

## THE NEW DIVIDEND TAX CUT: BUSH'S PRESCRIPTION FOR RESCUING THE ECONOMY

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### I. INTRODUCTION

President Bush unveiled his 2004 “economic growth” package on February 3, 2003, which contained nearly \$1.47 trillion in tax cuts through the year 2013.<sup>1</sup> Essential to Bush’s plan was the elimination of the double taxation on dividends.<sup>2</sup> It was estimated that the elimination of the double taxation on dividends would not only encourage economic growth but also result in economic savings of \$388 billion.<sup>3</sup> Bush has stated that his plan would reduce bankruptcies,<sup>4</sup> improve corporate governance and eliminate various biases in the current system.<sup>5</sup>

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1. Patti Mohr & Sonya Harmon, *Bush Calls for \$1.47 Trillion in Gross Tax Cuts*, 2003 TAX NOTES TODAY, 23-1, Feb. 3, 2003 [hereinafter *Bush Calls*].

2. *Id.*

3. *Id.* “The largest provision in the growth package would eliminate the double taxation of corporate dividends (\$388 billion through 2013) by eliminating the tax shareholders pay on dividends for which the corporation has already paid taxes.” *Id.*

4. White House website, *The President’s Jobs and Growth Plan: Increasing Savings and Investment*, at [www.whitehouse.gov/infocus/economy/save\\_investment.html](http://www.whitehouse.gov/infocus/economy/save_investment.html) (last visited November 8, 2003).

5. *Id.* The position paper goes on to provide that the dividend proposal will benefit the economy by:

Increased Jobs: The Council of Economic Advisors (CEA) estimates the . . . entire Jobs and Growth plan, including the dividend exclusion, would help the economy create 1.4 million jobs by the end of 2004. A large share of that job creation is attributed to eliminating the double tax on corporate earnings. Better Wages: The double tax on corporate income increases the cost of capital for corporations. According to the CEA, the President’s plan would reduce the cost of capital for investments in equipment by more than 10 percent. For investment in structures—the weakest part of the economy today—the cost of corporate equity capital would be cut by more than one-third. That reduction would encourage higher levels of corporate investment and capital

Furthermore, the President stated that the primary economic goal behind his dividend proposal was to increase gross domestic product (“GDP”) by increasing corporate investment through reducing the cost of equity capital.<sup>6</sup> Also included with Bush’s economic growth package were several other provisions which helped raise money for the federal government<sup>7</sup> and which would also have made several temporary tax cuts permanent.<sup>8</sup> Bush’s economic growth package is now called the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the “Act”).<sup>9</sup> Shortly after Bush’s tax cut announcement,<sup>10</sup> both the Senate and the

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accumulation, resulting in greater productivity increases and, therefore, higher wages for workers.

*Id.*

6. Department of Commerce, Bureau of Economic Analysis, *Gross Domestic Product: Fourth Quarter (Advance)*, January 30, 2003, [hereinafter BEA January 2003 Report], provides that GDP is a combination of components. The components are: (1) consumption or personal consumption expenditures; (2) investment including business investment, changes in inventory, and investment by people in residential housing; (3) government spending at all levels; and (4) net exports, the difference between exports and imports. *Id.*

7. See *Bush Calls*, *supra* note 1.

At a newly re-estimated cost of \$690 billion through 2013, Bush’s ‘economic growth’ package makes up the bulk of the 10-year tax cut price tag. Treasury revised the cost of the plan by \$16 billion through 2013 because it would be retroactive to January 1, 2003. Also, the growth package now includes a proposal to extend a waiver for net operating loss carrybacks and carryforwards that are allowed against the taxpayer’s alternative minimum taxable income through 2005 (\$1 billion through 2013).

Bush also wants to consolidate and expand tax-free retirement savings plans (\$6.4 billion through 2013), enact a host of tax incentives (\$190.5 billion through 2013), and simplify a few tax provisions (\$1.6 billion through 2013). He also calls for permanently extending expiring provisions, including the research credit (\$68 billion through 2013) as well as making permanent the provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) that expire in 2010 (\$523 billion through 2013).

The budget includes several new provisions that would raise revenue by: permitting private collection agencies to engage in specific, limited activities to support IRS collection efforts (\$1 billion through 2013); combating abusive tax avoidance transactions (\$1 billion through 2013); limiting related party interest deductions (\$4 billion through 2013); increasing Indian gaming activities (\$41 million through 2013); and deposit the full amount of excise tax imposed on gasohol in the Highway Trust Fund (\$4.9 billion through 2013).

*Id.*

8. *Id.* “Bush included provisions to extend and make permanent existing tax cuts—including the research credit (\$68 billion), all the provisions in EGTRRA that expire in 2010, and a package of temporary tax cuts known as the ‘extenders’ (\$11 billion through 2013).” *Id.*

9. President George W. Bush, *Bush Statement on Introduction of Jobs and Growth Tax Act of 2003*, 2003 TAX NOTES TODAY 40-26, Feb. 27, 2003. See also Senate, House of Representatives, *Draft Version of Final Tax Bill Conference Agreement Available*, 2003 TAX NOTES TODAY 100-7, May 22, 2003, [hereinafter *Draft Version*].

10. Patti Mohr, *House and Senate Taxwriters to Introduce Bush Tax Package*, 2003 TAX NOTES TODAY 39-2, Feb. 26, 2003.

House quickly issued their own, albeit different, versions of the Act.<sup>11</sup> In May 2003, the House and Senate agreed to combine their two bills in a deal brokered by Vice President Dick Cheney.<sup>12</sup> Shortly thereafter, on May 22, 2003, the Act was approved by both the House and Senate.<sup>13</sup> Bush signed the Act into law on May 28, 2003.<sup>14</sup> Bush's proposed tax cuts have been a point of contention for many Americans since the tax cuts were first introduced.<sup>15</sup> The tax cuts have not only pit Democrats against Republicans, but have also pit wealthy and lower income Americans against each other. Whether the new tax cuts will achieve their intended effect of boosting the American economy is yet to be seen. The purpose of this paper is to cover the Act as passed by Congress and signed by President Bush, discussing each of the major provisions contained within the Act and examining the differing views as to whether it will succeed.

## II. THE DRAFT JOB AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003

Under a deadline imposed by President Bush, House Ways and Means Committee Chairman William M. Thomas (R-California) and Senate Finance Committee Chairman Charles E. Grassley (R-Iowa); the House and Senate settled their differences over the content of the Act.<sup>16</sup> A final version of the Act was proposed and accepted by both the House

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11. Sen. Don Nickles, *Legislative Text of S. 2, the Jobs and Growth Tax Act of 2003*, 2003 TAX NOTES TODAY 40-18, Feb. 27, 2003; Rep. William M. Thomas, *Legislative Text of H.R. 2, the Jobs and Growth Tax Act of 2003*, 2003 TAX NOTES TODAY 40-19, Feb. 27, 2003.

12. James Kuhnhen, *House, Senate Leaders Agree on \$350 Billion Tax-Cut Deal*, MIAMI HERALD, May 22, 2003, at 15A.

13. See *Draft Version*, *supra* note 9.

14. Patti Mohr, *Bush Signs Tax-Cut Package*, 30 TAX NOTES INT'L 869, 869 (2003) [hereinafter *Bush Signs*].

15. Harold Pepperell, *Why Eliminating the Dividend Tax Is Not the Answer*, 2003 TAX NOTES TODAY 42-35, Feb. 28, 2003.

In a sense, you almost have to feel sorry for the Bush administration ideologues who are trying to put together a coherent tax program that will stimulate long-term economic growth. It appears their original intentions may have been good but somewhere along the line they got hijacked by their obsession with the notion that lopsided tax cuts for the rich are the answer to everything, and miss their mark.

