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LaCosta Rickford 10/6/03
Operator's Signature Date

2003 HOUSE FINANCE AND TAXATION

HCR 3044

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2003 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HCR 3044**

House Finance and Taxation Committee

☐ Conference Committee

Hearing Date February 10, 2003

Tape Number	Side A	Side B	Meter #
1	X		4.1
Committee Clerk Signature	Jamie Stein		

Minutes:

REP. WESLEY BELTER, CHAIRMAN Called the hearing to order.

REP. AL CARLSON, FARGO Introduced the resolution, which deals with the President's economic growth and tax relief plan. There are critics on both sides and supporters on both sides of this issue. Some of the things it does do, we have a lot of people who invest in the stock market in our country, and we have people who have lost a lot of money in the stock market in recent years. What we have done for years, is double tax the dividends, which doesn't seem right. That is why it is part of the package, to get rid of that taxation. Also, part of this package which affects middle income Americans, is that it excelerates reduction of the marriage penalty tax, it has a faster increase in the child tax credit and it takes into account, an immediate implementation of a new or lower 10 percent tax bracket. There are things that I think he is promoting for the good of the country and they are good for North Dakota. That is why I brought both resolutions HCR 3043 and HCR 3044 forward.

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Operator's Signature — Date 10/16/03

SANDY CLARK REPRESENTING THE NORTH DAKOTA FARM BUREAU Testified in support of both resolutions, HCR 3043 and HCR 3044. The estate tax is a very important issue to their members and have worked on it for a very long time on the repeal of the estate tax. They have worked through the process where it comes back in 2010 and then goes back on in 2011, we certainly concur with both resolutions.

REP. WES BELTER, DIST. 22 Testified in support of the resolution. He stated, double taxation of dividends is an extremely important issue, particularily for the young people. The reality of the difficulty that faces social security, the young people of today, will need to invest their own money and provide for their own retirement more then they ever had to in the past. Government will try to do as much as it can to preserve social security, but that will be a major task because of the demographics of our nation. With the dropping of the birthrate, more and more people will be on the receiving end of social security, and a lot fewer to pay in. The young people will really be challenged. The elimination of the double taxation of dividends will be something that will be very important to the young people's investment plans in the future. I think this is very important, that we as a state, forward this type of legislation to the federal level.

REP. KELSH Asked for an explanation of how dividends are double taxed.

REP. BELTER The way they are double taxed is, now when a company makes profits, those taxes are paid out, then you pay a tax on those dividends, then when you receive the dividends as an individual, you again pay tax on them. Oftentimes, we look at a big corporation and say they should pay their fair share, and they do pay their corporate tax, but those dividends are yours, you are the stockholder, you are the one taking a risk because you invested in this company. So, when the corporation pays out dividends, you as a stockholder have to pay a tax on the dividends

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when it leaves the company, but then when you receive the dividends you again pay a tax. That can be quite substantial.

REP. WINRICH On the issue of double taxation, I pay income tax on the money I earn and get from my investments, etc., yet, when I go out to buy something with that money, I again have to pay a sales tax, so is the sales tax a double tax and we should eliminate that also?

REP. BELTER No, the sales tax is not a double tax because that, in a sense, is a discretionary tax and is not tied to the same thing. When you purchase something, you made a decision to buy that, and that decision is not tied to a company's earnings or to your earnings. It is a decision you made, and to me, it is an entirely separate thing. The corporation dividend tax is all tied together.

REP. WINRICH Corporations also have the discretion whether or not to declare a dividend. Microsoft in particular, have said they have huge reserves because they haven't distributed profits as dividends, the same sort of discretionary decision enters into that.

REP. BELTER I think it is a mistake, on the part of corporations, to hold a large amount of cash, and I realize they sometimes hold that cash because they want to, at some point, reinvest it. I believe dividends belong to the stockholders. I think that is one of the problems we face in America, right now, that boards of directors are not always delivering to the stockholders. Oftentimes, boards of directors are the holders of a large amount of that stock, so, they don't want to get taxed either, so they hold the cash, and I think that is wrong.

JOHN RISCH, REPRESENTING THE UNITED TRANSPORTATION UNION Testified in opposition of the bill. Two years ago the congressional budget of our office projected that the United States would have a 5.6 trillion dollar budget surplus, now the estimates have dropped

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from a 5.6 trillion dollar surplus to a 1.6 billion dollar deficit. He felt paying sales tax is a form of double taxation and payroll taxes, social security and medicare taxes on your income, in conjunction with income tax on your income, is another form of double taxation. The tax form is laden with forms of double taxation. To eliminate all forms of double taxation, would simply be unsustainable for government to operate. He related to President Bush's Tax Plan. See attached copy.

REP. WIKENHEISER Referred to the president's proposed dividend income tax reduction, won't it stimulate the economy, the people will spend more money, it creates jobs, they pay income tax, isn't this something which would bring in more money?

JOHN RISCH Certainly, it makes sense to the government to stimulate the economy, when things are at a downturn. The problem with the president's tax proposal is the year 2003, is an enormous tax reduction of 1.4 trillion dollars, only allows for 36 billion dollars for the year 2004. The intent is to stimulate more savings rather then consumption. If we wanted to stimulate consumption we could eliminate social security, medicate tax for a month or something like that, and put more money in people's hands. That would be more helpful.

REP. WIKENHEISER But at the same time, if you want to get some money for investments, don't we have to reduce the taxes for the people that pay them, what good is it for me to get a tax reduction, when I don't have to pay any now?

JOHN RISCH There are ways to stimulate consumption by giving a rebate on your payroll taxes, social security or medicare. We could do that. We could do a lump sum payment for all people who file, or those that don't file. The problem is, when you take someone with a great

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10/6/03
Date

deal of wealth, they oftentimes, don't spend that money, they save the money, it doesn't stimulate the economy quickly like someone spending the money will.

REP. KELSH Rep. Carlson mentioned interest rates in his testimony, interest rates are low right now, what would you envision happening to interest rates if these two resolutions were enacted?

JOHN RISCH The more the government demands and borrows money from the private sector, the more impact it has on upward push of interest rates, which has an adverse affect on the entire economy. Low interest rates, overall, stimulate the economy, encourage the building of houses, etc.

REP. GROSZ It is very alarming if the United States on an average, if this average top one percent, thirty thousand dollar tax relief, if the average North Dakota got thirteen thousand, I read that it would not be very conducive for having wealthy people in the state to be able to spend their dollars and reinvest in the industry, I think North Dakota should be taking, not only the fence with the concurrent resolution, but should be taking it further and try to solve ways to get the wealthy into our state, not providing things to keep them out.

JOHN RISCH I think the issue here is, much of the concentrated wealth is in much larger cities. North Dakota doesn't have many high income people. I don't know that we can do anything with the tax to bring people out here.

