Congress of the United States
U.S. House of Representatives
COMMITTEE ON WAYS AND MEANS
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December 1, 2005

Oppose Tax Increase on Over 17 Million American Families

Dear Colleague:

As you are aware, the tax cut reconciliation bill (H.R. 4297) was pulled from the Floor schedule before Thanksgiving recess. I expect that it will be on the schedule the week of December 5, 2005.

Frankly, it will be quite easy for me to oppose that bill. I think this is the wrong time to enact another tax cut, particularly another tax cut for the wealthiest in our society. This country is fighting a war in Iraq with no end in sight. The deficit is going through the roof, we've got problems with Medicare that are going unanswered, and we haven't addressed the shortfall facing Social Security. To add further insult, the House and Senate are cutting programs that protect the most vulnerable in our society in order to facilitate this tax cut.

I recognize that there are differences between the parties concerning the appropriateness of extending many of the 2001 and 2003 tax cuts. Those differences should be the subject of a vigorous partisan debate. However, there are aspects of the tax reconciliation bill as reported by the Committee on Ways and Means that should be of concern to Members from both parties. **Quite simply, the Committee bill would result in a tax increase next year on over 17 million American families.** The size of that tax increase could be as large as $3,640 for families hit the hardest.

In recent years, the Congress has resorted to a large number of budgetary gimmicks to reduce the cost of the tax reductions promised in the big print of recent legislation. Those gimmicks include phase-ins, sunsets, temporary provisions, and the alternative minimum tax (AMT). Now the Congress is forced to grapple with the consequences of those budgetary gimmicks. Even Acting Majority Leader Roy Blunt concedes that there are limits to what Congress can afford. "We weren't able to maintain 100 percent of our bills' current tax policies." (*Congress Daily*, November 16, 2005.)

The AMT is one of the largest of the budgetary gimmicks. The Joint Committee on Taxation has estimated that over the next 10 years the AMT alone will deny approximately $740 billion of the tax relief promised in the big print of the 2001 and 2003 tax reduction legislation (See *Tax Notes*, September 26, 2005, page 1582).

Under current law there are two provisions (terminating at the end of this calendar year) that mitigate the effect of the AMT. The first is a temporary increase of the AMT exemption level, and the second is a waiver of the AMT limitations on the allowance of non-refundable credits. If neither of those provisions are extended, the AMT exemption would drop from $58,000 (for joint returns) to $45,000 next year, and non-refundable credits (such as the credits for college tuition and the dependent care credit) would be subject to disallowance by reason of the AMT. With no extension, the number of AMT taxpayers would skyrocket from 3.6 million in 2005 to 19 million next year (See Joint Committee on Taxation, May 20, 2005, JCX-37-05, page 11).

The temporary increase in the exemption is by far the most significant of the two AMT provisions, both in terms of its revenue effect and its impact on the number of individuals subject to the AMT. A one-year extension of the exemption increase would cost approximately $28.7 billion, whereas a similar extension of the waiver of the AMT limitations on non-refundable credits would cost only $2.8 billion. Extending the AMT exemption would reduce the number of AMT taxpayers next year by 14 million, from 19 to 5 million. However, merely extending the waiver of the AMT limitations would reduce the number of AMT taxpayers next year by slightly more than one million, from 19 to 17.8 million (See JCX-37-05, page 14).

The Ways and Means Committee was faced with a choice. Ways and Means Committee Chairman Bill Thomas has publicly acknowledged the budget numbers would not permit both an extension of AMT relief and an extension beyond 2008 of the rate reductions for dividends and capital gains.

Even I was surprised by the choice made by the Republican Members of the Ways and Means Committee. The Committee bill extends the rate reductions for dividends and capital gains even though those provisions do not expire until the close of calendar year 2008, **and even though nearly 50 percent of the benefit of those rate reductions will be enjoyed by the wealthiest one-fifth of one percent of individuals, all with annual incomes over $1 million.**

In contrast, the Ways and Means Committee bill does not extend the temporary increase in the AMT exemption, the only major tax benefit otherwise expiring at the end of 2005 that was not extended by the Committee bill. (The Committee bill does extend the waiver of the AMT limitations on non-refundable credits.)

As a result of that choice, the number of individuals subject to the AMT would skyrocket from 3.6 million in 2005 to approximately 17.8 million next year. Virtually all of those 17.8 million taxpayers would face a tax increase next year if the Committee bill becomes law.

