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THE RANGEL AMT PROPOSAL VERSUS UNPAID-FOR REPEAL OF THE AMT: WHICH IS BETTER TAX REFORM?

By Aviva Aron-Dine

KEY FINDINGS

- Rep. Charles Rangel's proposal to replace the Alternative Minimum Tax with an income tax surcharge meets the criteria for tax reform. It would be simpler and more progressive — and likely more economically efficient — than the current AMT.
- The surcharge would affect only a small minority (about 3 percent) of households, all of them high income. It would be indexed to inflation, so it would never grow to affect the middle class.
- The proposal would reduce taxes for low-, middle-, and upper-middle-income households. It would scale back the 2001 and 2003 tax cuts for high-income households but still leave them with sizable net tax cuts. (Households with incomes over $1 million would still get an average tax cut of $21,000 in 2008, for example.)
- The proposal is also revenue-neutral, so it would add nothing to the deficit. In contrast, the proposal to repeal or sharply reduce the AMT without paying for it could add as much as $2 trillion to deficits over the coming decade (2008-2017). For this reason, the Rangel proposal would likely be better for the economy.

Last fall, House Ways and Means Committee Chairman Charles Rangel introduced major tax legislation (H.R. 3970) that would repeal the Alternative Minimum Tax and finance repeal by imposing an income tax surcharge on high-income households. The package also includes expansions of the Earned Income Tax Credit, refundable Child Tax Credit, and standard deduction and a reduction in the corporate income tax rate, financed by reforms to the corporate income tax.

This analysis focuses on the bill's AMT proposal. That proposal meets the key criteria for tax reform: it eliminates a feature of the current tax code that suffers from a number of problems and replaces the lost revenue in a way that is simpler, more progressive, and probably more economically efficient.

Republican congressional leaders have sharply attacked the Rangel plan as a massive tax increase that would seriously damage, or even "doom," the U.S. economy. This response should arouse concern from members of both political parties who envision someday enacting bipartisan tax reform legislation that, like the 1986 Tax Reform Act, is revenue neutral. If any legislation that lowers some taxes and raises others to compensate is vilified as a "tax increase," fiscally responsible tax reform will become all but impossible.

The Rangel AMT plan should be evaluated on basic tax-reform criteria. That is, it should be compared with current law and alternative proposals on such measures as revenue adequacy, equity, efficiency, and simplicity. This analysis finds that the Rangel bill scores high relative to both the existing AMT and the most frequently discussed alternative approach to AMT reform: repealing the AMT without paying for it.[1]

Rangel Bill Improves on Current Law

The Rangel bill would repeal the AMT, at a cost of about $800 billion over the next decade (2008-2017), according to the Joint Committee on Taxation. To make up for this very large revenue loss, it would implement a surcharge of 4 percent on adjusted gross income above $200,000 (above $150,000 for singles), rising to 4.6 percent on adjusted gross income above $500,000 (above $250,000 for singles).[2]

For example, a married couple with AGI of $210,000 would pay a surcharge of $400 (4% x [$210,000 - $200,000]). A married couple with AGI of $510,000 would pay a surcharge of $12,460 (4% x [$510,000 - $200,000] + 0.6% x [$510,000 - $500,000]).

The Surcharge Compared to the AMT

In response to the Rangel proposal, Senate Finance Committee Ranking Member Charles Grassley commented, "We wouldn't accomplish anything by scrapping the AMT and replacing it with something almost as bad."[3] This raises the question: is the Rangel bill's alternative way of raising revenue "almost as bad?" Answering this question requires examining each of the major complaints policymakers and analysts have voiced about the AMT and assessing whether the Rangel bill's income tax surcharge would pose similar problems or raise any major problems of its own.

1. Surcharge Would be Indexed for Inflation and Would Not Swell Over Time

The biggest concern most policymakers have about the AMT is that, if no action is taken, it will swiftly grow to affect millions of additional taxpayers. For example, under current law, 26 million taxpayers — or about *17 percent* of all households in the country — will owe AMT for 2008.

In contrast, if the Rangel plan were put into effect, no one would owe AMT, and only *3 percent* of households would owe the proposed income-tax surcharge, according to estimates by the Urban Institute-Brookings Institution Tax Policy Center. (See Figure 1.) This is less than one-fifth the share of households that would owe the AMT under current law.

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1 The bill's expansions of the Earned Income Tax Credit and refundable Child Tax Credit are also good policy. For CBPP analysis of these proposals, see Aviva Aron-Dine and Arloc Sherman, "Ways and Means Committee Chairman Charles Rangel's Proposed Expansion of the EITC for Childless Workers: An Important Step to Make Work Pay," October 25, 2007, http://www.cbpp.org/10-25-07tax.htm and Aviva Aron-Dine, "Improving the Refundable Child Tax Credit: An Important Step Toward Reducing Child Poverty," revised November 13, 2007, http://www.cbpp.org/10-24-07tax.htm.

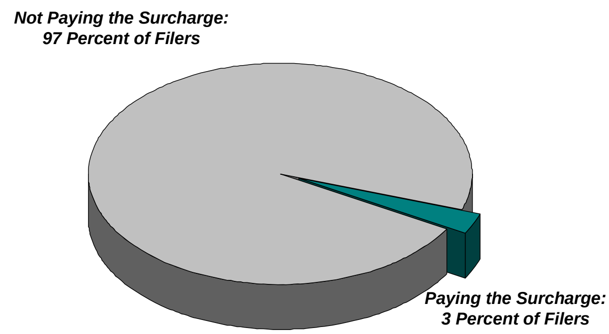
2 To be more precise, the bill sets the threshold for the 4 percent surcharge at $200,000 *or* the AGI level above which 90 percent of married couples would owe AMT under current law, whichever is higher. In practice, this entails starting the surcharge at $200,000. However, the legislative language underscores an important point: almost every married couple that would owe the surcharge — and 97 percent of married couples with AGI between $200,000 and $500,000 — would owe AMT under current law.