REP. KLEIN If the people are holding the money, it is not going to do the economy any good, it is when they release the money that it will do better.

JOHN RISCH Certainly, I think the paying of dividends is a good idea. Oftentimes, companies like Microsoft and other companies of not paying dividends, this would encourage

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them to do it. An interesting note is that much of corporate America is not pursuing this nontaxation of dividends, because oftentimes, they believe investing the money in corporations is a better use of their money then paying it out.

REP. DROVDAL Referred to Rep. Wikenheiser's question regarding tax cuts have generally stirred the economy and ended up with an increased tax structure for the federal government, as your testimony appears, you feel it will be deficit spending, a lot of people feel that deficit spending as more to do with 9 11 then with tax cuts, could you comment on that?

JOHN RISCH There are a lot of facts dealing with the economy, and a big part of that is September 11. Remember the 1980's, when there were dramatic cuts in taxes, and prices, in an effort to stimulate the economy. The results at the end of the 1980's were tremendous budget deficits. We did get out of the slump, but I don't know how much was attributed to regular cycles or the tax cuts, but we did get out, and later on Congress did raise taxes to make some of the loss of revenues.

REP. BELTER Thanked Mr. Risch for stimulating the conversation for the sake of the young people who were visiting from schools throughout the area. He stated, we are talking about public policy, although, it is very easy for us as individuals or as legislators to say, let's get the big guy. I am sensing that from your testimony, furthermore, the very rich have the ability to pay and so we should extract that money from them. I guess my argument is from a public perspective, I find it very difficult to divide low cost middle income and upper income, why should we have a policy that more or less goes out and gets those who happen to be successful, some of that success may be that they inherited it all, and didn't do anything to earn it, but a lot of these young people here today, hopefully, will be very successful, and some will be average

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and some less than average, but why should we go out and kind of target those who are more successful. I think we need to have a public policy which is fair to everyone.

JOHN RISCH I agree with you that we need a system that is fair, and the reason why we should go after those people that have the money is because, that is where the money is. It is the lowest income people who are paying a great deal of taxes, as far as percentage of their income, through payroll tax, tax on medicare, sales tax. Whereas, higher income people pay a lot of money in taxes, for the percentage of their income, they have the most ability to pay. It costs a lot of money to wage a war with Iraq, it costs a lot of money to provide a prescription drug program, it costs a lot of money for a lot of things, the best way to raise that money is from those who have it.

With no further testimony, the hearing was closed.

COMMITTEE ACTION

REP. WINRICH Commented that both labor and capital have an obligation to support the government to share the returns they gain from our economy through wages and salaries or through dividends and interest. It is reasonable public policy to tax income whether it is earned or unearned income.

REP. CLARK Made a motion for a **DO PASS**

REP. WEILER Second the motion **MOTION CARRIED BY VOICE VOTE WITH 3 NO VOTES.**

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Date: 2-10-03
Roll Call Vote #: 1

2003 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HCR 3044

House FINANCE & TAXATION Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Do Pass

Motion Made By Rep. Clark Seconded By Rep.

Representatives	Yes	No	Representatives	Yes	No
BELTER, CHAIRMAN					
DROVDAL, VICE-CHAIR					
CLARK					
FROELICH					
GROSZ					
HEADLAND					
IVERSON					
KELSH					
KLEIN					
NICHOLAS					
SCHMIDT					
WEILER					
WIKENHEISER			Place on		
WINRICH			consent calendar		

Total (Yes) 9 No 4

Absent 1

Floor Assignment Rep Belter

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REPORT OF STANDING COMMITTEE (410)
February 10, 2003 12:48 p.m.

Module No: HR-25-2106
Carrier: Belter
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HCR 3044: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO PASS** (9 YEAS, 4 NAYS, 1 ABSENT AND NOT VOTING). HCR 3044 was placed on the Eleventh order on the calendar.

(2) DESK, (3) COMM

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2003 SENATE FINANCE AND TAXATION

HCR 3044

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Date

2003 SENATE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. HCR3044

Senate Finance and Taxation Committee

☐ Conference Committee

Hearing Date March 3, 2003

Tape Number	Side A	Side B	Meter #
1	X		35-1398
1		X	1730-2595

Committee Clerk Signature [signature]

Minutes:

Senator Urlacher opened the hearing on HCR3044. All committee members are present. This resolution is urging Congress to enact the President's 2002 economic growth and tax relief plan.

Representative Al Carlson (mtr #40) - Is the primary sponsor of the resolution. Introduced the resolution and explained its intent. This resolution has to do with the 2002 economic growth plan. Reviewed the sections of the bill.

Senator Seymour (mtr #353) - What are your thoughts on the national debt?

Representative Carlson (mtr #366) - Explained his views on decreasing taxes and the effect on economic growth.

Sandy Clark, ND Farm Bureau (mtr #511) - Gave ND Farm Bureau's support of this resolution. Supports a Do Pass.

Bob Graveline (mtr #541) - Testified in support of HCR3044. Reviewed the section that deals with eliminating double taxation of dividends.

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[signature] 10/6/03
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Senator Seymour (mtr #621) - What is the history of people's retirement accounts?

Mr. Graveline (mtr #635) - Balances mostly down, especially investments in the equity market.

Jon Risch, United Transportation Union of Railway Workers (mtr #694) - Testified in opposition to HCR3044. Feels this resolution contradicts past resolutions put in place to require a balanced budget at the federal level. Talked briefly about the dividend exclusions in the resolution and how that would apply more to the wealthy. Referenced a handout that gave information on taxing dividends. See exhibit A.

Senator Urlacher (mtr #1398) - Given there is no further testimony, closed the hearing on HCR3044.

Senator Urlacher reopened the discussion on HCR3044. All committee members are present.

Senator Nichols (mtr #1740) - Not comfortable with the resolution. Feels the federal government should have a balanced budget. At this time the State has to have a balanced budget.

Senator Urlacher (mtr #1895) - Not a lot of stop gaps. Some portions of the resolution are better than others.

Senator Nichols (mtr #1930) - Agreed that some parts are better than others. But feels now is not the time.

Senator Wardner (mtr #1980) - Reviewed the sponsor's intent when introducing this resolution.

Senator Urlacher (mtr #2040) - Feels the resolution is complex. Favors leaving the dollars in the hands of the people.

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Senator Seymour (mtr #2093) - Agree with the philosophy of the resolution.

Senator Syverson (mtr #2123) - Asked for historical background. Seems to have a political flavor.

Senator Wardner (mtr #2202) - Answered Senator Syverson based on his own experience.

Senator Urlacher (mtr #2282) - The direction of the resolution is evaluated.

Senator Wardner (mtr #2442) - Moved a Do Pass on HCR3044. Second by Senator Tollefson.

Roll call vote 4 yea, 2 nay, 0 absent. Carrier is Senator Tollefson.

