Joint Economic Committee Democrats

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The Impact on Families of the House and Senate Spending and Tax Reconciliation Provisions: A Preliminary Analysis

If the Congress stays on its current course, the FY 2006 tax and spending reconciliation bills will increase the federal budget deficit, cut spending for programs that benefit middle- and lower-income families, and extend enacted tax cuts for high-income families. Upper-income families will gain far more from the tax cuts than they will lose from the spending cuts, while middle- and lower-income families will suffer larger losses from the spending cuts than they will gain from the tax cuts.

Those conclusions are based on the following analysis, which quantifies the impact of the House and Senate reconciliation bills on families. The analysis compares the dollar value of the loss in benefits from cuts in spending that affect people directly with the gain in after-tax income from the tax cuts for families in each fifth of the income distribution. The analysis is preliminary because the House has not yet passed its tax reconciliation bill and because substantial differences between the House and Senate measures remain unresolved.

Overview of the House and Senate bills

The FY 2006 budget resolution called for $35 billion of reconciled cuts in outlays and up to $70 billion of reconciled tax cuts over the next five years, which would produce a net increase in the five-year budget deficit of $35 billion. The Senate has passed a spending reconciliation bill with $35 billion in spending cuts and a tax reconciliation bill with nearly $60 billion in tax cuts. The House has passed a larger spending bill than the Senate, with cuts of $50 billion over the next five years. The House Ways and Means Committee has reported out a tax bill with $56 billion of cuts, and the final House tax reconciliation bill is likely to look very similar.

The spending cuts in the House bill are not only larger than those in the Senate bill, but they also cut more deeply into programs that directly benefit middle- and lower-income families. Thus, if the final spending bill looks more like the House bill than the Senate bill, it would increase the budget deficit by less, but it would have a harsher distributional impact.

The benefits from both the Senate and the House tax bills are heavily tilted toward upper-income taxpayers, but the bills differ significantly in their details. For example, the Senate bill contains provisions addressing the alternative minimum tax (AMT), but it does not extend the dividend and capital gains tax cuts that expire in 2008. The House bill extends the dividend and capital gains provisions, but not the major portion of the AMT provisions. Because the budget resolution allows reconciled tax cuts of up to $70 billion, the final bill could be larger than either the House or Senate bill, which would increase the budget deficit and most likely increase the distributional imbalance of the entire package.

House Spending Reconciliation Bill

The spending reconciliation bill passed by the House would cut net mandatory spending by $50 billion over five years—$15 billion more than the $35 billion of reconciled spending cuts called for by the FY 2006

Table 1

Budgetary Effects of the House Spending Reconciliation Bill

(billions of dollars)

Provision	Change in Outlays 2006-2010
Payments for individuals, allocable by income group	
Program cuts	
Student loan programs[a]	-13.8
Medicaid	-8.4
Farm programs	-2.9
Food stamps	-0.6
Supplemental Security Income	-0.7
Child welfare services	-0.6
Program cuts, subtotal	-27.0
Program expansions	
Katrina health care relief	2.6
Other provisions[b]	2.4
Program expansions, subtotal	4.9
Net impact, payments for individuals	**-22.0**
Other provisions	
Spectrum auction proceeds[c]	-8.7
PBGC premium increases	-6.2
Child support enforcement cuts	-4.9
Medicaid[d]	-3.0
Import duties	-3.2
Other[e]	-1.8
Total, other provisions	**-27.9**
Total	**-49.9**

Source: CBO cost estimate of H.R. 4241, "The Deficit Reduction Act of 2005", as passed by the House of Representatives on November 18, 2005, and JEC Democratic Staff calculations.

[a]Excludes student loan provision reducing guaranty agencies' share of collections.

[b]Includes funding for LIHEAP, TANF, and child care.

[c]Includes offsetting spending for digital transition and public safety.

[d]Includes limits on pharmacy reimbursement and other unallocable provisions.

[e]Includes proceeds from selling federal land, increasing visa fees, and other provisions.

