THE TAXONOMIST

Another Colossal Corporate Tax Cut?

By Robert S. McIntyre

As I write this, the House has just passed its version of the Third Annual Bush Tax Cut and the Senate is about to debate its bill. Both are irresponsible, gimmick-ridden, economically wrongheaded and heavily tilted toward the rich. President Bush would accept no less. Some of this information you may have gleaned from the newspapers. But what you've probably never heard mentioned is the enormous corporate tax cut embedded in the House bill.

Over the next three years, House Republicans want to slash business taxes by $167 billion. More than half of that is slated for 2005, when the goal is to reduce corporate tax payments by a third. That's an enormous tax cut. But on the rare occasions when the press reports on the House's planned corporate giveaways, it dismisses them as a mere $39 billion in corporate tax cuts over 11 years.

How do House GOP leaders manage to style a business tax cut that costs a staggering $88 billion in the year it takes full effect as only a paltry $3.5 billion average annual tax reduction? Simple. They assert that the tax cut is only temporary, and that most of its cost will be recaptured through future stiff corporate tax increases.

Of course, we heard this blarney last year, when Congress and Bush enacted the largest corporate tax cut in a generation, entailing new business tax breaks costing $114 billion over three years. At the time, I wrote, "These provisions are supposed to expire in a few years, but experience suggests they're more likely to be routinely extended in perpetuity" (See *TAP*, 5/6/02). But the press fell for the Republican spin that most of the tax cuts would be recaptured later, and duly reported only the alleged $34 billion net cost over a decade.

The 2002 corporate tax cut was billed as an "economic stimulus." Then, as now, our economy faced serious excess capacity: businesses could make more products than consumers wanted to buy. Oddly, Congress and Bush concluded that rather than trying to boost demand, the answer to the over-capacity problem was to encourage even more over-capacity, by offering tax subsidies for buying machinery and equipment.

Not surprisingly, this nonsensical strategy hasn't worked. By the end of 2002 the Business Roundtable reported that more than 80 percent of its members planned no added investment—although they were surely happy to take the money for doing what they would have done anyway. Yet faced with the abject failure of their previous effort at stimulus, House Republicans won't admit their mistake. Instead, they've concluded that even bigger corporate subsidies are necessary.

The centerpiece of both the failed 2002 corporate stimulus plan and its successor this year involves tax write-offs for depreciation. That's the amount that companies can deduct for the wear and tear on their equipment and buildings over time. Even before 2002, the tax code was extremely generous in this regard, providing extra depreciation write-offs worth about $40 billion in tax savings annually compared to reasonable allowances. In many cases, these excess write-offs produced *negative* tax rates on the profits from new investments. In other words, investments were more profitable after taxes than before.

Notwithstanding the tax code's existing beneficence to corporate investment, last year's tax bill increased the amount that companies can write off on typical equipment purchases in the first year from 40 percent of the cost to 58 percent, effective through 2004. Now the House's pending tax-cut bill wants to boost that first year write-off to 70 percent and extend it through the end of 2005. If the new measure passes, the combination of the two bills will provide a total of $271 billion in additional business tax breaks from 2002 through 2005.

But not to worry, we're told. The way depreciation works, extra deductions now mean lower deductions in the future, since ultimately businesses can write off only 100 percent of the cost of their equipment. That theory has practical meaning, however, only if the law allowing the extra first-year write-offs expires. Otherwise, the added tax breaks generated by new equipment purchases will dwarf the partial recapture of past breaks.

Perhaps cowed by all the big numbers or maybe just forgetful, reporters seem willing to trust the House Republicans' promise that if they succeed in cutting business taxes by $271 billion in the first half of this decade, they will cheerfully allow business taxes to *increase* by $211 billion over the next eight years. Pardon me if I'm more than skeptical that this will happen. On the contrary, I have little doubt that Bush Annual Tax Cut IV next year will try to make sure it doesn't.

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