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Date: 3.3.03
Roll Call Vote #: 1

2003 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HCR 3041

Senate Finance and Taxation Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number ______

Action Taken Do Pass

Motion Made By Sen. Wardner Seconded By Sen. Tollefson

Senators	Yes	No	Senators	Yes	No
Senator Urlacher - Chairman	✓		Senator Nichols		✓
Senator Wardner - Vice Chairman	✓		Senator Seymour		✓
Senator Syverson	✓				
Senator Tollefson	✓				

Total (Yes) 4 No 2

Absent ______

Floor Assignment Sen. Tollefson

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REPORT OF STANDING COMMITTEE (410)
March 3, 2003 12:20 p.m.

Module No: SR-37-3720
Carrier: Tollefson
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HCR 3044: Finance and Taxation Committee (Sen. Urlacher, Chairman) recommends **DO PASS** (4 YEAS, 2 NAYS, 0 ABSENT AND NOT VOTING). HCR 3044 was placed on the Fourteenth order on the calendar.

(2) DESK, (3) COMM

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2003 TESTIMONY

HCR 3044

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10/6/03

Date

John Risch
HCR 3044

Citizens for Tax Justice , 202-626-3780 January 27, 2003

Bush 2003 Tax Plan a Big Fat Zero for a Third of Nation's Taxpayers

Percentages with no tax cut are much higher in poorer states

Click here to see this analysis in PDF format.

Related CTJ Analyses	
Cost of Bush 2003 Tax Plan Estimated	2/3/03
Senate Democratic Tax Plan	1/30/03

Almost a third of America's couples and singles would receive absolutely no tax cut from President Bush's proposals to accelerate some of his previously-enacted tax cuts and exempt dividends from personal income taxes. A new analysis released by Citizens for Tax Justice looks at the 2003 effects of the latest Bush tax cut plan on a state-by-state basis. The analysis finds that the shares of taxpayers slated to get no tax cut are especially high in lower-income states.

Nationwide, 31 percent of taxpayers would get nothing from the Bush plan.

Click here to see this chart in PDF format.

The Bush 2003 Tax Cut Plan, State-by-State

State	Average tax cut for state s middle 20%	Average tax cut for state s top 1%	% of couples & singles with zero tax cut	Number with zero tax cut	% of couples & singles with <$100 tax cut*	Number with <$100*	Rankings: Middle 20% tax cut	Rankings: Tax cut for top 1%	Rankings: % with zero tax cut	Rankings: % with <$100 tax cut
United States	**$ 289**	**$ 30,127**	**31%**	**42 million**	**48%**	**64 million**				
Alabama	188	20,471	39%	818,100	57%	1,176,900	48	33	5	2
Alaska	425	19,936	23%	67,300	42%	124,700	3	35	49	48
Arizona	250	22,431	31%	682,400	50%	1,108,700	35	30	19	17
North Dakota	250	13,268	32%	96,500	49%	144,800	34	50	16	23
Ohio	287	20,387	28%	1,580,900	47%	2,634,500	24	34	32	32
Oklahoma	240	17,700	38%	569,100	53%	798,000	39	42	6	9
Oregon	318	19,645	30%	510,800	50%	834,500	18	36	24	17
Pennsylvania	285	29,051	30%	1,766,100	49%	2,846,300	25	17	24	23
Rhode Island	215	22,039	31%	153,200	50%	248,800	46	31	19	17
South Carolina	184	18,295	36%	687,800	55%	1,042,300	49	41	8	5
South Dakota	272	23,700	30%	103,600	49%	171,300	27	25	24	23
Tennessee	232	23,566	35%	970,300	51%	1,407,600	43	26	10	15
Texas	283	32,571	32%	2,971,700	48%	4,440,700	26	14	16	27
Utah	366	24,385	28%	265,700	48%	458,500	7	22	32	27

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CENTER ON BUDGET AND POLICY PRIORITIES

Revised January 31, 2003

THE FULL COST OF THE ADMINISTRATION'S AGENDA FOR NEW TAX CUTS IS AT LEAST $2.3 TRILLION THROUGH 2013

by Joel Friedman and Richard Kogan

PDF of full report
HTM of fact sheet
PDF of fact sheet

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Most observers were startled at the high cost of the Bush Administration's "economic growth" package. The Administration estimates that its tax-cut proposal would cost $670 billion through 2013, or more than double the price tag of $300 billion that was being circulated in the weeks leading up to the release of the package. But even the higher cost for its new package of tax cuts reflects only a portion of the Administration's overall tax-cutting agenda. When we include the Administration's stated objective of making permanent the tax cuts enacted in 2001 but that expire in 2010, and reflect conservative estimates of its intention to fix the Alternative Minimum Tax starting in 2005, the size of the revenue loss rises to nearly $1.9 trillion through 2013. When the interest costs associated with these expensive tax cuts are included, the total impact on the budget would be $2.3 trillion through 2013.

- Making permanent the tax cuts enacted in 2001, which expire in 2010, would cost about $635 billion, largely between 2011 and 2013. The Administration has repeatedly stated its intention to make these tax cuts permanent, including the proposal in its budget last year and making it a campaign issue in the 2002 mid-term elections.

- Fixing the Alternative Minimum Tax would cost at least $575 billion between 2005 and 2013. Current estimates show that the number of taxpayers who will face this alternative tax rising from about 2 million today to nearly 40 million by the end of the decade. The Administration provides temporary AMT relief in its new economic package, delaying the advent of this problem through 2005. A senior Administration official was quoted in a recent *New York Times* article as saying that Administration planned to take care of the long-term AMT problem "in its second term."

Cost of Bush Administration Tax-Cut Agenda, 2003-2013 (in billions)

	Revenue Loss	Interest	Total
Economic Growth Package	$670	$250	$920
Make 2001 Tax Cuts Permanent	$635	$55	$690
Fix Alternative Minimum Tax	$575	$110	$685
Total	**$1,880**	**$415**	**$2,295**

- The lower revenues resulting from these three tax cuts — enacting the new "growth" package, making the 2001 tax cuts permanent, and fixing the AMT — increase the debt and the interest payments on that debt. These higher interest payments would total more than $400 billion through 2013, bringing the total cost of these tax-cut proposals to $2.3 trillion.[1]

Total Cost — Including the 2001 Tax Cut — Equals $4.2 Trillion Through 2013

As noted, combining the cost of the new tax cuts with the cost of extending the 2001 tax cuts and providing modest relief from the individual AMT would cost $2.3 trillion through 2013. These costs come on top of the original cost of the 2001 tax cut, which extends through 2010. In total, the costs from 2001 through 2013 of the enacted tax cuts and the new tax cut agenda amount to $4.2 trillion, including interest. In 2013, the combined revenue losses would constitute a larger share of

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the economy than did the Reagan tax cuts of the early 1980s.

