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Citizens for Tax Justice
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House Proposal to Pay for AMT Relief by Closing Loopholes Would Make the Tax Code Fairer and Avoid Increasing the Deficit

The House Ways and Means Committee approved a bill (H.R. 6275) this week that would temporarily prevent the Alternative Minimum Tax (AMT) from expanding its reach to families who are mostly well-off, but not as wealthy as those the tax was originally intended to target. Almost all lawmakers agree that this step should be taken. But President Bush and Republican leaders oppose the Ways and Means bill because it offsets the cost of AMT relief with revenue-raising provisions in order to avoid an increase in the budget deficit.

The AMT was created to ensure that wealthy Americans pay at least some federal income taxes no matter how skillful they are at finding loopholes. It is reasonable that Congress wants to prevent it from affecting more families, but there is no reason why the deficit should be increased to provide tax relief for those who are relatively well-off. The Ways and Means bill would offset the cost of AMT relief mainly by closing unwarranted tax loopholes, which will in turn make the tax code fairer and more economically efficient.

AMT Relief Will Benefit the Well-Off, So the Middle-Class Should Not Have to Pay for It

The table below shows that two thirds of the benefits of AMT relief will go the best-off 10 percent of taxpayers. Over nine tenths will go to the best-off 20 percent. From the standpoint of tax fairness, it would be acceptable if the cost of AMT relief was offset by taxes on well-off families or very rich families. But it cannot possibly be acceptable to have middle-income or even low-income families pay for AMT relief, since they do not benefit from it.

Effects of Extending AMT Relief into 2008

Income group	Income Range	Average Income	# with tax cut	% with tax cut	Ave. tax cut with	Ave. tax cut all	% of total tax cut
Lowest 20%	Less than $19,000	$ 12,200	—	—	$ —	$ —	—
Second 20%	$19,000 – 32,000	24,800	—	—	—	—	—
Middle 20%	$32,000 – 52,000	40,600	534,016	1.9%	–660	–13	0.6%
Fourth 20%	$52,000 – 87,000	67,400	5,192,366	18.5%	–942	–174	8.0%
Next 10%	$87,000 – 127,000	103,800	9,133,255	65.1%	–1,638	–1,067	24.5%
Next 5%	$127,000 – 179,000	147,900	5,998,196	85.5%	–2,556	–2,185	25.1%
Next 4%	$179,000 – 481,000	263,900	5,253,778	93.6%	–4,692	–4,394	40.3%
Top 1%	$481,000 or more	1,597,600	263,481	18.8%	–3,687	–692	1.6%
All Units		$ 72,200	26,391,238	18.6%	$ –2,318	$ –430	100.0%

Total cost: $ 61.2 billion

Notes: Figures show the 2008 effects of extending the 2007 AMT relief into 2008 (indexed for inflation). "Ave. tax cut with" means tax cuts for those helped by AMT relief. "Ave. tax cut all" means the average for all taxpayers in each group.

Source: ITEP Tax Model, June 19, 2008

Unfortunately, that's what might happen if AMT relief is deficit-financed. That's because we don't know who's going to pay off the increased national debt that results. The debt and the interest thereon must somehow be paid off with tax increases or cuts in public services. Tax increases could be implemented across-the-board, which would affect everyone. If Congress instead chose to slash services, they would soon discover that most public services are programs that the middle-class depends on or supports, including Medicare, Medicaid, Social Security, veterans benefits and defense, and other federal services like education and environmental protection.

What Is the AMT and Why Is It a Problem?

The AMT was enacted in 1969 to ensure that very wealthy Americans are not able to escape paying a reasonable amount in income taxes by using loopholes. Its reach has been expanded over the years, but it's still mostly a tax on the wealthy. Historically, large AMT exemptions have kept the vast majority from being affected by the AMT.

But when George W. Bush pushed through his big tax cuts in 2001, he was adamant that he would not make corresponding adjustments in the AMT exemptions and rates, because making such adjustments would have sharply increased the estimated cost of his tax plan. Because the AMT is an alternative tax, which is only paid if it exceeds the regular income tax, lowering regular tax rates meant more families would be subject to the AMT.

If unaddressed, the AMT would take back some of the Bush tax cuts. So every year or two since President Bush took office they have enacted what is often called a "patch" — legislation that increases the exemptions that keep most of us from paying the AMT.

The bill approved by the House Ways and Means Committee this week would apply a patch for 2008,[1] and that's the part everyone in Congress agrees should be done. What's caused more consternation is the fact that the bill would replace the revenue lost to AMT relief.

President Bush and Republican Leaders Defend "Carried Interest" Loophole Allowing Millionaires to Pay Income Taxes at Lower Rates than Working-Class Americans

The Ways and Means bill would pay for AMT relief mostly by closing loopholes that make our tax code less fair and that distort economic decision-making.

The bill would raise around half of the needed revenue by closing the loophole for "carried interest" paid to private equity fund managers (managers of buyout funds, hedge funds and other similar investment funds).

Carried interest is a form of compensation paid to fund managers in return for investing other people's money. Most of us who earn an income from work are subject to federal income taxes at progressive rates, starting at 10 percent and going up to 35 percent for the very wealthiest. Private equity fund managers are at the top of this wealthy group, but nevertheless

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[1]Without a "patch" provided by Congress, the exemption from the AMT reverts to $33,750 for single taxpayers and $45,000 for couples. The last patch enacted by Congress increased the exemption to $44,350 for singles and $66,250 for couples, for 2007 only. The Ways and Means bill would increase the exemption to $46,200 for single taxpayers and $69,950 for couples for 2008.

pay only 15 percent — the special low capital gains tax rate — on their carried interest.