Table 2

Distributional Impact of House Spending Cuts in Payments for Individuals

Share of Spending Cuts and Family Income by Family Income Group (percent)

Income Group	Share of Spending Cuts*	Share of Family Income
Bottom 20 percent	22	3
Second 20 percent	16	8
Middle 20 percent	15	14
Fourth 20 percent	18	23
Top 20 percent	30	52

Source: JEC Democratic Staff calculations using data from CBO and Census Bureau public use files.

*$22.2 billion of cuts in payments for individuals allocable by income group from Table 1.

budget resolution and included in the Senate spending reconciliation bill.

Approximately $22 billion of the spending cuts in the House bill are for payments for individuals. Those are the cuts that can be allocated to families in different income groups (**Table 1**). Among these are about $14 billion in cuts to student loan programs and nearly $9 billion in Medicaid cuts. The Medicaid cuts are partially offset by a one-time increase in Medicaid spending for hurricane victims.

That $22 billion in spending cuts is spread relatively evenly across families in all income groups. Because income is so unevenly distributed, however, the share of those spending cuts borne by lower-income families is substantially larger than their share of total income (**Table 2**). For example, families in the bottom fifth of the income distribution receive only about 3 percent of total income, but they bear 22 percent of the total cuts in spending on payments for individuals.

This analysis does not allocate $28 billion of spending cuts that do not directly reduce federal payments for individuals, such as the proceeds from auctioning electromagnetic spectrum licenses. Nevertheless, some of the additional cuts will hurt vulnerable families. For example, the roughly $5 billion in cuts to child support enforcement efforts will reduce payments to single parents and their children by over $7 billion,

Table 3

Budgetary Effects of the Senate Spending Reconciliation Bill

(billions of dollars)

Provision	**Change in Outlays 2006-2010**
Payments for individuals, allocable by income group	
Net program cuts	
Student loan programs	-7.1
Farm programs	-2.7
Net program cuts, subtotal	-9.8
Net program expansions	
Medicare	11.8
Medicaid	1.8
Net program expansions, subtotal	13.6
Net impact, payments for individuals	**3.8**
Other provisions	
Medicare[a]	-16.8
PBGC premium increases	-6.7
Medicaid[b]	-6.1
Spectrum auction proceeds[c]	-5.3
ANWR oil and gas development proceeds	-2.5
Other provisions[d]	-1.0
Net impact, other provisions	**-38.5**
Total net spending cuts	**-34.6**

Source: CBO cost estimate of S. 1932, "The Deficit Reduction Omnibus Reconciliation Act of 2005", as passed by the Senate on November 3, 2005.

[a]Includes elimination of payments for Medicare Advantage health plans and other provisions.

[b]Includes limits on pharmacy reimbursement and other unallocable provisions.

[c]Includes offsetting spending for digital transition and public safety.

[d]Includes increasing visa fees and other provisions.

according to an analysis by the Congressional Budget Office.

Senate Spending Reconciliation Bill

The spending reconciliation bill passed by the Senate on November 3rd cuts spending by about $35 billion over five years. In contrast to the House bill, the Senate bill includes both cuts in payments for individuals and program expansions that, in dollar terms, roughly offset the spending cuts (**Table 3**). While the proposed cuts in the student loan and farm programs will have a direct impact on families in all income groups, families across the income distribution will also benefit from program expansions in Medicare and Medicaid. Some families in each income group will be net gainers and some will be net losers from these spending cuts, but there is little net impact on any income group as a whole.

The Senate bill achieves net savings through spending cuts or increases in offsetting receipts that are not readily identified as payments for individuals and therefore cannot be allocated by income group. These savings come from provisions such as a reduction in inefficient payments to plans in the Medicare Advantage program, as recommended by the Medicare Payment Advisory Commission; a limit on Medicaid payments to pharmaceutical companies; higher employer pension insurance premiums; and proceeds from auctioning electromagnetic spectrum licenses.