The Administration is expected to propose even more tax cuts in its new budget, which will be released in February. Last year's budget also included tax cut proposals related to energy, education, and health insurance. If these tax cuts were assumed, the total cost of the Administration's tax-cut plans would be even higher. The Administration's policy proposals should be considered together to gauge the long-term costs and the affordability of these proposals.

The "Economic Growth" Package

The President announced his new "economic growth" package on January 7, 2003. The package includes $670 billion of tax cuts and $4 billion of new spending for personal re-employment accounts. The centerpiece of the Administration's tax-cut package is a proposal to exempt from individual income taxes corporate dividends that are paid out of corporate profits that are subject to the corporate income tax. The Administration estimates this permanent tax cut would reduce revenues by $364 billion through 2013.

The other major component of the package is a proposal to accelerate implementation of four tax-cut provisions enacted in 2001. These provisions include reducing the rates that apply to the top four individual income tax brackets, increasing the amount of taxable income subject to the 10 percent rate, raising the child tax credit to $1,000, and increasing the standard deduction and the amount of taxable income subject to the 15 percent rate for married couples. Under current law, these provisions become fully effective at various points between 2006 and 2010; the Administration proposes to make them all fully effective in 2003.

Making the 2001 Tax Cuts Permanent

The large package of tax cuts enacted in 2001 expires in 2010. Since enactment of these tax cuts, the Administration has consistently voiced its support for making them permanent. It included this proposal in its budget last year. During the 2002 mid-term elections, the President highlighted making the 2001 tax cuts permanent as an issue. There is little doubt the Administration will again propose to make these tax cuts permanent when it presents its new budget in February.

The 2001 tax cuts include the following provisions affecting individual income taxes:

- A new 10 percent bracket was created for the first $6,000 of taxable income for single individuals ($12,000 for married couples). Previously, that income had been taxed at a marginal rate of 15 percent, so this provision cut taxes by 5 percentage points on $6,000 of income, or $300. The first-year reductions were mailed out in the form of $300 rebate checks.
- The marginal income tax rates for the four upper tax brackets (which previously had been 28 percent, 31 percent, 36 percent, and 39.6 percent) were reduced in stages to lower rates; the first stage occurred in 2002 and the next stages are scheduled for 2004 and finally 2006.
- The child tax credit, previously at $500 per child, was increased in slow stages to $1,000 per child. Because the first stage was effective in 2002, the child tax credit is currently $600 per child. In addition, a portion of the child tax credit was made "refundable" for certain working families whose income was so low that their income tax liability before application of the child tax credit was smaller than the child tax credit they would otherwise receive.
- The standard deduction, the 15-percent rate bracket, and the Earned Income Tax Credit were modified so all married couples would pay lower income taxes than they had previously. The first two of these provisions are not effective until 2005.
- In addition, many education, pension, and IRA provisions were altered to provide additional tax breaks to those who can afford to save more of their income in tax-sheltered accounts.

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Why Do the Tax Cuts Expire in 2010?

Some argue that the tax cuts expire in 2010 to comply with Senate rules. However, compliance with this rule would have only required the measure to expire in 2011. The framers of the tax cut chose to have it expire in 2010 rather than in 2011 because the earlier expiration made the total multi-year price tag of each provision seem smaller; as a result, more tax-cutting provisions could be shoe-horned into the legislation.

Finally, exemptions from the estate tax were gradually increased (for example, the amount of an estate exempt from income taxes was immediately increased from $650,000 to $1,000,000 for an individual and twice that for a couple). The tax rate applicable to the taxable portion of estates was gradually decreased, and by 2010 the entire estate tax was repealed.

In its newly released annual report, the Congressional Budget Office estimates that making permanent the tax cuts that expire in 2010 would reduce revenues by more than $635 billion through 2013.[2] This period, through 2013, is the same as the period covered by the Administration's cost estimate of its new economic plan. If these two Administration proposals — making the 2001 tax cuts permanent, and its economic growth package — are combined, the revenue loss through 2013 would be $1.3 trillion.

The Alternative Minimum Tax

The growth of the Alternative Minimum Tax poses significant problems for the individual income tax. Any solution to the AMT is likely to be very costly to implement. The Administration acknowledged this problem in its budget last year when it wrote that simplifying the AMT was "an increasingly important objective of tax policy." In a recent *New York Times* article, Assistant Secretary for Tax Policy Pamela Olson was reported as stating that the Administration planned to propose a solution to the AMT, but probably not until President Bush's second term. The article states, "The target date is 2005, she said. 'We are working on it,' Ms. Olson said." [3] Although addressing the AMT problem is part of the Administration's plans, it is not part of its estimate of the cost of its tax-cut agenda.

Source of the AMT Problem

The Alternative Minimum Tax is a parallel tax system that was originally intended to ensure that tax filers with high incomes could not avoid paying taxes altogether by aggressively using available deductions and exemptions. These taxpayers calculate their tax liability according to both the regular income tax and the AMT, and then pay whichever amount is higher. Unlike the regular income tax code, the key components of the AMT are not indexed for inflation. Thus as incomes rise to reflect the effects of inflation, the AMT imposes a higher burden. As a result, more taxpayers are projected to become subject to the AMT over time. This problem was exacerbated by the tax cuts in 2001, which reduced tax liabilities under the regular income tax code, particularly for those with high incomes, without making corresponding adjustments in the AMT.

About two million taxpayers are currently subject to the AMT. The Treasury Department estimates that the number of taxpayers subject to the AMT will soar by 2012 to 39 million — about one of every three taxpayers in the nation — assuming the 2001 tax cuts are made permanent. Many middle-class families would find themselves subject to the AMT, and the swollen AMT would "take back" much of the tax cut from many of the tax filers it would affect. It is inconceivable the President or the Congressional leadership of either party will allow the AMT to mushroom in this manner.

High Cost of AMT Relief

It will be very costly to prevent the individual Alternative Minimum Tax from exploding in size and encroaching heavily upon middle-class taxpayers in years ahead. Last year, the Administration's proposal to make the tax cut permanent did not include any changes to the AMT. As a result, the Joint Committee on Taxation cost estimate cited above of the Administration's proposal to make the tax cut permanent does not assume any additional AMT relief. This conveniently reduced the *apparent* cost of making the tax cut permanent, but yielded the unacceptable result of 39 million taxpayers being subject to the AMT by 2012.

In its new economic growth package, the Administration proposes to increase the AMT exemption through 2005.

