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SUSTAINING PROGRESSIVITY IN THE BUDGET PROCESS: A COMMENTARY ON GALE & ORSZAG'S *AN ECONOMIC ASSESSMENT OF TAX POLICY IN THE BUSH ADMINISTRATION, 2001–2004*

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Abstract: This Commentary proposes the adoption of pay-go procedural rules for tax lawmaking that favor tax cuts that decrease income inequality, in response to biases in distributional tables and distortions in the political process. It suggests that the failure to use present value analysis in the budget process has had unfortunate, unintended consequences, in particular, a congressional preference for a prepaid-type consumption tax. This Commentary argues that efforts to index the Alternative Minimum Tax (the “AMT”) should not deflect attention from the AMT’s most fundamental distributional problem—its failure to treat dividends and capital gains as preference items. It suggests that there may be some institutional advantages in global sunsets of important tax legislation, even when the legislation is not intended to expire. Finally, this Commentary considers the intersection of budget processes and progressivity in the tax expenditure budget. It argues that the Bush administration’s recent changes in the treatment of the corporate tax and its incomplete analysis of comprehensive tax bases, undermine the usefulness of the tax expenditure budget, and have made tax expenditures suddenly appear more progressive, even though they are not.

INTRODUCTION

Doctors William Gale and Peter Orszag, in *An Economic Assessment of Tax Policy in the Bush Administration, 2001–2004*, present a disturbing picture of recent tax policy: one that is fiscally irresponsible and decreasingly progressive.¹ Their analysis demands that economists and lawyers work together to design a policy that will strive simultaneously

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¹ See generally William G. Gale & Peter R. Orszag, *An Economic Assessment of Tax Policy in the Bush Administration, 2001–2004*, 45 B.C. L. Rev. 1157 (2004).

for economic justice and fiscal discipline. In response to their economic analysis, this Commentary identifies some of the legal challenges that their analysis presents. In particular, I suggest the adoption of procedural mechanisms and substantive biases into tax law making that are explicitly designed to address inequality, even while lawmakers primarily focus on fiscal responsibility and economic growth.

This Commentary addresses four issues raised by Doctors Gale and Orszag that lend themselves to legislative or administrative approaches that could be sensitive to distributional effects, and my suggestions are offered in the spirit of specifically meeting some of the concerns identified in their Article. First, a major theme of Doctors Gale and Orszag's analysis is the affordability of the George W. Bush administration's tax cuts, and their analysis indicates how difficult it will be to pay for a permanent extension of those policies.² The current impasse in Congress on deficits and revenue centers on budget rules, specifically whether lawmakers should adopt a pay-go rule that requires tax cuts to be offset concurrently with spending cuts (or tax increases).³ Although I agree with the many commentators who argue that Congress should reenact a so-called pay-go rule for tax lawmaking,⁴ I propose that such a rule should serve the dual goals of distributive fairness and fiscal disci-

² See *id.* at 1168–83.

³ As of this writing, the Senate has adopted a pay-go rule that would apply to all tax cuts and spending increases, but the House of Representatives has declined to follow suit. See S. Con. Res. 95, 108th Cong. § 408 (2004) (enacted). The George W. Bush administration has argued for a rule that requires fiscal discipline only for spending. See OFFICE OF MGMT. & BUDGET, ENSURING FISCAL RESPONSIBILITY, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2005, at 35, 36, 38 (2004), available at <http://www.whitehouse.gov/omb/budget/fy2005/pdf/budget/fiscal.pdf>; OFFICE OF MGMT. & BUDGET, STATEMENT OF ADMINISTRATIVE POLICY, H.R. 3973—SPENDING CONTROL ACT OF 2004 (June 23, 2004) [hereinafter STATEMENT OF ADMINISTRATIVE POLICY], available at <http://www.whitehouse.gov/omb/legislative/sap/108-2/hr3973sap-h.pdf>. For an explanation of why the Bush administration's rule is meaningless, see generally Paul McDaniel, *Commentary: Assessing the Bush Administration's Tax Agenda*, 45 B.C. L. REV. 1247 (2004) (discussing tax expenditures).

⁴ Tax policy analysts have overwhelmingly supported such a rule. See Sheldon Pollack, *Contemporary U.S. Tax Policy*, 104 TAX NOTES 309, 309 (2004) (reviewing C. EUGENE STEUERLE, *CONTEMPORARY U.S. TAX POLICY* (2004)); Timothy Catts, *Greenspan Calls for Tax Cut Offsets as Senate Mulls Reconciliation Options*, 2004 TAX NOTES TODAY (Feb. 26, 2004), LEXIS, 2004 TNT 38-1; Ctr. on Budget & Policy Priorities, *CBPP Calls for Renewal of Pay-Go Rules*, 2004 TAX NOTES TODAY (Apr. 20, 2004), LEXIS, 2004 TNT 77-20; Comm. for a Responsible Fed. Budget, *Committee for a Responsible Federal Budget Supports Pay-Go Rules*, 2004 TAX NOTES TODAY (Mar. 16, 2004), LEXIS, 2004 TNT 52-18; Douglas Holtz-Eakin, *Budget Process Reform Could Have "Unintended Consequences," CBO Director Testifies*, 2004 TAX NOTES TODAY (Mar. 23, 2004), LEXIS, 2004 TNT 57-51; Richard E. May, *Beware of Some Budget Reform Ideas, Legislative Consultant Testifies*, 2004 TAX NOTES TODAY (Mar. 23, 2004), LEXIS, 2004 TNT 57-55.

pline by creating a bias in favor of tax cuts that decrease income inequality and a bias against tax cuts that increase income inequality. The data in Doctors Gale and Orszag's Article support this more nuanced approach to procedural budget rules.⁵

A second theme of Doctors Gale and Orszag's Article is the misleading budget picture created by the expanding number of expiring provisions and backloaded tax cuts. They argue that sunsets have been used to allow a larger annual tax cut to fit within a given multi-year budget total.⁶ In response, I suggest that the sunset of the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act") does not look as bad now as it did when it was first adopted, and that there may be some advantages in global sunsets of important tax legislation.⁷ Furthermore, sunsets may not be the most pressing problem in the presentation of budget numbers. The failure to account for present values may cause greater distortion in the budget process, and some of the manipulation apparent in budget numbers would be impossible if present values were required. Even more important, I argue that the failure of budget procedures to use present value analysis has contributed to an unnecessarily regressive design of recent rules.⁸

A third major concern that Doctors Gale and Orszag (and many others) discuss is the Alternative Minimum Tax (the "AMT").⁹ They predict that it will affect forty million taxpayers by 2014,¹⁰ and they imply that indexing the exemption for inflation could, in part, fix the problems of the AMT.¹¹ Although indexing is clearly desirable compared to Congress's current inclination to do nothing,¹² I argue that a focus on indexing the AMT may distract policymakers from the more fundamental design problems inherent in the AMT, and that the 2003

⁵ See *infra* notes 17–34 and accompanying text.

⁶ Gale & Orszag, *supra* note 1, at 1184.

⁷ Pub. L. No. 107-16, 115 Stat. 38 (2001).

⁸ See *infra* notes 35–52 and accompanying text.

⁹ See Gale & Orszag, *supra* note 1, at 1165–66. National Taxpayer Advocate, Nina Olson, in her 2003 report to Congress, stated that the Alternative Minimum Tax (the "AMT") is the most serious problem facing taxpayers. See Nina E. Olson, *Preface to INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, NATIONAL TAXPAYER ADVOCATE 2003 ANNUAL REPORT TO CONGRESS*, at iv (Dec. 31, 2003) (stating that the AMT is the problem that needs "the most immediate and thorough response"), available at http://www.irs.gov/pub/irs-utl/nta_2003_anual_update_mcw_1-15-041.pdf.

¹⁰ See Gale & Orszag, *supra* note 1, at 1165; see also Appendix 1 (prepared by William G. Gale).

¹¹ Gale & Orszag, *supra* note 1, at 1165–66.

