taxation for House Proposal and Urban-Brookings Tax Policy Center Analysis of Administration, House, Senate, and P.L. 108-27, Calendar Year 2003[a]

Adjusted Gross Income (Agi); (Income Category for Jct Computed Figures)[b]	Administration Proposal (From Urban-brookings Tax Policy Center)[c,d]	House Proposal (Computed from Jct Figures)[e]	House Proposal (From Urban-brookings Tax Policy Center)[c,d]	Senate Proposal (From Urban-brookings Tax Policy Center)[c,d]	P.l. 108-27 (From Urban-brookings Tax Policy Center) [c,d]
Less than $10,000	Less than 0.05%	0.0%	Less than 0.05%	0.1%	Less than 0.05%
10,000 to 20,000	0.4%	0.1%	0.3%	0.6%	0.3%
20,000 to 30,000	0.8%	0.3%	0.8%	0.9%	0.8%
30,000 to 40,000	1.0%	0.6%	1.0%	1.0%	1.0%
40,000 to 50,000	1.2%	0.8%	1.1%	1.1%	1.1%
50,000 to 75,000	1.3%	0.9%	1.2%	1.2%	1.2%
75,000 to 100,000	2.2%	1.4%	2.1%	2.1%	2.1%
100,000 to 200,000	2.3%	2.1%	2.3%	2.2%	2.2%
200,000 to 500,000	2.4%	3.3% for greater than $200,000	2.5%	2.2%	2.2%
500,000 to 1,000,000	3.6%		3.5%	3.1%	3.5%
More than 1,000,000	4.2%		4.4%	3.5%	4.4%
All	1.8%	1.6%	1.8%	1.7%	1.8%

Source: Urban-Brookings Tax Policy Center and CRS calculations of Joint Committee on Taxation estimates.

Notes:

a. Statistics are for calendar year; baseline is prior law. As appropriate, the above analysis includes the following general provisions: increase child tax credit; increase in refundability rate for additional child tax credit; expand the 10% bracket, expand width of the 15% bracket and increased standard deduction (marriage penalty provisions), accelerate reduction in the tax rates under EGTRRA; increase AMT exemption; and reduced taxation of dividends (and capital gains).

b. Tax units with negative AGI are excluded from the lowest income class but are included in the totals.

c. Includes both filing and non-fling units. Tax units that are dependent of other taxpayers are excluded from the analysis.

d. After-tax income is AGI less individual income tax net of refundable credits.

e. Notes one through three from table 2 apply.

Table 4. Percentage Change in After-Tax Income by Percentiles, 2003[a,b]

AGI Class[c]	Administration Proposal	House Proposal	Senate Proposal	P.l. 108-27
Lowest Quintile (0 - 20%)	less than 0.05%	less than 0.05%	0.1%	less than 0.05%
Second Quintile (20 - 40%)	0.3%	0.3%	0.5%	0.3%
Middle Quintile (40 - 60%)	0.9%	0.8%	0.9%	0.8%
Fourth Quintile (60 - 80%)	1.1%	1.1%	1.0%	1.1%
Next 10% (80 - 90%)	1.9%	1.8%	1.8%	1.8%
Next 5% (90 - 95%)	2.4%	2.3%	2.2%	2.3%
Next 4% (95 - 99%)	2.3%	2.3%	2.2%	2.2%
Top 1% (99-100%)	3.6%	3.6%	3.0%	3.6%
All	1.8%	1.8%	1.7%	1.8%

Source: Urban-Brookings Tax Policy Center.

Notes:

a. Statistics are for calendar year; baseline is prior law. As appropriate, the above analysis includes the following general provisions: increase child tax credit; increase in refundability rate for additional child tax credit; expand the 10% bracket, expand width of the 15% bracket and increased standard deduction (marriage penalty provisions), accelerate reduction in the tax rates under EGTRRA; increase AMT exemption; and reduced taxation of dividends (and capital gains).

b. Includes both filing and non-fling units. Tax units that are dependent of other taxpayers are excluded from the analysis.

c. Tax units with negative AGI are excluded from the lowest income class but are included in the totals.

