

Revenue Impacts of the Fiscal Cliff Deal

While the White House and members of Congress have described the fiscal cliff deal as raising \$620 billion in revenue, the Joint Committee on Taxation (JCT), the official revenue estimator for Congress, has projected that it will actually reduce revenue by \$3.9 trillion over a decade.¹ The widely-used \$620 billion figure is calculated by administration officials comparing the bill's provisions making permanent *most* of the Bush-era tax cuts to a proposal for making permanent *all* the Bush-era tax cuts.² Further, as explained below, the revenue "savings" is likely to be offset by the business tax cuts that are also included in the bill and which are likely to be extended over and over throughout the decade and beyond.

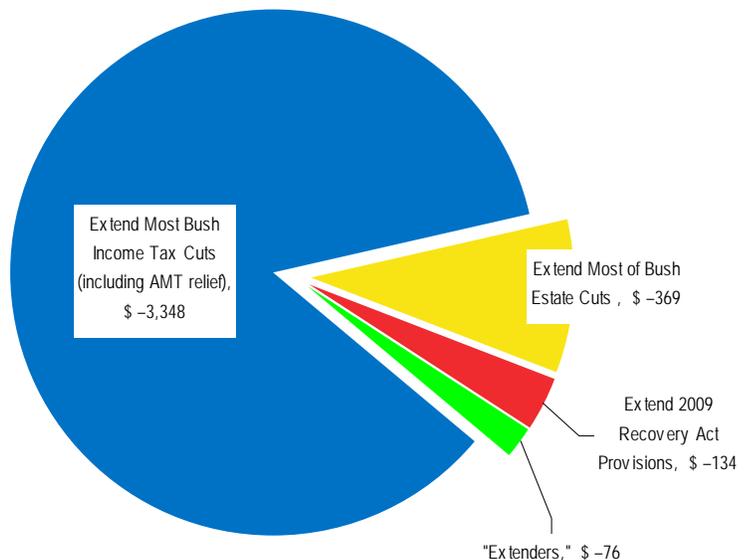
The JCT figures show that:

The fiscal cliff deal makes permanent 85 percent of the Bush income tax cuts, at a cost of \$3.3 trillion over ten years.³ Making permanent all of the income tax cuts would have cost an additional \$598 billion over ten years, according to JCT.

The fiscal cliff deal makes permanent 95 percent of the Bush estate tax cut that was still in effect in 2012, at a cost of \$369 billion over ten years.⁴ Making permanent all of the estate tax cut in effect in 2012, as Republicans proposed, would have cost an additional \$19 billion over ten years, according to JCT.

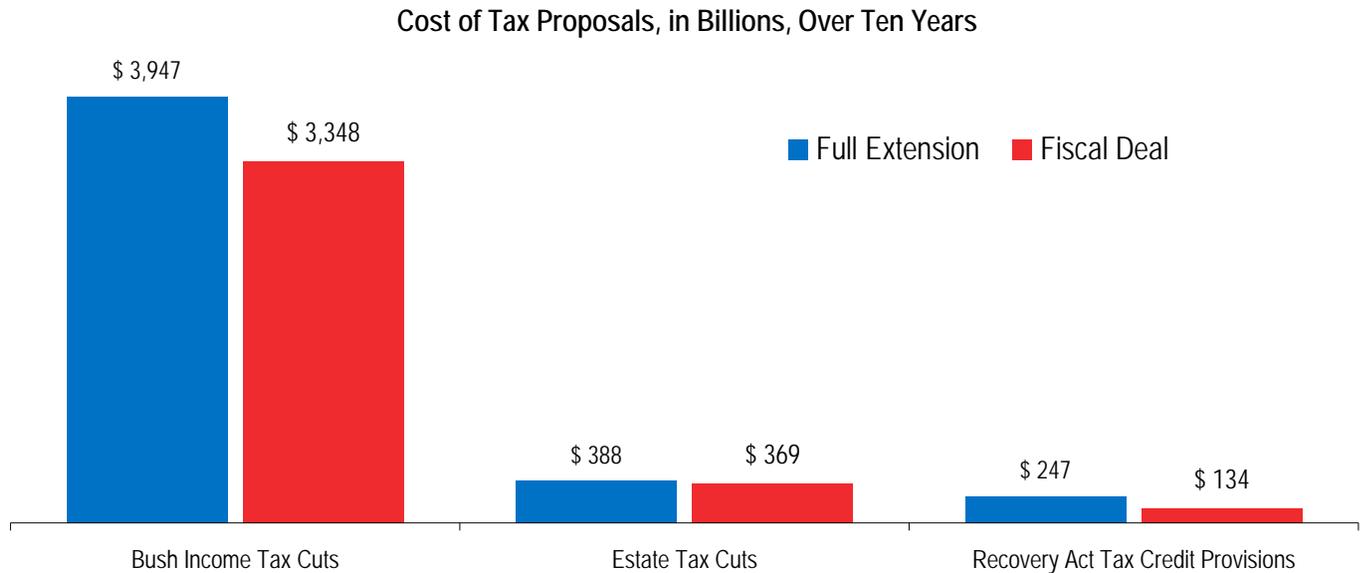
In other words, a full extension of the Bush-era income tax cuts and estate tax cuts would have cost an additional \$617 billion over ten years. (That includes the additional \$598 billion in income tax cuts and the additional \$19 billion in estate tax cuts.) This is the origin of the widely reported (rounded) estimate of \$620 billion in revenue saved under the fiscal cliff deal.