¹² As this issue goes to press, President Bush is signing the Working Families Tax Relief Act of 2004, which extends the current exemptions for AMT purposes through 2005. H.R. 1308, 108th Cong. § 103 (2004) (presented to President Bush on September 9, 2004).

dividend and capital gains tax cuts¹³ now pose the greatest challenge for redesigning the AMT.¹⁴

Finally, because this Symposium is about both progressivity and budget processes and because Doctors Gale and Orszag's Article argues that the Bush administration has given a "misleading" budget picture,¹⁵ I think it is important to note that the Bush administration has been undermining the information presented in the tax expenditure budget (the "TEB") by gradually modifying the baseline it uses in its analyses and skewing that baseline so that tax expenditures look more progressive than they really are.¹⁶

I. PAYING FOR TAX CUTS WHILE PRESERVING PROGRESSIVITY

Ideally, taxes and spending would be determined as one integrated policy.¹⁷ Unfortunately, we rarely see an analysis that considers both the taxing and spending sides of the budget equation together. The numbers in Doctors Gale and Orszag's Table 6 are the type of information typically seen in analyses of tax changes, and they confirm the Bush administration's claim that everyone gets a tax cut.¹⁸ But they are incomplete because either our children will pay for these cuts later,¹⁹ or some of us will be paying for them soon through the loss of government services.²⁰ As the recent tax cuts inevitably will squeeze some government services, it becomes important to consider who will pay the price for those cuts. Tables 7 and 8 are the missing piece in most analyses.²¹ They contain a distributional analysis of the incidence of the Bush administration's tax cuts and the spending cuts

¹³ See Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, §§ 301-302, 117 Stat. 752, 758-64 (2003) (codified at I.R.C. § 1(h) (West Supp. 2004)) (reducing rate on net capital gain to five percent and fifteen percent and treating dividends like net capital gain).

¹⁴ See *infra* notes 53-68 and accompanying text.

¹⁵ Gale & Orszag, *supra* note 1, at 1173.

¹⁶ See *infra* notes 69-110 and accompanying text.

¹⁷ In this way, we really could determine whether the overall system of economic rights and responsibilities is truly just. See LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE* 14 (2002) (arguing that traditional tax policy analysis has been "myopic" in treating "justice in taxation as a separate and self-contained . . . issue").

¹⁸ Gale & Orszag, *supra* note 1, at app. tbl.6.

¹⁹ Deficit financing for tax cuts may push the burden of payment onto future generations. See Gale & Orszag, *supra* note 1, at 1176; see also William Gale & Laurence Kotlikoff, *Effects of Recent Fiscal Policies on Children*, 103 TAX NOTES 1281, 1281 (2004).

²⁰ Doctors Gale and Orszag's Table 4 offers hypothetical (and unrealistically large) spending cuts that would be necessary to pay for the tax cuts. See Gale & Orszag, *supra* note 1, at app. tbl.4.

²¹ See *id.* at app. tbls.7 & 8.

that will be needed to pay for them, and they attempt to provide comprehensive information on the incidence of the tax cuts by looking at how they will be financed. This is the type of information that we need to understand the full picture of tax cuts, and I hope that it will become a regular part of government budget analyses in the future. Tables 7 and 8 show that the real burden of the Bush administration's tax cuts will fall on households in the bottom four quintiles.²²

I suggest that the assumption that Doctors Gale and Orszag make in generating the numbers in these tables may understate the real burden that will be borne by low-income taxpayers. Their more progressive assumption is that the tax cuts will be financed by tax increases or spending cuts that impose burdens that are proportional to income.²³ But given the limited discretion that Congress has to adjust spending, it is actually much more likely that the tax cuts will be paid for with spending cuts (or tax increases) borne disproportionately by low-income families. Domestic discretionary spending on programs like education, infrastructure, and social services will be the easiest targets for spending cuts.²⁴ The assumption that Doctors Gale and Orszag make is reasonable in light of our ignorance about which policies actually will be adopted, but it paints a brighter picture for low-income Americans than is realistic. Thus, a comprehensive analysis of tax and spending cuts would likely show a significantly more regressive pattern than reflected in Tables 7 and 8.

Unfortunately, the government does not do a comprehensive analysis, so legislation is adopted on the basis of information that looks more like Table 6 than Table 8.²⁵ This information skews the perception that lawmakers have of the effects of their actions, making it important to balance that bias with a counteracting mechanism. Procedural rules could be designed to reflect the fact that distributional tables systematically understate the burden that tax cuts impose

²² See *id.* at app. tbls.7 & 8. For a fuller analysis of this issue by Doctors Gale and Orszag and Isaac Shapiro, see generally William Gale et al., *Distribution of the 2001 and 2003 Tax Cuts and Their Financing*, 103 TAX NOTES 1539 (2004).

²³ See Gale & Orszag, *supra* note 1, at 1190.

²⁴ The Bush administration's 2005 budget includes these cuts. See generally *CTR. ON BUDGET & POLICY PRIORITIES, ADMINISTRATION'S BUDGET WOULD CUT HEAVILY INTO MANY AREAS OF DOMESTIC DISCRETIONARY SPENDING AFTER 2005* (Mar. 5, 2004) (detailing cuts to environmental, educational, veterans, health, and transportation programs), available at <http://www.cbpp.org/2-27-04bud2.pdf>; Press Release, Ctr. on Budget & Policy Priorities, *President's Budget Would Slash Major Housing Program by 30 Percent by 2009* (Mar. 8, 2004) (describing 2005 proposed budget cuts to the federal housing voucher program), available at <http://www.cbpp.org/2-12-04hous-pr.pdf>.

²⁵ See Gale & Orszag, *supra* note 1, at app. tbls.6 & 8.

on low-income households. I propose a pay-go rule corrected for the bias inherent in the distributional tables by incorporating a bias in favor of tax cuts for low-income units, but against tax cuts for high-income units. Tax cuts that decrease inequality could be subject to lower procedural hurdles than tax cuts that increase inequality.²⁶ Including a bias against regressive tax cuts can be understood as a mechanism for better integrating the taxing and spending sides of the budget that are often considered in isolation from one another.

It also makes sense to have different procedural rules, depending upon the distributional effects of the underlying substantive provisions, because of the political economy of tax cuts. In addition to compensating for the invisibility of spending cuts that burden the low-income units, procedural rules could also help correct for distortions in our political system that systematically disadvantage the poor.²⁷ Procedural rules benefiting the poor are a good mechanism for counterbalancing the disproportionate share of political power enjoyed by the rich for their own benefit. To the extent that political preferences are likely to be distributed throughout the income spectrum, we may be comfortable with the rich speaking generally on behalf of the poor. But for economic issues, the divergent interests of the rich and poor should be troubling in our political system.

The current debate about budget rules has been focused on the readoption of a pay-go rule,²⁸ with some people arguing that a pay-go rule should cover only spending and other people arguing that it should apply to both tax cuts and spending.²⁹ Unfortunately, the de-

²⁶ Although the details are not crucial to the idea, such a rule could require a supermajority vote in both Houses of Congress for tax cuts that provide larger increases in after-tax income for high-income taxpayers than for low-income taxpayers. This rule adopts the most widely accepted notion of progressivity, and the Tax Policy Center already provides this type of data. See Gale & Orszag, *supra* note 1, at 1187 (providing a standard treatment of progressivity).

²⁷ The rich are not only big campaign contributors who are ably represented by lobbyists; they are often the politicians themselves. For example, all four candidates on the 2004 presidential ticket were millionaires.

²⁸ See, e.g., H.R. 4663, 108th Cong. (2004); H.R. 3973, 108th Cong. (2004); S. Con. Res. 95, 108th Cong. (2004) (enacted) (setting forth congressional budget resolution). As part of the Budget Enforcement Act of 1990, Congress adopted a rule that required revenue cuts to be matched by spending cuts. That legislation expired on September 30, 2002. See Martin Sullivan, *Economic Analysis: Will Budget Rules Chill Tax Cut Fever?*, 100 TAX NOTES 1241, 1243 (2003).