Table 5 shows an excerpt from the Department of the Treasury's distributional analysis of P.L. 108-27. It does not include a comparison of after-tax income nor does the analysis offer the data to make that computation. Rather, it is based upon the change in the distribution of total individual income taxes. In contrast to the previous illustrations, other taxes such as payroll taxes and excise taxes are not incorporated into this analysis. Interpretation is complicated without additional information such as the number of taxpayers within each category, and even with such information, the presentation would respond to a substantively different question than an assessment of an individual's well-being as previously discussed. It considers the question of which taxpayers most heavily support government services through income taxes, before and after the change in law. Similarly, the percent change in individual income taxes does not provide a meaningful assessment of the change in one's standard of living. For example, an individual who pays a dollar in income tax and then pays no tax after the change will receive a 100% reduction in tax liability, but this effect will be negligible on his lifestyle. The percentage change would also exhibit a different pattern if other federal taxes were included.

Table 5. Comparison of the Distribution of Total Individual Income Taxes, 2003[a]

Cash Income Class[b]	Distribution of Total Individual Income Taxes[c]		Percent Change in Individual Income Taxes
	Prior Law	Law with P.l. 108-27[d]	
less than $30,000	-2.0%	-2.6%	-15.5%
30,000 to 40,000	2.1%	1.9%	-19.3%
40,000 to 50,000	3.7%	3.6%	-14.0%
50,000 to 75,000	11.6%	11.7%	-11.1%
75,000 to 100,000	12.1%	12.0%	-12.7%
100,000 to 200,000	27.6%	27.9%	-11.0%
more than 200,000	44.8%	45.4%	-10.8%
Total[e]	100.0%	100.0%	-11.9%

Source: Excerpt from a table prepared by the Department of the Treasury.

Notes:
a. The provisions of P.L. 108-27 included are i) accelerate to 2003 the reductions in income tax rates above 15% scheduled for 2004 and 2006; ii) accelerate to 2003 the increase in the width of the 10% bracket for single and joint filers scheduled for 2008; iii) accelerate to 2003 the increase in the standard deduction and the width of the 15% bracket for joint filers scheduled to phase in between 2005 and 2009; iv) accelerate to 2003 the increase in the child credit from $600 to $1,000 scheduled to phase in between 2005 and 2010; v) an increase in the AMT exemption amounts; and vi) a reduction in the tax rates on dividends and capital gains to 5% (for taxpayers in the 10% and 15% ordinary income tax brackets) and to 15% (for taxpayers in the higher ordinary income tax brackets).
b. Cash income consists of wages and salaries, net income from a business or farm, taxable and tax-exempt interest, dividends, rental income, realized capital gains, cash transfers from the government, and retirement benefits. Employer contributions for payroll taxes and the federal corporate income tax are added to arrive at a family's cash income used in the distributions.
c. The refundable portions of the earned income tax credit (EITC) and the child credit are included in the individual income tax. Individual income taxes are estimated at 2000 income levels under 2003 law as if it were fully phased in law, so exclude provisions that expire prior to the end of the budget period (ignoring the sunset of EGTRRA in 2011) and are adjusted for the effects of unindexed parameters.
d. The change in individual income taxes under P.L. 108-27 is estimated at 2000 income levels as if the change represented fully phased in law (ignoring the sunset of EGTRRA in 2011).
e. Families with negative incomes are excluded from the lowest income class but included in the total line.

Similarly, among a wide variety of distributional measures released by the Urban-Brookings Tax Policy Center, one statistic presented is the average tax change among income quintiles. This absolute measure is presented in **Table 6**, and would not, alone, offer sufficient information to determine whether or not a modification to the tax law would result in a system that relatively favors or burdens those with higher incomes. The average tax change among income classes suggests high income taxpayers benefit much more, in absolute dollars, than lower income taxpayers. Nonetheless, it is important to recognize that these same taxpayers currently have a larger proportion of the total income and pay a higher fraction of the total taxes - a result of the generally progressive federal tax structure. Therefore, tax changes that result in both more and less favorable relative treatment of high income taxpayers would likely result in larger changes in average taxes for the highest taxpayers.

Table 6. Average Tax Change by Income Percentile, 2003

AGI Class	Average Tax Change
Lowest Quintile (0 - 20%)	-$1
Second Quintile (20 - 40%)	-$38
Middle Quintile (40 - 60%)	-$217
Fourth Quintile (60 - 80%)	-$482
Next 10% (80 - 90%)	-$1,270
Next 5% (90 - 95%)	-$2,125
Next 4% (95 - 99%)	-$3,145
Top 1% (99-100%)	-$20,786
All	-$715

Source: Urban-Brookings Tax Policy Center.