Tax Reconciliation Proposals

The Tax Relief Act of 2005 (S. 2020) passed by the Senate on November 18th, would reduce federal revenues by $57.8 billion over the next five years. This is $12 billion less than the $70 billion of reconciled tax cuts in the FY 2006 budget resolution.

The Senate reconciliation tax package provides hurricane-related tax relief, extends a number of expiring tax provisions, provides new tax incentives for charitable giving, and offsets some of the tax cuts with revenue increases (**Table 4**). The biggest tax cuts are a one-year extension of the alternative minimum tax relief provisions that expire at the end of this year, and a one-year extension of the research and experimentation tax credit. The major revenue raising provisions in the Senate package include clarification of the economic substance doctrine, which would limit tax shelter transactions ($5.2 billion over five years), and a change in accounting rules for large integrated oil companies ($4.3 billion over five years).

The original reconciliation bill introduced by Senate Finance Committee Chairman Grassley had included a one-year extension of the lower dividend and capital

Table 4

Budgetary Effects of the Senate Tax Reconciliation Bill
(billions of dollars)

Provision	Change in Revenues 2006-2010
Hurricane Tax Relief	**-7.0**
Extension of Expiring Tax Provisions	
Taxes on Individuals Allocated to Family Incomes	
Extend increased AMT exemption and adjust for inflation	-30.5
Extend AMT nonrefundable personal credits	-2.9
Extend above-the-line tuition deduction	-7.4
Extend retirement savers credit	-4.1
Extend deduction for state and local sales taxes	-2.6
Subtotal	**-47.5**
Taxes on Businesses Allocated to Family Incomes	
Extend increase in small business expensing	-7.3
Extend and modify the research credit	-9.9
Subtotal	**-17.2**
Other Expiring Provisions	**-3.4**
Charitable Giving Incentives and Miscellaneous Provisions	**-1.5**
Offsetting Revenue Increases	**18.8**
Total	**-57.8**
Memorandum: total allocable to families	**-64.7**

Source: JCT, *Estimated Revenue Effects of the Tax Provisions Contained in S. 2020, the "Tax Relief Act of 2005"*, JCX-82-05R, November 29, 2005.

Table 5

Budgetary Effects of the HouseTax Reconciliation Bill
(billions of dollars)

Provision	Change in Revenues 2006-2010
Extension of Expiring Tax Provisions	
Taxes on Individuals Allocated to Family Incomes	
Extend lower tax rates on dividends	-13.3
Extend lower tax rates on capital gains	-7.3
Extend AMT nonrefundable personal credits	-2.8
Extend above-the-line tuition deduction	-1.7
Extend retirement savers credit	-2.8
Extend deduction for state and local sales taxes	-2.1
Subtotal	**-30.0**
Taxes on Businesses Allocated to Family Incomes	
Extend increase in small business expensing	-7.3
Extend and modify the research credit	-9.9
Subtotal	**-17.1**
Other Extensions and Modifications	**-9.0**
Total	**-56.1**
Memorandum: total allocable to families	**-47.1**

Source: JCT, *Estimated Revenue Effects of H.R. 4297, the "Tax Relief Extension Reconciliation Act of 2005,"* JCX-81-05, November 18, 2005.

gains tax rates scheduled to expire in 2008, at a five-year cost of about $10 billion. However, the final bill passed by the senate did not include any extension of the dividend and capital gains cuts.

The full House has not yet voted on a tax reconciliation bill. The Tax Relief Extension and Reconciliation Act of 2005, reported by the Ways and Means Committee on November 15th, would reduce federal revenues by $56.1 billion over the next five years (**Table 5**). It would modify and extend for one-year certain tax provisions that will expire at the end of this year, and extend for two years other provisions that expire in the next three years. It includes a two-year extension of the lower rates on dividends and capital gains through 2010.

Key differences between the House and Senate tax reconciliation bills

While the House and Senate tax reconciliation bills contain a number of identical provisions, major portions of the two packages are very different. Most notably, the Senate bill indexes and extends through 2006 the higher individual alternative minimum tax exemptions that expire at the end of this year, while the House bill allows the higher exemption to expires. Also, the House bill extends the lower tax rates on dividends and capital gains through 2010, while the Senate bill allows the lower rates to expire as scheduled after 2008.

