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Extending the 2001, 2003, and 2004 Tax Cuts

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Summary

The Economic Growth and Tax Relief Reconciliation Act of 2001 reduced marginal income tax rates, provided marriage tax penalty relief, provided temporary relief from the alternative minimum tax (AMT), and increased the child tax credit. All of the act's provisions are scheduled to sunset (revert to prior law levels) at the end of 2010. The Jobs and Growth Tax Relief Reconciliation Act of 2003 accelerated the implementation of certain tax reductions originally enacted in the 2001 act. The 2003 act also reduced the tax rate on dividend and long-term capital gains income. The dividend and capital gains tax relief is scheduled to expire after 2008. The Working Family Tax Relief Act of 2004, extended many of the tax provisions scheduled to expire at the end of 2004 (it did not, however, extend the capital gains/dividend tax reductions). The 2004 tax reductions, however, are still scheduled to sunset after 2010 as per the original 2001 legislation required.

Since all of the tax reductions expire at some point in the future, Congress faces the issue of whether to extend and/or make the reductions permanent. The AMT relief expires at the end of 2006 and the capital gains/dividend tax cuts expire in 2008. Some have suggested extending the AMT tax provisions and the capital gains/dividend tax reductions under the tax reduction provisions contained in the 2006 budget resolution.

The conference agreement on the 2006 budget resolution, H.Con.Res. 95, was approved by both chambers on April 28, 2005, and contained $106 billion in tax relief over the next five years, approximately $70 billion of which would be protected through the reconciliation process. As part of reconciliation, on November 18, the Senate approved the Tax Relief Act of 2005 (S. 2020). This bill would, among other things, extend AMT tax relief and the deduction for state and local taxes through 2006. On November 15, the Ways and Means Committee approved H.R. 4297 which, among other things, would provide a one-year extension for both the deduction of state/local general sales taxes and the treatment of nonrefundable personal tax credits under the AMT. It would also extend the capital gains/dividend tax reductions for two years.

This report will be updated to reflect legislative activity.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) reduced marginal income tax rates, created a new 10% income tax bracket, provided marriage tax penalty relief, increased the child tax credit, and increased the alternative minimum tax (AMT) exemption. These changes were scheduled to phase in over a period of several years.

All of the changes in EGTRRA (including the tax rate changes) will expire (sunset) after 2010. Congress included the sunset in EGTRRA to avoid a Byrd rule (Section 313 of the 1974 Congressional Budget Act, as amended) violation in the Senate. The Byrd rule prohibits "extraneous matter" in reconciliation legislation.[1] Under the rule, extraneous matter includes, among other things, language that would cause an increase in the budget deficit (or reduce budget surpluses) in a fiscal year beyond those covered by the reconciliation legislation. As a result of the Byrd rule, EGTRRA contained language providing for the expiration of all of its provisions at the end of calendar year 2010, since the years after 2010 were outside the reconciliation budget window.

In 2003, in an effort to stimulate the economy, Congress passed the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA; P.L.108-27). JGTRRA accelerated the implementation of certain tax reductions originally enacted as part of EGTRRA. These included marriage tax penalty relief, expansion of the 10% tax bracket, an increase in the child tax credit to $1,000, and an increase in the AMT exemption. These changes were temporary and were scheduled to be in effect for two years, 2003 and 2004.

In addition, JGTRRA lowered the maximum tax rate on qualified dividend income and long-term capital gain income (gains on assets held longer than 12 months) to 5% (0% for 2008) for taxpayers in the 10% and 15% marginal income tax brackets. The maximum dividend and capital gains tax rate was reduced to 15% for taxpayers in marginal income tax brackets exceeding 15%. These changes were effective for assets sold or exchanged on or after May 6, 2003, and before January 1, 2009.

In September 2004, Congress passed the Working Families Tax Relief Act of 2004 (WFTRA; P.L. 108-311). WFTRA extended several tax provisions that were scheduled to expire at the end of 2004. These expiring tax reductions were enacted under JGTRRA, which had accelerated implementation of tax reductions originally enacted in 2001 under EGTRRA.

WFTRA extended the $1,000 child tax credit through 2009 (for 2010, the EGTRRA provisions apply and the child tax credit will remain at $1,000). In addition, WFTRA accelerated, to 2004, the increase in the refundability of the child tax credit. For 2004 through 2010, the child tax credit will be refundable to 15% of a taxpayer's earned income in excess of the applicable threshold. The 2004 Act also contained a provision including combat pay in earned income for purposes of computing child tax credit refundability.[2]

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[1] CRS Report RL30862, *Budget Reconciliation Process: The Senate's "Byrd Rule,"* by Robert Keith.

[2] See CRS Report RS21860, *The Child Tax Credit*, by Gregg Esenwein.