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This temporary fix allows the Administration to avoid subjecting more tax filers to the AMT as a result of its proposed tax reductions, notably accelerating the implementation of the reductions in the upper-bracket income tax rates. Because the Administration proposes this increase in the AMT exemption only through 2005, it again is able to hide the full cost of addressing the AMT problem. The result, however, is that the AMT problem returns with a vengeance n 2006.[4]

In short, the cost of extending AMT relief beyond 2005 is essentially an "off-book liability" that must be considered a part of the long-term cost of the Administration's proposal to make the tax cut permanent and enact new tax cuts. The Administration has provided no indication it would countenance scaling back parts of the enacted tax-cut package or raising other taxes to pay for the cost of this inevitable AMT relief, or redirecting the AMT in a cost-neutral manner that frees large numbers of middle-class taxpayers from the AMT but expands its applicability to those at the highest-income levels. It is necessary and appropriate therefore to include the cost of addressing this AMT problem when assessing the long-term implications of the Administration's tax-cut proposals. The Urban Institute-Brookings Institution Tax Policy Center has undertaken the most thorough review of the AMT issue to date.[5] A modest option outlined in that analysis would reduce revenues by about $575 billion through 2013.[6] This cost estimate is conservative because this level of relief would still leave more than 10 million tax filers on the AMT at the end of the decade.

Conclusion

The Administration's costly "economic growth" package represents only a portion of the Administration's overall tax-cutting plans. It is sure to propose making permanent the tax cuts enacted in 2001 and that expire in 2010. Further, so that these tax cuts do not dramatically increase the number of tax filers subject to the Alternative Minimum Tax, the Administration has indicated that it will propose some type of AMT relief starting in 2005, when the temporary relief in its "growth" package expires. Taken together, these three tax proposal would reduce revenues by almost $1.9 trillion through 2013. Further, this loss of revenues will lead to a higher debt, and thus to an increase in interest payments totaling more than $400 billion through 2013. When these two costs are combined, the overall impact on the budget of the Administration's tax cut plans reaches almost $2.3 trillion through 2013. Finally, when these costs are added to the costs of the tax cut enacted in 2001, the total cost of tax cuts from 2001 through 2013 mounts to $4.2 trillion, including interest payments.

End Notes:

[1] Recent testimony by Peter Orszag, the Joseph A Pechman Senior Fellow in Economic Studies at the Brookings Institution, included an estimate that the combined cost of EGTRRA extension, the new "economic growth" package, AMT relief, and interest would total $2.2 trillion through 2013. Orszag's testimony attributed slightly more to an extension of EGTRRA and slightly less to AMT relief than does this analysis. Orszag's estimates include an element of AMT relief within the category of "EGTRRA extension;" his figure for EGTRRA extension includes the cost of extending through 2013 the AMT extension enacted through 2004 in EGTRRA. Our analysis instead treats that AMT cost in the AMT category because when the President proposed to extend expiring EGTRRA provisions in his FY 2003 budget, he did not include an extension of the AMT exemption. Whichever approach one uses, the total is more than $2 trillion.

[2] Our figure of $635 billion also includes the extension of two small education and pension tax breaks enacted in EGTRRA and scheduled to expire at the end of 2005 and 2006, respectively. See "The Budget and Economic Outlook: Fiscal years 2004-2013," CBO, January 29, 2003, pp 72 and 73.

[3] David Cay Johnston, "Alternative Tax Looms Large Despite Plans for Other Cuts," *The New York Times*, January 10, 2003.

[4] Note that the Administration's temporary AMT relief builds on a similar provision in the 2001 tax-cut package that increased the AMT exemption through 2004. The cost of providing permanent AMT relief would have driven the cost of the 2001 tax-cut package well above what the fiscal year 2002 Congressional budget resolution allowed. So the framers of the tax cut resorted to the gimmick of letting this AMT relief sunset at the end of 2004, knowing that Congress would have no choice but to extend AMT relief before the provision expired.

[5] Leonard Burman, William Gale, Jeffery Rohaly, and Benjamin Harris, "The Individual AMT: Problems and Potential Solutions," Urban-Brookings Tax Policy Center Discussion Paper No. 5, September 2002.

[6] The AMT option would index the AMT exemption, tax bracket thresholds, and exemption phase-out threshold for inflation beginning in 2002. These indexed levels would become effective starting in 2006, after the temporary relief proposed by the Administration has expired. This option is used here to ustrate the likely cost of the Administration's agenda because indexing the AMT parameters at 2002 levels produces an exemption amount in 2005 quite imilar to the Administration's proposal for that year (2005 is the final year of AMT relief under the Administration's new plan). The Tax Policy Center analysis also includes the cost-neutral AMT option alluded to above (see Burman et al., op cit.)

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CENTER ON BUDGET AND POLICY PRIORITIES

Revised January 30, 2003

BUSH "GROWTH PLAN" WOULD WORSEN STATE BUDGET CRISES

by Iris J. Lav

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The Bush Administration's proposal for "Economic Growth and Job Creation" provides no fiscal relief for the states, which are struggling with deficits likely to total at least $70 billion for the fiscal year beginning in July. To the contrary, preliminary estimates suggest the plan's federal tax cuts would cause states to lose more than $4 billion a year, making state budget deficits larger. Since states must balance their budgets, this new revenue loss will require states to cut state programs more deeply and/or to raise state taxes to a greater degree.

The Administration has said the plan is intended to promote economic growth and job creation. But when states must cut programs to balance their budgets, they lay off workers, reduce payments to contractors, cut reimbursements to providers, or lower benefit payments to individuals. This reduces the money people have to spend and thereby decreases demand for private sector goods and services. Tax increases have a similar effect. Far from promoting economic growth and job creation, the effect of failing to aid states and further increasing state deficits is economic contraction and reduction in employment.

- The largest effect on states would come from the proposed exclusion of corporate dividends from the taxable income of individuals. This dividend exclusion would reduce revenue in most of the 37 states and the District of Columbia that link their own tax systems to the federal taxation of dividends. Preliminary estimates suggest that the changes would cost these states $4 billion a year in the first year or two. The six other states that tax dividends independently could also experience revenue losses. Including these states would raise the estimate of revenue loss to $4.3 billion.

- In conjunction with the dividend exclusion, the plan would reduce capital gains taxes for investors in corporations that do not pay dividends but instead reinvest their earnings. Some 39 states and the District of Columbia would lose revenue as a result of this proposal. The modest initial cost of this provision is included in the above estimate. Over time, however, the cost of this capital gains tax break would grow substantially, so the essential loss too states is likely to exceed $4 billion a year.

- Another proposal would have a small effect on state revenues. The Bush plan also would increase the amount of investments that small businesses can deduct in the year the investments are made. All states that tax business income except California and Michigan will experience some revenue loss from this change, with a potential aggregate revenue loss in the ballpark of $200 million a year.

- The federal tax reductions in the Bush plan would be permanent. They would continue to reduce state revenues for the foreseeable future.

- These new revenue losses would be on top of revenue losses that states already are feeling as a result of federal tax changes enacted in 2001 and in the 2002 stimulus package. For example, changes in the estate tax that the federal government enacted in 2001 — specifically, the phase-out of the state estate tax credit between 2002 and 2006 — will cost states $16 billion from 2003-2007 and more in years after that. New tax breaks for retirement and education savings and the bonus depreciation provision also are reducing state revenue.

