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Citizens for Tax Justice

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Budget Plan Approved by the House Deals with Tax Policy in a More Responsible Way than the Senate Version

Conference Committee Should Back House Tax Policies on AMT, Estate Tax, and Social Security

Last week, the House and Senate both passed their own versions of the fiscal year 2009 federal budget resolution. There are some important differences between them that must be worked out by a House-Senate conference committee, which will negotiate a final resolution to be passed by both chambers. Even though the budget resolution is not law and is not binding, it does serve as a blueprint for the tax and spending policies that Congress will pursue in the coming year. This blueprint can also include procedural rules that make it easier or more difficult to pass certain types of legislation.

The resolution approved by the House offers more responsible tax provisions than the Senate version, for a number of reasons:

1.) The House budget plan uses "reconciliation instructions" that would make it easier to pass a bill to provide relief from the Alternative Minimum Tax (AMT) without increasing the deficit. Any further increase in the national debt is likely to be borne, in the long-run, by the middle-class, so it would be unfair to take on debt to provide AMT relief, which mostly benefits families that are relatively wealthy. The Senate plan, unfortunately, does not include reconciliation because the Senate assumes that an AMT patch will be deficit-financed.

2.) The House plan does not emphasize cuts in the estate tax. CTJ's data shows that the estate tax now affects fewer than 1 percent of estates. The Senate decided, however, to cut the estate tax for these few, wealthiest families and pay for this tax cut with budget surpluses that may not materialize.

3.) The House plan would not cut taxes on better-off Social Security recipients. Such a tax cut, which the Senate plan includes, would reduce revenues that are shoring up Social Security, while only benefitting those seniors who are well-off.

Reconciliation Instructions to Pay for AMT Relief

One way the House version differs from the Senate version is the use of "reconciliation instructions" that instruct the relevant committees to produce legislation to meet some fiscal goal. Such legislation can be passed in the Senate with only a simple majority of votes rather than the 60 votes usually needed to overcome a filibuster by the minority party.

In particular, the House plan includes reconciliation instructions to provide another year of relief from the Alternative Minimum Tax (AMT) without increasing the budget deficit. In other words, this provision encourages the tax committees to produce a bill that provides a year of

AMT relief but that also includes provisions to raise revenue to offset the cost of such relief.

The AMT was originally created in the late 1960s to ensure that very wealthy Americans pay at least some federal income tax no matter how skillful they are at using tax loopholes. In recent years, however, the AMT's reach has threatened to expand dramatically. In part, that's because Congress has not permanently indexed the AMT exemptions for inflation. But the most important reason for the AMT's potential expansion is that the Bush tax cuts reduced ordinary income taxes without permanently changing the AMT. As more families see their ordinary income tax liability fall below their liability under the AMT, that means the AMT becomes relevant to the lives of more and more taxpayers.

Instead of permanently indexing the exemptions for inflation, Congress has been enacting "patches" to the AMT each year, measures that temporarily increase the exemptions to keep the AMT from affecting more taxpayers. Lawmakers are adamant that the AMT must be patched, permanently reformed or even repealed altogether. The question is how such relief will be paid for: with offsetting revenue increases or by further increases in federal borrowing.

As the table below shows, AMT relief mostly benefits the best-off fifth of families in America (excluding the best-off one percent). As such, it would be unfair to push the costs of AMT relief onto middle-income taxpayers. But if AMT relief is deficit-financed, that's probably exactly what will happen, since the increased national debt will eventually have to be paid for by cuts in public services or higher taxes on everyone.

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**	**40,700**	540,631	1.9%	–664	–13	0.6%
Fourth 20%	**$52,000 – 87,000**	**67,300**	5,146,577	18.4%	–927	–170	8.1%
Next 10%	**$87,000 – 126,000**	**103,000**	9,093,126	64.8%	–1,622	–1,051	24.9%
Next 5%	**$126,000 – 177,000**	**147,000**	5,984,765	85.3%	–2,514	–2,144	25.4%
Next 4%	**$177,000 – 466,000**	**259,000**	5,255,322	93.7%	–4,417	–4,137	39.3%
Top 1%	**$466,000 or more**	**1,501,000**	274,479	19.6%	–3,548	–694	1.6%
All Units		**$ 70,900**	**26,307,462**	**18.5%**	**$ –2,247**	**$ –416**	**100.0%**

Total cost: **$ 59.1 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, Mar. 18, 2008

Senators who favor borrowing were able to filibuster a bill last year that would have offset the costs of AMT relief by closing the loophole for carried interest paid to private equity fund managers and by cracking down on their use of offshore tax shelters. With no other way in sight to pass an AMT patch, Democratic leaders were then forced to pass a patch that was not paid for, increasing the national debt by $50 billion.