²⁹ H.R. 4663, which failed to pass the House of Representatives, would have applied to spending, but not tax cuts. President Bush supports that approach. See STATEMENT OF ADMINISTRATIVE POLICY, *supra* note 3. A substitute amendment to H.R. 4663 also would have

bate about a pay-go rule is taking place against the backdrop of provisions benefiting the poor and middle class that are scheduled to expire this year.³⁰ The proponents of a broad pay-go rule are clearly more serious about real fiscal restraint, but they might not be sufficiently sensitive to the differing distributional issues that arise depending on the particular tax or spending provision. The more nuanced pay-go rule that I propose would be less likely than a blanket rule to hold hostage to fiscal discipline tax cuts or spending increases that benefit the poor.

The recent debate over the child tax credit provides a good example. Last year, the House of Representatives voted not only to permanently extend the \$1000 per child tax credit, but also to increase the income ceiling for eligibility from \$110,000 to \$250,000 for married couples.³¹ The increased ceiling portion of the legislation would have cost \$69 billion, approximately thirty percent of the provision's overall cost.³² If this legislation were subject to the type of pay-go rule that I propose, increasing the income ceiling for eligibility would be subject to a high procedural hurdle (that is, greater consensus) if not financed by offsetting revenue increases or spending cuts in the bill. Conversely, a distributionally sensitive procedural rule would be less demanding of the provision that accelerates the refundable portion of the credit for very poor families.³³ The alternative that was offered by House of Representatives Committee on Ways and Means member Charles Rangel would have been subject to a less stringent procedural rule overall because it would have provided greater tax benefits to poor people than prior law and higher rates for top earners, decreasing income inequality in all of its aspects.³⁴ Although increased re-

extended the pay-go rules to tax cuts. See Dustin Stamper, *House Fails to Pass Pay-Go Bill*, 103 TAX NOTES 1577, 1577 (2004).

³⁰ Congress considered multiple expiring provisions in 2004. See, e.g., Child Credit Preservation and Expansion Act of 2004, H.R. 4359, 108th Cong. (2004) (covering the extension of the \$1000 child credit); H.R. 4181, 108th Cong. (2004) (dealing with the extension of marriage penalty relief for filers claiming the standard deduction); H.R. 4275, 108th Cong. (2004) (covering extension of the ten percent bracket); H.R. 4227, 108th Cong. (2004) (dealing with the extension of AMT relief for only one year). These provisions were included in some form in the Working Families Tax Relief Act of 2004, Pub. L. No. 108-311, §§ 101, 103, 118 Stat. 1166, 1167-68 (2004).

³¹ H.R. 4359 (adopted by the House of Representatives on May 20, 2004).

³² See Dustin Stamper, *House Approves Child Credit Bill in Last of Four Tax Cut Measures*, 103 TAX NOTES 939, 939 (2004) (citing statistics from the Tax Policy Center).

³³ H.R. 4359, § 2(c) (accelerating the increase in the refundable portion of credit).

³⁴ Representative Charles Rangel's alternative to H.R. 4359 would have increased the refundability of the credit for low-income households, would have repealed an inflation adjustment that applies to low income families, and also would have increased the rate of

fundability would require government resources, the proposed procedural rule that I suggest effectively abrogates the pay-go constraint for inequality-reducing changes.

This more nuanced approach to budget rules clearly adds some complexity to the legislative process, but not to the Internal Revenue Code (the "Code") itself, in which increased complexity is most troubling. Under such an approach, lawmakers would be required to separate out the analysis of different parts of a single piece of legislation and to focus on the distributional effect of every part, a welcome improvement to the clarity of the legislative process. Although overwhelmingly favorable to the rich, the Bush administration's tax cuts contain provisions that benefit the poor and the rich. The tendency to discuss all of the Bush administration's tax cuts as a single monolith threatens to sweep the treatment of the more progressive provisions in with the regressive provisions. The effort to extend the ten percent bracket or the child tax credit should neither be part of the same debate nor be subject to the same procedural constraints that should apply to extending the rate reductions for the rich or permanently repealing the estate tax. Although procedural rules that create a bias in favor of the poor cannot solve the fundamental problem of unequal political power, they at least can shift the balance slightly so that benefits for the rich require a higher level of consensus and transparency.

II. BUDGET NUMBERS AND SUNSETS

In their Article, Doctors Gale and Orszag discuss how the Bush administration's time frame for analysis is misleading because the costs of the Bush administration's proposals continue to grow indefinitely into the future.³⁵ They also describe how the tax cut's budget effects differ in the long and the short terms.³⁶ By carefully circumscribing the parameters for the numbers presented, the Bush administration can present the budget information so that it appears more or less favorable. One problem of presentation in distribution tables (and other budget documents) is the failure to include present

tax on income in excess of \$1 million. See Charles B. Rangel, *Rangel Substitute for H.R. 4359 Would Put Budgetary Conditions on Child Credit Extension*, 2004 TAX NOTES TODAY (May 17, 2004), LEXIS, 2004 TNT 97-25. The provision adopted by both Houses of Congress extended the \$1000 credit amount and increased its refundability. See H.R. 1308, 108th Cong. §§ 101 (a), 102 (2004).

³⁵ Gale & Orszag, *supra* note 1, at 1173.

³⁶ *Id.* at 1172-75.

value calculations for tax provisions with significant timing elements.³⁷ Budget numbers can be manipulated easily by choosing to adopt legislation that maximizes revenues in the short run at the expense of future revenues, and it is well known that the numbers that appear within the budget window are not always what they seem. The secondary effects of such manipulations, however, are less noticeable, and they recently have included a bias toward less progressive provisions. The incentive that Congress has to manipulate the schedule of revenues by deferring costs into the future has encouraged the adoption of particular substantive laws. For example, the increasing use of tax-prepaid savings vehicles, in which all the potential revenue shortfall is in the future, are favored by the budget rules that look to a short time frame without present values. But they are troubling from a fairness perspective because they contribute to the narrowing of the tax base to wage income only.³⁸

This trend is continuing to grow. The Bush administration is hoping to expand the use of tax-prepaid savings vehicles with new Lifetime Savings Accounts ("LSA"). Like Roth Individual Retirement Accounts ("IRA"), contributions to LSAs would be nondeductible, but all withdrawals would be free of tax.³⁹ We can expect LSAs to be a more popular and widely used savings vehicle than the Roth IRA and education savings plans currently in the Code, because the latter contain significant restrictions on withdrawals, whereas the LSAs would not. Taxpayers who can afford to save \$5000 a year, the proposed maximum in the Bush administration's 2005 budget proposal, will be able to do so tax free for any purpose.⁴⁰ This would provide a significant benefit when savings accrue over a long period. At the same time that savers enjoy the generous tax break, the exemption of capital income from tax under such a provision would barely show up in the budget projections for the next ten years for the following two reasons: (1) in the short term, taxpayers will be more likely to contribute than to withdraw from such programs because they are new, and contributions bear the full tax burden, and (2) any withdrawals

³⁷ Senator Joe Lieberman introduced a bill to require the government to calculate present values for its liabilities, but it was not adopted. See *Honest Government Accounting Act*, S. 1915, 108th Cong. (2003).

³⁸ These vehicles include Roth Individual Retirement Accounts, I.R.C. § 408A (West Supp. 2004); tuition savings accounts, I.R.C. § 529; and health savings accounts, I.R.C. § 223.

³⁹ OFFICE OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2005, at 246 (2004), available at <http://www.whitehouse.gov/omb/budget/fy2005/pdf/spec.pdf>.

⁴⁰ *Id.*

over the short term will not have had sufficient time to grow very much, and the tax benefit increases as the earnings on the investments increase over time. In another paper, Doctors Gale and Orszag have estimated that the long-term revenue losses from the Bush administration's savings proposals are \$1.30 in present value revenue cost for every dollar collected today.⁴¹ Ignoring present values in describing the budget effects of new tax provisions encourages the adoption of rules that appear cheap even though they are not, and they have the unfortunate effect of moving the Code more in the direction of a wage tax.

