Summary

Penn Wharton Budget Model projects that the Senate TCJA satisfies the budget resolution requirement of reducing revenue by less than $1.5 trillion over the next 10 years. However, the Senate TCJA reduces net revenue in several years beyond the 10-year budget window. The Senate TCJA, therefore, fails a key provision of the Byrd Rule, which prohibits provisions in budget reconciliation that reduce net revenue in any year after the 10-year window.

Key Points

- To use the reconciliation process that allows certain bills to pass with a simple majority vote in the Senate, the Senate Tax Cuts and Jobs Act (amended) must satisfy the Byrd Rule.
- PWBM projects that the Senate bill will satisfy one part of the Byrd rule, as the 10-year net revenue shortfall will be less than $1.5 trillion in the associated budget resolution.
- However, the Byrd Rule also requires that bills do not reduce net revenue (revenue net of outlays) after the 10-year budget window. Thus far, government scorekeepers have not weighed in on the Rule publicly. PWBM, however, projects that the provisions in the Senate TCJA will reduce net revenue in each year from 2028 to 2033 and will therefore fail the Byrd Rule.

The Senate Tax Cuts and Jobs Act, Amended (11/15/17): The Byrd Rule

Introduction

Penn Wharton Budget Model (PWBM) previously reported static and dynamic analysis of the (amended) Senate Tax Cuts and Jobs Act (TCJA), as of November 21, 2017. This brief reports on the consequences for the Byrd Rule. Readers are encouraged to read some of our previous analyses for related definitions used in this brief.

The Budget Reconciliation Requirement

To maintain consistency with budget reconciliation requirements, the amended Senate TCJA involves numerous major sunsets (expiry of provisions), discussed in our static and dynamic analysis of the amended bill. The amendments aimed to satisfy the fiscal year 2018 budget resolution that the bill not lose more than $1.5 trillion dollars over the first 10 years. PWBM projects the Senate bill, as amended, will lose $1.3 trillion on a static basis, including changes in outlays in the 10-year window, consistent with Joint Committee on Taxation's (JCT) definition. (The reduction in outlays includes, in particular, changes made to the Affordable Care Act.) This total revenue loss, therefore, satisfies the budget resolution for use in the reconciliation process, which requires only a simple majority of votes in the Senate. However, meeting the budget resolution's maximum net revenue loss target satisfies only one part of the Byrd Rule.

Net Revenue Losses in Any Year outside of the 10-Year Budget Window

PWBM projects that the bill will actually slightly raise some revenue (about $25 billion) over the entire period between 2027 (the last year of the budget window) and 2040. However, Table 1 below shows that in *each* of the years between 2027 and 2033, PWBM projects that the bill will continue to reduce revenues net of outlays, not

including the additional costs of debt service. In contrast, the Byrd Rule prohibits a decrease in net revenue in *any* year after the 10-year budget window, not just revenue neutrality across time after the first 10 years. As a result, by our calculations, the Senate's TCJA (Amended) does not satisfy one of the key requirements of the Byrd Rule.

Table 1: Estimates of the Effect of the Senate Tax Cuts and Jobs Act on Federal Tax Revenues and Outlays by Year

Year	Revenue Change (billions of $)	Outlay Change (billions of $)	Revenue Net of Outlay Change (billions of $)
2018-2027	-1,639	-312	-1,327
2028	-80	-50	-29
2029	-75	-53	-21
2030	-71	-55	-15
2031	-67	-57	-9
2032	-68	-59	-8
2033	-64	-61	-3
2034	-62	-63	1

Note: Revenue and outlay estimates do not include the cost of debt service.

Explanation

There are three reasons for the reduction in revenues net of outlays after the 10-year window: (a) permanent revenue losses due to a lack of offsetting sunsets; (b) income shifting to years within the 10-year window to exploit sunsets; and (c) reclassification of income to exploit differences in marginal tax rates, potentially permanent or due to sunsets.

The largest permanent revenue loss comes from the permanent "New corporate tax rates and repeal of corporate Alternative Minimum Tax (AMT)" that we estimated in our static analysis. This cost is only partly offset by the sunsetting of individual "New tax rate and bracket structure" that we estimated.

Income shifting occurs when taxpayers shift the realization of income toward tax years with lower tax rates. For the Senate bill, we estimate that some income will be shifted to be realized within the 10-year budget window to take advantage of lower tax rates before they sunset. This shift reduces realized income after the 10-year window, making compliance with the Byrd Rule more challenging. *Income reclassification* further exploits differences in marginal tax rates between types of income (e.g., regular income versus pass-through or corporate), potentially due to permanent tax rate difference or due to sunsets. Like the JCT, PWBM incorporates behavioral responses to changes in marginal tax rates.[1] PWBM uses an elasticity of taxable income in the middle of the elasticity range presented by Saez, Slemrod and Giertz.[2]

The Byrd Rule states that if the net effect of a bill increases the deficit in any year beyond the 10-year window then any provision that increases the deficit beyond the window can be struck. As noted above, the individual "New tax rate and bracket structure" provision sunsets. Nonetheless, we estimate that the shifting of income to inside the 10-year window will then reduce net tax revenue collected outside of the 10-year window, thereby

contributing to raising the deficit at that time. As a result, the individual tax provision, even with its sunset, could be struck in its entirety if the Senate Parliamentarian makes a similar determination following a point of order.

How might Senate TCJA (Amended) Pass the Byrd Rule?

The Senate Parliamentarian, in consultation with official budget scorekeepers (the JCT and CBO), has not yet weighed in publicly on Byrd Rule compliance. Such determination would usually occur following a point of order made by a senator after the bill is introduced for a vote. Of course, when making amendments, official scorekeepers might have provided non-public estimates to bill writers pertaining to Byrd Rule compliance. If official scorekeepers, for example, determine the net effect of the bill does not increase the deficit in any year beyond the 10-year window, potentially due to substantially less income shifting than we estimate, then the Senate Parliamentarian might determine compliance with the Byrd Rule following a point of order. However, barring changes to the bill, PWBM estimates that, based on its own model, the Senate bill does not satisfy the Byrd Rule, despite recent amendments.

Conclusion

PWBM projects that the Senate tax bill, as amended, satisfies the budget resolution that requires the tax bill to reduce revenue by less than $1.5 trillion within the 10-year budget window. However, we estimate that the Senate TCJA continues to reduce revenue in years beyond the 10-year budget window. Bills that reduce net revenue after 10 years do not satisfy the Byrd Rule to qualify for use of the reconciliation process.

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1. See "Overview of Revenue Estimating procedures and methodologies used by the staff of the Joint Committee on Taxation JCX-1-05." ↩
2. "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review." Journal of Economic Literature 2012, 50:1, 3–50. (Previously, NBER Working Paper No. w15012.) ↩