This year, if the House prevails, a bill to provide AMT relief without increasing the deficit can be offered as part of the reconciliation process. It would be protected against a Senate filibuster and its chances of passage would be greatly enhanced.

More Unnecessary, Unjustified Cuts in the Estate Tax

As happened last year, the Senate adopted an amendment that put the chamber on record as supporting a new cut in the estate tax. This would be a boon for the very wealthiest Americans but would provide no benefit whatsoever to 99 percent of all taxpayers.

Number of estates owing federal estate taxes in 2005 and 2006 by state

	# of Estates Owing Tax		% of Estates Owing Tax			# of Estates Owing Tax		% of Estates Owing Tax	
	2005	2006	2005	2006		2005	2006	2005	2006
Total United States	**20,164**	**22,624**	**0.8%**	**0.9%**	Missouri	336	371	0.6%	0.7%
Alabama	198	219	0.4%	0.5%	Montana	61	92	0.8%	1.1%
Alaska	4	*	0.1%	*	Nebraska	153	62	1.0%	0.4%
Arizona	261	371	0.6%	0.8%	Nevada	191	144	1.1%	0.8%
Arkansas	95	142	0.3%	0.5%	New Hampshire	114	131	1.1%	1.3%
California	4,044	4,492	1.7%	1.9%	New Jersey	780	739	1.1%	1.0%
Colorado	240	210	0.8%	0.7%	New Mexico	128	75	0.9%	0.5%
Connecticut	352	399	1.2%	1.4%	New York	1,720	1,750	1.1%	1.1%
Delaware	121	83	1.7%	1.1%	North Carolina	355	523	0.5%	0.7%
District of Columbia	85	44	1.6%	0.8%	North Dakota	35	*	0.6%	*
Florida	1,801	2,482	1.1%	1.5%	Ohio	497	790	0.5%	0.7%
Georgia	352	429	0.5%	0.6%	Oklahoma	173	196	0.5%	0.5%
Hawaii	118	131	1.3%	1.4%	Oregon	192	290	0.6%	0.9%
Idaho	34	48	0.3%	0.5%	Pennsylvania	716	732	0.6%	0.6%
Illinois	1,122	1,120	1.1%	1.1%	Rhode Island	77	111	0.8%	1.1%
Indiana	294	270	0.5%	0.5%	South Carolina	165	272	0.4%	0.7%
Iowa	174	237	0.6%	0.9%	South Dakota	31	46	0.5%	0.6%
Kansas	207	191	0.9%	0.8%	Tennessee	209	204	0.4%	0.4%
Kentucky	186	160	0.5%	0.4%	Texas	1,012	1,082	0.7%	0.7%
Louisiana	141	198	0.3%	0.4%	Utah	53	66	0.4%	0.5%
Maine	88	116	0.7%	0.9%	Vermont	33	47	0.7%	0.9%
Maryland	548	542	1.3%	1.2%	Virginia	547	657	1.0%	1.1%
Massachusetts	706	606	1.3%	1.1%	Washington	336	472	0.8%	1.0%
Michigan	401	551	0.5%	0.6%	West Virginia	70	163	0.3%	0.8%
Minnesota	203	230	0.5%	0.6%	Wisconsin	284	232	0.6%	0.5%
Mississippi	89	106	0.3%	0.4%	Wyoming	32	*	0.8%	*

* No estate tax figures are provided by IRS for 2006 for these states.

Sources: IRS and Centers for Disease Control and Prevention.

CTJ's recent figures on the estate tax show that it affected less than one percent of estates during 2005 and 2006. Those estates were allowed an exemption of $1.5 million per spouse. The exemption is now $2 million and in 2009 it will rise to $3.5 million. Under current law, the estate tax is scheduled to shrink for several years until disappearing altogether temporarily in 2010. Then in 2011, the estate tax rules are scheduled to revert to those that were in place prior to the Bush tax cuts.

