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The Amazing Disappearing Tax Revenue
Officials, Economists Ponder Whereabouts

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The exploding federal budget deficit has triggered fierce recriminations among politicians over who is to blame, but in Washington's less-partisan budget circles, the White House's projected $455 billion deficit for 2003 has underscored a growing mystery: Where has all the tax revenue gone?

"No one knows," said Douglas Holtz-Eakin, the director of the nonpartisan Congressional Budget Office. "Not answering the question is just admitting our ignorance."

Washington's tax take has fallen for three straight years, a phenomenon not seen since the Great Depression. But unlike then, the economy is actually growing, albeit slowly. As of June 30, the first nine months of this fiscal year, individual income tax receipts have fallen to $605 billion, down $39 billion from the comparable period last year, the Treasury Department said Wednesday. Corporate income taxes slid to $98 billion from $116 billion.

A sluggish economy and tax cuts certainly bear much of the responsibility, budget experts say. But neither factor can completely explain the $269 billion slide in tax receipts since 2000.

"The fact is, CBO, [the White House,] Treasury don't know what's happening right now, other than we're getting less revenue," said Dan L. Crippen, a recently retired Congressional Budget Office director. "It's kind of a sad state of affairs."

As the stock market bubble burst and the economy slipped into recession in 2001, the first budget adjustments were straightforward. White House and congressional budget economists lowered projections of income tax revenue and sharply reduce expectations on capital gains taxes from the sale of stocks.

In January 2001, the CBO forecast that capital gains tax receipts this year would reach $119 billion. By January 2003, that forecast had been knocked down to $51 billion -- below 1996's level. Predictions of individual income tax receipts for 2003 fell this year to $899 billion from 2001's estimate of $1.18 trillion.

With the passage of each of three tax cuts since 2001, budget forecasters reduced tax revenue forecasts. For this fiscal year's projection, the White House even arbitrarily knocked off $25 billion from expected tax revenue just in case.

But even after those adjustments were made, tax revenue has continued to fall well below expectations. Last week's forecast by the White House determined that tax receipts for 2003 would be $80 billion lower than anticipated just six months ago. For fiscal 2004, estimated receipts were adjusted downward by nearly $125 billion. At a loss, White House economists lopped off another $15 billion from their 2003 tax receipt forecast and $30 billion from their 2004 projection.

Economists say the problem is a data lag: It takes the Internal Revenue Service two years to itemize its massive tax take into separate taxation categories. The CBO just got its hands on the IRS's detailed tax data from 2001. In the absence of a precise breakdown, forecasters simply watch four large categories as they flow in: corporate taxes, individual income taxes withheld by employers, individual income taxes mailed in as estimated tax payments and end-of-the-year payments, and payroll taxes for Social Security and Medicare.

They watch those large piles of money in the context of broad economic trends, watch for abnormalities, such as corporate taxes falling behind corporate profits, then try to divine the future.

A White House economist, speaking on condition of anonymity, pointed to two large pots of money that remain strangely depleted: corporate taxes and non-withheld income taxes, those tax checks individuals send in as estimated payments or with their tax returns. That is only a clue, the official said.

"We can pinpoint the location of the error, but we can't say the cause," he said.

Budget experts have hunches, and they continue to think the stock market is the culprit.

Robert D. Reischauer, a former CBO director now at the Urban Institute, said income tax receipts in the late 1990s were probably inflated by huge bonuses, sales commissions and the redemption of stock options, all of which depended in part on swollen stock prices.

Unlike capital gains taxes, those windfalls are reported as ordinary income, not a separate line item in tax data. Determining just how much of the tax take of 2000 came from bonuses and stock options is next to impossible, and so is backing those factors out of current projections. But they do tend to come to the Treasury as non-withheld income taxes.

Likewise, past capital losses and other adverse impacts of the 2001 bust may still be depleting tax takes, because they can be used to offset current taxation. That could be depleting corporate taxes.

Reischauer provided his own example. After the bust, he continued paying his estimated quarterly taxes at basically the rate he had paying during the boom, ultimately overpaying taxes for two years. When the IRS asked if he wanted a refund, he opted to credit the overpayment to this year's taxes.

"OMB and CBO have no idea what is attributable to taxpayers like me," Reischauer said. "I'm not terribly critical about what the administration has put out," added Reischauer, who is a Democrat.

Crippen also suggested that rising health care costs are causing corporations to shift some taxable wages to untaxed health benefits.

But how to quantify any of this for the purpose of a budget projection is simply unknowable, budget experts say.

"Federal budget forecasts are only good until lunch tomorrow," said Stan E. Collender, a federal budget expert at Fleishman-Hillard Inc. "Anything after that is just a guess."

The White House economist made no apologies for missing revenue targets, nor did other independent economists. After all, they noted, the administration's projections have been no more wrong than the forecasts of CBO or private-sector economists.