- In other words, federal tax changes in 2001 and 2002 have made state budget holes deeper. Now, despite the most severe state budget crises in 50 years, the Administration is proposing measures that would make the problems still more acute.

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The Proposed Tax Changes

There are three elements of the Administration plan that would reduce state revenues: the exclusion of corporate dividends from individual taxation, the reduction in taxation of capital gains income derived from investments in corporations that reinvested their earnings, and the increase in amount of investments that small businesses can write off as an expense in the year the investment is made.

Dividend Exclusion

The Administration plan would allow individuals to exclude from their federal taxable income the corporate dividends they receive from corporations that have paid federal corporate income taxes on their profits.[1] Each of the 41 states and the District of Columbia that levy an income tax includes dividends in taxable income. Two other states have limited income taxes that also tax dividend income. Many of these states would lose revenue as a result of this change.[2]

Some 37 states and the District of Columbia use federal income definitions in their own tax systems. These states, with a few exceptions, would automatically exclude dividends from state taxable income if they were excluded from federal taxable income.[3] A few states — Alabama, Arkansas, Mississippi, New Jersey, Pennsylvania, and Tennessee — ask taxpayers to report directly the amount of dividends they receive rather than deriving dividend income from the federal tax return. These states would not automatically lose revenue, but would undoubtedly face pressure to conform to the federal treatment.

Aid for the Unemployed Is Not State Fiscal Relief

Some $3.6 billion in the Administration's package is designated for a specific new program of "personal reemployment accounts" that would be administered through the states. States would be required to use the money to set up accounts of up to $3,000 for each unemployed worker. The accounts would be used by the workers for the expenses of job search, job training, child care or other expenses. Whatever the policy merit of these accounts, they would not provide fiscal relief. These funds could not be used to help states balance their budgets because the funds would have to be spent on the new program.

Even though all states would face pressure to conform with the dividend exclusion, some states might want to "decouple" from the federal change. That is, they may want to continue taxing dividend income. It is worth noting that when the "bonus depreciation" provisions were enacted in the March, 2002 stimulus package, there were 30 states that subsequently did decouple from the new federal treatment of depreciation.[4] The extent of decoupling was unprecedented; never in recent decades had so many states decided to decouple from a federal change.

The response of states to the bonus depreciation provisions is unlikely to be a model for the state response to the dividend exclusion. The bonus depreciation provision is temporary; it expires in September 2004. States that decoupled from the bonus depreciation knew that after a short period of time, their tax laws on depreciation would once again conform to federal treatment. The dividend exclusion, however, would be permanent. In the majority of states that have the tradition of conformity to federal tax law, it can be quite difficult to sustain a major difference from federal law over time. Taxpayers generally view such differences as burdensome and the same, largely upper-income taxpayers and corporations that are pushing for this change in dividend rules at the federal level would oppose decoupling. These taxpayers would be likely to push their states to follow the federal lead and exempt dividend income.

Standard & Poor's Raises Concerns on Effect of Proposal on States

In a January 9, 2003 release, Standard & Poor's Rating Services notes with respect to the Bush plan, "Not only is there no direct money flowing to states under the current proposal, there would also be income tax revenue erosion and cost increases in servicing the debt." It notes that this is particularly problematic at this time, when nine states already have negative rating outlooks and the ratings of six states have been downgraded in the last year. It observes that this proposal would add further uncertainty to a budget process that is just beginning.

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The release also addresses the issue of whether states would be able to avoid the revenue loss from the change in taxation of dividends. It says: "State legislatures now convening to develop fiscal 2004 budgets will have to consider significant budget and tax policy issues arising from the federal stimulus package however it ultimately develops. To preserve the state revenues coming from dividends, states would be required to decouple current state income tax structures from the federal system, a step they did not take with the elimination of estate taxes in 2001." It goes on to say that despite the fiscal situation of the states, decoupling is not that likely. "State legislative changes to tax structure, even given the obvious necessity and benefit, will likely prove difficult, at best."

The Standard & Poor's analysis concludes with the following concern. "...if the proposal moves forward in its current form, fiscal pressure will be even more acute for state governments already facing estimated fiscal 2004 budget deficits totaling more than $60 billion. As a result, further credit deterioration over the next year is likely." Needless to say, lower ratings mean immediately higher interest costs for states, which will further increase fiscal stress.

Source: Standard & Poor's, No Relief For States Under Bush Proposal; Credit Outlook Remains Bleak, January 9, 2003.

Capital Gains Tax Reduction

In conjunction with the dividend exclusion, the plan would reduce capital gains taxes for investors in corporations that do not pay dividends but instead reinvest their earnings. This is intended to avoid disadvantaging companies that focus on reinvestment and growth rather than on paying annual dividends. According to Administration documents, the concept of a "deemed dividend" would be established. When a corporation (that pays federal corporate income taxes) retains earnings that can be used for reinvestment in the business, the shareholders would be allowed to increase the "basis" of the stock they hold in that corporation. For example, a shareholder who bought a stock for $50 a share might be able to adjust that purchase price (that is, his "basis" in the stock) upward by $1 in a year that the company retains its earning rather than pays dividends. If the corporation continued to retain its earnings in each of five years at a level that resulted in a basis adjustment of $1 a year, the shareholder's basis in the stock would be $55 a share, rather than the $50 a share for which the stock was purchased. If the shareholder then sold the shares at $60 a share, his or her capital gain that was subject to taxation would be $5 a share rather than $10 a share.

Some 39 states and the District of Columbia use federal definitions to determine the basis of an asset and the amount of capital gains income subject to taxation when an asset is sold. These states — all states with an income tax except Hawaii and Pennsylvania — would lose revenue as a result of this proposal, although the amount of loss cannot be estimated at this time.

Here too, it would be difficult for states to decouple from this type of permanent change. Taxpayers may object to decoupling because it would require them to calculate their income in very different ways for federal and state purposes. Moreover, this is a provision that would have a modest effect on state revenues initially, because the adjustments to the basis of stock values would not apply retroactively. This means that decoupling immediately would save only modest amounts of money for states. As a result, policymakers might fail to place a high priority on the need to decouple

Over time, however, as upward adjustments would be made year after year to the basis of outstanding shares, the revenue loss would grow. The Tax Policy Center at Urban Institute and The Brookings Institution estimates that this change ultimately would eliminate 15 percent of all capital gains income.

Revenue Loss: Dividends and Capital Gains

Table 1 shows preliminary estimates of the annual revenue loss that states would incur as a result of exempting dividend income from taxation and the associated reduction in capital gains taxes. The 37 states and the District of Columbia that currently link their taxation of dividends to the federal tax treatment would together lose about $4 billion a year. If the states that independently tax dividends are included, the revenue loss rises to $4.3 billion. For example, California would lose $1.2 billion a year, and New York $524 million. Illinois would lose $132 million, Iowa $57 million, and Maine $31 million.