Take their proposal to eliminate the tax on dividends, which they have made the centerpiece of their tax cut program. It accounts for \$364 billion of the \$674 billion total. Their theory is that giving the richest 10 percent who own 86 percent of all securities a \$364 billion gift by eliminating the tax on dividends will boost the stock market, and that the recipients of this bonanza will reinvest the money in the market. They assume this equates with economic growth.

*Id.*

16. *Id.*

and Senate on May 23, 2003.<sup>17</sup> President Bush signed the Bill on May 28, 2003.<sup>18</sup> The President, while content that the two Houses finally settled their differences and gave him the tax cuts for which he had been asking, was not altogether happy over the actual amount of tax cuts, referring to them at one point as “itty bitty.”<sup>19</sup> Generally, the Act reduces the capital gains and dividend tax rates to five and fifteen percent through 2007,<sup>20</sup> and to zero and fifteen percent in 2008.<sup>21</sup> Rate reductions apply to capital gains starting May 6, 2003 and to dividends starting January 1, 2003, according to the Joint Committee on Taxation (“JCT”).<sup>22</sup> The Act further accelerates the child credit increase,<sup>23</sup> the marriage penalty relief,<sup>24</sup> and the expansion of the fifteen percent income tax rate bracket for married couples.<sup>25</sup>

The Act adopts the House’s approach on dividend and capital gains taxes, including its sunset provision (the reduction to fifteen percent would expire after 2008).<sup>26</sup> This aspect of the Act is estimated to cost about \$150 billion.<sup>27</sup> The Act does not allow for any increases in taxes or

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17. *Id.*

18. *See Bush Signs, supra* note 14, at 869.

19. *See Pepperell, supra* note 15.

20. *See Draft Version, supra* note 9 at §§ 301-302.

21. *Id.* at § 302.

22. *Id.*

23. *Id.* at § 101.

24. *Id.* at § 102.

25. *Id.*

26. *See Thomas, supra* note 11. On February 27, 2003, Rep. William M. Thomas (R-California), Chairman of the House Ways and Means Committee, introduced the Jobs and Growth Act of 2003 (“House Bill”). The most notable difference between the Senate Bill and the House Bill was the amount of tax cuts the bills would allow. The House Bill provided for \$550 billion in tax cuts, while the Senate Bill provided for \$350 billion in tax cuts. Other notable differences between the two bills were that the House bill would not have eliminated dividend taxes altogether. Rather, the House Bill would have reduced dividend taxes for a short period of time under the sunset provision of the House Bill. By contrast, the Senate Bill did not have a sunset provision and would completely have eliminated the dividend tax. Beyond the dividend provision, the House bill added a 50 percent bonus depreciation provision extended through 2005 (\$21 billion). *See also* Nickles, *supra* note 11. On February 27, 2003, Senate Budget Committee Chair Don Nickles (D-Okla.) and Senator Zell Miller (D-Ga.), introduced the Jobs and Growth Act to the Senate (“Senate Bill”). In general, the Senate Bill was similar to the President’s proposed plan. The Senate bill provided tax cuts totaling \$350 billion through 2013, which was a smaller amount of tax cuts than originally proposed by Bush and, subsequently, the House. However, several aspects of the Senate Bill kept in place several other key factors originally proposed by President Bush including: the acceleration of tax cuts scheduled to go into effect as a result of the Economic Growth and Tax Relief Reconciliation Act (“EGTRRA”) of 2001; the dividend tax cuts; a temporary exemption from the alternative minimum tax for middle income individuals; and an increase in the I.R.C. § 179 small-business expensing limit.

27. *See Draft Version, supra* note 9, § 301-302.

fees.<sup>28</sup> The Act expands the child tax credit for 2003 and 2004 to \$1,000,<sup>29</sup> including a \$1,000 payment from the Treasury to even parents who do not earn enough income to pay taxes.<sup>30</sup> The credit would shrink back to the current \$600 in 2005 and then expand again in 2006.<sup>31</sup> The Act also accelerates the marginal tax rate reduction to be effective on January 1, 2003, instead of 2006.<sup>32</sup> However, these rate reductions would revert back to current rates in 2005 for one year to limit the costs to the Treasury.<sup>33</sup> Lastly, the Act would provide \$20 billion in aid to states, with half earmarked for Medicaid cost relief.<sup>34</sup>

The Act not only includes the dividend elimination provisions, but several other amendments that lawmakers were able to add. For example, Senator John Ensign (R-Nevada) was able to include his amendment No. 622 which “would allow companies to repatriate foreign earnings at a reduced 5.25 percent rate for one year only.”<sup>35</sup> Another notable addition to the Act is a plan which would establish a commission to “comprehensively reform the federal tax system in a manner that generates appropriate revenue for the federal government.”<sup>36</sup> A “Sense of the Senate” addition was made which might repeal a 1993 increase on Social Security benefits and institute a requirement that parents who continuously fail to pay child support must include that amount in their gross income.<sup>37</sup>

The Treasury, in anticipation of the Act, released a breakdown of the distributional effects of the major individual income tax provisions in the final conference agreement of the Jobs and Growth Tax Relief Reconciliation Act of 2003 that the House and Senate leaders officially approved on May 22, 2003.<sup>38</sup> The Treasury agrees that the Act will provide a marked difference to all taxpayers, regardless of their income level.<sup>39</sup> For example, “the bill in 2003 would provide an average tax

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28. *Id.* at § 101.

29. *Id.*

30. *Id.*

31. *Id.* at §§ 102–105.

32. *Id.*

33. *Id.*

34. *Id.* at §§ 401-402.

35. See Patti Mohr, *Senate Passes Tax Package with Dividend Exclusion*, 99 TAX NOTES WEEKLY 943, 945 (2003) [hereinafter *Senate Passes*].

36. *Id.*

37. *Id.* See *Senate Passes*, *supra* note 35, at 945 (providing a more complete list of other amendments made to the Draft Act).

38. U.S. Treasury Department, *Treasury Gives Examples of Tax Relief Under 'Jobs and Growth' Plan*, 2003 TAX NOTES TODAY 100-17, May 23, 2003.

39. *Id.*

reduction for all income groups of 11.9 percent. Individuals between \$30,000 and \$40,000 would receive a 19.3 percent income tax reduction in 2003 and individuals earning more than \$200,000 would see a 10.8 percent income tax reduction in 2003.”<sup>40</sup> A married couple aged 65 with an income of \$80,000 derived from dividends and Social Security benefits would see the least benefit under the tax cut plan (18 percent).<sup>41</sup>

*A. Specific Provisions of the Jobs and Growth Reconciliation Tax Act*

The Act, which is the third biggest tax cut in the history of the United States,<sup>42</sup> specifically cuts taxes in several areas and further includes certain provisions which are intended to provide incentives for small business to help spur economic activity and growth.<sup>43</sup> The Treasury estimates that 68 million women will see their taxes decline by an average of \$1,338.<sup>44</sup> An estimated 45 million married couples will receive average tax cuts of \$1,786.<sup>45</sup> In addition, 34 million families with children will benefit from an average tax cut of \$1,549.<sup>46</sup> At least six million single women with children will receive an average tax cut of \$558.<sup>47</sup> At least 12 million elderly taxpayers will receive an average tax cut of \$1,401.<sup>48</sup> Around 23 million small business owners will receive tax cuts averaging \$2,209.<sup>49</sup> About three million individuals and families will have their income tax liability completely eliminated by the Act.<sup>50</sup> Each of the major provisions affecting taxpayers is discussed below.

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40. *Id.*

41. *Id.*

42. *See Bush Signs, supra* note 14, at 869.