A wage tax not only tends to be more regressive than an income tax, but also is more likely to be regressive than a cash-flow type consumption tax, such as the traditional IRA, in which contributions are deductible and withdrawals are taxed in full. A progressive cash-flow type consumption tax is likely to be more progressive, in fact, than a progressive wage tax because (1) a lower or middle income person might have a lower marginal rate at retirement than during his or her working years, whereas a rich person is more likely to have the same (high) rate at both times, and (2) a cash-flow tax would impose more tax on investors whose savings performed better over their lives and who are therefore better off when savings are withdrawn for consumption. Pre-paid and post-paid consumption taxes are often considered to be equivalent, but they are only equivalent *ex ante*, whereas *ex post* is what should matter for determining fairness.⁴²

Thus, the Code's move toward increasing prepaid-type savings vehicles is troubling to the extent that it is a numbers-driven decision about what kind of consumption tax to have, based on the perception of short versus long-term budget effects. If we are going to move further from an income tax and closer to a consumption tax, as we have been doing over the past decade,⁴³ a cash-flow type consumption tax

⁴¹ See Leonard Burman, William Gale & Peter Orszag, *Key Thoughts on RSAs and LSAs 2* (Feb. 2, 2004), available at <http://www.urban.org/UploadedPDF/1000600.pdf>.

⁴² The mathematical equivalence depends on certain assumptions about tax rates and rates of return. This equivalence formed the basis of the Department of the Treasury's alternative approaches in *Blueprints for Basic Tax Reform*. See DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 123-24 (1977), available at <http://www.treas.gov/offices/tax-policy/library/blueprints/full.pdf>.

⁴³ There are other examples of the move towards a consumption tax that are not explicitly savings-oriented. For example, the bonus depreciation allowances in I.R.C. § 168(k) (West Supp. 2004) inch closer towards a consumption tax expensing model, and the reduction in the rate of tax on dividend and capital gain income moves closer towards exempting capital income from tax, as in a prepaid-type consumption tax.

would look more meager during the budget window period—because investments would be expensed—but would have significant long-term equity advantages compared to a wage tax.⁴⁴ To the extent that budget manipulation is affecting substantive decisions about the design of tax rules that have real distributional differences, it is important for the budget rules to include present value analyses, even apart from the integrity of the numbers themselves.

The Bush administration's budget manipulations that most concern Doctors Gale and Orszag arose on account of the sunsets included in the 2001 Act and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "2003 Act").⁴⁵ Because of those sunsets, Doctors Gale and Orszag's central inquiry in their Article is whether the Bush administration's tax cuts should be made permanent. That Congress must also ask itself that question now—should it act to extend the tax cuts—when the fiscal situation has deteriorated so significantly, sheds new, flattering light on the 2001 Act's sunset. In hindsight, the sunsets may not be as bad as the alternatives would have been. Sunsets, therefore, may be a constructive, though cynical, tool for policymakers.

Although these sunsets were adopted because of the revenue effects they would create, sunsets affect issues beyond revenue. In particular, a sunset alters Congress's institutional responsibility for legislation, tying it in to specific future oversight of policy. Sunsets can be seen as a tool to extend the duration of the legislative process, allowing for more congressional deliberation as circumstances develop over an extended period of time. Congress sometimes adopts laws in too much haste, and the reconciliation process, which abbreviates law making, contributes to this risk.⁴⁶ In other areas of the law, the role of the judiciary sometimes includes requiring greater congressional deliberation, but judicial review of tax legislation has never included this

⁴⁴ This argument assumes realistic taxpayer behavior and rules; that is, it assumes that taxpayers do not adjust their portfolios perfectly on account of changes in tax rules and that the realization rule and limitations on loss allowances remain in the Internal Revenue Code (the "Code"). For an analysis of why a cash-flow consumption tax is fairer than a wage tax, see generally Edward J. McCaffery, *The Fair Timing of Tax* (2003), available at <http://ssrn.com/abstract=441344> (date posted Sept. 8, 2003). See also Gale & Orszag, *supra* note 1, at 1220–24 (indicating that a wage tax provides transition relief to existing capital and is therefore more regressive than a cash-flow consumption tax).

⁴⁵ See William G. Gale & Peter R. Orszag, *Sunsets in the Tax Code*, 99 TAX NOTES 1553, 1553 (2003) (arguing that the "[r]ecent sunsets have been motivated by the desire to manipulate budget rules and hide the likely costs of new tax cuts").

⁴⁶ Under reconciliation, debate is limited. See generally Michael Evans, *The Budget Process and the "Sunset" Provisions of the 2001 Tax Law*, 99 TAX NOTES 405 (2003) (describing the reconciliation process).

type of inquiry.⁴⁷ Requiring Congress to revisit important tax changes in light of increasing fiscal concerns, renewed caution, or other relevant post-enactment developments are all reasons to favor sunsets for major tax legislation that alters a long-followed course or drastically alters federal revenues.⁴⁸

This institutional justification for sunsets is best suited to major legislative changes because of their policy importance, and not all tax law sunsets fit into this category. An alternative to the blanket sunset in the 2001 Act was piecemeal sunsets of individual provisions, a common practice in the tax law. Historically, Congress has extended minor expiring provisions. Although these extensions may be considered harmless, it is possible that small, piecemeal sunsets ultimately may be worse for fiscal discipline, distributive justice, and legal complexity than global sunsets of the type that the 2001 Act faces.⁴⁹

First, as a matter of fiscal discipline, piecemeal renewal allows Congress to chip away at revenue in very small increments, each action seeming insignificant to the overall budget picture. Conversely, reenactment on a global sunset requires an overall fiscal assessment under which it is more difficult to ignore a dire fiscal situation. Second, as a matter of distributive justice, piecemeal sunsets make the expiration of provisions that benefit lower-income families easy for politicians because the publicity that surrounds the sunset of a small provision is likely to be far less than the publicity surrounding its original adoption. For example, as Doctors Gale and Orszag point out, the "Saver's Credit" for low-income families, and the deduction for educational expenses of lower- and middle-income families are not proposed for extension in the Bush administration's budget pro-

⁴⁷ See, e.g., *Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank*, 527 U.S. 627, 639-41 (1999) (invalidating federal statute when Congress had insufficient evidence to show constitutional inadequacy of state remedies); *United States v. Lopez*, 514 U.S. 549, 563 (1995) (noting that "to the extent that congressional findings would enable us to evaluate the legislative judgment that the activity in question substantially affected interstate commerce, even though no such substantial effect was visible to the naked eye, they are lacking here").

⁴⁸ Prior to the adoption of the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act"), economist Eugene Steuerle argued that the best argument for sunsets is based on parity for tax and expenditure programs. He wrote that "[s]unsets simply move some programs closer to the status accorded to appropriated programs, for which annual or periodic decisions must be made if they are to continue or grow." Eugene Steuerle, *Sunsets: The Case for and Against*, 78 TAX NOTES 1713, 1713 (1998). Viewed in this way, sunsets do not seem particularly dramatic or insidious.

⁴⁹ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 901, 115 Stat. 38, 150.

posal, but there has been little public attention paid to their imminent disappearance.⁵⁰ Finally, the piecemeal approach causes confusion because it requires taxpayer attention to detail, burdening planning and compliance. The ever-changing benefit from the child credit (\$1000 to \$700 to \$1000 to \$500 over the next six years) that Doctors Gale and Orszag describe is a good example of why we should avoid piecemeal sunsets that affect the tax of relatively unsophisticated taxpayers.⁵¹ If a family cannot predict its child tax credit reasonably or count on it annually, it will not be encouraged to spend it, and a reduction in the tax credit from one year to the next is particularly bad for the morale of average taxpayers who are understandably disappointed when they fill out their returns.

In 2001, the most likely alternative to the sunset of the 2001 Act was a permanent tax cut for the rich, including permanent repeal of the estate tax.⁵² Reinstating a repealed estate tax would have been virtually impossible, and the ensuing loss to progressivity would have been devastating. Although it is unrealistic to expect that Congress will allow the full return of the estate tax as it existed prior to the 2001 Act, for proponents of progressivity, revisiting is better than repeal.

