

THE BROOKINGS INSTITUTION 5 on 45:

What tax cuts can Congress pass?

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(MUSIC)

PITA: You're listening to 5 on 45 from the Brookings podcast network, analysis and commentary and Brookings experts on today's news regarding the Trump administration.

GALE: My name is Bill Gale I'm a senior fellow in Economic Studies at The Brookings Institution and co-director of the Tax Policy Center. I want to talk today about the Republican effort to cut taxes. This is a fast-changing situation, so here are some thoughts as of Monday morning September 25th.

One might think that enacting tax cuts would be a slam dunk given that Republicans are in control of the White House, the House, and the Senate. But in order to reach an agreement on tax cuts there are a number of issues they will have to address. Here's a guide to several of those issues.

First, how big will the tax cut be? In various White House documents and campaign proposals, President Trump has proposed a total of 7.8 trillion dollars over the next 10 years according to estimates from the Tax Policy Center. Even with all the revenue raisers he's proposed, the net tax cut still comes out to about three and a half trillion dollars and that's after accounting for dynamic scoring. Last week however the Senate seemed to reach an informal agreement that the tax cut would only be about one and a half trillion dollars. The House has not yet acted.

So, let's use one and a half trillion is the size of the tax cut. That's quite large of course, but it's nowhere near large enough to accommodate everything that the White House and Congress wants to do. So, the second question is which proposals will make it into the tax cut, and which proposals won't? This is an issue that will pit many groups against each other. Some businesses want lower tax rates on corporations and passed through entities like partnerships and S-corporations, others want more generous investment incentives. Likewise, every industry will want to defend the tax subsidies that it currently has whether its realtors, or oil and gas, or someone else.

Another issue will arise around eliminating the income tax deduction for state and local taxes. Many Republicans want to remove this deduction but many others, including a wide variety of Republican governors and mayors, want to keep it.

Another issue here is how much of the tax cuts should go to the rich, how much to the middle class, how much to low income households? The White House and the Treasury secretary have said that the rich won't get a net tax cut. But almost all of the tax changes that Republicans are talking about mainly help the rich. The package is said to include a cut in the corporate rate to 20 percent from its current level of 35, and cuts in the top income tax rate and the tax rate on partnerships and other pass-through organizations. It's extremely difficult to see how a package like that would not cut taxes for high income households by very large amounts. But let's say they've resolved all those issues, how big the tax cut will be, and what will be in it.

The third issue is how to get it through the Congress, and a number of constraints arise there. The Republicans are planning to use a process called "reconciliation" to push through tax cuts. Reconciliation allows Congress to fast track bills that are consistent with the budget resolution reconciliation bills are not subject to filibuster in the Senate, and so they can be enacted with 50 votes plus the vice president. Originally reconciliation was designed to ease the passage of bills that reduce the deficit, but under President George W. Bush Congress used reconciliation to cut taxes and thus raise the deficit.

Still reconciliation is not a free pass. To use it, Republicans first have to pass a budget resolution which requires almost all of them to agree on spending levels.

Then they have to pass a number of additional hurdles. A provision called the Byrd Rule disallows reconciliation bills to raise the deficit in any year after the end of the budget window which is currently set at 10 years. That rules out long-term tax cuts unless they're fully paid for with spending cuts or unless they can acquire 60 votes in the Senate. And the Byrd rule may preclude temporary tax cuts too, recently the Joint Committee on Taxation estimated that even a three-year cut to corporate tax rates would trigger the Byrd Rule because firms would shift taxable income into that 3-year window and away from future years.

All right, the fourth issue I will raise here is how Republicans will say they will pay for the tax cut. Their formal proposal may include a lot of revenue raisers, closing down various deductions and so on, but it would be surprising if those provisions survive the political dealing that will go on. Republicans will probably use a variety of budget gimmicks to skirt the rules and they will claim the tax cut generates lots of economic growth and will selectively cite evidence to support that claim.

Lastly one interesting possibility is that the Republicans may try to peel off some Democratic support. A number of Democratic senators are up for re-election in states that warn in the 2016 election. So far this year the Democrats have held firm on votes regarding Obamacare repeal, it remains to be seen how many of them will be willing vote with the Republicans on tax cuts.

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