43. *Id.*

44. U.S. Treasury Department, From the Office of Public Affairs, *Effects of Major Individual Income Tax Relief Provisions in Jobs and Growth Tax Relief Reconciliation Act of 2003*, at <http://www.ustreas.gov/press/releases/js410.html> (May 22, 2003) [hereinafter *Effects of Major Individual Income Tax Relief*].

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.* The Treasury further provides additional statistics on how the Act will benefit taxpayers. The Treasury provides that accelerating the 2004 and 2006 rate cuts in 2003 will provide 32 million taxpayers with an average tax cut of \$1,060. Accelerating the expansion of the ten percent rate bracket will reduce taxes for 69 million taxpayers, on average by \$76. Enacting marriage penalty relief in 2003 will reduce taxes for 34 million married couples by an average of \$589. Increasing the child tax credit to \$1,000 in 2003 will provide 26 million families with an average tax cut of \$623. Lowering the tax rate on capital gains and dividend income will reduce taxes for 26 million taxpayers with income from these two sources by an average of \$798. Among those with tax cuts will be seven million elderly taxpayers whose taxes will decline, on average, by \$1,088.

### 1. Acceleration of the Child Tax Credit

Bush's original tax act in 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), increased the tax credit per child from \$600 to \$1,000.<sup>51</sup> However, EGTRRA phased in this child tax credit between 2005 through 2010.<sup>52</sup> The Act increases the child tax credit to \$1,000 beginning in 2003 and 2004.<sup>53</sup> The increased child tax credit expires in 2007 and returns to its previous level of \$600.<sup>54</sup> Starting in July 2003, this increased child tax credit is paid in advance.<sup>55</sup> The determination of whether an individual will receive this child tax credit is based on the taxpayer's 2002 tax return information.<sup>56</sup> According to the Treasury, the payment is made in the same manner that the original rebate checks were issued in 2001.<sup>57</sup> The estimated tax relief

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51. I.R.C. § 24(a)(2) (2003).

52. *Id.*

53. *See Draft Version, supra* note 9, at § 101.

54. *See* Karen Masterson, *House: Tax Cut for Poor Can Wait; Bill Delays Child Credit*, HOUSTON CHRONICLE WASHINGTON BUREAU, June 13, 2003, at A1.

55. Internal Revenue Service Press Release, *Taxpayers to Receive Advance Child Tax Credit This Summer*, at <http://www.irs.gov/newsroom/article/0,,id=109810,00.html> (May 28, 2003) [hereinafter *Taxpayers to Receive*].

56. *See Effects of Major Individual Income Tax Relief, supra* note 44.

57. *See Id. See also Taxpayers to Receive, supra* note 55:

Beginning the last week of July, eligible taxpayers who claimed the Child Tax Credit on their 2002 tax returns will automatically receive an advance payment of the 2003 increase in this credit, the Treasury Department and Internal Revenue Service announced today.

Taxpayers will not have to take any action to get this advance payment of up to \$400 per qualifying child. The Treasury Department and IRS will perform all the calculations and automatically mail a notice and a check to each eligible taxpayer. "The only thing the taxpayer needs to do is cash the check," said Mark W. Everson, IRS Commissioner. "If you qualify, we will send you a notice. There's no need to call, no need to apply, no need to fill out another form. The IRS will do all the work. A few days after the notice, you will get the check." The checks – an advance payment of the 2003 increase in the Child Tax Credit – will be based on the child tax credit claimed on the taxpayer's 2002 tax return. The Jobs and Growth Tax Relief Reconciliation Act of 2003 increased the maximum child tax credit for 2003 to \$1,000 per child, up from \$600 for tax year 2002. The law further instructed the Treasury Department to provide the difference – up to \$400 per child – as an advance payment to each eligible taxpayer this summer. The Treasury Department will issue about 25 million of these checks this year, beginning with three principal mailings on July 25, Aug. 1 and Aug. 8. Taxpayers who filed returns after April 15 – for example, those with automatic extensions – will receive their advance payments after the IRS processes their returns. They should not make any change to their 2002 returns or remittances based on an expectation of an advance payment check. The IRS will send notices to taxpayers on July 23, July 30 and Aug. 6, informing them of their advance payment amount. The IRS urges taxpayers to hold on to these notices for their 2003 tax returns. They will need to take the advance payment into account when determining the amount of their child tax credit on the 2003 tax return. Taxpayers who are not eligible for the advance payment may still qualify for the

in the calendar year 2003 is expected to be \$19 billion.<sup>58</sup>

The increased child tax credit has turned out to be one of the more controversial provisions of the Act, namely because the Act was written to exclude low income and military families from receiving the rebate checks this summer based on the rationale that these groups do not pay taxes.<sup>59</sup> Democrats have strongly argued that this is just another example of how Bush is pandering to the middle and upper income taxpayers.<sup>60</sup> Republicans have been quick to defend their decision to omit low income individuals from the rebate checks.<sup>61</sup> House Majority Leader Tom Delay stated, "It's difficult to give tax relief to people who don't pay taxes."<sup>62</sup>

Congress has received further criticism for not only excluding the poor but, more surprisingly, excluding military personnel from receiving the rebate checks in 2003. Representative Charles Rangel of New York has stated, "The Republicans actually think that the child of a combat veteran should receive a smaller tax credit than the child of a member of Congress because the member pays more income tax. . . [t]heir tax cut plans put the wealthy first and punish those who sacrifice the most for their families and their country."<sup>63</sup>

Republicans have reacted to the criticism by proposing another child tax credit bill that would increase the number of recipients for the

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increased child tax credit of up to \$1,000 when they file the 2003 tax return next year. For instance, a taxpayer who did not have a child in 2002, but had one in 2003, would not receive an advance payment but may qualify for the full \$1,000 credit on the 2003 tax return.

*Id.* See also Internal Revenue Service Press Release, *Mailing Schedule for Advance Child Tax Credit Payments*, available at <http://www.irs.gov/newsroom/article/0,,id=109829,00.html> (June 19, 2003).

The Treasury Department will begin mailing checks for the advance payment of the increased Child Tax Credit on July 25, with most checks mailed by August 8. These will cover eligible taxpayers who filed their 2002 tax returns by April 15. As the IRS processes returns from taxpayers who filed after that date, it will schedule advance payments on a weekly basis. No checks will be sent after December.

For the first three weeks, the checks will be sent according to the last two digits of the taxpayer's social security number:

00-33—mailed July 25

34-66—mailed August 1

67-99—mailed August 8

*Id.*

58. See *Effects of Major Individual Income Tax Relief*, *supra* note 44.

59. See Masterson, *supra* note 54, at A1.

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*



rebate checks to those taxpayers that at least earned \$10,500 in 2002.<sup>64</sup> Any taxpayer earning less than \$10,500 in 2002 would have to wait until 2004 in order to benefit from the increased child tax credit.<sup>65</sup> This bill has not yet been enacted into law.

## 2. Acceleration of the Ten-Percent Bracket Expansion

Under EGTRRA, Bush's 2001 tax act,<sup>66</sup> the ten percent tax bracket was to expand in 2008.<sup>67</sup> The Act expands the ten percent tax bracket effective in 2003 and 2004.<sup>68</sup> The Act also increases the pool of taxpayers included in this ten percent tax bracket.<sup>69</sup> For example, the upper end of the ten percent tax bracket has been increased to include unmarried individual taxpayers who make \$7,000 and married taxpayers who make \$14,000.<sup>70</sup> The Treasury estimates that the tax reduction from this provision in calendar year 2003 will be \$5 billion.<sup>71</sup>

## 3. Acceleration of the Reduction in Income Tax Brackets

EGTRRA provided tax rate reductions for all taxpayers. However, EGTRRA provided that the tax rate reductions for income tax brackets in excess of 15 percent were scheduled to begin being reduced in 2004 and 2006. The Act accelerates these reductions such that they take place in 2003.<sup>72</sup> The acceleration of the new brackets results in new rates of 25 percent, 28 percent, 33 percent and 35 percent.<sup>73</sup> According to the Treasury, these reduced tax rates are expected to benefit married taxpayers with combined taxable incomes greater than \$47,450 and single taxpayers with taxable income of more than \$28,400.<sup>74</sup> Furthermore, the expected tax relief in the calendar year 2003 is

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64. *See id.* Previously, a taxpayer must have made more than \$26,625 in 2002 in order to receive a rebate check. *Id.*

65. *Id.*

66. EGTRRA provides American with \$1.35 trillion in tax cuts over ten years. Bush has also stated that while more tax cuts were needed, EGTRRA made the recession one of the shallowest ever. *Id.*

67. *See Draft Version, supra* note 9, at § 104.

