Tax Reform, the Budget, and the Budget Process

Tax Foundation University Week 6
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Topics

• How the budget rules affect how you craft a tax reform plan
• How the Blueprint’s designers may have had the budget process in mind
• Alternative revenue sources, spending offset, other means of coping with budget issues
• Transition issues
Quick overview of Reconciliation

• Legislative process that allows lawmakers to make changes to spending and revenue levels.
• Needs to be used as part of a budget resolution.
• Can increase or decrease budget deficits over the budget resolution’s window
• Avoids filibuster and thus can be passed with only a simple majority
• Reconciliation is subject to a number of restrictions
Quick overview of Reconciliation

• Byrd Rule: Unless overruled by 60 votes, the reconciliation bill cannot increase deficits outside of the budget window
• Senate PAYGO rules still apply, unless waved
• Only one reconciliation bill dealing with revenue per budget resolution
Tax Reform and Reconciliation

• What do the budget rules mean for tax reform?
  • Revenue/budget neutrality vs. Tax cut
  • Temporary vs. permanence
  • Static vs. Dynamic Scoring
Tax Reform and Reconciliation

• Revenue/budget neutrality
  • In order not to be “Byrd-able,” tax reform needs to be revenue neutral outside of the budget window.
  • House GOP proposal offsets its tax cuts with a few major base broadeners: elimination of the state and local tax deduction, elimination of deduction for net interest expensing, and the border adjustment
  • Trump proposal calls for elimination of S+L, but doesn’t specify much more
  • Could also be offset with spending cuts
Tax Reform and Reconciliation

Annual Revenue Impact of the House GOP Blueprint
Tax Reform and Reconciliation

• Permanence vs. Temporary
  • One way to offset revenue loss outside of the budget window is to have your tax cut expire.
  • If plan slightly increases deficits in the out-years, it is not necessary to make your whole plan expire.
  • Caution: length of tax cut is not the same as length of revenue impact!
  • What about a longer budget window?
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Real GDP Growth Under Three Different Corporate Tax Regimes

- Permanent 15 Percent Rate
- Temporary 15 Percent Rate
- Baseline (35 Percent Rate)

2017-2021: Extra investment boosts growth
2022-2026: Investment stalls in expectation of tax increase

Source: Tax Foundation Taxes and Growth Model

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• Dynamic Scoring
  • Dynamic scoring incorporates economic impacts into revenue forecasts.
  • For tax plans, this could provide additional revenue, especially in the later years.
• Caution:
  • Dynamic scoring will not completely offset any tax
  • JCT’s model will penalize significant increases in the deficit
Remaining Issues in Tax Reform

• Interaction with Healthcare bill

• If lawmakers jettison some of the proposed base broadeners, such as the border adjustment, what will take its place?

• Will lawmakers attempt to make the plan closer to revenue neutral within the budget window?
  • How would they do that?