WFTRA also extended marriage penalty relief (standard deduction and 15% tax bracket for joint returns set at twice the level as those for single returns) through 2008. (In 2009 and 2010, EGTRRA provisions apply which will maintain the level of the standard deduction and 15% tax bracket for joint returns). The 2004 act also extended the increase in the 10% income tax bracket through 2010.

WFTRA included a one-year extension in the increase in the basic exemption for the alternative minimum tax (AMT) originally enacted under JGTRRA. (EGTRRA also included a temporary increase in the AMT exemption which was then superseded by the JGTRRA increases.) The AMT exemption for 2005 will be $58,000 for joint returns and $40,250 for unmarried taxpayers. In 2006, the AMT exemption would revert to its prior law levels of $45,000 for joint returns and $33,750 for unmarried taxpayers.

These temporary increases in the basic exemption for the AMT have been enacted as a means of mitigating the interaction between the reductions in the regular income tax and the AMT. Extending or otherwise modifying the AMT is probably the most pressing individual income tax issue facing the 109th Congress. It is estimated that, if the reductions in the individual income tax are extended beyond 2010, then the number of taxpayers subject to the AMT will increase from about 1.8 million in 2001 to over 18 million in 2006, and then to over 41 million in 2013.[3]

Absent congressional action, the AMT will "take back" most of the tax relief granted through the income tax.[4] Hence, Congress faces not only the issue of whether or not to extend and/or make permanent the reductions in the regular income tax, but more urgently, it must face the issue of how to repair the individual AMT.[5]

Counterbalancing congressional desire to provide continued tax relief is concern over the current and projected size of the federal budget deficit. The revenue effects of extending and/or making permanent the 2001 and 2003 tax reductions are substantial. Moreover, once the costs of fixing the AMT are included, the revenue costs associated with maintaining the current level of tax relief increase considerably.

For instance, the following table presents some order of magnitude estimates of the cost of extending the EGTRRA/JGTRRA tax reductions and reforming the AMT. It should be noted that if these policy options are deficit financed (that is, there are no offsetting tax increases or spending reductions), then there will be additional revenue losses associated with servicing the increase in the public debt that these policy options engender. The table presents estimates of both the direct and indirect costs of these tax policy options.

As shown in the table, as a rough estimate, the total cost (both direct and indirect) of extending the EGTRRA/JGTRRA tax cuts and reforming the AMT will be more than

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[3] For more information see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Gregg Esenwein.

[4] For more information on the "take back" effect see CRS Report RS21817, *The Alternative Minimum Tax (AMT): Income Entry Points and "Take Back" Effects*, by Gregg Esenwein.

[5] See CRS Report RS22100, *The Alternative Minimum Tax for Individuals: Legislative Initiatives and Their Revenue Effects*, by Gregg Esenwein.

$2 trillion over the FY2006 through 2015 period. As an alternative measure, an order of magnitude estimate indicates that the out year per annum cost (including debt servicing) of these tax policy options will be slightly larger than 2% of gross domestic product (GDP). The cost will increase as a percentage of GDP as time progresses.

Table 1. Order of Magnitude Estimates of the Revenue Costs Associated with Extension of EGTRRA/JGTRRA and Reform of the AMT

FY2006 through FY2015 (Billions of dollars)	
Extend EGTRRA/JGTRRA:	$1,318
Reform the AMT: (Extension of increased AMT exemption and indexation of AMT exemption and tax brackets.)	$642
Debt Service:	$326
Total:	$2,286

Source: Congressional Budget Office. *The Budget and Economic Outlook: An Update.* Table 1.6. August 2005. Calculations by CRS.

Dividend and Capital Gains Tax Reductions

JGTRRA reduced the tax rates on qualified dividends and long-term capital gains. These reductions, however, are scheduled to expire at the end of 2008. At that point, tax rates on dividends and capital gains will revert to their prior law levels.

Since these provisions expire before the bulk of the 2001/2003 tax cuts, there has been some discussion in Congress about extending the provisions for dividends and capital gains during this session of the 109th Congress. It has been suggested that these tax reductions could be extended under the tax relief provisions of the 2006 budget resolution.

The conference agreement on the 2006 budget resolution, H.Con.Res. 95, was approved by both chambers on April 28, 2005, and contained $106 billion in tax relief over the next five years, approximately $70 billion of which would be protected through the reconciliation process.

The Congressional Budget Office (CBO) estimates that extending the dividend and capital gains tax reductions would reduce federal revenues by approximately $160 billion over the FY2008 through FY2015 period.[6]

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[6] Congressional Budget Office, *Budget Options*, Feb. 2005, p. 267.

Deduction for State and Local General Sales Taxes

The American Jobs Creation Act of 2004 contained a provision which allowed taxpayers to take a deduction for state and local general sales taxes instead of the itemized deduction for state and local income taxes. This provision was to be in effect for two-years, 2004 and 2005. However, as its expiration approaches at the beginning of 2006, Congress is considering whether to extend this provision.