III. FIXING THE ALTERNATIVE MINIMUM TAX

One of the major concerns Doctors Gale and Orszag raise in their Article is the projected growth of the AMT. They estimate that 40 million households may be subject to the AMT in ten years.⁵³ As the chart in Appendix 1 shows, indexing the exemption would prevent massive increases in the numbers of taxpayers on track to become subject to the AMT.⁵⁴ Nevertheless, Table 2 of Doctor Gale and Orszag's article suggests that there is something more fundamentally troubling about the AMT than its failure to index the exemption.⁵⁵ It shows the effect of the AMT on the Bush administration's tax cuts and illustrates that by 2014, the AMT will take back almost forty percent of the tax cut for taxpayers

⁵⁰ Gale & Orszag, *supra* note 1, at app. tbls.1c & 1d.

⁵¹ See *id.* at app. tbl.1b.

⁵² The tax cut was supported by at least half of the members of the Senate, but it did not have the support of sixty members, which would have been necessary to prevent a possible filibuster of the bill if it had not been considered under the Congressional Budget Act of 1974's reconciliation process. For a full discussion of the procedural aspects of the 2001 Act, see generally Evans, *supra* note 46.

⁵³ Gale & Orszag, *supra* note 1, at 1165.

⁵⁴ See Appendix 1 (prepared by William G. Gale).

⁵⁵ See Gale & Orszag, *supra* note 1, at app. tbl.2.

with AGIs between \$75,000 and \$100,000 and sixty-five percent for taxpayers with AGIs between \$100,000 and \$500,000. But taxpayers with incomes exceeding \$1 million will lose a mere seven percent of their cut to the AMT. Thus, taxpayers receiving the greatest cuts from the Bush administration's tax plan are also the ones who are able to keep most of it despite the AMT. According to these numbers, the AMT is destined to become a force for decreasing progressivity, compared to the regular tax, even though the regular tax has itself become more generous to the rich.⁵⁶

Given that the AMT is on course to tax middle-class married people with children in high-tax states more heavily than rich families with tax preferences that understate their taxable income compared to their economic income, repeal of the AMT is an attractive option.⁵⁷ An alternative to repeal, however, is substantive reform that would return the AMT to its original purpose, which was to ensure that high-income taxpayers could not use preferences to obliterate their tax liability.⁵⁸ We could better design the AMT so that it can fulfill its original promise of making the rich pay their share.

The core problem with the AMT is its anachronistic understanding of tax preferences. The reason why the richest taxpayers in Table 2 suf-

⁵⁶ See Gale et al., *supra* note 22, at 1540 tbl.1 (showing that tax rates declined more for high-income taxpayers than for low-income taxpayers, and that high-income taxpayers enjoyed a greater percentage increase in after-tax income than low-income taxpayers on account of the 2001 Act and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "2003 Act")).

⁵⁷ Repeal of the AMT is the preferred approach of many experts. See, e.g., Allen Kenney, *Former Commissioners Say It's Time to Scrap AMT*, 103 TAX NOTES 1466, 1466-67 (2004) (reporting on testimony of former Internal Revenue Service Commissioners Donald Alexander, Sheldon Cohen, Mortimer Caplin, and Fred T. Goldberg). The National Taxpayer Advocate has repeatedly called for repeal. See INTERNAL REVENUE SERV., *supra* note 9, at 15 (reiterating the Advocate's 2001 recommendation for repeal); see also Matthew Bailey, *National Taxpayers Union Warns of "AMT Storm"*, 2004 TAX NOTES TODAY (Apr. 22, 2004), LEXIS, 2004 TNT 79-23 (identifying supporters of the repeal of the AMT); Section of Taxation, Am. Bar Ass'n et al., *Tax Simplification Recommendations from ABA, AICPA, and TEI*, 2000 TAX NOTES TODAY (Feb. 25, 2000), LEXIS, 2000 TNT 39-82 (presenting a joint recommendation advocating repeal of the AMT).

⁵⁸ The original version was adopted after a few wealthy taxpayers were reported to have paid no tax. See Leonard Burman et al., *The AMT: Out of Control*, TAX POL'Y ISSUES & OPTIONS (Urban-Brookings Tax Policy Ctr., Wash., D.C.), Sept. 2002, at 1, available at http://www.urban.org/UploadedPDF/310565_AMT_OutofControl.pdf. It has recently been noted that the original version of the AMT was "a minimum tax primarily on capital gains." Yonne Hinson & Ralph Tower, *Influence of Long-Term Capital Gains on Individual AMT*, 102 TAX NOTES 403, 404 (2004). The original list of nine types of preferences included capital gains, excess investment income, and accelerated depreciation. See Tax Reform Act of 1969, Pub. L. No. 91-172, § 301, 83 Stat. 487, 580.

fer so little from the AMT is because the AMT preferences bear little resemblance to the real preferences that are now in the Code, namely the reduced rates on capital gains and dividends.⁵⁹ Middle and upper-middle-income taxpayers are being hit with the AMT mostly because they pay high state and local taxes,⁶⁰ have a lot of children,⁶¹ or incur substantial employee business expenses.⁶² A few must pay because they have worthless stock options⁶³ or high attorney's fees in connection with successful employment discrimination actions.⁶⁴ None of these are preferences that allow taxpayers to enjoy greater economic income than taxable income—they are all real costs that affect taxpaying ability.⁶⁵ Even if the exemption is adjusted for inflation, it will still take back significant tax benefits from many upper-middle-class families, while exempting much of the income enjoyed by the truly wealthy. The richest taxpayers do not need to worry too much about the AMT's effect on their preferred income because their low-rate capital gains and dividends are not subject to it.⁶⁶ If we are serious about imposing a minimum effective rate of tax on a broad base of income (which is what the AMT was intended to do), then it should extend to the income received in the form of dividends and capital gains, which the rich receive in large amounts.⁶⁷ The biggest tax cuts for the rich from the 2001 and

⁵⁹ The AMT is designed to prevent some anachronistic sheltering behavior. See I.R.C. § 58 (2000) (disallowing tax shelter farm losses). But it does not affect the preferential rates in I.R.C. § 1(h) (West Supp. 2004).

⁶⁰ See I.R.C. § 56(b)(1)(A)(ii) (disallowing deduction for taxes).

⁶¹ See *id.* § 56(b)(1)(E) (disallowing personal exemptions).

⁶² See *id.* § 56(b)(1)(A)(i) (disallowing miscellaneous itemized deductions).

⁶³ See *id.* § 56(b)(3); *Tax Simplification: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways & Means*, 108th Cong. (2004), (statement of Nina Doherty, Sales Engineer, Rivermine Software, Fairfax, Virginia, describing how the AMT on worthless incentive stock options caused her family financial ruin), <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=1631> (June 15, 2004).

⁶⁴ The Supreme Court has granted certiorari to determine how to treat this issue. *Banks v. Comm'r*, 345 F.3d 373, 373 (6th Cir. 2003), *cert. granted*, 124 S. Ct. 1712 (2004); *Banaitis v. Comm'r*, 340 F.3d 1074, 1074 (9th Cir. 2003), *cert. granted*, 124 S. Ct. 1713 (2004).

⁶⁵ Doctor Gale has written elsewhere that more than ninety percent of taxpayers currently subject to the AMT find themselves there because of dependent exemptions, standard deductions, or itemized deductions for taxes, medical expenses, or miscellaneous expenses. Leonard Burman, William Gale & Jeffrey Rohaly, *The AMT: Projections and Problems*, 100 TAX NOTES 105, 106 (2003).

⁶⁶ See *id.* at 106, 115. Capital gains were the main target of the original AMT, but they have not been subject to the AMT since 1986, when the capital gains preference was repealed. When the preferential rate was reintroduced, the AMT preference was not. See *id.*

⁶⁷ In 2000, the 400 taxpayers with the highest incomes averaged \$124.9 million in net capital gains apiece. Joel Slemrod, *The Fortunate 400*, 100 TAX NOTES 935, 936 (2003). In 2001, taxpayers with adjusted gross incomes ("AGI") in excess of \$1 million averaged about

2003 Acts—the cut in dividend and capital gain rates and the repeal of the estate tax—are largely immune to the AMT.⁶⁸ Although indexing is not a bad idea, the fundamental flaws in the AMT's design should not be forgotten when focusing on indexing.

