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Fair Tax Policy Requires a Fair Revenue Baseline

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Wonder why taxes keep going up? There are many reasons, but the latest congressional trick is to *assume a tax hike*. The prop in this fiscal magic show is the Congressional Budget Office (CBO) revenue baseline, a rabbit hidden so deep in the weeds that it went unnoticed for years. Most of the time, Congress has to vote on legislation to raise taxes. But with baseline magic, the tax hike occurs automatically unless Congress votes to stop it.

Few subjects draw yawns faster than budget rules and process. Yet these often guide and sometimes govern budget decisions with profound implications for taxpayers, the economy, and the tussle over resources. In 2008, baseline magic could produce a $70 billion tax hike if legislators are not careful.[1]

The purpose of the budget rules and process is to guide deliberations over taxation and spending, assuring Members due opportunity to express their wills and voices yet still pushing the exercise forward to conclusion. As Congress works its will, the rules and process that guide the fight must be fair in perception and practice, favoring neither side in the debate. But, in practice, they are not fair. As the House and Senate go about fine-tuning the budget resolution for 2009, they should seize the opportunity to restore fairness to the process.

A Baseline of Fairness. The budget rules, particularly the Pay-As-You-Go (PAYGO) rules, come into play when a proposed change in tax policy changes the expected level of tax receipts. The CBO revenue baseline is the starting point for these calculations, so the assumptions that underlie the calculation of the revenue baseline can, and in practice do, bias the outcome of debates over tax policy.

For many years, the CBO revenue baseline reflected the outwardly appealing assumption that current law would be maintained throughout the forecast period, typically the next five or 10 years. In years past, this assumption was mostly innocuous because, with few exceptions, Congress rarely displayed the bad form of enacting significant tax provisions with expiration dates. The one significant exception has been the R&D tax credit, which limps along year-by-year with successive extensions.

In 2001 and again in 2003, Congress enacted major tax relief that included doubling the per child tax credit, lowering tax rates, repealing the death tax, and cutting the capital gains and dividend tax rates. However, for the legislation to be passed, it was necessary that these provisions be allowed to expire after 2010. Following long-established precedent, the CBO assumes in its revenue baseline that these tax cuts will expire, thus showing a massive increase in receipts in 2011 and beyond.

AMT Patch Fight Demonstrates Baseline Problem. The current fight over the AMT patch is

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heavily influenced by the CBO baseline. In 2007, some Members of Congress struggled and strained all year long to explain how extending the AMT patch to avoid raising taxes on millions of taxpayers was also a tax cut that had to be offset under PAYGO.[2] They could never explain how preventing a tax increase was a tax cut, and they certainly knew they could never explain that sleight of hand to their constituents.

Members of Congress were put in this mind-bending position because the CBO revenue baseline was telling them something that just made no sense. Under the CBO baseline, extending the patch was scored as a tax cut. If the CBO baseline were constructed sensibly, extending the AMT patch would be shown as maintaining current law and thus not changing the level of tax receipts.[3]

In 2007, Congress managed at the last minute to pierce the fog rising from the CBO baseline and enacted an AMT patch without an accompanying tax increase. Congress must extend the AMT patch again in 2008 and once again overcome the confusion arising from the CBO revenue baseline.

Is Changing the CBO Revenue Baseline Fair? An absurd consequence of the CBO revenue baseline is that legislation extending tax relief, which by 2010 will have been the law of the land for either eight or 10 years, is estimated to be a tax cut. On the other hand, suppose the CBO were to follow the more sensible practice of assuming that current tax laws that are set to expire continue indefinitely. In that case, extending the tax relief would still require legislation, but the legislation required to prevent a massive tax hike would not be shown in the official revenue tables as a tax cut.

Such a change in CBO scoring practices may seem at first to be an unfair attempt to make extension of the tax cuts easier. Extending current law would surely become easier, but correcting the revenue baseline would also make the process fairer and more sensible by comporting the conventions that guide the revenue baseline with those that guide the spending baseline.

When the CBO formulates its baseline for discretionary spending, it properly assumes that future discretionary spending will rise with inflation. Thus, spending is shown to increase in the baseline year after year even though the authority to spend expires at the end of the current fiscal year. A tax provision expires, and its effects are dropped from the revenue baseline; discretionary spending expires and yet is maintained in the spending baseline plus inflation. This inconsistency in treatment biases the budget discussion.

Similarly, certain multi-year spending programs such as the State Children's Health Insurance Program are sensibly assumed in the spending baseline to extend indefinitely, long after they are set to expire. The same holds for the farm program, the highway program, and many others. Extending these expiring provisions in the spending baseline while dropping expiring provisions from the revenue baseline injects a clear bias into Congress's deliberations. It is unfair and should be remedied.

An Easy Change. Fortunately, returning fairness to the revenue baseline is an easy job. The CBO needs only to treat tax policy and spending policy in a parallel fashion. The CBO need make no specific assumption about future congressional action, but it can make the simple general assumption that current law, whether spending or tax, will continue indefinitely until Congress acts to change the law.

This change can be made at any time, but the ideal moment to direct the CBO to make this change is during the formulation of the annual budget resolution. The CBO can and should make the

1. For a more complete discussion of the revenue baseline issue, see J. D. Foster, Ph.D., "AMT Fix Becomes Massive Tax Hike Via Misleading CBO Baselines," Heritage Foundation *WebMemo* No. 1695, November 7, 2007, at *www.heritage.org/Research/Taxes/wm1695.cfm.*
2. See J. D. Foster, Ph.D., "Tax Hikes Hiding in Budget Resolutions' Treatment of AMT Patch," Heritage Foundation *WebMemo* No. 1846, March 11, 2008, at *www.heritage.org/Research/Taxes/wm1846.cfm.*
3. Curiously, the language of the current budget resolution indicates that those same Members of Congress who inflicted this mind-bender on their colleagues in 2007 intend to do so again in 2008. Fortunately, in this case, history is almost sure to repeat itself, and the AMT patch will again be extended without a companion tax hike.

change of its own accord; but if the CBO stands pat, simple directive language would suffice to compel it to correct its methodology and return fairness to the revenue baseline and the budget process.

Conclusion. The budget process needs to be fair and unbiased toward specific outcomes. The assumptions that go into the CBO revenue baseline fail this test, as they have done for many years. The Congress should take the opportunity presented by the debate over the budget resolution to instruct the CBO to treat expiring tax provisions the same way it treats expiring spending provisions: continuing them in the baseline.

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