Notes: Identical to those outlined in Table 4.

Two basic economic principles inform the discussion of distributional analysis: vertical equity and horizontal equity. An analysis of vertical equity assesses how taxpayers with different incomes are treated, relative to the tax burden of a proposal. The measures of percentage of after-tax income, by income category, shown in the previous analyses provides information related to the concept of vertical equity. An analysis of horizontal equity assesses how taxpayers with equal incomes but in different circumstances are treated, relative to the tax burden under a proposal. In addition to vertical equity issues, horizontal equity issues are raised within the context of tax cuts directed at married couples, families with children, and dividends and capital gains.

Several of the tax reduction provisions included in H.R. 2 were not solely dependent upon an individual's income or wealth, but on other characteristics such as family status and, even indirectly, other deductions for which a taxpayer may be eligible. For example, due to the acceleration in the tax reductions targeted at married couples and the increase of the child tax credit, single taxpayers and those without children benefit less than married taxpayers and families with children. This result provides the basis for the anecdotal example cited by the Secretary of the Treasury on the President's proposal, "A typical family of four with two earners making a combined $39,000 will receive a total of $1,100 in tax relief, compared to the taxes they paid in 2002, under the President's plan...".[14]

The "marriage penalty" occurs for certain families when the incomes are combined and subjected to progressive income tax rates.[15] In contrast, it is possible that others experience a "marriage bonus," particularly in cases where two incomes are unequal, since the exemption amounts and rate brackets are broader under the prior law for married couples. In terms of the taxation of families with children, an assessment of the "fairness" of the existing tax system is contingent upon how one believes children and family sizes should be treated vis a vis the income tax system. Several theories are available to guide this choice such as: treating children as consumption, treating children as investment, and maintaining comparable before-tax and after-tax income between families of different sizes (ability to pay). Regardless of the treatment of families before the proposals, the distribution of all of the proposals favored married couples and families compared to single taxpayers.

As the largest single provision in terms of reduced revenue, the reduction or elimination of the taxation of dividends, and at times, capital gains, exhibits specific vertical and horizontal distributional effects.[16] In terms of horizontal equity, it may be argued that owners of capital were unfairly taxed under the prior tax structure compared to those holding other investments such as corporate debt. Therefore, any reduction in these taxes would have disproportionately benefitted owners of corporate equity over other classes. However, this argument fails to account for the mobility of investment in search of equal, risk-adjusted returns on an after-tax basis. (Those holding corporate equities at the time of passage may indeed benefit from a one-time windfall from the reduction in taxes.) Horizontal fairness considerations, in other words, do not apply in the usual way because investors are free to choose whether or not to invest in heavily taxed assets.

As a result, the more significant analysis might reside with issues of vertical equity: do the tax reductions contribute to distributional issues within the tax system? Most economists believe that the economic incidence of a tax on capital income largely falls on the owners of capital (as opposed to labor, for example). Further, the distribution of both dividends and capital income is more concentrated among those taxpayers with higher incomes compared to those with lower incomes, generally. As illustrated in **Table 7**, with the exception of the lowest income categories, dividends generally account for a higher percentage of income for those with the highest incomes. The distribution of capital gains make up an even greater proportion of adjusted gross income for tax returns from higher income groups than from lower income groups. Consequently, and notwithstanding the limitations of using adjusted

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[14] U.S. Department of the Treasury, *Secretary Snow's Opening Statement before the House Ways and Means Committee Testimony on the President's Budget*, JS-02, Feb. 4, 2003. Posted on the Treasury's Web site at [http://www.treas.gov/press/releases/js02.htm].

[15] For further information on the marriage tax penalty, see CRS Report RL30419, *The Marriage Tax Penalty: An Overview of the Issues*, by Jane G. Gravelle.

[16] For a more extensive discussion of issues of equity and distribution, see CRS Report RL31597, *The Taxation of Dividend Income: An Overview and Economic Analysis of the Issues*, by Gregg A. Esenwein and Jane G. Gravelle.

gross income as a measure of income, those with higher incomes bore a greater burden of the tax on capital gains and dividends under prior law. Similarly, higher income taxpayers were expected to benefit the most from a reduction in taxes on dividends and capital gains.