IV. MANIPULATION IN THE TAX EXPENDITURE BUDGET⁶⁹

Doctors Gale and Orszag show various ways that the Bush administration has brought about an overt shift in tax policy.⁷⁰ In addition, the Bush administration is making a less overt, but troubling, attack on the TEB, undermining the value of that document. The TEB is just as important a source of information about government spending policies as is the regular budget. As direct government spending increasingly focuses on defense and security, other social and economic programs seem to find a more amenable home in the Code,⁷¹ which provides an indirect, albeit just as real, source of public funds. According to the Joint Committee on Taxation (the "Joint Committee"), the projected spending through the Code for 2004 through 2008 will be \$4715 billion.⁷² As this amount increases, the TEB's importance as a source of data on government functions also increases.

\$1.7 million in net capital gain. Calculations based on table entitled "2001 Individual Income Tax, All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income." INTERNAL REVENUE SERV., STATISTICS OF INCOME, INDIVIDUAL COMPLETE REPORT 2001, at tbl.1.4 (Mar. 2004), <http://www.irs.gov/pub/irs-soi/01in14ar.xls> (last modified Mar. 23, 2004).

⁶⁸ The preference for capital gains and dividends is not a preference item for AMT purposes. Yvonne Hinson and Ralph Tower found that the AMT could lead to tax on capital gains in excess of the maximum fifteen percent statutory rate, but in a highly regressive way. Hinson & Tower, *supra* note 58, at 405. As the amount of a taxpayer's long-term capital gain increases, they found that the marginal rate on long-term capital gain decreases so that taxpayers with \$1 million of long-term capital gain had an effective rate of tax close to the fifteen percent statutory rate, whereas taxpayers with only \$30,000 of long-term capital gain had an effective rate of over twenty-one percent on their long-term capital gain on account of the AMT. *Id.*

⁶⁹ Although the ideas in this section were first presented on April 16, 2004 at "The State of the Federal Income Taxation Symposium: Rates, Progressivity, and Budget Processes" at Boston College Law School, this Part of the Commentary was published previously as Linda Sugin, *What Is Happening to the Tax Expenditure Budget*, 104 TAX NOTES 763 (2004).

⁷⁰ Gale & Orszag, *supra* note 1, at 1158.

⁷¹ For example, healthcare funding was increased during the last year with the adoption of I.R.C. § 223 (West Supp. 2004), authorizing tax-favored "Health Savings Accounts" as part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, § 1201, 117 Stat. 2066, 2469-79.

⁷² STAFF OF JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2004-2008, at 20-29 tbl.1 (JCS-8-03) (Comm. Print 2003), available at

The TEB is not as transparent as the regular budget because it creates new entitlements with unknown effects, and it also attempts to quantify an admittedly elusive number—revenue loss.⁷³ Yet despite its shortcomings, the TEB generally has been a useful tool because it identifies programs that might be administered through direct spending programs, rather than through the Code.⁷⁴ It also provides data that can help to determine how the policies within the Code change over time. Unfortunately, under the Bush administration, the integrity of the information presented in the TEB has been diminished substantially. Because of this, the impression of distributional effects arising from spending policies operated through the Code has been skewed. Although there has been some attention to the Bush administration's manipulations in the presentation of the regular budget, little attention has been focused on the manipulations in the TEB.⁷⁵ This is troubling because the TEB is just as important a source of information about government spending policies as the regular budget. The Bush administration, however, seems to be undermining the information in the TEB by making small, but crucial, adjustments in the analysis underlying the official numbers by adding an array of useless information that sheds doubt on the data included in the budget itself.

<http://www.house.gov/jct/s-8-03.pdf>. This number may be compared to annual total net outlays slightly in excess of \$2000 billion, according to the Bush administration. See OFFICE OF MGMT. & BUDGET, *supra* note 39, at 338 tbl.20-1.

⁷³ The creation of entitlements with unknown costs is not unique to the TEB, but all items on that budget are essentially entitlements. See STANLEY S. SURREY & PAUL MCDANIEL, *TAX EXPENDITURES* 102 (1985). The Joint Committee on Taxation's (the "Joint Committee") tax expenditure budget estimates "revenue losses" or "reductions in income tax liabilities" on account of provisions in the Code. See STAFF OF JOINT COMM. ON TAXATION, *supra* note 72, at 2. Both the Department of the Treasury and the Joint Committee compile tax expenditure budgets. The Bush administration's version is included in the Office of Management and Budget's compilation of the entire federal budget. The Bush administration estimates both projected revenue losses and outlay equivalents. See OFFICE OF MGMT. & BUDGET, *supra* note 39, at 294 tbl.18-3, 296 tbl.18-5.

⁷⁴ I have written on this issue previously in Linda Sugin, *Tax Expenditure Analysis and Constitutional Decisions*, 50 HASTINGS L.J. 407, 415-18 (1999).

⁷⁵ See, e.g., Gale & Orszag, *supra* note 1, at 1168-72, 1183-86 (suggesting that the sunsets in the 2001 and 2003 Acts were intended to hide the cost of the legislation, and that the presentation of Social Security and Medicare shortfalls over a long horizon, compared to the Bush administration's presentation of the cost of tax cuts over a short horizon, misleads people into believing that the tax cuts are less costly than they really are); see also RICHARD KOGAN & DAVID KAMIN, *CTR. ON BUDGET & POLICY PRIORITIES, PRESIDENT'S BUDGET CONTAINS LARGE CUTS IN DOMESTIC DISCRETIONARY PROGRAMS* (JUNE 7, 2004) (claiming that "budget tables that would normally show [particular budget] cuts are missing from the budget books that the Office of Management and Budget issued"), available at <http://www.cbpp.org/2-5-04bud.pdf>.

Over the last few years, the Bush administration has adjusted the methodologies it has used to determine the normal tax base, which has long been used for determining tax expenditures.⁷⁶ In 2003, in its official presentation of the TEB,⁷⁷ it changed the methodology for determining the tax expenditure from accelerated depreciation, and concluded that the tax expenditure is much smaller than the amount arrived at using the prior method.⁷⁸ In 2004, it continued to chip away at the base with its treatment of the 2003 Act tax cuts for dividends and capital gains.⁷⁹ There is nothing sacred about the normal tax base.⁸⁰ Nevertheless, its consistent use has allowed policymakers to recognize the direction and magnitude of changes in government subsidies over time. Changes to the baseline mislead those who rely on the numbers presented in the budget.

Consider two examples that illustrate how the Bush administration's approach undermines the informational value of the TEB: its analysis of comprehensive tax bases and its adoption of a presumption against a separate corporate tax. The Bush administration includes its analysis of comprehensive tax bases in an "Appendix,"⁸¹ suggesting that the administration is aware that its analysis is unconventional. The transformation of the corporate tax, however, is taking place within the official TEB itself and is reflected in the numbers included therein. These examples show how the Bush administration's adjustments make the Code appear less generous to homeowners and holders of capital than would the traditional approach.

The most recent Bush administration estimates of tax expenditures include appendices that evaluate current tax expenditures un-

⁷⁶ The Joint Committee, which has been more consistent in its adherence to a single standard, describes the "normal income tax structure" as "a broad concept of income." STAFF OF JOINT COMM. ON TAXATION, *supra* note 72, at 2.

⁷⁷ See generally OFFICE OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2004 (2003), available at <http://www.whitehouse.gov/omb/budget/fy2004/pdf/spec.pdf>. Although there have been some differences between the versions compiled by the Joint Committee and the Bush administration, particularly since the Ronald W. Reagan administration adopted an alternative reference baseline, they largely identify the same provisions as tax expenditures. For a comparison of the versions, see STAFF OF JOINT COMM. ON TAXATION, *supra* note 72, at 13-16. I am suggesting that this general historical parity between the budgets may now be eroding on account of the Bush administration's recent changes.

