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The Byrd Rule & Tax Reform

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Congress is getting close to voting tax reform and relief legislation into law through the Tax Cuts and Jobs Act (TCJA). The goals of tax reform are to lower rates and simplify the tax code for individuals by increasing the standard deduction and eliminating many special tax preferences for wealthier Americans. On the business side, reducing rates will grow the economy, create jobs, and restore U.S. competitiveness abroad.

The task of bringing lawmakers to a consensus on such major, complex legislation is difficult enough, but the process of moving the legislation has its own set of challenges owing to the need to pass muster with the Senate's "Byrd rule." This well-intentioned rule ultimately leads to some bizarre legislative maneuverings.

The Process and Reconciliation

Moving legislation in the Senate can be challenging, unless one party has a supermajority. Under regular order, legislation could face a filibuster, a parliamentary tactic used to delay or prevent the Senate from closing debate and proceeding to a vote on legislation. Closing a filibuster requires a petition for cloture signed by 16 Senators followed up with a vote achieving a three-fifths majority.

To avoid the 60-vote hurdle, the Senate has increasingly made use of the reconciliation process, a process originally intended to "reconcile" budget numbers with a simple majority vote. Filibusters are not permitted under reconciliation and debate is limited to 20 hours (10 hours for a conference report). However, this process has its own special rules and limitations.

Reconciliation can be used for legislation to change "mandatory" or entitlement spending like Medicare and Medicaid (though any changes to Social Security face a higher bar), tax revenues, and the federal debt limit. Before proceeding with reconciliation, the House and Senate must agree to a budget resolution with instructions to congressional committees specifying changes in the budget categories under their jurisdiction. Typically, resolutions are drafted for a ten-year budget window. Although reconciliation requires a minimum of a five-year window, lawmakers can set it for any longer horizon. Additionally, reconciliation can only be used once per year for each of the specified areas, unless Congress passes a revised budget resolution.

After the committees draft specific legislation to meet the reconciliation targets, the

Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) produce cost estimates and assessments of the changes. JCT reports on revenue changes (and the outlay effects from refundable credits), while CBO includes JCT's figures and adds in spending changes and economic projections. These analyses must be included in the committee reports on the legislation, but only if they are submitted in a timely manner.

The Byrd Rule

The reconciliation legislation then must be able to withstand points of order under the "Byrd rule." Named for former Senator Robert Byrd (D-WV), the rule originated as an amendment to the Consolidated Omnibus Budget Reconciliation Act of 1985 and was made permanent in 1990. The Byrd rule blocks provisions that:

- are extraneous,
- change Social Security,
- increase deficits outside of the 10-year budget window,
- to achieve the reconciliation instructions,
- produce no change in revenues or spending, and
- make "incidental" changes that don't alter the overall level of spending or revenues.

A Byrd rule point of order can be called against any section of the legislation, or against any amendment or section of an amendment. Whether a provision is an "extraneous item" is subject to the interpretation of the presiding officer, who generally relies upon guidance from the Senate Parliamentarian. Waiving the Byrd rule requires 60 votes. If the challenge is sustained, the offending section is stricken, leaving the rest of the underlying bill or amendment intact.

The reconciliation process was originally designed with the idea of enabling an easier path to passage for deficit reduction legislation. But because of the difficulty of moving legislation through the Senate under regular order subject to a filibuster, reconciliation has been used to enact tax relief (such as President George W. Bush's tax cuts through the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003), welfare reform (the Personal Responsibility and Work Opportunity Act of 1996), and was also used to consolidate all new federal student loans through the Direct Loan program and enact the subsidies in the Affordable Care Act (Health Care and Education Reconciliation Act of 2010).

TCJA and the Byrd Rule

This year, the House and Senate agreed on a budget resolution with reconciliation instructions providing for $1.5 trillion in tax cuts over the next ten years. The House Ways and Means Committee and the Senate Finance Committee then set to work, separately, to fill in the details to achieve that target. In the Senate, the bill language had to be navigated around the peculiarities of the Byrd rule, leading to some odd provisions.

One of the main techniques employed over the years to avoid the Byrd box is to delay or sunset the implementation of good provisions. The Bush tax cuts of 2001 and 2003 present prime examples of this practice. Because the Byrd rule prohibits deficit increases beyond the period of the budget resolution, the tax cuts were drafted to expire in 2010. This temporary policy led to a "fiscal cliff," as taxpayers faced the prospect of a painful tax hike as the cuts were set to expire. After a two-year extension, the tax cuts were eventually made permanent for individuals with income under $400,000 ($450,000 for joint filers).

The TCJA also includes provisions that sunset. JCT's score of the version of the TCJA as passed by the Senate identified 28 expiring provisions, including the increased standard deduction and the individual income tax rate reductions, the treatment of business "pass-through" income to individuals, the elimination of the state and local income tax deduction, and the capping of the property tax deduction, all of which would sunset after 2025. While the House bill scrapped both the estate tax and the Alternative Minimum Tax, the Senate bill retains them while reducing the number of filers impacted by the double-filing system. These funds were used to expand the tax cuts for pass-throughs. The reduction in the corporate income tax would be delayed until 2019. In total, the bill remains under the resolution cap at $1.447 trillion.