Expensing for Small Businesses

One other piece of the Administration plan, "expensing" for small businesses, would result in a small annual reduction in state revenue. This provision would increase the ability of small businesses to consider a portion of investments

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made as an expense that can be deducted

immediately, rather than deducted gradually over the life of the asset. The proposal would increase the amount that can be expensed from $25,000 to $75,000. All states that tax business income except California and Michigan would likely experience some revenue reduction as a result of the increased ability of small businesses to expense investments. The revenue loss to the states is likely to be in the ballpark of $200 million a year.

Other Tax Cuts Enacted in 2001 and 2002 Also Hurt States

If enacted, the Administration's package would represent the third piece of tax legislation since the Administration took office that resulted in states losing revenue. Federal tax reductions included in the stimulus package enacted in March 2002 and in the 2001 Economic Growth and Tax Relief Reconciliation Act have led to unplanned and — given the current fiscal crisis — undesirable revenue reductions in most states.

Further Adverse Effects on States:
Cost of State and Local Borrowing Likely to Rise

States would also be hard hit by the anticipated increase in interest rates expected to result from this package. Higher interest rates increase the cost of borrowing for states, putting further strain on their budgets. Two factors would contribute to an increase in interest rates. First, the dividend proposal would draw funds away from the bond market, as dividend-paying stocks became more attractive investments following the tax cut. To compete for investor dollars with stocks paying dividends that are fully exempt from taxation, entities that issue bonds — including state and local governments — would have to offer higher interest rates. Second, the high cost of the package as a whole — $674 billion over ten years — would enlarge long-term deficits and increase government borrowing. As government borrowing needs crowd out other borrowers, long-term interest rates can rise.

Economists Peter Orszag and William Gale at the Brookings Institution have estimated that the enlargement of the federal deficit and increase in government borrowing would, in the long run, increase interest rates by approximately one-half of one percentage point (50 basis points). No analysis currently is available that quantifies the extent to which competition for investor dollars from stocks paying tax-free dividends would push up the interest rates that state and local governments must pay on their tax-exempt bonds. It is clear, however, that the dividend proposal would put upward pressure on interest rates.

The California State Treasurer's Office surveyed the comments that had been made by experts on the subject of tax-exempt bond interest rates. For those that made estimates, the general consensus was that the Administration proposal would result in relative increases in state and local bond interest rates of between 0.25 percent and 0.50 percent (25 to 50 basis points).

The Treasurer's office then estimated the cost to state and local governments of increased interest costs of this magnitude. It noted that over the past five years the average annual issuance of long-term state and local tax-exempt bonds nationwide was $170.57 billion. Assuming that this volume prevails for the next ten years, some $1.7 trillion in bonds would be issued over that period. If interest costs increased by 50 basis points, the report finds that "... the total increased interest payments by our nation's taxpayers over the life of the state and local bonds projected to be issued nationwide over the next 10 years would equal $154.96 billion." If interest costs increased by 25 basis points instead of 50 basis points, then the increased interest over the life of the bonds would equal $77 billion.

Source: California State Treasurer Phil Angelides, No Dividends: How Taxpayers Lose Under the Bush Plan, January, 2003. www.treasurer.ca.gov.

Among the changes that have already reduced state revenues are the following.

- The 2001 tax law included repeal over the next four years (2002-2005) of the federal estate tax credit to which

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all state estate taxes are tied. The elimination of this credit will effectively repeal most state estate taxes, unless states change the way they link to the federal law. While 17 states and the District of Columbia have decoupled from the federal estate tax changes, the remaining states stand to lose $16 billion in the period from fiscal year 2003 to 2007. In 2006, the first year this provision will be fully in effect, the states that are continuing to link to federal law will experience a $4.2 billion revenue loss, and the revenue loss will increase in subsequent years. (Some states have constitutional bars to decoupling; others are not able to do so for other reasons.)

- The economic stimulus legislation enacted in March 2002 allows firms to claim an immediate federal tax deduction of up to 30 percent of the cost of new equipment purchases, rather than depreciating the cost gradually over several years as under prior law. The vast majority of states historically have used federal depreciation rules for computing state business taxes, and so would be forced to give businesses an additional tax break — on top of the federal break — unless they "decoupled" their state tax rules regarding depreciation from the federal change. While 30 states have decoupled, the other states continue to suffer a revenue loss of $4 billion over the period bonus depreciation is in effect, through September 2004.
- The 2001 tax law made a number of other changes that result in many states losing revenues automatically. They include the liberalization of pension rules, the increase in the contribution limits to IRAs and 401(k), and the additional tax breaks for education.

None of these other tax reductions were offset with any kind of assistance to states to compensate for the revenue losses.

With the exception of bonus depreciation, all of these tax changes — including the tax changes being proposed in the Bush package — extend at least through 2010, and the tax cuts enacted in 2001 will continue beyond then if those tax cuts are made permanent. They will continue to reduce state revenue year after year.

Stimulating the Economy

One of the most effective ways to stimulate the economy at this time would be to provide significant fiscal relief that states could use to avoid budget reductions or tax increases. When states cut programs, they lay off workers, reduce the extent to which they contract for services, lower benefit payments to individuals, and cut reimbursements to providers. This reduces the money people have to spend and thereby reduces demand for private sector goods and services. Tax increases have a similar effect. In other words, the actions states take to balance their budgets contract the economy and cause a loss of jobs.

State governments have already acted to close budget deficits of approximately $50 billion for state fiscal year 2003 (which runs through June 30, 2003 in most states) and face additional deficits they must close of about $17.5 billion in 2003. In addition, states face further budget deficits of $60 billion to $85 billion for state fiscal year 2004.[5] These represent the largest state budget gaps in half a century. Unless they receive assistance, states will be making massive cuts in expenditures — including expenditures for education and health insurance — and increasing taxes substantially to meet their balanced budget requirements.

As Brookings Institution economist William Gale observed in a recent *Los Angeles Times* op-ed, "The best way to boost the economy right now would be to increase federal aid to the states, which are facing their worst financial crisis in decades." Unfortunately, the Bush Administration proposal fails to include such a measure, aggravating state fiscal problems instead.