⁷⁸ OFFICE OF MGMT. & BUDGET, *supra* note 39, at 322-23.

⁷⁹ Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, §§ 301-302, 117 Stat. 752, 758-64 (2003) (codified at I.R.C. § 1(h) (West Supp. 2004)).

⁸⁰ I have argued against its constitutionalization on those grounds. See Sugin, *supra* note 74, at 418-30.

⁸¹ See OFFICE OF MGMT. & BUDGET, *supra* note 39, at 314-25.

der an ideal income tax and an ideal consumption tax.⁸² But without providing any constructive information, the method used in that presentation undermines the normal tax base of the traditional budget because the Bush administration starts with the items listed in the traditional TEB and asks whether each item would be a tax expenditure in a comprehensive income tax (or consumption tax). It concludes that only fourteen of the thirty largest items in the TEB would be tax expenditures in a comprehensive income tax.⁸³

In comparing the current list to an ideal, the Bush administration's analysis chooses a reference point that bears no relation to either our actual tax or the ideal itself. Of what use is the conclusion that the step-up in basis at death under section 1014 would not be a tax expenditure if we had a mark-to-market system because in such a system the step-up amount would always be zero?⁸⁴ Similarly, what good is it to know that state and local taxes would be properly deductible if government benefits were included in income?⁸⁵ The table included in the Appendix, with its list of questionable items from the TEB⁸⁶ is insidious (rather than simply useless) because it has the effect of questioning the normative significance of many of the largest items in the TEB.⁸⁷

The deduction for home mortgage interest, the second largest item in the Bush administration's official TEB, is part of a special analysis of owner-occupied housing in the Appendix: in a comprehensive income tax, the imputed income from home ownership would be taxable, and therefore, the costs of producing that income, like home mortgage interest, property taxes, and depreciation, would be properly deductible.⁸⁸ Consistent with such an analysis and the taxation of imputed income, the deduction for home mortgage interest would not be

⁸² See *id.* (regarding fiscal year 2005); OFFICE OF MGMT. & BUDGET, *supra* note 77, at 130-40 (regarding fiscal year 2004).

⁸³ OFFICE OF MGMT. & BUDGET, *supra* note 39, at 324 app. tbl.1.

⁸⁴ This is the essence of the argument made in *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2005*. See *id.* at 316.

⁸⁵ *Id.* at 317.

⁸⁶ The table is divided into sections with subtitles that include "Possibly a Tax Expenditure Under a Comprehensive Income Tax, But with Some Qualifications" and "Probably Not a Tax Expenditure Under a Comprehensive Income Tax." See *id.* at 324 app. tbl.1.

⁸⁷ For example, it treats as "uncertain" the exclusion of employer contributions for medical insurance premiums and medical care, the largest single item on the official TEB. See *id.* at 294 tbl.18-3, 324 app. tbl.1.

⁸⁸ OFFICE OF MGMT. & BUDGET, *supra* note 39, at 294 tbl.18-3. This is standard textbook analysis. See LAURIE MALMAN ET AL., *THE INDIVIDUAL TAX BASE* 348 (2002).

a tax expenditure.⁸⁹ The Bush administration's Appendix Table 3, "Revised Tax Expenditure Estimates," applying this approach, quantifies the tax expenditure as the failure to include the imputed income, rather than as the allowance of the supporting deductions.⁹⁰ The result is that the tax expenditure for homeowners in the official TEB is almost four times larger than it would be in the Bush administration's alternative: imputed rent for 2005 is about \$24 billion, according to Appendix Table 3, compared to the TEB's \$89 billion for the deductions of home mortgage interest and home property taxes.⁹¹ The Bush administration's revised estimates imply that homeowners do not receive nearly as large a government subsidy under the Code as the TEB suggests.⁹²

In addition to its failure to defend adequately its determination of \$24 billion for the 2005 imputed rent on owner-occupied housing, the Bush administration's approach actually does not revise the tax expenditure analysis fully in keeping with a comprehensive income tax base.⁹³ It only attempts to account for the imputed income from living in one's home—a consumption item. But it completely ignores the untaxed appreciation in that home.⁹⁴ A comprehensive income

⁸⁹ See OFFICE OF MGMT. & BUDGET, *supra* note 39, at 323.

⁹⁰ See *id.* at 325 app. tbl.3.

⁹¹ The Bush administration notes that the estimate is only one-third as large as the tax expenditure for the home mortgage deduction because it does not aggregate the tax expenditure for the property tax deduction. See *id.* at 323.

⁹² The table quantifies the tax expenditure for imputed rent on owner-occupied housing as about \$24 billion for 2005. This is compared to the estimate of the tax expenditure for the deductibility of home mortgage interest of almost \$70 billion, plus \$19 billion for the deductibility of taxes on owner-occupied homes. *Id.* at 294 tbl.18-3. Under the Bush administration's analysis, actually imputing the \$24 billion income (that is, taxing it or including it in the TEB) to homeowners makes the \$89 billion in home-related deductions disappear from the TEB.

⁹³ The Bush administration states that "[t]his estimate starts with the [National Income and Product Accounts (the "NIPA")] calculated value of gross rent on owner-occupied housing, and subtracts interest, taxes, economic depreciation, and other costs in arriving at an estimate of net-rental income from owner-occupied housing." *Id.* at 323 (citing National Income and Product Accounts, Table 2.4). The Commerce Department's NIPA Table 2.4.5., "Personal Consumption Expenditures by Type of Product," contains a 2002 entry of \$820.7 billion for "owner occupied nonfarm dwellings—space rent," which indicates that the Bush administration's adjustments to the NIPA data were quite substantial. BUREAU OF ECON. ANALYSIS, U.S. DEP'T OF COMMERCE, NATIONAL INCOME AND PRODUCT ACCOUNTS TABLES § 2 tbl.2.4.5 (2004), <http://www.bea.gov/beanipaweb/TableView.asp?SelectedTable=69&FirstYear=2002&LastYear=2003&Freq=Year> (last revised Aug. 5, 2004).

⁹⁴ The Code permanently excludes from tax most gains from appreciation in owner-occupied housing, favoring homes compared to other investment assets. See I.R.C. § 121 (West Supp. 2004). But even deferral of gain until sale is a significant tax benefit.

tax would have to include both consumption and accumulation.⁹⁵ Thus, the Appendix's analysis, even on its own terms, is incomplete in a way that understates tax benefits enjoyed by homeowners.⁹⁶

The Bush administration's use of the comprehensive benchmark provides no useful information for policymakers looking at the Code. If we are interested in knowing how much our tax system departs from an ideal income tax, it is nonsense to start from an evaluation of the current list of tax expenditures. Rather, to be internally consistent, we must start all over again and identify the comprehensive income tax baseline. Once comprehensive income, without regard to sources, uses, or administration, is determined, then a TEB could be devised by comparing our system to that ideal. But a comprehensive income base would differ significantly from the normal tax base that traditionally has been the underpinning for the TEB. For example, it would include gains and losses as they accrue over time, and an array of non-cash consumption benefits.⁹⁷

The Bush administration's Appendix is misleading compared to an analysis that uses comprehensive income as the baseline because only a subset of appropriate departures from that base is considered. By starting with the current TEB, the Bush administration's tables only allow for the recharacterization of tax expenditures as normal, but do not allow for the recharacterization of anything that currently is treated as normal as a tax expenditure. To the extent that normal items under the traditional standards are more generous to high-income taxpayers, the Bush administration's analysis exacerbates that bias and makes the resulting set of tax expenditures appear less favorable to those taxpayers than would a more comprehensive approach. For example, if the Bush administration defined an ideal income tax as the general baseline, then the TEB would include the benefits from

⁹⁵ A consumption tax, by design, fails to tax accumulation. The difficulty of taxing the accumulation aspect of income has led some people to prefer a consumption tax to an income tax. See, e.g., William Andrews, *A Consumption Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1115 (1974) (arguing that the "worst inequity, distortion and complexity [in the income tax] arise out of inconsistency in the treatment of accumulation").