3 Press release from Senator Charles Grassley, October 25, 2007, http://finance.senate.gov/press/Gpress/2007/prg102507.pdf.

Moreover, while the percentage of filers that would owe the AMT is projected to continue to grow rapidly in future years, the percentage of filers that would owe the surcharge would remain at very low levels. The AMT exemption level is not indexed for inflation, so taxpayers whose earnings merely keep pace with inflation can be pushed onto the AMT as the years go by. The Tax Policy Center estimates that by 2010, some 32 million taxpayers — or 21 percent of all households — would owe the AMT under current law. In contrast, the income thresholds for the tax surcharge in the Rangel bill *would* be indexed, so no additional taxpayers would begin to owe the surcharge unless they experienced real income growth (i.e., income growth that exceeded inflation).

FIGURE 1

Proposed Surcharge Would Affect Only the Most Well-Off Households



Source: CBPP calculations based on Urban-Brookings Tax Policy Center data.
Note: TPC also estimates that, in 2008, 17 percent of filers would owe AMT under current law.

2. Middle- and Upper-Middle-Income Households Would Not Owe the Surcharge

Another common criticism of the AMT is that it is poised to become an "assault on the middle class."[4] This criticism can be overstated; under current law, the AMT would remain a very progressive tax, even though it would grow to affect increasing numbers of middle- and upper-middle-income households. Even by 2010, when a large majority of the *people paying the AMT* would have incomes *below* $200,000, the majority of the *AMT taxes paid* would still come from households with incomes *above* $200,000. (Almost none of the taxes would come from households with incomes under $75,000.) Many middle-income people would pay relatively modest amounts of AMT, while a smaller number of upper-income households would pay considerably larger amounts.[5]

Nevertheless, the proposed surcharge would be substantially more progressive. It would impose *no* tax burden on middle- or upper-middle-income households, since no married couple with AGI below $200,000 (and no single filer with AGI below $150,000) would owe it. Furthermore, *the surcharge would impose a much lower average tax burden on households in the $200,000 to $500,000 range than the AMT would*. The Tax Policy Center estimates that, in the aggregate, the surcharge would cost these households about *half* what the AMT would.[6] (See Figure 2.)[7]

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[4] Leonard E. Burman, "The Alternative Minimum Tax: Assault on the Middle Class," *Milken Institute Review*, October 29, 2007, http://www.taxpolicycenter.org/publications/url.cfm?ID=1001113.

[5] For further discussion, see Aviva Aron-Dine, "Myths and Realities About the Alternative Minimum Tax," Center on Budget and Policy Priorities, February 14, 2007, http://www.cbpp.org/2-14-07tax.htm#m1.

[6] The Tax Policy Center groups households into income categories based on cash income, a different — and generally broader — income measure than AGI. As a result, not all households in the Tax Policy Center's $200,000 - $500,000 category would owe the surcharge.

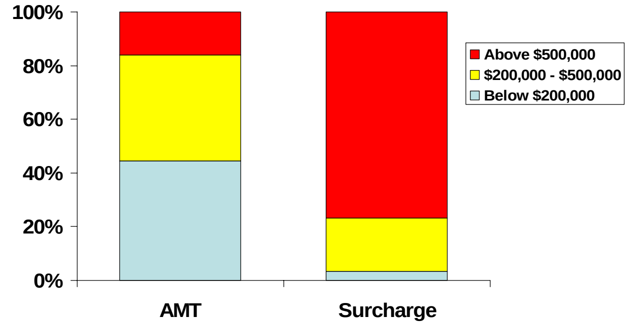
[7] In many cases, comparing shares of taxes paid does not accurately compare the progressivity of different tax policies. In this instance, however, the measure is meaningful because two criteria are met: (1) the estimates used for the two tax policies (the AMT and the surcharge) assume the same distribution of income and (2) the two policies raise the same amount of revenue. For discussion of why the shares of taxes paid measure is misleading when these criteria are not met, see Aviva Aron-Dine, "Have the 2001 and 2003 Tax Cuts Made the Tax Code More Progressive?" Center on Budget and Policy Priorities, March 19, 2007, http://www.cbpp.org/3-19-07tax.htm.

Only households with incomes over $500,000 — the group that has received by far the largest tax cuts as a result of the 2001 and 2003 tax cuts — would, as a group, pay more under the Rangel approach than under the AMT, and these households still would receive large net tax cuts from the combined effect of the 2001 and 2003 tax cuts and the Rangel plan. Analysis by the Tax Policy Center finds that if the Rangel bill were in effect in 2008, the average tax cut for households with incomes over $500,000 would still be $14,000.

FIGURE 2

Proposed Surcharge Is More Progressive Than the AMT

Distribution of AMT and Proposed Surcharge, 2010



Source: Tax Policy Center. Note: the Tax Policy Center estimates group households into income groups based on cash income, a broader measure than AGI.

3. Surcharge Would Be Extremely Easy to Calculate

The third major complaint about the AMT is that it is complicated to compute. This complexity imposes relatively little burden on most AMT taxpayers, since most of them use software (or tax preparers) to calculate their tax liability. But it does render the tax system more opaque, and it appears to frustrate taxpayers, policymakers, and analysts.