Table 7. Dividends and Capital Gains as a Percentage of Adjusted Gross Income, 2000

Income Category	Adjusted Gross Income (AGI) Less Deficit	Dividend Amount	Dividends as Percent of AGI	Net Capital Gains, Losses, and Distributions	Net Capital Gains as Percent of AGI
No AGI	-$58,599,965	$1,576,463	na	$6,629,135	na
Less than $5,000	34,203,382	1,126,432	3.3%	1,545,803	4.5%
5,000 to 10,000	95,975,660	1,903,650	2.0%	2,685,021	2.8%
10,000 to 15,000	151,243,464	2,667,185	1.8%	2,518,815	2.7%
15,000 to 20,000	203,601,716	3,192,758	1.6%	2,724,105	1.3%
20,000 to 25,000	224,389,266	2,491,989	1.1%	3,256,199	1.5%
25,000 to 30,000	229,375,741	2,617,639	1.1%	3,054,874	1.3%
30,000 to 40,000	470,892,948	5,390,865	1.1%	6,877,584	1.5%
40,000 to 50,000	465,603,449	6,288,365	1.4%	8,329,955	1.8%
50,000 to 75,000	1,044,655,055	14,571,639	1.4%	23,353,710	2.2%
75,000 to 100,000	737,503,612	12,568,533	1.7%	22,364,044	3.0%
100,000 to 200,000	1,066,341,747	26,866,194	2.5%	65,289,214	6.1%
200,000 to 500,000	613,755,638	23,168,417	3.8%	79,496,171	13.0%
500,000 to 1,000,000	269,020,887	11,465,353	4.3%	54,864,271	20.4%
1 to 1.5 million	120,604,227	5,162,730	4.3%	31,196,776	25.9%
1.5 to 2 million	76,710,836	3,489,259	4.5%	22,383,144	29.2%
2 to 5 million	199,393,478	8,072,349	4.0%	69,183,786	34.7%
5 to 10 million	120,577,375	4,694,445	3.9%	50,077,200	41.5%
10 million or more	300,128,133	9,673,414	3.2%	174,712,625	58.2%

Source: CRS calculations based on Internal Revenue Service *Statistics of Income*, Fall 2002.
Note: Capital gains include net capital gains plus capital gain distributions minus net capital losses for each income cohort.

Appendix

This appendix provides a side-by-side comparison of prior law, President Bush's economic growth portion of the FY2004 Budget proposal, H.R. 2, as approved by the House, the proposal adopted by the Senate Finance Committee on May 9, and P.L. 108-27. (Some initial notes are included in the Senate Finance Committee column that reflect changes made on the Senate floor.) It also presents item-by-item revenue estimates prepared by the Joint Committee on Taxation. The table is not intended to be comprehensive but does contain the principal provisions of each proposal.