68. *Id.*

69. *Id.*

70. *Id.* Formerly, the high end of this bracket was \$6,000 for unmarried individual taxpayers and \$12,000 for married taxpayers.

71. *See Effects of Major Individual Income Tax Relief, supra* note 44.

72. *See Draft Version, supra* note 9, at § 102.

73. *See Effects of Major Individual Income Tax Relief, supra* note 44. The previous tax rates were 27 percent, 30 percent 35 percent and 38.6 percent. *See also* I.R.C. § 1(f)(8) (West 2003).

74. *See Effects of Major Individual Income Tax Relief, supra* note 44.

expected to be \$29 billion.<sup>75</sup>

#### 4. Acceleration of the Reduction of the Marriage Penalty

The tax code has historically created an anomaly wherein married taxpayers did not receive double the standard deduction that two unmarried taxpayers receive. EGTRRA sought to rectify this problem. Initially, the phase-in of relief for married couples was to begin in 2005 and continue until 2009 under EGTRRA. However, under the Act, the phase-in of relief for married taxpayers is to begin in 2003.<sup>76</sup> The provision of the Act generally increases the deduction that married taxpayers may take.<sup>77</sup> Therefore, in 2003, the standard deduction that a married couple may take now will be double the amount of the standard deduction for a single taxpayer.<sup>78</sup> The increase in the standard deduction for married couples is expected to benefit married taxpayers with a combined taxable income of \$47,450 and will result in tax relief in 2003 of \$19 billion.<sup>79</sup>

#### 5. Increase in Small Business Expensing for New Investment

This provision amends I.R.C. § 179(b) of the Code pertaining to the dollar limitations imposed on business as to the amount they may take in depreciation deductions.<sup>80</sup> The amount that a small business may deduct in depreciation will immediately increase from \$25,000 to \$100,000 in 2003.<sup>81</sup> This provision of the Act will be immediately effective for small businesses.<sup>82</sup> It is intended to spur spending among small businesses,

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75. *Id.*

76. *See Draft Version, supra* note 9, at § 103. *See also* I.R.C. § 63(c) (West 2003).

77. *See Draft Version, supra* note 9, at § 103.

78. *See Effects of Major Individual Income Tax Relief, supra* note 44.

79. *Id.*

80. I.R.C. § 179 (West 2003). Taxpayers (other than estates, trusts and certain noncorporate lessors) that purchase qualifying depreciable property may elect to deduct the cost of such property in the year in which it is placed in service rather than recover the cost over a number of years through modified accelerated cost recovery system (MACRS) deductions. If the election is made, neither MACRS deductions nor the investment tax credit is available with respect to the portion of the cost of the property subject to the election. The Code § 179 expense allowance operates independently of the additional 30 percent first-year depreciation allowance under Code § 168(k). The Code § 179 allowance is claimed first and the 30 percent allowance is then claimed on the basis of qualifying property as reduced by the Code § 179 allowance. In general, Code § 179 property is property used in connection with the active conduct of a taxpayer's trade or business that would be subject to depreciation but for the election. The maximum allowable deduction is \$24,000 in 2001 and 2002, but this amount is increased for certain enterprise zone businesses. *Id.*

81. *See Draft Version, supra* note 9, at § 202.

82. *Id.* at §§ 201-202.

which in turn should spur economic growth.<sup>83</sup> However, the amount qualifying for immediate deduction will begin to phase out when the small business has invested an excess of \$400,000 (originally this amount was \$200,000).<sup>84</sup> The estimated tax relief in 2003 for small business is \$3 billion.<sup>85</sup>

The Treasury has provided several statistics and examples as to how the Act will benefit small business owners.<sup>86</sup> According to the Treasury, 23 million small business owners would receive tax cuts averaging \$2,209.<sup>87</sup> Owners of flow-through entities, including small business owners and entrepreneurs, comprise about 400,000 of the 600,000 tax returns that would benefit if the reduction in the top tax bracket were accelerated to 2003, from its currently scheduled 2006.<sup>88</sup> Furthermore, these small business owners would receive 79 percent (about \$9.7 billion) of the \$12.4 billion in tax relief from accelerating to 2003 (from 2006) the reduction in the top tax bracket to 35 percent.<sup>89</sup> The increase in the expensing for new investment would encourage small business owners to purchase the technology, machinery and other equipment that they would need to expand.<sup>90</sup>

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83. *Id.*

84. *See Draft Version, supra* note 9, at §§ 201-202; *Effects of Major Individual Income Tax Relief, supra* note 44. *See also* I.R.C. § 179 (West 2003). For property placed in service after 1990, Code § 179 property is depreciable property (as defined in Code § 1245(a)(3)) that is acquired by purchase for use in the active conduct of a trade or business (Code § 179(d)(1)). *Depreciable property.* Code § 1245 property includes the following broad classifications of depreciable property: (1) Personal property; (2) Other tangible property (not including most buildings and their structural components) that: (a) is used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services; (b) is a research facility used in connection with any of the activities set forth in (a), above; or (c) is a facility used in connection with any of the activities set forth in (a) for the bulk storage of fungible commodities; (3) That part of any real property (other than property mentioned in (2), above) that has an adjusted basis reflecting amortization deductions set forth in Code § 1245(a)(3)(C); (4) Single-purpose agricultural or horticultural structures; and (5) Storage facilities (other than buildings and their structural components) that are used in connection with the distribution of petroleum or primary products of petroleum; (6) Any railroad grading or tunnel bore. For property placed in service before 1991, Code § 179 property was defined as tangible depreciable property (§ 38 property). Section 38 property was substantially similar to those types of property set forth in § 1245(a)(3). *Id.*

85. *See Effects of Major Individual Income Tax Relief, supra* note 44.

86. *See* U.S. Department of Treasury, *Provisions in Jobs and Growth Tax Relief Reconciliation Act of 2003 for Small Business Owners*, at <http://www.ustreas.gov/press/releases/js413.html> (May 22, 2003).

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

## 6. Temporary State Fiscal Relief

Currently, states across the U.S. are experiencing their “worst financial crisis in 50 years.”<sup>91</sup> The states’ financial crisis has in part been brought about due to homeland security and education reforms which many states are scrambling to implement.<sup>92</sup> Therefore, in an effort to help the states stabilize their budgets, the Act contains a provision which would provide \$20 billion in state aid, half of which is to cover Medicaid.<sup>93</sup> The payments that each state will receive will depend on the population of that state.<sup>94</sup> A state is defined as any of the 50 states of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the United States Virgin Islands, Guam, the Commonwealth of the Northern Mariana Islands and American Samoa.<sup>95</sup> Furthermore, each state will be limited in how the funds are spent. More or less, the state may only use the money received under the Act for types of expenditures permitted under the most recently approved budget for the state.<sup>96</sup>

## 7. Elimination of Double Taxation on Dividends

The most widely publicized and most controversial provision of the Act is the elimination of the double taxation on dividends.<sup>97</sup> In the Economic Report of the President,<sup>98</sup> Bush stated, “Ending the double tax on corporate income would increase the ability of a corporation to raise equity capital, providing near term support to investment while improving the long-term capital markets.”<sup>99</sup> For years, many investors have debated the fairness of subjecting corporate dividends to two levels of taxation. Under prior law, a dividend was taxed first at the corporate level and then again at the individual level after the investor receives the dividend.<sup>100</sup> The Senate and the House each proposed eliminating the

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91. Bob Kemper, *Bush Not Helping States, Experts Say: Underfunded Mandates Burden Tax-Shy Coffers*, CHICAGO TRIBUNE, May 30, 2003, 11C (providing also “that the national Conference of State Legislatures reports that state deficits have totaled about \$200 billion since 2001”).