The proposed income tax surcharge would be extremely simple: it would just apply a tax rate (4 percent or 4.6 percent) to the portion of a taxpayer's AGI above a given threshold. Since filers must already report AGI on their tax forms, the surcharge would add only seconds to the process of computing one's taxes, even for those who prepare their tax returns without the help of special software.

Surcharge Would Advance AMT's Original, Legitimate Objectives

The AMT was created in 1969 with the goal of making sure that high-income households did not largely or entirely escape federal income tax through the use of deductions, exemptions, and other tax preferences. The idea was to apply a lower rate of tax to a much broader base (one without most of the exemptions, deductions, and other preferences allowed under the regular income tax). This would combat tax shelters and help ensure that all households paid their fair share in taxes.

A key criticism of the AMT is that it has evolved away from this objective in several respects:

- The AMT has accumulated loopholes of its own, since many of the tax preferences that exist under the regular income tax now apply to the AMT as well. Of the ten largest tax expenditures under the regular income tax, most are allowed at least in part under the AMT.

- Most AMT taxpayers now face *higher* marginal tax rates under the AMT than they would under the regular income tax. This is largely the result of the AMT's reach into the upper-middle class (itself a result of the fact that the AMT exemption is not indexed for inflation and the fact that regular income tax rates were lowered in 2001 *without* corresponding reductions in the AMT rates).

- The AMT misses altogether many very-high-income households that pay tax at very low rates. Because many high-income individuals receive a very large share of their income in the form of capital gains and dividends, and because capital gains and dividend income is taxed at a maximum 15 percent rate, many high-income taxpayers pay tax at very low effective tax rates — lower than many middle-income individuals pay. And since capital gains and dividends are taxed at a 15 percent rate *under the AMT as well*, the AMT fails to ensure that these individuals pay a fair share of their income in taxes.[8]

Unlike the AMT, the income tax surcharge in the Rangel bill would apply to a very broad tax base, since it would be applied to adjusted gross income. The surcharge thus would operate in a manner consistent with the AMT's original goal — ensuring that all high-income households pay at least some modest amount of income tax, no matter how many deductions and exemptions they take, what form their income comes in, or how many tax shelters they exploit.

The fact that the surcharge would be levied on a broader tax base than the AMT uses also should make it more economically efficient. Because the surcharge would apply to a very broad measure of income, it could not easily be avoided by shifting income into a different form (e.g. by recharacterizing ordinary income as capital gains) or by taking advantage of various tax breaks. Researchers have found that because taxes levied on a broader income base provide less incentive for shifting income into different forms, they induce fewer economic distortions and, all else being equal, are *more efficient economically* than taxes levied on a narrower income base.[9] (Economists across the political spectrum generally regard behavioral responses to tax preferences, such as buying a larger house so as to be able to claim a larger deduction for home mortgage interest or investing in tax planning activities so as to disguise ordinary income as capital gains, as economically inefficient.)

Finally, and perhaps surprisingly, replacing the AMT with the proposed surcharge would actually *lower marginal income tax rates* for many households. The Tax Policy Center estimates that in 2008, the Rangel plan would decrease marginal tax rates on ordinary income for *22 percent* of households, while raising marginal tax rates for only *7 percent* of households. In other words, *three times as many taxpayers would have their marginal tax rates reduced as would have them raised.* This is another channel through which the Rangel bill could improve economic efficiency.

Marginal tax rates on both ordinary income and capital gains would be lowered for many households with incomes between $200,000 and $500,000, the income range in which the AMT exemption now phases out. That phase-out raises marginal rates on both ordinary income and capital gains. As a result, repealing the AMT, as the Rangel bill would do, lowers marginal tax rates in that income range.[10]

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[8] For further discussion, see Citizens for Tax Justice, "A Progressive Solution to the AMT Problem," December 2006, http://www.ctj.org/pdf/amtsolution.pdf. The AMT does impose a higher tax rate on capital gains and dividend income for households in the AMT exemption phaseout range (in 2007, married couples with AMT income between about $150,000 and $400,000).

[9] More specifically, researchers have found that the behavioral response to increases in tax rates on broad income measures (such as AGI) is much smaller than the behavioral response to increases in taxes on income *after* exemptions and deductions. See Jon Gruber and Emmanuel Saez, "The Elasticity of Taxable Income: Evidence and Implications," *Journal of Public Economics*, 2002, Table 1, Wojciech Kopczuk, "Tax Bases, Tax Rates, and the Elasticity of Reported Income," National Bureau of Economic Research Working Paper No. 10044, October 2003, and Ian W. Parry, "Tax Deductions and the Marginal Welfare Cost of Taxation," *International Tax and Public Finance*, September 2002.

[10] See Greg Leiserson, "The 15 Percent Rate on Capital Gains: A Casualty of the Alternative Minimum Tax," Urban-Brookings Tax Policy Center, March 7, 2007, http://www.taxpolicycenter.org/publications/url.cfm?ID=901052. For

What About the Main Alternative: Repealing the AMT Without Paying For It?

The explicit or implicit alternative offered by the Rangel plan's most vociferous critics is to repeal (or substantially scale back) the AMT without paying for it. Senate Finance Committee Republicans John Ensign, Mike Crapo, Gordon Smith, Pat Roberts, and Jim Bunning reacted to Rep. Rangel's proposal by introducing legislation (S. 2318) that would repeal the AMT and extend various other tax cuts without offsets. Similarly, Ways and Means Committee Ranking Member Jim McCrery issued a press release suggesting that his preferred alternative to the Rangel bill is to provide permanent AMT relief (as well as permanent extension of the 2001 and 2003 tax cuts) without offsetting the cost. (See discussion in the appendix.)

