THE TAXONOMIST

Evildoer

Our President just can't stop pushing more harmful tax cuts for the rich

By Robert S. McIntyre

If, like our President and Vice-president, you strongly believe that cutting taxes leads to higher tax revenues, then the past year and a half must have been very disappointing. Despite the huge tax cut enacted in the spring of 2001, personal income tax collections have plummeted since George W. Bush took office, dropping from 10.1 percent of the economy in fiscal 2000 to 9.6 percent in fiscal 2001 to only 8 percent in fiscal 2002. But sadly, dashed hopes haven't led to second thoughts. On the contrary, Bush has decided that our economy is lagging because his 2001 tax cut simply wasn't big enough. So he now wants to increase it—by more than half.

Bush's original 2001 tax cut plan will cost $1.3 trillion over this decade, or $1.6 trillion including interest. The President pegs the ten-year price tag on his new tax cut package at another $674 billion—$900 billion with interest. That, plus Bush's $114 billion in corporate tax cuts enacted a year ago, brings his hoped-for tax cuts to a total of $2.6 trillion, so far. Absent a supply-side miracle, Bush seems willing to condemn our country to huge budget deficits forever as long as taxes on the best-off Americans go down.

What does Bush have in store for us this time? In the short run, his latest gift to the well off involves speeding up the income tax rate cuts enacted in 2001, which otherwise aren't scheduled to take full effect until 2006. The purpose here is to lock in most of his upper-income tax reductions before it becomes even more obvious that we can't afford them. To make his plan look slightly less tilted, Bush also calls for boosting the per-child tax credit to $1,000 now, rather than waiting until 2010.

Over the next ten years, however, most of the cost of Bush's latest tax-reduction program stems from his proposed tax cuts on dividends and capital gains. Although many reporters and investment analysts initially expressed confusion about this scheme, the details are spelled out pretty clearly in a 1992 report written by Glenn Hubbard, head of Bush's Council of Economic Advisers, back when he worked in the Bush-I Treasury.

Bush claims his new plan will end the so-called "double taxation" of corporate profits. But even the administration's chief booster for the dividend tax break, Hubbard, seems to understand that Bush is committing rhetorical fraud. In his 1992 Treasury report, Hubbard admitted that a large share of profits—most, these days—aren't taxed at all due to "tax preferences," but recommended that we should ignore that bothersome fact except in the most egregious cases.

Following this twisted logic, Bush's plan would generally make dividends tax-free. There is one caveat, however. Under what might be called the *CSX Exception* (after the notorious tax-avoiding company previously run by Bush's new Treasury Secretary), a corporation that pays nothing in taxes would *not* be able to pay its shareholders tax-free dividends. To be precise, dividends would be tax-exempt only if they don't exceed a company's taxable income less taxes paid. Given today's high level of corporate tax avoidance, this rule actually seems to have some teeth. Even so, a company that sheltered two-thirds of its earnings still could pay out a fifth of its profits in tax-free dividends (more than most companies pay out now), despite the fact that not a penny of those profits was "double taxed."

Moving in the opposite direction, there's also the *Microsoft Codicil*, designed to appeal to high-tech companies that often don't pay dividends. Under this frighteningly complicated provision, shareholders of a company that pays less than the maximum amount in tax-exempt dividends could be "deemed" to have received a tax-free dividend and reinvested it right back in the company's stock. That lets the shareholders pretend to have paid more than they really did for their stock, and thus pay lower capital gains tax when they sell it. Within a decade, almost half of the cost of Bush's so-called "dividend exemption" is likely to reflect lower capital gains taxes.

Not surprisingly, the benefits of Bush's dividends-and-capital-gains tax cut are extremely tilted toward those who own the most stock, that is, the wealthiest people. Half of the tax breaks would go to the best-off one percent of the taxpayers and four-fifths would go to the best-off 10 percent.

Bush's zeal to cut taxes for the wealthy seems to know no bounds. If once again that turns out to be a terrible economic strategy, he's apparently willing to bear the political consequences.

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