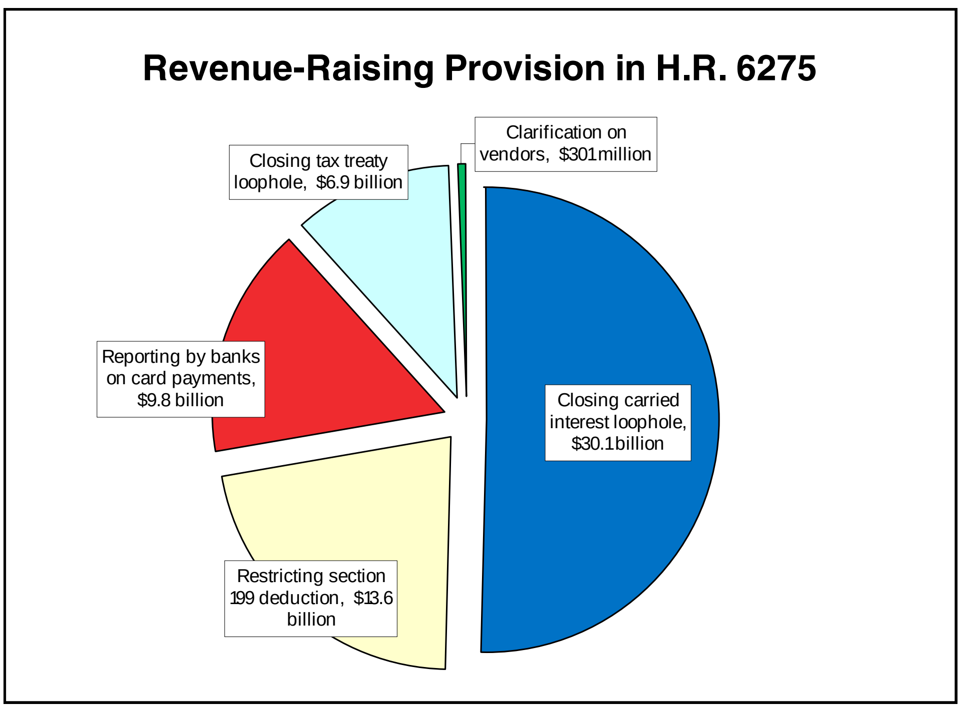
If an unmarried receptionist working for a private equity firm earns $42,500 a year, the top federal marginal tax rate that applies to his income is 25 percent. This is on top of payroll taxes of around 15 percent that he pays on all of his income.[2] The fund managers he works for, however, pay only the 15 percent "capital gains" rate on the "carried interest" they receive as compensation for managing other people's money.

These fund managers can sometimes earn hundreds of millions of dollars (sometimes in excess of a billion dollars) in carried interest, and yet their compensation is subsidized by the rest of us through the tax code. That's why Congress would be justified in closing the carried interest loophole even if it was not trying to raise revenue to pay for some other tax cut.

Other Revenue-Raising Provisions

A second revenue-raising provision would restrict the use of a deduction for manufacturing (often called the section 199 deduction) by oil and gas companies. Some might wonder why oil and gas companies could use a deduction for "manufacturing" in the first place. A few years ago, Congress actually redefined manufacturing for the purposes of this deduction so that it included oil and gas production, obviously at the behest of the energy industry.

In 2005 President Bush said "I will tell you with $55 oil we don't need incentives to oil and gas companies to explore. There are plenty of incentives." Well, now the price of oil is getting close to $140 per barrel and yet the President and his allies in Congress are defending this and many other loopholes that provide a subsidy through the tax code to oil companies at a time when they're making record profits.



The third revenue-raising provision would require banks to report to the IRS payments made to businesses by credit card or debit card. Since this was part of the Bush administration's budget proposal for next year, this provision should not be controversial.

The fourth revenue-raising provision is also sensible policy but has elicited unjustified protests from Republican leaders. It would stop foreign corporations with subsidiaries in the U.S. from

[2]While the employee and employer both nominally pay half of the federal payroll tax, economists and analysts generally agree that even the employer-paid portion is ultimately borne by the employee in the form of lower wages or benefits.

manipulating international tax treaties to avoid taxes. U.S. subsidiaries of foreign corporations usually have to pay withholding taxes on passive income — but not if they are based in a country that has a treaty with the U.S. allowing that country to have sole taxing power. The idea is that income should be taxed by one national government, not multiple national governments.

The problem is that some corporations take advantage of this system to avoid paying taxes to any government. Corporations based (on paper at least) in a non-treaty country can shift profits from a U.S. subsidiary to another subsidiary in a treaty country and then shift them to the parent corporation in the non-treaty country, ensuring that they are never taxed. The Ways and Means bill would require the U.S. subsidiary to pay whichever tax is higher, the one due under the current rules, or the one that would be due if the payment was made directly to the parent company. This would effectively shut down this tax dodge.

A fifth and final revenue-raising provision would raise a small amount of money by clarifying how the taxes owed can be collected from vendors doing business with the federal government.

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