Rep. McCrery has made clear that he views any proposal that replaces the revenue lost by repealing or scaling back the AMT as a tax increase.[11] Senate Finance Committee Ranking Member Charles Grassley also has argued that the cost of AMT repeal or reform should not be offset.

The Fiscal Impact of Deficit-financed AMT Repeal

The fiscal, economic, and distributional consequences of repealing the AMT without paying for it would all be negative. Unpaid-for AMT repeal would add $1.1 trillion to deficits over the coming decade. Continuing the current AMT patch would be cheaper, but not by much: it would add $791 billion to deficits in the decade ahead.

Moreover, these estimates assume that the 2001 and 2003 tax cuts would expire as scheduled or that their extension would be paid for. Those who oppose paying for AMT repeal or reduction typically also urge that the 2001 and 2003 tax cuts be extended without offsets. If that occurred, AMT repeal would add *$2 trillion* to deficits over the next ten years, and simply extending the AMT "patch" each year would add $1.3 trillion to deficits. (See Table 1.)

Table 1: Fiscal Impact of Unpaid-For AMT Repeal or Reform, 2008-2017

	Continue AMT Patch	Repeal the AMT
If Tax Cuts Expire	$791 billion	$1.1 trillion
Add'l Cost, Tax Cuts Extended	$527 billion	$849 billion
Total Fiscal Impact	$1.3 trillion	$2.0 trillion

Source: CBPP calculations based on Joint Tax & CBO data. Includes costs of added debt service.

estimates of the Rangel plans effects on marginal tax rates, see http://www.taxpolicycenter.org/numbers/Content/Excel/T07-0313.xls and http://www.taxpolicycenter.org/numbers/Content/Excel/T07-0314.xls.

[11] See Rep. McCrery's statement as cited in Meg Shreve, "Rangel Introduces Major Tax Reform Bill," *Tax Notes*, October 26, 2007.

White House and Congressional Republican Budgets have Counted on AMT Revenues and Assumed Any AMT Changes Would be Revenue Neutral

Given how strongly congressional Republican leaders now object to paying for AMT repeal or reduction, one might assume they have always objected to the level of revenue that would result from addressing the AMT's problems in a revenue-neutral fashion. Yet that is not the case. The revenue levels contained in every budget resolution formulated by the Republican Congress from 2001 through 2006 assumed neither AMT repeal nor AMT reform and, in fact, counted on a large infusion of revenue from a rapidly expanding AMT.

Similarly, the alternative budget resolution that House Budget Committee Republicans prepared *last year* — as well as President Bush's budget this year and last year — counted on rapidly growing AMT revenues. (Senate Budget Committee Republicans did not prepare an alternative budget.) These budget plans would not have achieved their avowed goal of balancing the budget by 2012 had they not assumed this large stream of AMT revenue. (See the table below.)

In short, when faced with budgetary tradeoffs, both Republican congressional leaders and the White House have consistently produced budgets that rested on the unstated premise that the revenue from an expanding AMT is necessary and that any changes in the AMT would be revenue neutral. This principle also guided the President's directive to his tax reform commission in 2005. The commission proposed AMT repeal and other tax changes to offset the cost.

Had Congressional Republican budgets reflected the policy that Republican leaders call for now — repealing or providing permanent relief from the AMT without paying for it — those budgets would have had to show much larger deficits.

2012 Surplus(+)/Deficit(-) – Billions of Dollars		
	House Budget Committee Republicans' FY 2008 Budget Resolution	President's FY 2008 Budget
Surplus/Deficit Shown in Budget	+$100	+$61
Surplus/Deficit If AMT Is Repealed Without Offsets	-$71	-$110

Source: CBPP calculations

The fiscal differences are even starker over a longer time period. If the Rangel plan were enacted and the Pay-As-You-Go rules (which require the costs of all tax cuts and entitlement increases to be offset) were scrupulously followed in the decades ahead, the federal budget would still remain on an unsustainable fiscal path;[12] by 2050, projected deficits would reach about 11 percent of the Gross Domestic Product, and the national debt would be about equal in size to the entire U.S. economy. But repealing the AMT and extending the 2001 and 2003 tax cuts *without* offsets would make these problems sharply worse — it would more than double the magnitude of the budget shortfall. Deficits would soar to about 20 percent of GDP by 2050, and the national debt would be more than

[12] For a description of the methodology behind these projections and a more in-depth discussion of the long-run budget problem, see Richard Kogan, Matt Fiedler, Aviva Aron-Dine, and James Horney, "The Long-Term Fiscal Outlook Is Bleak: Restoring Fiscal Sustainability Will Require Major Changes to Programs, Revenues, and the Nation's Health Care System," Center on Budget and Policy Priorities, January 29, 2007, http://www.cbpp.org/1-29-07bud2.htm.

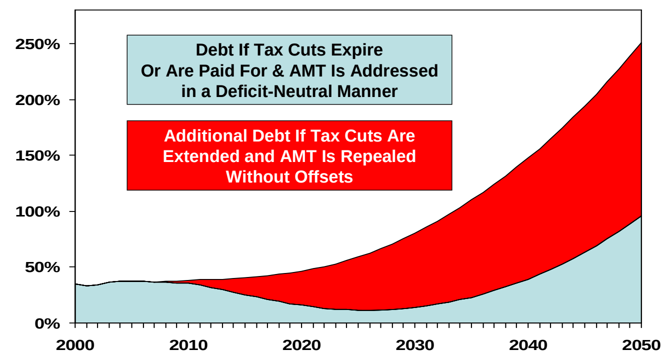
These estimates take into account the fact that the Rangel plan would replace the AMT with a surcharge that — as required by the Pay-As-You-Go rules — raises the same amount of revenue *over the next ten years*. Outside the ten-year window, however, revenues from the surcharge would grow at about the same rate as overall individual income-tax revenues. In contrast, AMT revenues would continue to grow much more rapidly.

two and a half times the size of the economy. (See Figure 3.) Repealing the AMT without offsetting the cost would account for *up to two-fifths of the additional budget shortfall* that this course of action would produce.