Table 1
Preliminary Estimates of State Revenue Loss Resulting From Federal Dividend Exclusion State Fiscal Year 2004
(in thousands of dollars)

	Revenue Loss		Revenue Loss
Alabama	*$39,000*	Missouri	86,000
Arizona	47,000	Montana	23,000
Arkansas	*40,000*	Nebraska	30,000
California	1,183,000	New Hampshire	20,000

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Colorado	75,000	*New Jersey*	*117,000*
Connecticut	90,000	New Mexico	20,000
Delaware	18,000	New York	524,000
Georgia	120,000	North Carolina	132,000
Hawaii	23,000	North Dakota	5,000
Idaho	22,000	Ohio	152,000
Illinois	132,000	Oklahoma	36,000
Indiana	42,000	Oregon	91,000
Iowa	57,000	*Pennsylvania*	*97,000*
Kansas	45,000	Rhode Island	22,000
Kentucky	44,000	South Carolina	57,000
Louisiana	44,000	*Tennessee*	*53,000*
Maine	31,000	Utah	29,000
Maryland	87,000	Vermont	16,000
Massachusetts	175,000	Virginia	129,000
Michigan	111,000	West Virginia	16,000
Minnesota	110,000	Wisconsin	97,000
Mississippi	*17,000*	District of Columbia	31,000
Total: States that currently use federal taxes as basis for taxing dividends			**$4,033,000**
Total: All states that tax dividends			**$4,335,000**

2004 #5 A

Notes:
States in italics tax dividends, but do not derive the amount of dividends to be taxed from the federal tax form.
The estimate uses information on taxable dividend income by state from the Internal Revenue Service, Statistics of Income Bulletin, Spring 2001. The dividend income reported in the SOI was adjusted to remove interest payments from mutual funds that the IRS requires to be reported as dividends, and to include personal trust dividend income that is reported elsewhere. See William G. Gale, "About Half of Dividend Payments Do Not Face Double Taxation," Tax Notes, November 11, 2002. The estimate reflects the Administration's proposal to exempt dividends only if the issuing corporation has paid federal income tax, as well as the "deemed dividends" proposal that will reduce capital gains taxes. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not levy any form of income tax and thus would not lose revenue.

End Notes:

[1] The Council of Economic Adviser's description of the Administration plan notes that "...corporate income that is not taxed at the firm level would not be eligible to be excluded from the individual income tax." Corporations would have to inform the recipients of the dividends whether some or all of their dividends are eligible for exclusion from individual taxation. CEA, January 7, 2003.

[2] The states that do not levy any form of income tax, and thus would *not* lose revenue, are Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. The states that just tax interest and dividend income are New Hampshire and Tennessee.

[3] The exceptions are states that do not conform unless they enact legislation to adopt new federal changes. Most such states do so routinely, but a few are less likely to adopt changes. Those that may be somewhat less likely to adopt changes include California, which maintains some differences with federal taxation, and Virginia, which recently enacted legislation stating that it will not adopt federal changes automatically.

[4] The bonus depreciation provisions allow businesses that purchase equipment between September 2001 and September 2004 to deduct immediately 30 percent of the cost of the equipment, rather than deducting the cost over the useful life of the equipment.

[5] See Iris J. Lav and Nicholas Johnson, *State Budget Deficits for Fiscal Year 2004 are Huge and Growing*, December 23, 2002. http://www.cbpp.org/12-23-02sfp.htm

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LaCosta Rickford 10/6/03
Operator's Signature Date

Results Bush Proposal

Front

EDITED BY SHERIDAN PRASSO

PROFIT & CLOSS

DIVIDENDS: [illegible] ULTIMATE PERK

JUST WHEN YOU THOUGHT there was no way to pile on more CEO perks, along comes yet another: Bush's plan to eliminate income tax on dividends. For CEOs of the nearly 350 companies in the S&P 500 that pay dividends, their tax savings would add up to more than $200 million. And that doesn't include the biggest beneficiary of all: Microsoft Chairman Bill Gates.

Tax-free gains?

Microsoft's plan to pay a 16¢-a-share dividend for the first time would give Gates $100 million—and he wouldn't have to pay the $38.4 million tax on it. Microsoft CEO Steven Ballmer would get to keep $14.6 million of his dividend otherwise owed in taxes.

Other execs with big potential savings, based on the number of shares they own, are:

- Micky Arison, Carnival Cruises—$36.8 million
- Phil Knight, Nike—$17 million
- Sanford Weill, Citigroup—$6.4 million
- John Hess, energy company Amerada Hess—$5.5 million.

With such windfalls in the offing, normally stingy CEOs may end up dispensing dividends more generously—for shareholders and for themselves. *Louis Lavelle*

THE LAST LOST BACKERS

COMMENTARY

By Peter Coy

WHY THE DIVIDEND TAX CUT ADDS CLUTTER TO THE TAX CODE

Rich or poor, Americans agree on one thing about the U.S. tax code: It's too complicated. Each April, the 1040 form and its slew of schedules reduce people to tears. Unfortunately, President George W. Bush's bid to eliminate double taxation of corporate profits would make matters worse. It would add paperwork [illegible] in New York City.

The complexity might be acceptable if the changes brought enormous benefits. But even the plan's main author—Columbia University economist R. Glenn Hubbard, the outgoing chairman of the President's Council of Economic Advisers—predicts that the overall Bush tax plan will boost growth by only 0.2% a year while swelling the budget deficit. The Administration might produce fewer tax headaches and still achieve its aim of a fairer tax system by, say, fixing the alternative minimum tax, which was intended to apply to the rich but is soaking millions of middle-class families. Or, if its goal is to spur long-term growth, it could permanently accelerate depreciation of business investment.

The President's plan is clean enough in concept. It asserts that corporate profits should be taxed once and only once. So if a company pays $35 in tax on $100 of profit, shareholders should not have to pay tax on the remaining $65 of profit, whether the money is distributed to them as a dividend or is retained by the company, which would help increase the stock price and add to shareholders' eventual capital gains.

But the idea leads to endless complications in the real world. Already, colorful phrases like "basis clawback" and "cumulative net basis bumps" are entering the tax lexicon. On Jan. 21, the Treasury Dept. had to issue a 12-page "technical explanation" with clarifications and adjustments. [illegible] airlines and other money-losers will benefit from a change that preserves some tax advantages for companies with net operating losses.

The heaviest paperwork will be keeping up with constant changes in the "basis" of a stock—the price [illegible] shareholders are presumed to have paid per share. "We're crying in our beer here," says Gaylie E. Ward, senior vice-president for investment tax services at Fiduciary Trust Co. International, a New York money manager. It's not conceptually difficult, but then again, neither was the hugely expensive fix for the Y2K glitch, says Stephen J. Tall, a Fiduciary senior vice-president. He estimates it could take 18 months to write and test software to handle the changes if the bill passes.

Others are more optimistic. Securities Industry Assn. Chief Economist Frank A. Fernandez says the new information can be conveyed fairly easily if the Treasury sets things up right. Some also argue that variations of the Bush plan work well in other countries. Actually, they don't. Germany, Britain, and Japan are moving toward the current U.S. approach, and Italy and France are considering doing so.

The likely macroeconomic impact of the Bush tax plan may be up for debate, but there's little question about its impact on the complexity of the Internal Revenue Code: negative.

Coy is Economics Editor.

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