Table 8. Comparison of Principal Provisions

Prior Law	**President's Proposal**	**House**	**Senate Finance**	**P.L. 108-27**
		Individual Income Taxes		
		Individual Income Tax Rates		
Tax rates applicable to individuals' taxable income were 10%, 15%, 27%, 30%, 35%, and 38.6% for 2003; 10%, 15%, 26%, 29%, 34%, and 37.6% for 2004 and 2005; and 10%, 15%, 25%, 28%, 33%, and 35% for 2006 through 2010 under. EGTRRA's "sunset" provisions, rates in 2011 and beyond reverted back to the statutory rates effective prior to its passage: 15%, 28%, 31%, 36%, and 39.6%. The 10% tax rate bracket applied to the first $6,000 of taxable income of individuals and $12,000 for married couples filing jointly for 2003 through 2007. For 2008, 2009, and 2010, the 10% tax rate bracket applied to the first $7,000 of taxable income of individuals and $14,000 for married couples filing jointly. Both provisions were scheduled to expire along with all of the provisions of EGTRRA after 2010.	Would have accelerated the reduction in the tax rates for individuals scheduled for reduction in 2004 and 2006 under then existing law. The rates scheduled for 2006 (10%, 15%, 25%, 28%, 33%, and 35%) would have become effective for 2003 and thereafter. The 10% tax rate bracket would be expanded by $1,000 (to $7,000) for single individuals and by $2,000 (to $14,000) for married couples filing jointly. In short, the 2008 scheduled increase would be advanced to 2003. Estimated revenue loss: $58.3 billion in FY2003 and FY2004; $118.8 billion in FY2003 through FY2013 (11 years).	Would have accelerated the reduction in the tax rates for individuals scheduled for reduction in 2004 and 2006 under then existing law. The rates scheduled for 2006 (10%, 15%, 25%, 28%, 33%, and 35%) would have become effective for 2003 and thereafter. The 10% tax rate bracket would have been expanded by $1,000 (to $7,000) for single individuals and by $2,000 (to $14,000) for married couples filing jointly. The bracket size would have been annually adjusted for inflation. The reduced rates and expanded bracket would have been effective for 2003, 2004, and 2005. Beyond 2005, the rates imposed by EGTRRA would have been effective and would have expired, as scheduled in 2010. The expanded 10% bracket would have reverted to present law in 2006. Estimated revenue loss: $58.3 billion in FY2003 and FY2004; and $92.6 billion over 11 years.	Would have accelerated the reduction in the tax rates for individuals scheduled for reduction in 2004 and 2006 under then existing law. The rates scheduled for 2006 (10%, 15%, 25%, 28%, 33%, and 35%) would become effective for 2003 and thereafter. The 10% tax rate bracket would be expanded by $1,000 (to $7,000) for single individuals and by $2,000 (to $14,000) for married couples filing jointly. The bracket size would be annually adjusted for inflation. The reduced rates would begin in 2003 and expire, as scheduled, under EGTRRA after 2010. Estimated revenue loss: $58.3 billion in FY2003 and FY2004; and $118.8 billion over 11 years.	Accelerates the reduction in the tax rates for individuals scheduled for reduction in 2004 and 2006 under prior law. The rates scheduled for 2006 (10%, 15%, 25%, 28%, 33%, and 35%) became effective for 2003 and thereafter (given present law in 2006), but will expire as scheduled under EGTRRA after 2010. The law expands the 10% tax rate bracket by $1,000 (to $7,000) for single individuals and by $2,000 (to $14,000) for married couples filing jointly for 2003 and 2004. (For 2004, these amounts will be indexed for inflation.) In 2005, the tax rate brackets will revert to the schedule under prior law. Estimated revenue loss: $58.3 billion in FY2003 and FY2004; and $86.1 billion over 11 years.

Prior Law	President's Proposal	House	Senate Finance	P.L. 108-27
		Alternative Minimum Tax Exemption		
The alternative minimum tax exemption was set at $49,000 for joint returns and $35,750 for single returns for 2003 and 2004. The levels were reduced to $45,000 for joint returns and $33,750 for single returns for 2005 and thereafter.	Proposal would have increased the AMT exemption amount by $8,000 (to $57,000) for joint returns and by $4,000 (to $39,750) for single returns for 2003, 2004, and 2005. The increases would not have been applicable after 2005. Estimated revenue loss: $10.1 billion in FY2003 and FY2004; $37.3 billion over 11 years.	The size of the AMT exemption would have been increased by $15,000 (to $64,000) for joint returns and by $7,500 (to $43,250) for single returns for 2003, 2004, and 2005. The increases would not have been applicable after 2005. Estimated revenue loss: $15.0 billion in FY2003 and FY2004; $53.0 billion over 11 years.	The size of the AMT exemption would be increased by $12,000 (to $61,000) for joint returns and by $6,000 (to $41,750) for single returns for 2003, 2004, and 2005. [These were reduced on the Senate floor to $60,500 for joint returns and $41,500 for singles.] The increases would not be applicable after 2005. Estimated revenue loss: $13.6 billion in FY2003 and FY2004; $49.3 billion over 11 years.	The law increases the size of the AMT exemption by $9,000 (to $58,000) for joint returns and by $4,500 (to $40,250) for single returns for 2003 and 2004. The increases will not be applicable after 2004. Estimated revenue loss: $11.5 billion in FY2003 and FY2004; and $17.8 billion over 11 years.