FIGURE 3

Unpaid-For AMT Repeal and Tax Cuts Would Dramatically Worsen Already-Grim Budget Picture

Debt as a Share of the Economy



Source: CBPP calculations based on Congressional Budget Office data.

Economic Consequences of Unpaid-For AMT Repeal

Republican congressional leaders have charged that the Rangel plan would seriously damage the U.S. economy; House Minority Leader John Boehner has even declared that it would "doom" the economy.[13] In fact, the negative economic effects of eliminating the AMT without paying for it are probably *larger* than any adverse economic effects from the increase in marginal tax rates that a small percentage of households would face under the Rangel plan.

This conclusion emerges clearly from the evidence on deficit-financed reductions in marginal tax rates. If the harm caused by deficit financing generally equals or outweigh the economic benefits of marginal rate reductions, then it follows that the Rangel plan — which imposes an income tax surcharge to offset the cost of AMT repeal and thereby avoids adding to deficits — is probably better for the economy than deficit-financed AMT repeal or reduction.

Studies by economists at the Joint Committee on Taxation, the Brookings Institution, the Congressional Budget Office, and elsewhere all suggest that this is the case. For example, in a 2005 study, the Joint Committee on Taxation examined the economic effects of reducing marginal rates in the individual income tax. The Joint Committee found that "Growth effects eventually become negative without offsetting fiscal policy [i.e. without offsets] for each of the proposals, because accumulating federal government debt crowds out private investment."[14] In other words, lowering marginal tax rates is likely to *harm* the economy over the long run if the tax reductions are deficit financed.

Moreover, the evidence suggests that any negative economic effects from the Rangel plan would be small. The plan would restore marginal tax rates for the highest income households to essentially their 1990s level, and if Congress subsequently decides to let the 2001 and 2003 marginal tax rate reductions expire at the end of 2010, to modestly above the 1990s levels. A comparison of the current business cycle to the 1990s business cycle does not support the claim that returning to 1990s tax rates would damage the economy. Overall economic growth was somewhat stronger in the

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[13] Quoted in *USA Today*, "Rangel: $1 Trillion AMT Plan Is Not a Tax Increase," October 26, 2007.

[14] Joint Committee on Taxation, "Macroeconomic Analysis of Various Proposals to Provide $500 Billion in Tax Relief," JCX-4-05, March 1, 2005, http://www.house.gov/jct/x-4-05.pdf. For discussion of other studies, see Aviva Aron-Dine and Robert Greenstein, "The Economic Effects of the Pay-As-You-Go Rule," Center on Budget and Policy Priorities, March 19, 2007, http://www.cbpp.org/3-19-07bud.htm.

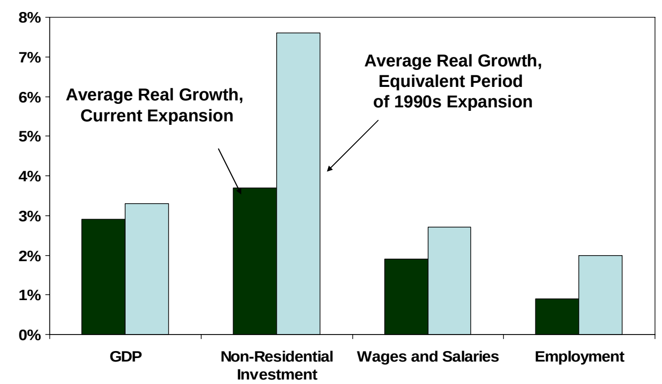
equivalent years of the 1990s than it has been in the current economic recovery.[15] Growth in investment, wages and salaries, and jobs also were stronger in the 1990s. (See Figure 4.) Furthermore, the performance of these economic indicators was stronger in most or all other post-World War II business cycles as well, despite the fact that marginal tax rates on high earners were much higher in those periods than they are today (and than they were in the 1990s).

Relationship Between Tax Rates and Economic Growth

More generally, one way to test the idea that higher tax rates have negative effects on economic performance is to look at the relationship between tax rates and the economy over time. If higher tax rates on high-income households did have effects large enough to seriously damage the economy, one would expect to see more robust economic growth in periods and places where tax rates were low and weaker growth where tax rates were high. Instead, as Brookings economists William Gale and Henry Aaron and then-Brookings economist, now-CBO Director, Peter Orszag have explained:

FIGURE 4

Current Recovery Weaker Than the 1990s Across A Range of Important Economic Indicators



Source: CBPP calculations based on Commerce Dept. and Labor Dept. data.