Cost (in billions) of Tax Provisions in the Fiscal Cliff Deal



Source: Joint Committee on Taxation, January 2013

The deal also extends several provisions from the 2009 economic recovery act that expanded refundable tax credits for low- and middle-income Americans, but only for five years.⁵ The five-year extension of these tax cuts costs \$134 billion, just 54 percent of the cost of a ten-year extension of these provisions.



Source: Joint Committee on Taxation, January 2013

The fiscal cliff deal also includes a package of provisions often called the “extenders” because they extend numerous special-interest tax breaks, mostly for large corporations, through 2013 and retroactively, to 2012. While JCT finds that these provisions will have a cost of \$76 billion by the end of the decade, a closer look at the figures makes it clear that they could cost far more. A strange thing emerges from a close examination of JCT’s cost figures. They show that while the ten-year cost of the extenders is \$76 billion, the cost in the first two years would actually be over \$100 billion — which is greater than the revenue “saved” in the first two years of the decade by allowing the high-income Bush tax cuts to expire.

This is largely explained by one of the most significant of the extenders: the provision extending “bonus depreciation,” which allows companies buying equipment to take depreciation deductions more quickly than the equipment actually wears out. The provision will allow companies to take depreciation deductions much earlier than they otherwise would, which will cost the Treasury more than \$50 billion over the first two years of the decade, according to JCT. But because those deductions will then be unavailable in later years when they would have otherwise have been claimed, the Treasury will actually collect more revenue during the rest of the decade, so that, according to JCT, the extension of bonus depreciation will have a *net* cost of just \$4.7 billion by the end of the decade.

Of course, in the event that Congress perpetually extends this provision, it will continue to have a large cost each year — and the legislative history makes this result seem likely. Bonus depreciation was enacted in 2002 and has only been allowed to expire for two years (2006 and 2007) since then. In every other year since 2002, Congress made this “temporary” break available. This legislative history is explained in a report from the Congressional Research Service which reviews efforts to quantify the impact of the provision and explains that “the studies concluded

that accelerated depreciation in general is a relatively ineffective tool for stimulating the economy.”⁶

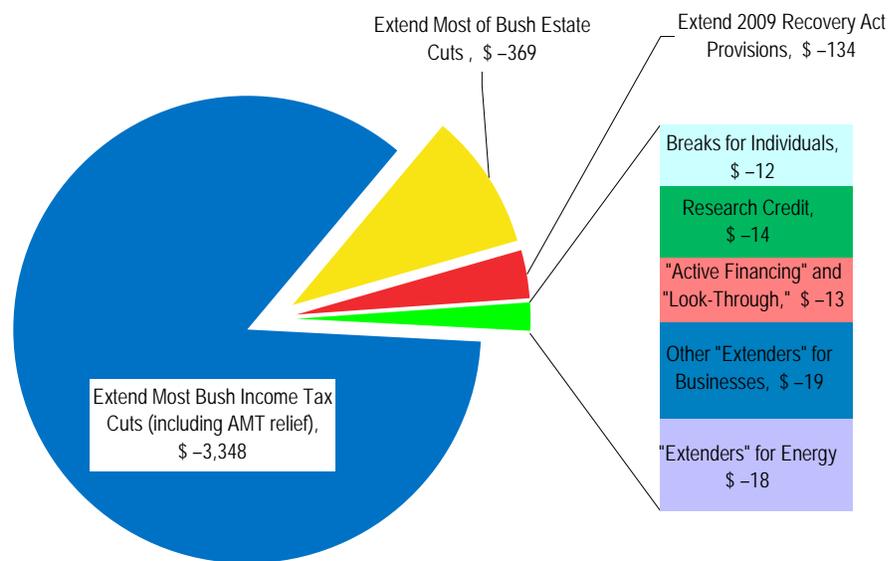
Among the other large corporate tax breaks that the fiscal cliff deal extends for two years is the research credit, at a cost of \$14 billion. Like the rest of the extenders it is officially a “temporary” provision, but no one believes it will be allowed to actually expire. Since it was enacted in 1981, the research credit has been extended 15 times, often retroactively, and has only been allowed to expire (with no retroactive extension) for one year during that entire time.⁷