Prior Law	**President's Proposal**	**House**	**Senate Finance**	**P.L. 108-27**
Married Couples				
Phased in an increase in the standard deduction for couples to twice that of singles: 167% of singles bracket in 2003 and 2004, 174% in 2005, 184% in 2006, 187% in 2007, and 190% in 2008 and 200% in 2009 and 2010. Phased in over 2005-2008 a broadening of the 15% rate bracket for couples to twice that of singles. From 2008 through 2010, the rate for married couples filing jointly was 200% of singles.	Would have accelerated, to 2003, the increase in the standard deduction for couples to twice that of singles. Would have accelerated, to 2003, the broadening of the 15% rate bracket for couples to twice that of singles. Estimated revenue loss: $30.9 billion in FY2003 and FY2004; $55.4 billion over 11 years.	The proposal would have accelerated, to 2003, the increase in the standard deduction for couples to twice that of singles. Would have accelerated, to 2003, the broadening of the 15% rate bracket for couples to twice that of singles. The provision would have been applicable to tax years 2003, 2004, and 2005. Beyond 2005, the standard deduction amounts and the size of the 15% rate bracket would have reverted to the schedule under EGTRRA. Estimated revenue loss: $29.8 billion in FY2003 and FY2004; $43.4 billion over 11 years.	Would accelerate, to 2003, the increase in the standard deduction for couples to twice that of singles. Would accelerate, to 2003, the broadening of the 15% rate bracket for couples to twice that of singles. The reduced rates would expire after 2010, as scheduled under EGTRRA. Estimated revenue loss: $29.8 billion in FY2003 and FY2004; $51.4 billion over 11 years. [The Senate adopted an amendment that would accelerate the increase in the standard deduction and broadening of the tax rate bracket for couples to 195% of singles in 2003 and 200% in 2004. Beyond 2004, the Senate version would have reverted to the phase-in under prior law.]	Accelerates the increase in the standard deduction for couples to twice that of singles for 2003 and 2004. Accelerates the broadening of the 15% rate bracket for couples to twice that of singles for 2003 and 2004. For 2005 and thereafter, the deduction and bracket width will revert to prior law and will expire after 2010, as previously scheduled under EGTRRA. Estimated revenue loss: $29.8 billion in FY2003 and FY2004; $35.1 billion over 11 years.

Prior Law	President's Proposal	House	Senate Finance	P.L. 108-27
Child Tax Credit				
The child tax credit was scheduled to be increased from $600 in 2003 to $1,000 in 2010. Specifically, the credit was scheduled to be $600 in 2003 and 2004, $700 in 2005 through 2008, $800 in 2009, and $1,000 in 2010. The credit was scheduled to revert to $500 in 2011 under EGTRRA's sunset provisions. The child tax credit was refundable to the extent of 10% of income over $10,500 for 2003 and 2004, 15% of income over $10,500, indexed for inflation from 2005 to 2010.	The plan would have accelerated the child credit increase to $1,000 to 2003. Estimated revenue loss: $19.4 billion in FY2003 and FY2004; $89.6 billion over 11 years.	Would have accelerated the child credit increase to $1,000 to 2003. The increase would have expired after 2005 and reverted to the amounts scheduled under EGTRRA. Estimated revenue loss: $19.5 billion in FY2003 and FY2004; $45.0 billion over 11 years.	The plan would accelerate the child credit increase to $1,000 to 2003. The reduced rates would expire, as scheduled under EGTRRA after 2010. Estimated revenue loss: $21.3 billion in FY2003 and FY2004; $93.3 billion over 11 years.	Accelerates the child credit increase to $1,000 from $600 for 2003 and 2004. In 2003, the amount of the increase ($400) is to be paid in advance to qualifying taxpayers. The reduced rates are scheduled to revert to prior law and expire, as scheduled under EGTRRA after 2010. Estimated revenue loss: $19.5 billion in FY2003 and FY2004; $32.5 billion over 11 years.