> "Historical evidence shows no clear correlation between tax rates and economic growth. The United States has enjoyed rapid growth both when taxes were low and when taxes were high. The strongest recent extended period of growth in U.S. history spanned the two decades from the late 1940s to the late 1960s, when the top marginal personal income tax rates were 70 percent of higher. Economic growth accelerated after the top marginal tax rate was increased from 31 percent to 39.6 percent in 1993. Comparisons across countries confirm that rapid growth has been a feature of both high- and low-tax nations."[16]

More careful studies, which have attempted to control for confounding factors and tease out any underlying negative relationship between taxes and growth, have found similar results. In one recent study, economists Gayle Allard and Peter Lindert undertook a particularly extensive examination of economic performance in developed countries since the 1960s. They analyzed the relationship between economic performance and government policy across a wide array of areas, including tax policy, spending policy, and regulatory policy in product and labor markets. They also controlled for various economic and demographic factors that could be expected to affect economic performance.[17] Allard and Lindert found that at levels of taxation at or even significantly above

[15] See Aviva Aron-Dine, Chad Stone, and Richard Kogan, "How Robust Is the Current Economic Expansion?" Center on Budget and Policy Priorities, revised October 16, 2007, http://www.cbpp.org/8-9-05bud.htm.

[16] Henry J. Aaron, William G. Gale, and Peter R. Orszag, "Meeting the Revenue Challenge," in *Restoring Fiscal Sanity*, eds., Alice M. Rivlin and Isabel Sawhill, Brookings Institution Press: Washington, D.C., January 2004.

[17] Gayle J. Allard and Peter H. Lindert. "Euro-Productivity and Euro-Job Since the 1960s: Which Institutions Really Mattered", National Bureau of Economic Research Working Paper, No. 12460, August 2006. See also Charles B. Garrison and Feng-Yao Lee, "Taxation, Aggregate Activity, and Economic Growth: Further Cross-Country Evidence on Some Supply-Side Hypotheses," *Economic Enquiry*, vol. XXX, January 1992, pp. 172-176 and Enrique G. Mendoza,

those now seen in the United States, increasing the ratio of revenues to GDP has tended to modestly *improve* economic performance. They explained this seemingly surprising result by noting that the additional revenues raised by higher-tax countries are frequently used to undertake growth-promoting activities, like investments in public education, infrastructure, and public health.[18]

Distributional Effects of Unpaid-For AMT Repeal

The AMT remains a progressive tax. Eliminating the AMT would thus, by itself, have regressive effects. As Tables 2 and 3 show, AMT repeal would provide tax reductions that are far larger — both in dollar terms and as a share of income — for high-income households than for middle- and low-income households.

Table 2 Distribution of Tax Cuts From AMT Repeal

Income Group	Average Tax Cut, Dollars	Percent Increase in After-Tax Income
Bottom Quintile	$0	0.0%
Second Quintile	$2	0.1%
Middle Quintile	$5	0.1%
Fourth Quintile	$90	0.7%
Top Quintile	$2,224	4.2%
Top 1 Percent	$10,001	2.6%

Source: Urban-Brookings Tax Policy Center. Figures are for 2007, assuming AMT relief had not been provided.

Table 3: Distribution of Tax Cuts From AMT Repeal

Income Group	Average Tax Cut, Dollars	Percent Increase in After-Tax Income
Below $50,000	$3	0.0%
$50,000 - $100,000	$184	0.3%
$100,000 - $200,000	$1,458	1.4%
$200,000 - $500,000	$5,877	2.7%
$500,000 - $1 million	$6,783	1.4%
Above $1 million	$17,623	0.8%

Source: Urban-Brookings Tax Policy Center. Figures are for 2007, assuming AMT relief had not been provided.

Moreover, these figures do not tell the whole story. They show only who would benefit from AMT repeal, not who would ultimately pay the price. As the Administration's own Treasury Department has found, tax cuts do *not* pay for themselves.[19] Nor can they be financed with higher deficits forever, especially since the nation is already on an unsustainable fiscal path. Eventually,

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Gian Maria Milsi-Ferretti, and Patrick Asea, "On the Ineffectiveness of Tax Policy in Altering Long-Run Growth: Harberger's Superneutrality Conjecture," *Journal of Public Economics* 66 (1997), pp. 99-126.

18 Even when the additional revenues are primarily used to finance what Allard and Lindert call "social transfers," that is, programs like Social Security, Allard and Lindert still do not find a negative effect of higher taxes on economic performance.

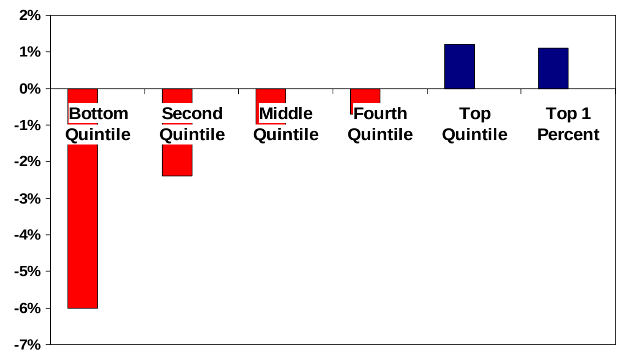
19 See James Horney, "A Smoking Gun: President's Claim That Tax Cuts Pay for Themselves Refuted by Administration's Own Analysis," Center on Budget and Policy Priorities, July 11, 2006, http://www.cbpp.org/7-11-06bud.htm.

today's unpaid-for tax cuts will have to be offset with tomorrow's tax increases or program cuts; there is simply no way around that.

FIGURE 5

AMT Repeal With Regressive Financing Would Increase Income Gaps

Gain or Loss As a Percent of After-Tax Income; Assumes Equal-Dollar-Per-Household Financing



Source: CBPP calculations based on Urban Institute-Brookings Institution Tax Policy Center data

As the tables above show, AMT repeal itself does little or nothing for households in the middle and bottom of the income scale. Yet these households would be hurt if government services ultimately were cut back to pay for AMT repeal or if less progressive taxes were increased.