Legislative Initiatives in the 109th Congress

Several bills have been introduced in the 109th Congress that would make either all of the 2001/2003 tax cut provisions or selected provisions permanent. In the Senate, the following bills have been introduced:

- **S. 6**. Introduced January 24, 2005, by Senator Rick Santorum. This bill would make the marriage penalty and child tax provisions permanent.
- **S. 7**. Introduced January 24, 2005, by Senator Jon Kyl. This bill would make the reductions in regular tax rates and capital gains/dividends tax rates permanent. It would also make the repeal of the estate tax permanent.
- **S. 78**. Introduced January 24, 2005, by Senator Kay Bailey Hutchison. This bill would make the marriage tax provisions permanent.
- **S. 246**. Introduced on February 1, 2005, by Senator Jim Bunning. This bill would make the changes to the adoption tax credit permanent.
- **S. 420**. Introduced February 17, 2005, by Senator Jon Kyl. This bill would make the repeal of the estate tax permanent.
- **S. 1112**. Introduced May 24, 2005, by Senator Chuck Grassley. This bill would make the educational savings provisions permanent.
- **S. 1524**. Introduced July 28, 2005, by Senator Mike Crapo. This bill would make the reduced tax rates on dividends and capital gains permanent.

In the House, the following bills making all or part of the 2001/2003 tax cuts permanent have been introduced:

- **H.R. 8**. Introduced on February 17, 2005 by Representative Kenny Hulshof. This bill would make the repeal of the estate tax permanent.
- **H.R. 183**. Introduced on January 4, 2005 by Representative Joseph Pitts. This bill would make the repeal of the estate tax permanent.
- **H.R. 268**. Introduced January 6, 2005, by Representative Dave Camp. This bill would make the changes to the adoption tax credit permanent.
- **H.R. 305**. Introduced January 25, 2005, by Representative Joe Wilson. This bill would make the changes to the adoption tax credit permanent.
- **H.R. 347**. Introduced January 25, 2005, by Representative Todd Russell Platts. This bill would make the changes to the adoption tax credit permanent
- **H.R. 351**. Introduced January 25, 2005, by Representative Todd Russell Platts. This bill would make the changes to the dependent care tax credit permanent and would make it refundable.

- **H.R. 809**. Introduced March 7, 2005, by Representative David Dreier. This bill would make the reduced tax rates on dividend and capital gains income permanent.
- **H.R. 1388**. Introduced March 17, 2005, by Representative Wally Herger. This bill would make the increase in expensing of certain depreciable assets permanent.
- **H.R. 1500**. Introduced April 6, 2005, by Representative David Dreier. This bill would make the reduction in the capital gain tax rate permanent.
- **H.R. 2320**. Introduced May 12, 2005, by Representative Jerry Weller. This bill would permanently extended the bonus depreciation enacted in 2003.

Some have suggested extending the AMT tax provisions, the capital gains/dividend tax reductions, and the deduction for state and local sales taxes under the tax reduction provisions contained in the 2006 budget resolution. The conference agreement on the 2006 budget resolution, H.Con.Res. 95, was approved by both chambers on April 28, 2005, and contained $106 billion in tax relief over the next five years, approximately $70 billion of which would be protected through the reconciliation process.

On November 15, 2005, as part of the reconciliation process, the Senate Finance Committee and the House Committee on Ways and Means approved separate measures extending various expiring provisions of the 2001, 2003 and 2004 tax cuts.

The Senate Finance Committee legislation, the Tax Relief Act of 2005 (S. 2020), was passed by the full Senate on November 18. This bill is estimated to cost almost $60 billion over fiscal years 2006 to 2010. Among other things, it would extend for one-year the AMT tax relief provisions and the deduction for state and local general sales taxes. The one-year extension of the deduction for state/local general sales taxes is estimated to cost $2.6 billion. The AMT tax relief includes both an extension of the higher exemption level and an extension of the treatment of nonrefundable credits against the AMT. In addition, the bill would also index the AMT exemption level for inflation. It is estimated that these changes would reduce federal revenues by $31 billion. The bill does not extend the tax reductions for capital gains/dividends scheduled to expire at the end of 2008.

The Committee on Ways and Means legislation, H.R. 4297, would extended the capital gains/dividend tax relief for two years. It is estimated that this two-year extension of the capital gains/dividend tax relief would reduce federal revenues by $20 billion. The Ways and Means Committee legislation would also extend the deduction for state and local sales taxes for one year at an estimated cost of $2 billion. While this bill includes a provision extending the ability to use nonrefundable personal credits against the AMT, it does not include an extension of the higher AMT exemption amount. The provision extending the treatment of nonrefundable credits under the AMT is estimated to cost $2.8 billion. In total, it is estimated that this bill would reduce federal revenues by $56 billion over the FY2006 through 2010 time period.