Prior Law	President's Proposal	House	Senate Finance	P.L. 108-27
		Business Taxes		
		Business Expensing		
Instead of depreciating certain business equipment, businesses with equipment investment of less than $200,000 were allowed to deduct up to $25,000 of the cost for tax purposes. (The $25,000 was reduced to the extent the investment exceeds $200,000.) The provision did not apply to off-the-shelf computer software.	The threshold investment level for small businesses would have been increased from $200,000 to $325,000. The amount eligible for deduction would have been increased from $25,000 to $75,000 beginning in 2003. After 2003, the threshold amounts and the deduction limit would have been indexed for inflation. The provision would have been extended to off-the-shelf computer software. Estimated revenue loss: $4 billion in FY2003 and FY2004; and $28.8 billion over 11 years.	The threshold investment level for small businesses would have been increased from $200,000 to $400,000. The amount eligible for deduction would have been increased from $25,000 to $100,000 beginning in 2003. After 2003, the threshold amounts and the deduction limit would have been indexed for inflation. The provision would have been extended to off-the-shelf computer software. The provision would have expired after 2007. Estimated revenue loss: $4.3 billion in FY2003 and FY2004; $2.7 billion over 11 years.	The threshold investment level for small businesses would be increased from $200,000 to $325,000. The amount eligible for deduction would be increased from $25,000 to $75,000 beginning in 2003. After 2003, the threshold amounts and the deduction limit would be indexed for inflation. The provision would be extended to off-the-shelf computer software. The provision would sunset after 2012. Estimated revenue loss: $4.1 billion in FY2003 and FY2004; $23.4 billion over 11 years. [The Senate approved an amendment that would have changed the Senate's version to more closely mirror the House version. The threshold investment level would have been increased from $200,000 to $400,000 and the eligible deduction would be increased from $25,000 to $100,000. The provision would sunset after 2007.]	The threshold investment level for small businesses is increased from $200,000 to $400,000. The amount eligible for deduction is increased from $25,000 to $100,000 beginning in 2003. After 2003, the threshold amounts and the deduction limit will be indexed for inflation. The provision is extended to off-the-shelf computer software. The provision will sunset after 2005. Estimated revenue loss: $4.3 billion in FY2003 and FY2004; $1 billion over 11 years.

Prior Law	President's Proposal	House	Senate Finance	P.L. 108-27
Depreciation				
In general, the tax code required businesses depreciate the cost of property over a scheduled time period. As a result of the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147), businesses were allowed to elect a first year depreciation deduction of 30% for certain property purchased between September 11, 2001 and September 11, 2004, and placed in service before January 1, 2005. This is also termed "bonus depreciation."	No provision.	Qualified property would have been eligible for a "bonus depreciation" deduction of 50% in the first year if acquired after May 5, 2003 and before January 1, 2006 and placed in service before January 1, 2006. (This enhanced depreciation provision would have thus been imposed for one additional year beyond the then existing 30% bonus depreciation deduction.) Estimated revenue loss: $33.2 billion for FY2003 and FY2004; $21.5 billion over 11 years.	No provision.	Qualified property is eligible for a "bonus depreciation" deduction of 50% in the first year if acquired after May 5, 2003 and before January 1, 2005. Estimated revenue loss: $43.2 billion for FY2003 and FY2004; $9.2 billion over 11 years.
Net Operating Losses				
In most instances, a net operating loss (NOL) can be carried back two years and forward for 20 years to offset against taxable income in those years. The Job Creation and Worker Assistance Act of 2002 (P.L. 107-147) extended the carryback period to five years for NOLs arising in 2001 and 2002. An NOL deduction was limited to offsetting 90% of a business's alternative minimum taxable income (AMTI).	No provision.	The proposal would have extended the enhanced five-year carryback period for NOLs arising in 2003 through 2005. The proposal also would have allowed both five-year carrybacks arising in 2003 through 2005 and carryforwards to taxable years 2003 through 2005 to reduce a business's AMTI by 100%. Estimated revenue loss: $20.9 billion for FY2003 and FY2004; $14.6 billion over 11 years.	No provision.	No provision.