92. *Id.*

93. *Id.* See also *Draft Version*, *supra* note 9, at § 401.

94. See *id.* at § 601.

95. *Id.* at § 601(f).

96. *Id.* at § 601(d)(2).

97. *Id.* at §§ 301-303.

98. Economic Report of the President, Chart 1-1 GDP Growth and the Contribution of Consumption, 27 (February 2003). See DOC 2003-3661, available at [http://w3.access.gpo.gov/usbudget/fy2004/pdf/2003\\_erp.pdf](http://w3.access.gpo.gov/usbudget/fy2004/pdf/2003_erp.pdf) (full text version).

99. *Id.* at 55.

100. See Treasury Department, *Treasury Releases Blue Book Detailing Tax Proposals in White*

double taxation on dividends differently in their legislative proposals.<sup>101</sup> The debate between the two chambers is helpful in understanding the policy behind the Act's dividend cut provisions.

The Senate bill originally began with a section that allowed for the total elimination of the double taxation of dividends.<sup>102</sup> The proposal then set forth how the Senate planned to achieve this goal.<sup>103</sup> More or less, this section provided that "gross income does not include the excludable portion (as defined in section 281) of any amount received as

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*House Budget, 2003 TAX NOTES TODAY 23-11 (Feb. 3, 2003).* This is a great and easy-to-follow discussion of how corporate dividends were taxed prior to the enactment of Bush's 2003 Tax Act. The taxation of corporate earnings is very simple. First, corporations are taxed on their earned income. Second, if the corporation distributes earnings, usually dividends, there is a second tax paid by those who hold the shares. But there is also the question of what happens if the corporation does not pay dividends, but instead, retains its earnings. If a corporation chooses to retain its earnings, the new value of the corporation's stock will reflect this retention of earnings. However, when the shareholder eventually decides to sell the shareholder's stock, the value will reflect the corporation's decision to retain the earnings. Thus, the shareholder will pay a higher capital gains tax than if the earnings had not been retained. The end result of this process is that, whether the income is distributed or not, the double taxation results in the tax rate on the corporation's income will be higher than any other tax rate imposed on any other type of income. In order to calculate the amount of earnings that a corporation can distribute to its shareholders, a corporation must calculate the Excludable Dividend Amount ("EDA") for each tax year. EDA reflects the income of the corporation that has already been taxed. To calculate EDA, a corporation is required to convert the amount of income taxes on its return from the previous year into the equivalent amount of income, but now taxed at the thirty-five percent rate. Then, from the amount taxed at thirty-five percent a subtraction is made of the amount of taxes shown on the previous year's return. This computation also includes foreign source income and Alternative Minimum Tax ("AMT"). Even if the tax rate paid by the corporation is not 35 percent, this formula requires the use of that tax rate. "Similarly, taxes paid at the AMT rate will be grossed-up at a 35 percent rate." The resulting computation is EDA. A dividend will be an "excludable dividend" to the extent of EDA. Excludable dividends are not taxed to shareholders. Conversely if the corporation's dividend distributions during a calendar year exceed EDA, then only a proportionate amount of each dividend distribution will be treated as an excludable dividend. If a distribution is not an excludable dividend, then there are several ways the dividend distribution can be treated. Generally, "distributions that are not excludable dividends generally will be treated as: first a return of basis and then capital gain to the extent of the CREBA, then a taxable dividend to the extent of the corporation's earnings and profits, then a return of capital to the extent of the shareholder's remaining basis, and then capital gain." Redemption distributions will remain the same as they are now under current law, therefore:

[t]he distinction between a redemption distribution that is treated as a dividend and a redemption that is treated as a sale or exchange of stock will remain as under current law. The proposal, however, may modify the attribution rules (particularly as they relate to options) for purposes of determining whether a redemption distribution is treated as a dividend.

*Id.*

101. Compare Nickles, *supra* note 11 with Thomas, *supra* note 11.

102. See Nickles, *supra* note 11. The elimination of the double taxation on dividends is found in § 201, titled, "Dividend Exclusion to Eliminate Double Taxation of Corporate Earnings."

103. *Id.* at § 116.

a dividend.”<sup>104</sup> In the case of retained earnings, “any excludable dividend amount of any corporation for any calendar year that exceeds the dividends paid by the corporation . . . the basis of stock in the corporation shall be increased in the manner and to the extent provided in section 282.”<sup>105</sup>

By contrast, the House bill did not call for the total elimination of the double taxation of dividends. Rather, its plan called for a reduced tax rate to be applied against dividends.<sup>106</sup> The House bill also included a corresponding cut in the tax rate applied against capital gains.<sup>107</sup> No such capital gains tax cut was contained in the Senate bill.<sup>108</sup> The House bill provided for the taxation of dividend income and most capital gains at a 15 percent rate (five percent for taxpayers in the ten percent and 15 percent brackets).<sup>109</sup> Normally, dividends are taxed as ordinary income<sup>110</sup> and most capital gains are taxed at a 20 percent rate (ten percent for low-income taxpayers).<sup>111</sup> The 15 percent rate would take

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104. *Id.* at § 116(a).

105. *Id.* at § 116(b). Furthermore, § 281 was the main section dealing with the elimination of the tax on dividends. It defined the excludable portion of dividends as follows:

[W]ith respect to any corporation for any calendar year, the excess of (A) the sum of the fully taxed earnings amount for the preceding calendar year, the aggregate amount of dividends received by the corporation during such preceding year which are excluded from gross income under section 116(a), and the aggregate amount of increases during such preceding year under section 116(b) in the basis of stock held by the corporation, over (B) the amount of applicable income tax taken into account under subparagraph (A).

*Id.*

However, one should note, if a corporation were to make a distribution of stock described in I.R.C. § 301(a), with respect to any class of stock in any calendar year which would not be excludable under § 116(a) of the Senate Bill, such distribution would not be treated as a dividend to the extent such distribution did not exceed the corporation’s cumulative earnings adjustment amount for such class as of the beginning of such year. If such distribution exceeded such amount, then the Senate Bill provided that a proportionate share of each distribution would be applied. The excludable dividend amount of a corporation for any calendar year would be increased by the excess of “the excludable dividend amount of such corporation for the preceding calendar year, over the maximum amount which could have been paid by the corporation as dividends during such preceding calendar year.” The rest of the Senate Bill pertaining to dividends detailed how basis adjustments were to be treated, when basis would be increased, what the effect the Senate Bill would have on earnings and profits, and granted the authority to allow for the carryover of the unallocated excess of the excludable dividends. *Id.*

106. *See* Thomas, *supra* note 11, at § 201.

107. *Id.* at § 206.

108. *See* Nickles, *supra* note 11.