The House bill does not include tax benefits for the hurricane affected areas, the charitable giving incentives, or the revenue raising offsets contained in the Senate bill. While the list of extended expiring provisions overlaps to a large extent, the sunsets for the extended provisions differ in some cases. For example, the Senate bill extends the retirement savers credit for three years, the House bill for two. The Senate bill extends the tuition deduction for four years, the House bill for one.

The bill that emerges from conference could include combined provisions from both bills, although it is hard to see how such a package could fit within the allowed $70 billion of reconciled tax cuts. A one-year extension of the lower rates on dividends and capital gains would cost about $10 billion, and could fit into the Senate package if the sunset date for other extended provisions were shortened. The House, however, has signaled that it is committed to at least a two-year extension. The House could agree to include some provisions of the Senate bill if it were willing to accept the revenue increases proposed by the Senate. The House, however, has already rejected the anti-tax shelter transaction provision in the past, and some members (as well as some Senators) have indicated their strong opposition to any bill that contains a change in accounting rules limited to major oil companies.

Although the total costs of the two bills are nearly the same over the next five years, their costs over the next ten years are quite different. The Joint Committee on Taxation (JCT) estimates that the Senate bill will lose $38.7 billion in revenue over the next ten years, about $19 billion less than the five-year revenue loss. Two provisions account for almost all of the difference. First, the bill extends for one year the increase in the amount of investment expense that small businesses can deduct immediately. While this reduces revenue through 2010, it increases revenue after 2010 because firms can no longer claim depreciation costs for the investment written off in the first year. Second, the JCT estimates that the provision to limit tax shelter transactions will raise increasing amounts of revenue over time, $15.9 billion over ten years compared with $5.2 billion over five.

The House bill, in contrast, will lose $80.5 billion in revenue over ten years according to JCT estimates, $24 billion more than the five year cost. The House bill contains the same extension of the increase in investment expensing for small businesses as the Senate bill, but the lower cost of that provision over ten years is more than offset by the additional ten-year cost of extending the lower tax rates on dividends and capital gains through 2010. The JCT estimates that the lower rates on dividends and capital gains will lose $50.8 billion in revenue over ten years. Most of that revenue loss occurs in 2011 and 2012, just beyond the five year window. While not part of the House bill, permanent extension of the lower rates would lose $160 billion in revenue over the next ten years.

Benefits in both the Senate and House Bills are skewed to upper-income families

Of the five-year, $69.6 billion cost of non-hurricane-related tax cuts in the Senate bill, about $65 billion is from extensions of major tax cuts for individuals and businesses that can be allocated by family income group (**Table 4**). In the House tax bill, about $47 billion of the $56 billion five-year cost is from extensions of major tax cuts that also can be allocated by family income group (**Table 5**). The Urban-Brookings Tax Policy Center estimates that in 2006, about 86 percent of the major tax cuts in the Senate bill go to the 20 percent of families with the highest incomes (**Table 6**). Families in this group have estimated income of approximately $80,000 or more. The Tax Policy Center estimates that 84 percent of the major tax cuts in the House bill go to the same richest 20 percent of families.

Although the tax bills appear to be similar in their distribution of the tax cuts across families, the distribution of the tax cuts among the 20 percent of families in the highest income group is very different in the two bills. Forty percent of the tax cuts in the House bill would go to families with incomes of $1 million or more, according to estimates by the Tax Policy Center. Those families would receive about 8 percent of the tax cuts in the Senate bill.

Provisions of the House bill that are not directly allocated in this analysis are other business tax cuts that would, on net, also be skewed towards higher-income families. The analysis does not allocate the revenue increases in the Senate bill, but they would also tend to come from higher-income families.