The research credit is supposed to encourage companies to conduct research, but it is allowed in situations in which it could not possibly have created any such incentive. The credit actually expired at the end of 2011 and the provision in this bill extends it retroactively for 2012 and well as for 2013. Obviously, it is impossible to encourage behavior that has already happened.⁸

To take another example, the extenders include arcane-sounding provisions known among tax lawyers as the “active financing exception” and the “CFC look-thru rules,” which essentially make it easier for multinational corporations to shift their domestic profits to offshore tax havens.⁹ The active financing exception was repealed in the loophole-closing 1986 Tax Reform Act, but was reinstated in 1997 as a “temporary” measure, and has been repeatedly extended since then. The CFC look-through rules were enacted in 2006 and have been extended since then. The fiscal cliff deal extends these provisions for two years, at a cost of \$13 billion.

Again, these provisions are retroactive to 2012. In fact, almost all of the so-called business tax incentives are retroactive!

Cost (in Billions) of Provisions in the Biden-McConnell Tax Deal with Detail on "Extenders"



Source: Joint Committee on Taxation, January 2013

¹ Joint Committee on Taxation revenue score of fiscal cliff deal, JCX-1-13, January 1, 2013. <https://www.jct.gov/publications.html?func=startdown&id=4497>

² See JCT's revenue score of a proposal to make permanent all the tax cuts, #12-2 198 December 19, 2012. <http://www.finance.senate.gov/legislation/download/?id=c9e44a34-1103-4575-8018-1139073316a7>

³ The fiscal cliff deal would essentially extend the Bush-era rate reductions on ordinary income and investment income for income up to \$450,000 for married couples and up to \$400,000 for singles. It would extend some other Bush-era tax cuts (repeal of the personal exemption phase-out and limit on itemized deductions, otherwise known as PEP and Pease) for married couples with income up to \$300,000 and singles with income up to \$250,000.

⁴ The fiscal cliff deal would largely extend the part of the Bush-era estate tax cut that was still in effect in 2012, which had increased the amount of assets exempt from the estate tax to \$5 million and had reduced the estate tax rate to 35 percent (although the fiscal cliff deal sets the estate tax rate a bit higher, at 40 percent).

⁵ The 2009 economic recovery act expanded the Earned Income Tax Credit and the Child Tax Credit and also replaced the Hope Credit for postsecondary education with the more generous American Opportunity Tax Credit. These provisions were in effect for 2009 and 2010 and then extended through the end of 2012, along with the Bush-era tax cuts.

⁶ Gary Guenther, "Section 179 and Bonus Depreciation Expensing Allowances: Current Law, Legislative Proposals in the 112th Congress, and Economic Effects," Congressional Research Service, September 10, 2012. <http://www.fas.org/sgp/crs/misc/RL31852.pdf>

⁷ The legislative history of the research credit is explained in Gary Guenther, "Research Tax Credit: Current Law, Legislation in the 112 Congress, and Policy Issues," Congressional Research Service, January 19, 2012.

⁸ There are other long-standing problems with the research credit, the least of which involve companies amending their tax returns to claim the credit years after the fact, even though the credit could not possibly have provided any incentive to conduct research if the recipients were unaware of it at the time the research was conducted. This and other problems with the research credit are illuminated by Martin Sullivan, "Time to Scrap the Research Credit," *Tax Notes*, February 22, 2010.

⁹ Citizens for Tax Justice, "Don't Renew the Offshore Tax Loopholes: Congress Should Kill the 'Extenders' that let G.E., Apple, and Google Send Their Profits Offshore," August 2, 2012. <http://ctj.org/pdf/offshoreextendersreport.pdf>