109. *See Draft Version*, *supra* note 9, at § 301(a). “Sections 1(h)(1)(B) and 55(b)(3)(B) are each amended by striking ‘10 percent’ and inserting ‘5 percent.’” *Id.*

110. *Id.*

111. *Id.* at § 301(a)(2). “The following sections are each amended by striking ‘20 percent’ and inserting ‘15 percent.’” *Id.*

effect immediately, stay in effect over the ten-year budget window,<sup>112</sup> and cost \$246 billion over the same period.<sup>113</sup>

Under the House bill, the lower rates for dividends were permitted for “qualified dividend income.”<sup>114</sup> The term “qualified dividend income” meant dividends received during the tax year from domestic corporations.<sup>115</sup> However, certain dividends were excluded from receiving favorable tax treatment under the House bill, including any current year or prior year dividend paid by a corporation exempt from tax under I.R.C. §§ 501 or 521;<sup>116</sup> any amount allowed as a deduction under I.R.C. § 591 (relating to deduction for dividends paid by mutual savings banks, etc.);<sup>117</sup> and any dividend described in I.R.C. § 404(k).<sup>118</sup> Furthermore, under I.R.C. § 302(a)(B)(iii) there are two other categories of dividends not included in the House bill for reduced tax treatment, which are: (1) any dividend on any share of stock with respect to which the holding period requirements of I.R.C. § 246(c) have not been met, and (2) dividends for which the taxpayer is obligated (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.<sup>119</sup>

What emerged in the final version of the Act more closely resembled the House’s approach on dividend and capital gains taxes. This provision of the Act would amend I.R.C. §§ 1(h)(1)(B), and 55(b)(3)(B) each by striking “10 percent” and inserting “5 percent” (zero percent for tax years beginning in 2007).<sup>120</sup> Furthermore, I.R.C. §§ 1(h)(1)(C), 55(b)(3)(C), and 1445(e)(1) are each amended by striking “20 percent” and inserting “15 percent.”<sup>121</sup> Most simply put, the Act would make the maximum tax rate equal 15 percent for dividends paid by corporations to individuals and on individuals’ capital gains, during 2003 through 2008.<sup>122</sup> For taxpayers in the ten percent and 15 percent ordinary income tax rate brackets, the rate on dividends and capital gains is reduced to five percent in 2003 through 2007 and to zero in 2008.<sup>123</sup>

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112. *Id.*

113. *Id.*

114. *Id.* at § 302(a)(B).

115. *Id.*

116. *Id.* at § 302(a)(B)(ii)(I).

117. *Id.* at § 302(a)(B)(ii)(II).

118. *Id.* at § 302(a)(B)(ii)(III).

119. *Id.* at § 302(a)(B)(iii).

120. *Id.* at § 301(a)(1).

121. *Id.* at § 301(a)(2).

122. *Id.* at §§ 301-302.

123. *Id.*

This aspect of the Act is estimated to cost about \$150 billion.<sup>124</sup>

The Act also included the House's sunset provision (the reduction to 15 percent would expire after 2008).<sup>125</sup> The provision pertaining to the reduced taxation on dividends though is set to sunset in all tax years after December 1, 2008.<sup>126</sup>

### III. WILL THE CUT CURE THE ECONOMY?

Commentators have split over whether the Act will improve the economy. Several commentators were supportive of the Bush plan. For example, the American Enterprise Institute ("AEI") commented positively on the elimination of double taxation of dividends. John Makin, Director of AEI, believes that the new proposal is sound tax policy.<sup>127</sup> Makin believes that the double taxation of dividends has had a negative effect on growth<sup>128</sup> and that eliminating the double taxation of dividends will increase growth.<sup>129</sup> All in all, Makin believes that elimination of the double taxation of dividends is a good thing.<sup>130</sup>

Furthermore, Alan Greenspan has supported President Bush's proposed dividend tax cuts since their inception in February 2003. In

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124. *Id.*

125. *Id.* at § 303.

126. *Id.*

127. John Makin, *Makin Remarks at Hearing on Ending Double Taxation of Corporate Dividends*, 2003 TAX NOTES TODAY 45-27, March 6, 2003 ("The proposal is sound tax policy.").

128. *Id.*

The current double taxation of dividends has produced three types of behavior that penalize growth. First, double taxation encourages overreliance on debt finance by corporations . . . . Second, the double taxation of dividends encourages management to retain cash inside the corporation rather than pay it out . . . . Double taxation has indeed reduced dividend payouts and so fewer people are receiving dividends.

*Id.*

129. *Id.*

Higher after-tax returns for investors receiving dividends would increase the price they would pay for stocks of companies paying dividends. For those companies, the cost of capital would fall, they would invest more, add to the capital of stock, increase the productivity of their workers, and pay their workers higher wages. The overall stock of capital would increase while the composition of the capital stock would be improved by virtue of the removal of the distortion that generates too much capital of companies that rely heavily on debt.

*Id.*

130. *Id.*

Elimination of the double taxation of dividends constitutes low-hanging fruit in the tax reform area. It would be an excellent start down the road to full elimination of the tax on corporate income and a movement toward an integrated tax system where corporate income is imputed to its ultimate owners—households—and taxed once at that level at the same rate that all income is taxed.

*Id.*



Greenspan's February 11, 2003 testimony during the Federal Reserve Board's Semiannual Monetary Policy Report to the Congress, he stated:

Let me . . . make two points with respect to this, Senator. The first thing is I have always supported the elimination of the double taxation of dividends because I think it is a major factor restraining flexibility in our economy. And as I pointed out in my prepared remarks, that moving in a direction of improving flexibility I think has very large long-term payoffs. However, I also commented in my prepared remarks and, indeed, testified before the House Budget Committee that pay-go rules [rules requiring tax decreases to be offset by tax increases or spending decreases], which expired in September in the House, and will expire here, are very important for the budgetary process. So, in my judgment, any initiative of such a form—and I do support the elimination of the double taxation of dividends; I would prefer that it be done at the corporate level [i.e., he would prefer a corporate deduction for dividends], but I think the way it is constructed in the president's program makes a good deal of sense over the long run as well. But it should be in the context of pay-go rules, which means that the deficit must be maintained at minimal levels.<sup>131</sup>

Other commentators go so far as to criticize those who do not agree with Bush's tax cuts.<sup>132</sup> Phillip D. Morrison, in support of Bush's proposed tax changes, provided:

Democrats must not understand the Bush dividend tax plan. If they did, they'd see that it has four potentially significant ramifications that should warm the cockles of any liberal's heart. The trouble is, for the Democrats to win these four policy victories, they would have to give the Republicans a victory—a victory that Democratic 'class warriors' find hard to swallow because the 'rich' (that is, investors) stand to benefit from them. That's a real shame because these four liberal policy victories could be more far-reaching than any Republican win, should the Bush plan become law:

First, the Bush dividend tax plan would cause the public disclosure of actual federal (and creditable foreign) taxes paid by public corporations. That disclosure would give investors an important window into public companies they do not have today, and could help force companies to explain the differences between their tax and book

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131. Chairman Alan Greenspan, Federal Reserve Board's Semiannual Monetary Policy Report to the Congress, Written Testimony, Response to Questions, *at* Questions and Answers (February 11, 2003) *at* <http://www.bis.org/review/r030212a.pdf>.

132. Phillip D. Morrison, *Why Democrats Should Love Bush's Dividend Tax Plan*, 2003 TAX NOTES TODAY 47-27 (March 7, 2003).

income—a change that could, itself, force book income to be more conservatively reported.

Second, the proposed dividend tax plan would effectively put the brakes on aggressive corporate tax planning, perhaps more effectively than the disclosure and penalty-based anti-tax-shelter approaches currently in favor.

Third, the Bush plan would likely cause certain corporate taxpayers to repatriate to the U.S. at least some low-taxed foreign earnings that today are reinvested abroad.