Changes were made along the way with the Byrd rule in mind. Originally, Republicans hoped to completely repeal the state and local tax deduction. Doing so would provide $1.27 trillion in revenue to plow into general tax reform. But to secure votes for passage, a compromise was struck to cap the deduction at $10,000. In order to maintain compliance with the Byrd rule, revenue had to rise elsewhere in the bill to "pay for" this change. Among other things, the corporate tax rate in the bills jumped from 20 percent to 21 percent.

The bill also would reform how taxes are adjusted for inflation by switching from the current Consumer Price Index (CPI) to a measure called "Chained-CPI," a methodology that takes into account how in certain circumstances consumers respond to higher prices through substitution of related, cheaper goods. Thus, under this calculation, inflation grows more slowly, which would mean that the bracket thresholds would be adjusted more slowly. Originally, H.R. 1 delayed use of Chained-CPI until 2023, but it was modified a few days later to take effect in 2018, thus providing more revenues for tax reductions, again in an effort to stick to the $1.5 trillion target.

A late revision to the bill added a repeal of the Affordable Care Act's (ACA) individual mandate. This idea, left over from the failed attempt earlier in the year to repeal and replace the ACA, would reduce the deficit by $338 billion through 2027. This provided additional room underneath the Byrd rule cap to expand the tax breaks for pass-throughs, adopt a revenue-losing compromise on SALT, and other changes.

The Dark Side of Sunsets

Relying on sunset provisions, though, can be a double-edged sword—on the one hand it produces budget projections from CBO and JCT that adhere to the limit set in the resolution. But on the other hand, it makes it impossible to predict the actual course of policy in coming years, as congressional action on extensions is always uncertain. In this case, Republicans have made business taxes permanent (though the Senate version currently phases in the rate reduction) and numerous items on the individual side are phased out in 2025. This stratagem dares Democrats to oppose extension before their expiration dates. As NTUF covered in a previous edition of The Baseline, Congress regularly enacts tax extender packages due to baseline and scoring issues. Republicans argue that the tax cut provisions that are sunset will be made permanent before they expire. As White House Office of Management and Budget Director Mick Mulvaney said, "What we tell folks is this: If it's good policy, it will become permanent. If it's bad policy, it will become temporary."

But in the meantime, opponents of reform will not let pass an opportunity to complain that the tax cuts for individuals will only provide short term, illusory benefits. This also leads to headlines like this one in the Washington Post: "The GOP's model family gets a tax cut in year 1 … and a tax hike in year 7."

Dynamic Scoring and the Byrd Rule

Congressional leaders do have some options to address the policy problems caused by gaming proposals to the budget score. They could have established a larger budget window in the resolution. Though the Byrd rule would still be in effect in years beyond the resolution, this would allow the reforms to extend longer before they would be sunset and need to be re-addressed.

In addition, dynamic scoring would provide a picture of how the economy will respond to changes in tax law. Most experts agree that tax cuts don't pay for themselves, but with the right mix of proposals, they can grow the economy and boost jobs, offsetting a portion of the revenue reductions. Dynamic scores provide a baseline projection under current law, and then a second number incorporating the macroeconomic feedback on jobs and economic growth that would occur under the proposed legislation. For example, JCT's dynamic score reduced the revenue loss under a tax extender package by 11 percent.

The JCT's dynamic score projected $458 billion in revenues from economic growth under the Senate's bill and $483 billion in the House's version, additional potential resources for broader tax reform that are excluded under current Senate rules. Moreover, JCT's methodology, which only sees anemic 0.7 to 0.8 percent growth, is on the low end of projections that forecast annual GDP growth from 2.8 percent to 3.8 percent.

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Unfortunately, under the Byrd rule only one score can be used on the Senate floor. This means that dynamic scores serve an advisory function to Congress, but cannot provide the numbers by which Byrd rule compliance is measured.

Conclusion

The Byrd rule has been criticized for blocking good reforms via reconciliation as well as leading to gaming of the score. The good news is that Congress can always go back to take another bite at the apple. This happened in 1986 as Congress and President Reagan worked on the last major tax reform effort. Reformers hoped to include additional measures to simplify the enforcement of certain excise taxes and to establish a taxpayer Bill of Rights. But because the proposals would not have a direct impact on spending or revenue levels they were unlikely to survive a Byrd Rule challenge. Thankfully, Congress included the legislation in the Technical and Miscellaneous Revenue Act of 1988.

This provides a valuable reminder today. Although there are other seemingly no-brainer reform recommendations – such as repealing the Foreign Account Tax Compliance Act – that are not included in either the House or Senate version of the TCJA, those ideas will live to fight another day.

It is important to consider how proposals will impact the budget, and the Byrd rule does impose discipline that forces members to weigh options. Any push to restore any of the targeted tax breaks that are repealed under the bill must be offset somewhere else. But the bottom line is that Congress should look to specific components of tax reform that get the best bang for the buck in terms of generating growth: ideas like full expensing and incentives to boost the stock of capital through saving and investing and job growth. Providing a consistent baseline policy and more transparency on the models used by CBO and JCT will also help provide taxpayers and lawmakers with honest budget figures.

The longevity of tax cuts faces a more serious threat. As Romina Boccia and Adam Michel warn, “Tax cuts without offsetting spending reforms are historically short-lived.” On an annual rate since 1940, federal spending has averaged 20 percent of GDP, while the tax receipts flowing into the Treasury have averaged 17 percent. Tax reform will allow Americans to keep more of what they earn and help grow the economy. But Congress and the President must adhere to the spending caps enacted in the Budget Reform Act and put other options on the table to address runaway spending.