⁹⁶ Taxpayers benefiting most from the home mortgage deduction are those earning \$200,000 and over (the highest income class in the distributional tables). Taxpayers earning between \$50,000 and \$75,000 receive an average benefit of \$1087, whereas those earning \$200,000 and over receive an average benefit of \$6305. Calculations based on STAFF OF JOINT COMM. ON TAXATION, *supra* note 72, at 35 tbl.3.

⁹⁷ A comprehensive income tax base is not self-defining, and there is a rich literature debating it. See generally COMPREHENSIVE INCOME TAXATION (Joseph A. Pechman ed., 1977); Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967).

the realization rule as a tax expenditure, which would more than offset the removal of the step-up in basis under section 1014 of the Code from the analysis. Similarly, inclusion of appreciation in home values, along with a sober assessment of imputed income from home ownership, would produce a more complete picture of the distribution of tax benefits among income groups.

If we evaluate significance within the budget process by looking at the numbers, the treatment of the corporate tax in the latest Bush administration TEB dwarfs any other issues concerning tax expenditures. The Appendix describes the corporate tax as a negative tax expenditure, and Appendix Table 3 quantifies the negative tax expenditure from the double tax on corporate profits at \$24 billion to \$34 billion each year from 2003 through 2009.⁹⁸

In addition to the treatment in the Appendix, the Bush administration's latest official version of the TEB itself, for the first time, treats integration of the corporate and individual taxes as normal, despite its statement that a separate corporate tax is part of the baseline.⁹⁹ This change in the definition of the normal base is demonstrated by its treatment of the capital gain and dividend rate cut contained in the 2003 Act, which it explains as follows:

Although not in line with previous reference tax law or normal tax law baselines, our tables exclude from the list of tax expenditures JGTRRA's reductions in the tax rate on dividends. Reference law used for the FY 2005 Budget includes capital gains as tax expenditure, but only to the extent capital gains have not previously been taxed under the corporate income tax. Similarly, the lower tax rate on dividends is not included as a tax expenditure under reference law because dividends have generally already been taxed under the corporate income tax.¹⁰⁰

The Bush administration justifies this treatment as a move toward a more comprehensive income tax base (despite the fact that the normal baseline for generating the TEB has never been a comprehensive income tax base). But the problem here is similar to the one discussed above concerning the Appendix: it is misleading to move selectively

⁹⁸ OFFICE OF MGMT. & BUDGET, *supra* note 39, at 325 app. tbl.3. This constitutes about sixteen percent of the total corporate tax receipts estimated earlier in the document. See *id.* at 239, 325.

⁹⁹ *Id.* at 299.

¹⁰⁰ *Id.* at 300. JGTRRA is the 2003 Act.

toward a comprehensive baseline. The Bush administration's TEB fails to give a complete picture relative to an integrated standard of comprehensive income, which might include a fair amount of dividends not taxed previously. If the TEB were to adopt accurately an integrated standard, the tax on corporate income would need to pass through, without corporate preferences, to individuals.

The Bush administration equates the corporate income tax with a double tax on corporate profits.¹⁰¹ This is not accurate if corporate income is not taxed fully at either level.¹⁰² The Bush administration fails to determine the extent to which income actually is taxed to the corporation, satisfying itself that dividends "generally" have been taxed at the corporate level.¹⁰³ Whether and how much tax has been paid by the corporation is an empirical question, the answer to which determines whether the Bush administration's treatment is defensible. There is reason to believe that corporate income is not taxed as heavily as the Bush administration assumes; according to a recent Government Accountability Office study, most corporations are paying no tax, and ninety-four percent are paying tax at rates less than five percent of income.¹⁰⁴

The Bush administration's new position in the TEB is contrary to the treatment of the classical system throughout the history of the TEB, and makes the recent tax cut directed at holders of corporate stock disappear entirely from the comparison of tax benefits before and after the 2003 Act. Its approach to the 2003 Act normalizes the loss of significant tax previously paid by individuals, without any real inquiry into how much tax is actually paid by the corporations making distributions that are now taxed at such drastically lower rates.¹⁰⁵ In its explanation, the Bush administration states that this treatment was determined "as part of Treasury's ongoing reevaluation of the tax expenditure concept" and that it "gradually" is changing the baseline

¹⁰¹ *Id.* at 318.

¹⁰² In his new book, economist Eugene Steuerle writes that "some individuals achieve very large capital gains on their successful investments far in excess of any retained earnings on which corporate tax may have been paid." STEUERLE, *supra* note 4, at 25.

¹⁰³ OFFICE OF MGMT. & BUDGET, *supra* note 39, at 300.

¹⁰⁴ See U.S. GEN. ACCOUNTING OFFICE, TAX ADMINISTRATION: COMPARISON OF THE REPORTED TAX LIABILITIES OF FOREIGN- AND U.S.-CONTROLLED CORPORATIONS, 1996-2000, at 2 (Feb. 2004), available at <http://www.gao.gov/new.items/d04358.pdf>. The General Accounting Office recently has become the Government Accountability Office.

¹⁰⁵ See OFFICE OF MGMT. & BUDGET, *supra* note 39, at 324 (quantifying the negative tax expenditure from multiple levels of tax under the classical system, while failing to substantiate or defend its treatment of earnings as "fully taxed at the corporate level").

used in the TEB.¹⁰⁶ But it is precisely this gradual change that is problematic because it is most likely to mislead. By redefining the baseline at a moment of a significant change in the law and distribution of the tax burden, the Bush administration's analysis succeeds in preventing the latest tax benefits for the rich from showing up in the TEB at all.¹⁰⁷ The Joint Committee's analysis quantifies the lost revenue from the reduced rate on dividends and capital gains as \$406 billion for 2004 through 2008,¹⁰⁸ whereas the Bush administration's 2005 through 2009 number is only \$178 billion.¹⁰⁹ Policymakers comparing last year's Bush administration budget with this year's Bush administration budget might not realize that the 2003 Act provided a tremendous windfall to individuals who enjoy that reduced rate.¹¹⁰ An innocent reader reasonably would conclude that recipients of capital gains now could expect to pay more in tax.

If the TEB is to do anything, it should indicate which policies the government supports through the tax system. The incremental attack being waged on the TEB baseline makes it increasingly difficult for that document to provide any useful information. Although that effect may have been deliberate, it is nevertheless a real loss for policymakers.

CONCLUSION

As federal economic policy develops, policymakers must grapple with the dire budgetary issues raised by Doctors Gale and Orszag. At the same time, policymakers must approach budget processes with great sensitivity to distributional concerns. This Commentary attempts to foster greater attention on some of the challenges to progressivity within current budget policy. A commitment to distributional fairness must be reflected in both the information side of the budget process, and in the determination of substantive changes in law. The TEB,

¹⁰⁶ *Id.* at 300.

¹⁰⁷ William Gale, Peter Orszag, and Isaac Shapiro have quantified the distribution of the 2001 and 2003 tax cuts, and concluded that the top 0.1% of the income distribution receives the largest percentage increase in after-tax income on account of the cuts. See Gale et al., *supra* note 22, at 1539.

¹⁰⁸ STAFF OF JOINT COMM. ON TAXATION, *supra* note 72, at 23.

¹⁰⁹ That number only includes capital gains because the Department of the Treasury treats the dividends as not producing any tax expenditure. OFFICE OF MGMT. & BUDGET, *supra* note 39, at 294 (tbl.18-3, 300).

¹¹⁰ Last year's budget of the Office of Management and Budget had almost \$260 billion as the five-year estimate, compared to \$178 billion in 2004. Compare OFFICE OF MGMT. & BUDGET, *supra* note 39, at 294 (regarding budget for fiscal year 2005), with OFFICE OF MGMT. & BUDGET, *supra* note 77, at 110 (regarding budget for fiscal year 2004).

revenue estimates, and distributional tables all need to present a more complete and reliable description than they currently provide, so as to enable policymakers to adopt laws that produce a fair distribution of the tax burden. A combination of procedural and substantive reforms would go a long way toward improving the results of the budget process, from the perspectives of both fiscal responsibility and distributional fairness.

APPENDIX I

AMT Taxpayers, 2005–2014