Fourth, the Bush plan would effectively repeal the capital gains tax on stock gains that represent real earnings, while retaining the tax for speculative ‘bubble’ gains.<sup>133</sup>

Perhaps more importantly, the Treasury itself fully supports Bush’s tax cuts. Treasury Secretary John Snow has stated:

The historic agreement between the House and the Senate on the President’s Jobs and Growth Plan is a great victory for hardworking Americans. The Agreement will give the economy the boost it needs to grow and create jobs so that millions of Americans can be more secure and confident. Both now and in the future.

It contains all the elements of the President’s plan. American families will benefit from speeding up the income tax rate reductions, increasing the child credit, and providing marriage penalty relief. Small business will get help by reducing tax rates on owners and entrepreneurs, and by dramatically increasing the amount they can deduct when buying new equipment. This will create and secure jobs.

It dramatically reduces the tax on dividends and investment. This will have a profoundly positive effect on job creation, corporate accountability and the well being of all Americans. It removes barriers to higher economic growth and represents an investment in the American people and their prosperity.

This bill is good for American workers, it is good for American Families, it is good for American investors and it is good for American entrepreneurs and small business owners.

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133. *Id.*

With agreement on President Bush's Jobs and Growth plan, the elements are there for the economy to continue its recovery in the second half of the year.<sup>134</sup>

However, some commentators were harsh in their criticism of the President's tax cuts. In an article by Harold Pepperell, the author stated:

In a sense, you almost have to feel sorry for the Bush administration ideologues who are trying to put together a coherent tax program that will stimulate long-term economic growth. It appears their original intentions may have been good but somewhere along the line they got hijacked by their obsession with the notion that lopsided tax cuts for the rich are the answer to everything, and miss their mark.

Take their proposal to eliminate the tax on dividends, which they have made the centerpiece of their tax cut program. It accounts for \$364 billion of the \$674 billion total. Their theory is that giving the richest 10 percent who own 86 percent of all securities a \$364 billion gift by eliminating the tax on dividends will boost the stock market, and that the recipients of this bonanza will reinvest the money in the market. They assume this equates with economic growth.<sup>135</sup>

Earlier this year, several Nobel Laureate Economists argued that Bush's tax cuts are "misguided."<sup>136</sup> One of the economists believes that the double taxation problem is not an essential problem that needs to be addressed immediately.<sup>137</sup> This same economist feels that the elimination of double taxation will do little to increase stock prices.<sup>138</sup> The economist further argues that a more sound fiscal policy would call for elimination of the tax on the corporate side rather than on the individual investor's side.<sup>139</sup> In addition, the economist argues that if Bush was truly concerned with the middle class and alleviating their double tax

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134. From the Office of Public Affairs, U.S. Treasury Department, *Treasury Secretary John Snow Statement on the House-Senate Conference Agreement on the Jobs & Growth Package*, at <http://www.ustreas.gov/press/releases/js407.html> (May 22, 2003).

135. *Id.*

136. Patti Mohr, *Nobel Economists Call Bush Tax Plan 'Misguided'*, 2003 TAX NOTES TODAY 28-1 (February 10, 2003) [hereinafter *Nobel Economists*].

137. *Id.* "Modigliani argued that the 'double tax' on corporate earnings is 'clearly not an urgent problem' that needs to be addressed. He said the current system works to encourage investment by subsidizing retained earnings." *Id.*

138. *Id.* "According to Modigliani, the dividend tax exclusion would do nothing to increase the stock price because it would not change the market price to corporate earnings ratio. He argued further that lawmakers should not use fiscal policy to increase stock prices." *Id.*

139. *Id.* "A better way to alleviate the double tax would be to eliminate the proportion of the tax on the corporate side, Modigliani said. He argued that Bush's decision to cut the tax on the shareholder side means that it is merely 'a program that enriches the rich.'" *Id.*

issues, Bush has other alternatives to focus his economic policy that would better serve the middle class.<sup>140</sup> Moreover, the economist argues that Bush's motive for eliminating the double tax on dividends is really just the first step in eliminating the progressive tax system.<sup>141</sup> Furthermore, another of the economists believes that eliminating the double tax will create a worse financial situation than we face currently.<sup>142</sup> Lastly, the economists argue that eliminating the double tax will just further complicate the tax system.<sup>143</sup>

An additional and more recent criticism of President Bush's plan has come from the Center on Budget and Policy Priorities ("CBPP").<sup>144</sup> In its report, CBPP criticizes the tax cut package tentatively agreed to by the administration and the Republican congressional leaders by arguing that the tax cuts are "heavily tilted" toward the nation's wealthiest individuals.<sup>145</sup> CBPP also argues that the "massive" use of gimmicks masks the Act's true cost. Rather, CBPP argues that the true cost of the Act in the long-run will be more than double what Congress is estimating right now.<sup>146</sup> This is mainly due to the fact that, even though the tax cuts are expected to sunset in 2008, both President Bush and congressional leaders have stated that they will seek to extend the tax cuts beyond the 2008 expiration date.<sup>147</sup>

Democrats have echoed the sentiment that the tax cuts will in

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140. *Id.*

Modigliani argued that if Bush is 'really concerned about double taxation,' he would address the double tax associated with Social Security, which he said discourages workers from saving for their retirements. Current law requires workers to pay more than 12 percent of their payroll toward FICA taxes and also taxes Social Security benefit payments that retirees receive. Modigliani said the end result is a 'double tax' that burdens middle-class retirees the most.

*Id.*

141. *Id.* "Modigliani suggested that the White House is proposing the dividend exclusion because it would be the first step toward eliminating the progressive tax on income." *Id.*

142. *Id.* "[T]he Bush proposal would worsen the fiscal situation with large and 'looming' deficits and would increase the growing wage gap." *Id.* (quoting Joseph E. Stiglitz).

143. *Id.* "[The economists] asserted that the dividend exclusion is misdirected to shareholders rather than corporations, is overly complex, and is not part of a revenue-neutral tax reform effort." *Id.* "[T]he White House dividend exclusion plan is based on a 'very simplistic argument' in favor of 'eliminating the double tax' on dividends. Although the slogan sounds simple, [Klien] said the plan would actually make the tax system more complicated." *Id.* (quoting Lawrence R. Klien).

144. *CBPP Critiques Conference Agreement, Costs of Tax Cut*, 2002 TAX NOTES TODAY 100-23 (May 22, 2003).

145. *Id.*

146. *Id.*

147. *Id.* "Although all provisions except one are scheduled to expire between the end of 2004 and 2008, the GOP leadership and the administration have indicated they intend to seek extensions on most of these provisions. If these provisions were extended, the true cost of the bill through 2013 would be \$810 billion to \$1.06 trillion." *Id.*

reality cost more than Republicans estimate.<sup>148</sup> They fortify this argument by pointing to the fact that the original estimates of the Senate bill by the Joint Committee on Taxation (“JCT”) were erroneous.<sup>149</sup> According to Democrats, when JCT published the cost of the Senate bill, it “assumed that the Senate wanted to eliminate the tax on dividends paid by a single year’s worth of corporate profits. In fact, the Senate bill would have allowed corporations to pay dividends tax-free using many past years of profits, which would be much more expensive for the Treasury.”<sup>150</sup> Senator Tom Daschle (D-South Dakota) stated that the difference between the estimated costs “could be in the tens of billions of dollars.”<sup>151</sup>

However, the most compelling criticism of Bush’s tax cuts is from an article written even before Bush was President.<sup>152</sup> In that article the author discussed the benefits of having a surplus as opposed to a deficit. When Bush inherited the Presidency there was a \$69 billion surplus<sup>153</sup> and three years into his presidency there is now a deficit and it is projected to grow substantially over the next few years.<sup>154</sup> The article points out that with a surplus the modernization and reformation of Social Security and Medicare will be possible, plus the United States will be able to finally reduce the national debt.<sup>155</sup> The reformation and modernization of Social Security and Medicare are important programs to fund, mainly due to the fact that very shortly the Baby Boomer generation is set to start retiring and without the money to provide for these programs many of these Baby Boomers may face hard times when they do retire.<sup>156</sup> However, the surpluses that grew in the 1990’s came about due to a completely different attitude in spending and tax cuts than currently exists in the White House. “The 1990 rules required that laws

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148. See New York Times Service, *House Republicans Agree to Suspend Dividend Tax*, THE MIAMI HERALD, May 21, 2003, at 15A.