In a statement reacting to the Rangel bill, Rep. McCrery commented, "Look at the real Democratic priorities. Look at their appropriations bills, look at children's health. What they need is more revenue. Boy, does this bill give them more revenue."[20] But Rep. McCrery's observation is simply wrong — it gets the budgetary situation exactly backwards. Children's health may be a priority, and providing for it and other needed investments may indeed require more revenue. *But the Rangel bill frees up no new resources for these objectives*. Since it is revenue neutral, it produces no new money that can be spent, and it thus does not help in passing health-care or other legislation. Meanwhile, Rep. McCrery's preferred alternative — deficit financing the same or similar AMT relief — would deprive the government of resources needed just to maintain *current* services and make good on *existing* commitments.

A simple calculation helps illustrate the consequences. Suppose that AMT repeal were eventually paid for in such a manner that the cost were split equally among all households (i.e., such that each household paid the same dollar amount to finance AMT repeal). Something close to this scenario could occur if repeal were ultimately financed entirely with cuts in government programs rather than tax increases, as Republican congressional leaders presumably would prefer.

Figure 5 shows the results. High-income households would gain, on average, from the combination of AMT repeal and the measures to finance it. But all other income groups would lose. For the lowest income group, the loss would amount to a sizeable 6 percent reduction in after-tax income. In other words, the rich would be made richer, the poor would be made poorer, and disparities in after-tax incomes — which, as discussed below, have already widened dramatically in recent decades — would be further enlarged.

Rangel Plan Has Appeal in Light of Recent Income and Tax Trends

In 2005, the share of the nation's (pre-tax) income going to the top 1 percent of households reached its highest level since *1929*.[21] Such a widening of the income gap might seem acceptable if all income groups had shared in the economic growth that has occurred over the past few decades. However, over the past 30 years (except for a short period in the late 1990s), skyrocketing incomes

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[20] Quoted in Steven R. Weisman, "Rangel Offering Big Tax Plan, and Big Target," *New York Times*, October 31, 2007.

[21] Aviva Aron-Dine, "New Data Show Income Concentration Jumped Again: Income Share of Top 1% At Highest Level Since 1929," Center on Budget and Policy Priorities, revised October 24, 2007, http://www.cbpp.org/3-29-07inc.htm.

at the top of the income scale have been accompanied by falling, stagnating, or only slowly rising incomes among middle- and low-income households.

This has certainly been the case in the current economic expansion. As of 2005, the incomes of the top 1 percent had increased about 20 percent since the end of the recession in 2001, while the incomes of the bottom 90 percent of households were still, on average, *below* where they were when the recession ended.

In addition, an important new study by economists Thomas Piketty and Emmanuel Saez finds that over the same period in which the distribution of pre-tax income became dramatically less equal, the federal tax system became substantially less progressive.[22] Between 1960 and 2000, effective tax rates for middle-income households increased slightly, while effective tax rates for high-income households fell sharply. Changes in the federal tax system thus have aggravated the increases in income inequality that occurred over this period.

The 2001 and 2003 tax cuts continued this trend. When fully in effect, these tax cuts will boost the after-tax incomes of the top 1 percent by nearly 7 percent, while increasing the incomes of the middle fifth of households by 2.3 percent and the incomes of the bottom fifth by 0.5 percent.[23]

Table 4: Distribution of Tax Cuts Enacted Since 2001

Income Group	Average Tax Cut, Current Law	Average Tax Cut, Rangel Bill Enacted
Below $50,000	$416	$497
$50,000 - $100,000	$1,389	$1,682
$100,000 - $200,000	$1,687	$4,042
$200,000 - $500,000	$2,492	$7,965
$500,000 - $1 million	$4,532	$10,398
Above $1 million	$122,630	$21,044

Source: Urban-Brookings Tax Policy Center. Tax-cut figures are for 2008.

Table 5: Distribution of Tax Cuts Enacted Since 2001

Income Group	Average Tax Cut, Current Law	Average Tax Cut, Rangel Bill Enacted
Bottom Quintile	$26	$104
Second Quintile	$397	$493
Middle Quintile	$794	$852
Fourth Quintile	$1,287	$1,451
Top Quintile	$4,993	$4,741
Top 1 Percent	$50,495	$13,525

Source: Urban-Brookings Tax Policy Center. Tax-cut figures are for 2008.

Repealing the AMT without offsetting the cost would pile on further, as Tables 2 and 3 demonstrate. Repeal would substantially enlarge tax cuts for upper-income households while doing little (or nothing) for the bottom 80 percent of households. Moreover, as discussed above, unpaid-for AMT repeal would likely make a large majority of Americans worse off over time, once the budget cuts or tax increases that ultimately would be needed to finance AMT repeal took effect.

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[22] Thomas Piketty and Emmanuel Saez, "How Progressive Is the U.S. Federal Tax System? A Historical and International Perspective," Journal of Economic Perspectives, Winter 2007.

[23] These figures do not take into account the *reductions* in income that ultimately will have to occur for many households when the tax cuts are paid for through higher taxes or lower benefits and services, as will eventually be necessary. See discussion above.

In contrast, the Rangel bill would pay for AMT repeal — as well as for its expansions of the EITC, Child Tax Credit, and the standard deduction — upfront. It forthrightly answers the question: who would foot the bill? Tables 4 and 5 show the answer: the Rangel proposal would pay for these policies by effectively scaling back the very large tax cuts conferred on the highest income 1 percent of households by tax reductions enacted in 2001 and 2003. This group would see its average tax cut shrink from $50,000 to $13,000 next year. The reduction would be concentrated among households with incomes over $1 million; they would see their average tax cut scaled back from a remarkable $123,000 in 2008, under current law, to $21,000.