Net Impact of Reconciliation Spending and Tax Cuts

The net effect of the House reconciliation spending and tax cut package would require low- and middle-income families to bear the brunt of the pain while demanding no net sacrifice from the highest-income families (**Chart 1**). While the spending changes in the Senate bill have a negiligible net effect on low- and middle-income families as a group, all of the savings would still be used to pay for tax cuts for the wealthy. It is impossible to know at this point how the differences would be resolved in conference, but any movement away from the Senate spending plan toward the House plan would worsen the distributional impacts. Combining the major tax cuts from the House and Senate bills would increase the dollar value of the tax cuts for high-income families. In either the House or the Senate proposal, the aggregate spending cuts are smaller than the aggregate tax cuts, which would worsen the budget deficit.

Table 6

Distributional Impact of Senate and House Tax Cuts

Share of Tax cuts by Family Income Group (percent)

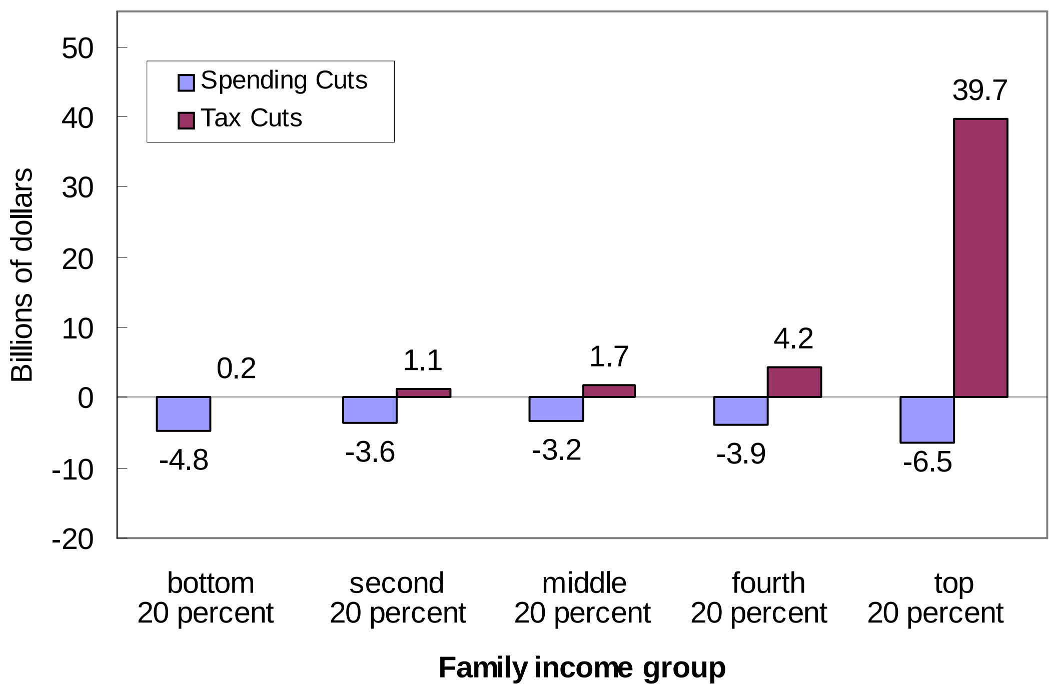
Income Group	Share of House Tax Cuts	Share of Senate Tax Cuts
Bottom 20 percent	0.4	0.4
Second 20 percent	2.4	2.1
Middle 20 percent	3.7	3.0
Fourth 20 percent	9.0	8.4
Top 20 percent	84.2	85.9

Source: Urban-Brookings Tax Policy Center, *Table T05-0294, House Tax Relief Extension Reconciliation Act of 2005 (H.R. 4297 as Reported by the Committee on Ways and Means), and Table T05-0296, Senate Tax Relief Act of 2005 (S. 2020)* , November 18, 2005.

Chart 1

Impact of House Budget Reconciliation on Families

2006-2010 Spending and Tax Cuts Affecting Families in the FY 2006 House Budget Reconciliation Bills, by Family Income Group



Source: JEC Democratic staff calculations using data from JCT, the Tax Policy Center, CBO, and Census Bureau public use files.

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