149. *Id.*

150. *Id.*

151. *Id.*

152. Jeff Lemieux, *Federal Budget Policy and the Surplus: Federal Budgeting in an Era of Surpluses*, 5 GEO. PUB. POL’Y REV. 7 (Fall 1999).

153. *Id.* at 7.

154. U.S. Department of Treasury, *The Debt to the Penny*, at <http://www.publicdebt.treas.gov/opd/opdpenny.html>, has the current U.S. debt at \$6,580,840,027,529.36 as of June 13, 2003. The national debt in 2000 was \$5,674,178,209,886.86. *Id.*

155. Lemieux, *supra* note 153, at 8. The author provides that, “if taxes are not cut and spending programs hold to current law, there is a good chance the federal budget will remain in surplus for several years and that a significant portion of the national debt will be paid off.” See also Table One provided in the author’s article.

156. *Id.*

cutting taxes or raising entitlements spending be offset by equivalent tax hikes or spending reductions elsewhere in the budget.”<sup>157</sup> More or less, under the Budget Enforcement Act of 1990<sup>158</sup> Congress adopted “a pay as you go rule for taxes and entitlements, and caps on so-called discretionary spending (mostly domestic and defense spending).”<sup>159</sup> Bush’s tax cuts have the potential to seriously harm the ability of the government to provide Social Security and Medicare for the soon-to-be retired Baby Boomers if the deficit keeps on climbing as is expected.<sup>160</sup> Therefore, a good argument could be made against Bush’s tax cuts, due to the fact that it will leave no money to help provide for the Baby Boomers’ retirement. Without this money, the plight of the elderly will only get worse. As a “compassionate conservative,” Bush should be aware of these looming problems and look to not only providing a temporary boost for the U.S. economy but also a boost that will provide for the future of all Americans.

Furthermore, even some well-to-do individuals, who are estimated to benefit the most from Bush’s recent tax cuts, are critical of them. Warren Buffet has noted, “[Buffet] already pays no greater share of his huge income in total taxes than does his receptionist.”<sup>161</sup> Furthermore, billionaire George Soros told CNBC that the tax cut is “basically using the recession to redistribute income to the wealthy.”<sup>162</sup>

Clearly, there are both positive and negative attributes associated with the Act and its key component: the elimination of the double taxation of dividends. Many people believe that the elimination of the double taxation of dividends will spur economic growth.<sup>163</sup> According to the White House, the President’s tax cuts will spur economic growth in three ways: (1) by encouraging consumer spending that will boost the economy and create jobs; (2) by promoting investment by individuals and businesses that will also lead to economic growth and job creation;

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157. *Id.* at 10.

158. 2 U.S.C. § 900 (2000) encodes the BEA.

159. Lemieux, *supra* note 153, at 10. *See also* Omnibus Budget Reconciliation Act of 1993 (Pub. L. 103-66); the Balanced Budget Act of 1997 (Pub. L. 105-33); Taxpayer Relief Act of 1997 (Pub. L. 105-34). “The 1993 law included spending cuts and tax hikes to reduce the deficit. The 1997 bills actually cut taxes but reduced the deficit by cutting projected spending by an even greater amount.” Lemieux, *supra* note 153, at 10.

160. *See* U.S. Department of Treasury, *The Debt to the Penny*, at <http://www.publicdebt.treas.gov/opd/opdpenny.htm>.

161. Jodie T. Allen, *Don’t Blow it all in One Place*, U.S. NEWS & WORLD REPORT, June 9, 2003, at 31, available at <http://www.usnews.com/usnews/issue/030609/opinion/9money.html>.

162. *Id.*

163. *See supra* notes 127, 131-34, and accompanying text for a discussion of those in favor of the Act.

and (3) by delivering critical help to unemployed citizens.<sup>164</sup> The President believes the plan will meet these goals by putting more money in taxpayers' hands, by speeding up the 2001 tax cuts, by encouraging investment since there will no longer be a double taxation on dividends, by offering assistance programs for small businesses as they grow through an increase in the expensing limits, and by adding monetary incentives to unemployed workers to find work as quickly as possible.<sup>165</sup> It is estimated by the Council of Economic Advisers that the President's plan will help the economy create more than 1.4 million jobs by the end of 2004.<sup>166</sup>

It is not only the White House stating that Bush's tax cuts, especially the elimination of the double taxation on dividends, will positively impact the economy. For example, Nobel Laureate Milton Friedman has stated that:

Tax cuts that increase incentives to produce and that eliminate distortions in the price system—supply-side tax cuts—give a double whammy. They restrain government spending and increase future income and current wealth. Permanent tax cuts are much to be preferred to temporary cuts. They are a stronger restraint on spending and do not need to be repeated.<sup>167</sup>

Therefore, there is clearly some expectation among several economists that the tax cuts will boost the economy, even if the boost is short term relief only.

#### IV. CONCLUSION

On May 23, 2003, a final version of President Bush's proposed tax cuts was finally approved by both Houses of Congress<sup>168</sup> and signed into law by President Bush on May 28, 2003.<sup>169</sup> Congress and President Bush have promoted this bill to the American public as the cure to fix

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164. White House Press Release, *President Bush Taking Action to Strengthen America's Economy*, at <http://www.whitehouse.gov/news/releases/2003/01/20030107.html> (May 27, 2003).

165. *Id.* The President's plan would create new employment accounts that would give unemployed workers, if they qualify, up to \$3,000 in assistance in job hunting. If those individuals find jobs quickly, the remaining balance of their employment accounts would be given to them in cash.

166. *Id.*

167. Dept. of Commerce Press Release, *Sec. Evans Takes Bush Economic Growth Message to Dallas Business*, at [http://www.commerce.gov/opa/press/2003\\_Releases/April/04\\_dallas\\_release.html](http://www.commerce.gov/opa/press/2003_Releases/April/04_dallas_release.html) (April 4, 2003).

168. The Vermont Republican Party, *President Bush's Economic Growth Plan Wins Praise*, at [www.vermontgop.org/the\\_right\\_medicine.html](http://www.vermontgop.org/the_right_medicine.html) (May 27, 2003). See *Draft Version*, *supra* note 9.

169. *Bush Signs*, *supra* note 14.

America's ailing economy.<sup>170</sup> The Act will have several significant effects on taxpayers, including a reduction in the double taxation of corporate dividends,<sup>171</sup> the expansion of the child tax credit,<sup>172</sup> and other amendments designed to help provide tax relief to married couples and small businesses.<sup>173</sup> The effectiveness of the Act has been the subject of much public debate.<sup>174</sup> Some commentators have avidly supported President Bush with the proposed tax cuts,<sup>175</sup> while others have complained bitterly that the tax cuts are too expensive and only favor wealthy Americans.<sup>176</sup> Several commentators believe that the tax cuts will spur the economy at least in the short run.<sup>177</sup> However, the effectiveness of the tax cuts is a question that only time will tell and, therefore, will be an issue to watch carefully in the coming months.

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170. *See Senate Passes, supra* note 35

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *See Makin, supra* note 127.

177. *See, Nobel Economists, supra* note 137.