All other income groups — i.e., all but the top one percent — would have their tax cuts *enlarged*, on average, under the Rangel bill. The distribution of tax-cut gains would thus become less skewed to those at the very top.

In light of the trends in the income distribution described above, this approach to financing AMT repeal has considerable appeal. It would address a problem in the tax code that nearly everyone agrees should be addressed, accomplish that without increasing deficits and debt, and do so by moderating the size of the tax cuts for those individuals who have benefited the most both from recent tax policies and from longer-term economic trends.

Appendix: How Many Households Would Get a Tax Cut Under the Rangel Bill?[24]

The Joint Committee on Taxation has estimated that the Rangel bill would cut taxes for 90 million households.[25] The Urban Institute-Brookings Tax Policy Center similarly estimates that 86 million households would get a tax cut from the legislation in 2008, while 3.7 million households (or 2.4 percent of households) would see a tax increase.

Even some of the households that would pay the new surcharge would get a tax cut, since the amount that they would gain from repeal of the AMT would exceed the amount they would pay under the surcharge. The Tax Policy Center estimates that among households in the $200,000 - $500,000 income group, *78 percent would get a tax cut*, while 18 percent would see their taxes go up.[26] The Tax Policy Center also estimates that 72 million households would pay less tax under the Rangel bill than if the AMT patch were extended (without the cost being offset). Only 5.4 million would pay more.

House Republican leaders, however, have spoken as though none of these tax cuts count. Ways and Means Committee Ranking Member Jim McCrery, for example, has described the 90 million figure as "pure snake oil,"[27] and in a November 8 press release, he asserted that new Joint Tax Committee estimates show that the Rangel bill would actually raise taxes on 113 million households by 2011.[28]

Rep. McCrery's press release, however, consists of a series of misleading or false statements. The estimates touted in the press release were produced in response to Rep. McCrery's request that the Joint Tax Committee compare two hypothetical scenarios and then report how many taxpayers would pay more in taxes in 2011 under the first scenario as compared to the second — under (1) a scenario in which the Rangel plan is enacted *and the 2001 and 2003 tax cuts are allowed to expire*, as compared to (2) a scenario in which all of the 2001 and 2003 tax cuts and AMT relief are extended *without any offsets.* Not surprisingly, taxpayers would pay more under a scenario in which all of the 2001 and 2003 tax cuts expire than under a scenario in which all of those tax cuts are extended. But Rep. McCrery's claim that these numbers depict the effects of the Rangel plan is deeply deceptive, for two reasons.

First, it rests on the premise that because the Rangel bill is silent on the subject of the 2001 and 2003 tax cuts, the bill is designed to let those tax cuts all expire. That is not the case. Rep. Rangel has made clear that his bill is an *AMT proposal*, not a statement about what should happen to the 2001 and 2003 tax cuts. Indeed, if every tax bill that is silent on the extension of the 2001 and 2003

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[24] Issues discussed here are addressed in more detail in Robert Greenstein and Aviva Aron-Dine, "Ways and Means Committee Republicans' Use of Joint Tax Committee Data Is Deeply Deceptive," Center on Budget and Policy Priorities, revised November 12, 2007, http://www.cbpp.org/11-9-07tax.htm.

[25] To our knowledge, Joint Tax Committee estimates of the number of households seeing tax increases have not been published.

[26] The Tax Policy Center estimates group households into income groups based on cash income, a broader measure than AGI, so not all households in the $200,000 - $500,000 range would owe the surcharge.

[27] Quoted in Heather M. Rothman, "Rangel Offers Face-Lift to Tax Code; GOP Dismisses Plan As A Tax Hike," *BNA Daily Tax Report*, October 26, 2007.

[28] The press release is available at http://republicans.waysandmeans.house.gov/News/PRArticle.aspx?NewsID=162. The JCT estimates are available at http://republicans.waysandmeans.house.gov/distribution_tables_jct.pdf.

tax cuts is assumed to end those tax cuts, then every Republican tax-cut bill enacted after 2001 can be regarded as a tax increase on millions of Americans.

Moreover, House Democrats have made clear that they support extending at least some provisions of the 2001 and 2003 tax cuts, provided the costs are offset. The large numbers of moderate- and middle-income families that Rep. McCrery contends will face "tax increases" under the Rangel bill benefit almost exclusively from three provisions of the 2001 tax cuts — the 10 percent tax bracket, the Child Tax Credit, and marriage penalty relief — that enjoy strong bipartisan support but that Rep. McCrery assumes the Rangel bill would terminate. But it makes no sense to claim that if Congress were to pass the Rangel plan, that would mean it had decided to let these provisions expire.

Second, Rep. McCrery's use of the Joint Tax numbers effectively assumes that deficit-financed tax cuts are a free lunch. His press release describes the estimates as measuring the effects of the Rangel plan against a "reality baseline." In fact, the estimates do precisely the opposite: they measure the effects against a *fantasy baseline* in which trillions of dollars in tax cuts are provided with no one ever footing the bill. It is hardly surprising that $3 trillion in deficit-financed tax cuts would leave most people with lower tax burdens than a $1 trillion tax reform proposal that is fully paid for. But this is not even comparing apples to oranges; it is comparing cotton candy to spinach.

Tax cuts are not free. Eventually today's unpaid-for tax cuts have to be offset with tomorrow's tax increases or program cuts. As discussed on page 11, once those eventual costs are taken into account, it is likely that regressive, unpaid-for tax cuts will leave households at all but the highest income levels worse off, not better off. It is this type of approach, rather than the Rangel bill, that ultimately could increase the burdens of 100 million Americans.