Prior Law	President's Proposal	House	Senate Finance	P.L. 108-27
Taxation of Dividends and Capital Gains				
Dividends				
A corporation pays tax on all of its taxable earnings up to the maximum rate of 35%. Individuals receiving distributions of after-tax earnings from a corporation in the form of dividends included the amount in their gross income and pay tax at the appropriate individual tax rate. Corporations receiving dividends from another domestic corporation were allowed to exclude at least 70% of the dividend received.	The proposal would have eliminated the double taxation of dividends by allowing individual and corporate shareholders to exclude dividends from their taxable income. (This was also termed "tax integration"). More specifically, the amount of the dividends eligible for exclusion would have been computed by the corporation and was termed the excludable dividend amount (EDA). In general, the EDA was a measure of the corporation's fully taxable income, reduced by the taxes it paid. The provision would have applied to distributions made beginning in 2003. Dividends from foreign corporations would have been excluded only in the case of foreign corporations conducting U.S. business. Estimated revenue loss: $30.9 billion in FY2003 and FY2004; $395.8 billion over 11 years.	Dividends received by an individual from domestic corporations would have been subjected to reduced rates: 15% for higher income taxpayers and 5% for those in the 10 and 15% tax rate brackets. (These same rates would have applied to capital gains.) Dividends from foreign corporations would not have received the reduced rates. The provision would have begun in 2003 and expire after 2012. Estimated revenue loss: $22.1 billion in FY2003 and FY2004; $245.8 billion over 11 years.	Would exclude the first $500 of qualified dividends received from taxable income, beginning in 2004. In addition, 10% of dividends received in excess of $500 would also be excluded from taxation from 2004 through 2007. From 2008 through 2012, 20% of dividends received in excess of $500 would be excluded from taxation. Dividends from foreign corporations would qualify for the exclusion. The provision would begin in 2004 and expire after 2012. Estimated revenue loss: $2.0 billion in FY2004; $81.1 billion over 10 years. [The Senate approved an amendment that would have reduced the taxation of dividends for foreign and domestic corporations by 50% in 2003 and provide a 100% exclusion in 2004, 2005, and 2006.]	The law reduces the individual tax rates applied to domestic and foreign corporate dividends received to 15% for taxpayers in the higher tax brackets and 5% for taxpayers in the 15% and 10% income tax brackets. This provision began in 2003 and is scheduled to expire after 2008. (In 2008 only, the applicable rates will be 15% and 0%, respectively.) Beyond 2008, the tax structure will revert to prior law. Estimated revenue loss: $21.8 billion in FY2003 and FY2004; $125.7 billion over 11 years.

Prior Law	**President's Proposal**	**House**	**Senate Finance**	**P.L. 108-27**
Capital Gains				
The capital gains upon sale of long-term capital assets (held more than 12 months) were taxed at 20% (10% for taxpayers in the 10 and 15% income tax brackets). For assets held more than 5 years, beginning with ownership after December 31, 2000, the maximum rate was 18% (8% for lower brackets).	The President's "tax integration" proposal to eliminate the double taxation of dividends would have effectively eliminated the tax on capital gains by allowing shareholders to adjust their basis in computing their capital gains. Therefore, prior to the sale of a stock, corporate income that was previously taxed would not have been subject to capital gains tax at the individual level. Estimated revenue loss: The Joint Committee on Taxation did not separate the revenue loss from the revenue loss attributed to the elimination of the tax on dividends.	The proposal would have reduced the 20% and 10% tax rates applicable to capital gains to 15% and 5%, respectively. The provision would have begun in 2003 and expired after 2012. Estimated revenue loss: $990 million for FY2003 and FY 2004; $31 billion over 11 years.	No provision.	The law reduces the 20% and 10% tax rates applicable to capital gains to 15% and 5%, respectively. This provision began in 2003 and is scheduled to expire after 2007. In 2008 only, the applicable rates will be 15% and 0%, respectively. Beyond 2008, the tax structure will revert to prior law. Estimated revenue loss: $1 billion in FY2003 and FY2004; $22.4 billion over 11 years.

Prior Law	President's Proposal	House	Senate Finance	P.L. 108-27
Other Major Provisions				
Revenue Raising Offsets				
For additional information on the then existing law for each of the underlying provisions, see U.S. Congress, Joint Committee on Taxation, *Description of the Chairman's Modification to the Provisions of the "Jobs and Growth Tax Act of 2003,"* and *Description of Additional Chairman's Modification to the Provisions of the "Jobs and Growth Tax Act of 2003,"* 108th Cong., 1st sess. (Washington: May 8, 2003).	No provisions.	No provisions.	The proposal approved by the Senate Finance Committee included more than two dozen revenue offsets, customs user fee extensions, and additional reform measures amounting to $ 5.8 billion in FY2003 and FY2004 and $92.4 billion over 11 years. Examples of major revenue offsets included clarification of the economic substance doctrine ($13.6 billion over the 11-year projection period) and repeal of the foreign earned income exclusion ($32.1 billion over the projection period). Customs user fee extensions included in the proposal would have extended the passenger and conveyance processing fee and the merchandise processing fee through 2013.	No provisions.
Assistance to State and Local Governments				
The federal government has provided state and local governments with assistance through a wide variety of programs, grants, and formulas.	No provision.	No provision.	The proposal would have created a fund to provide $20 billion in aid to state and local governments ($10 billion in FY2003 and $10 billion in FY2004). Estimated cost: $20 billion in FY2003 and FY2004.	The law creates a fund to provide $20 billion in aid to state governments. Estimated costs: $20 billion in FY2003 through FY2004.