An amendment adopted by the Senate would freeze the estate tax rules that will be in effect under current law in 2009 (exempting the first $3.5 million per spouse and taxing the excess at a rate of 45 percent). This huge cut in the estate tax, plus other tax breaks, would be financed using surpluses in the Social Security trust fund, which by 2012, according to official projections, would no longer be diverted to pay for other Bush tax cuts and the war in Iraq.

The House budget resolution does assume that an estate tax cut and other tax cuts can be extended — if Congress finds a way to pay for them. The Senate version is more problematic because it claims to pay for the estate tax cut with such a questionable revenue source.

Unnecessary, Unjustified Tax Cut for Better-Off Seniors

The Senate also adopted an amendment that would repeal the tax increase on Social Security benefits of better-off seniors that was enacted in 1993. The costs would be offset, but again, no offsets are specified in the amendment.

The federal government began taxing a portion of Social Security benefits in 1984, and increased the amount that can be included in taxable income to a maximum of 85 percent in 1993. The idea was to treat Social Security benefits more like other retirement income, such as pensions and IRA distributions.

For most retirees, the vast majority of Social Security benefits are income that has never been taxed. Most beneficiaries still pay no federal income taxes on their benefits, but above certain income levels benefits gradually become taxable. For the best off, 85 percent of benefits must be included in taxable income.

Effects of Repealing the 1993 Tax Hike on Social Security Benefits

Income Range	% of all Soc. Sec. recipients	% with tax cut	Ave. tax cut with cut	Ave. tax cut, all SS recipients	% of total tax cut
Less than $30,000	47.4%	—	$ —	$ —	—
$30,000 – 40,000	10.6%	2.0%	–418	–9	0.2%
$40,000 – 50,000	8.3%	26.4%	–301	–79	1.6%
$50,000 – 75,000	14.9%	73.2%	–681	–499	18.7%
$75,000 – 100,000	7.5%	93.8%	–1,273	–1,195	22.5%
$100,000 – 200,000	8.2%	96.7%	–1,870	–1,809	37.0%
$200,000 or more	3.1%	98.3%	–2,600	–2,556	19.8%
	100.0%	**31.4%**	**$ –1,270**	**$ –399**	**100.0%**
ADDENDUM					
Less than $50,000	66.3%	3.7%	–313	–12	1.9%
More than $100,000	11.3%	97.2%	–2,073	–2,014	56.9%

Total cost: $ 12.2 billion annually

Notes: Figures show the effects of repealing the 1993 tax increase on Social Security benefits, at 2008 income levels. "% with tax cut" means percent of all tax units with Social Security benefits who would get a tax cut from the proposal. "Ave. tax cut with cut" means average tax cuts for those helped by the proposal. "Ave. tax cut, all Social Security recipients" means the average for all taxpayers with Social Security.

Source: ITEP Tax Model, Mar. 18, 2008

Both Budget Plans Are More Responsible than the One Proposed by the President

It's true that both of the congressional budget plans are more responsible than the one proposed by President Bush. The President's plan proposes to permanently extend all of his tax cuts, which are otherwise scheduled to expire at the end of 2010. Making them permanent would cost a staggering $5 trillion over the 2011-2020 period and most of the benefits would go to the top one percent of all taxpayers.

There are certain elements of the Bush tax breaks that some lawmakers want to extend because they primarily benefit taxpayers who are not rich, like keeping the lowest income tax rate at 10 percent and making permanent the $1,000 child credit. Many Democratic lawmakers include cuts in the estate tax in this category of "middle-class" tax cuts, even though only the very richest families pay the estate tax. The House and Senate plans both assume an extension of the tax cuts that these lawmakers say benefit the middle-class.

New Tax Cuts in Senate Budget Plan Represents Misplaced Priorities

But the Senate, in its enthusiasm for tax-cutting, went much farther and made several ill-advised choices. The worst was the choice to eschew reconciliation instructions that would help ensure that an AMT patch does not lead to an increase in the national debt, as it did last year.

The other two tax policies in the Senate plan that are discussed here — the estate tax cuts funded by a questionable surplus and the cut in taxes on Social Security for well-off seniors — are bad policy because they mean that resources will be diverted from other priorities so that new tax breaks can go to families with huge estates and to well-off seniors.

For a nation facing a stalled economy, a healthcare crisis, and a war entering its sixth year, it's hard to imagine how lawmakers can justify giving priority to new tax cuts for the affluent. The House-Senate conference committee that takes up the budget resolutions should reject the choices that the Senate has made with regard to taxes and choose the responsible path set by the House of Representatives.

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