Amount of Tax Increase

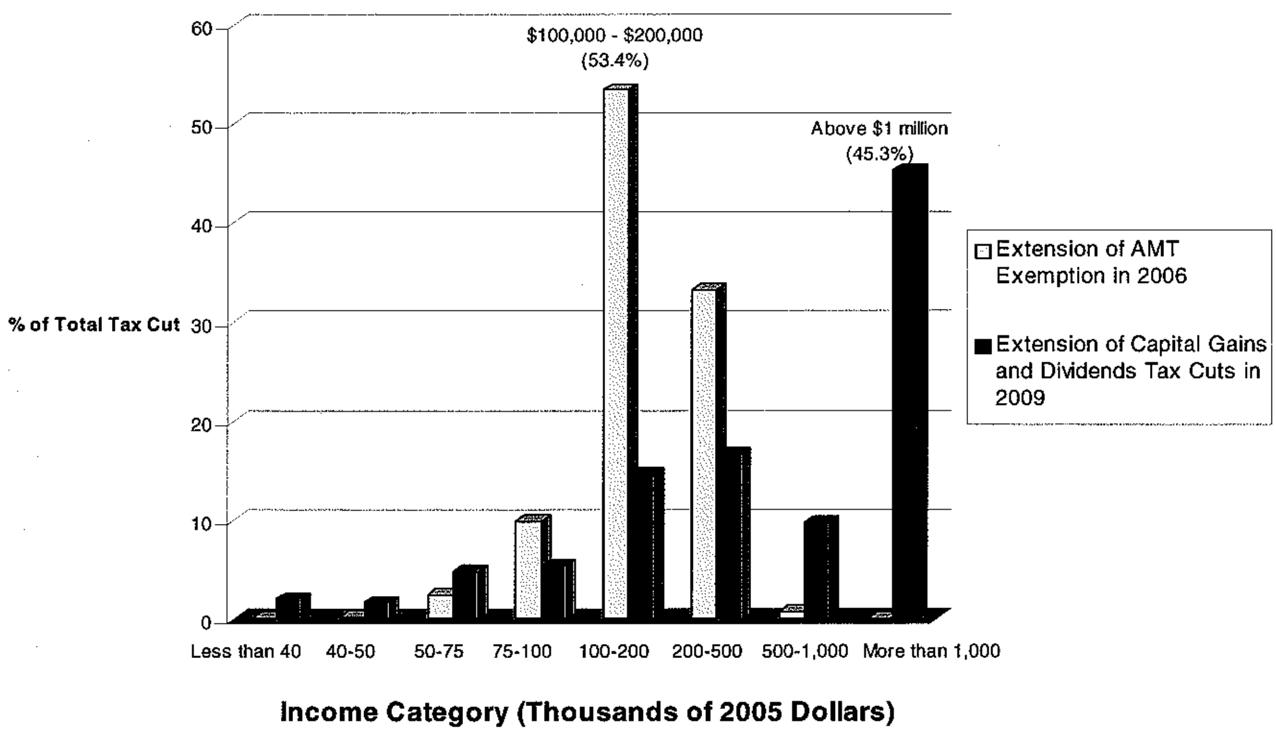
The amount of the tax increase would vary widely among the 17.8 million affected taxpayers, depending on the State in which the taxpayer resides, marital status, and number of children. However, two things are quite clear.

In calendar year 2005, approximately 3.6 million individuals will be subject to the AMT, even with the temporary increased exemption. Most of those individuals would face the maximum tax increase under the Committee bill. For married couples, the maximum tax increase is $3,640. Single individuals would face a maximum tax increase of half that size.

Second, the tax increases under the Committee bill would disappear at upper-income levels. Under current law, the AMT exemption begins to be phased out at incomes above $150,000 ($112,500 for single taxpayers). The current AMT exemption is totally phased out for individuals with incomes greater than $382,000 ($273,500 for single individuals).

The Ways and Means Committee bill provides extraordinary benefits for upper-income taxpayers. They will not face any tax increase by reason of the failure to extend the AMT exemption. But they would be the main beneficiaries of the extension of the lower rates for dividends and capital gains. The following chart shows the unfairness of the Committee decisions.

Capital Gains and Dividends Tax Cuts Disporportionately Benefit the Rich
Capital Gains and Dividends Rate Cut Compared with Extension of AMT Relief
(Shares of Tax Cuts by Income Categories)



Source: House Ways and Means Democratic Staff calculations based on estimates from the Urban-Brookings Tax Policy

Regional Disparities

The deduction for State and local income, property, and retail sales taxes is not allowed against the AMT. Therefore, the AMT in the past has disproportionately affected residents of States that have relatively high State and local tax rates. In the past, with the temporary AMT exemption, twelve States have had AMT participation rates (the percentage of their residents subject to the AMT) approximately equal to or greater than the national average. Those States (in order of their AMT participation rates) are New Jersey, New York, Connecticut, the District of Columbia, California, Massachusetts, Maryland, Rhode Island, Minnesota, Oregon, Virginia and Ohio (Source: Department of the Treasury, Internal Revenue Service). **Residents of those States would be the most likely to face the maximum tax increase from the Ways and Means Committee bill described above.**

However, failure to extend the AMT exemption would nationalize the AMT problem. In 2005, the AMT participation rate is 2.8 percent for "high-tax" States, 1.2 percent for "middle-tax" States and 0.9 percent in "low-tax" States. Next year, under the Ways and Means Committee bill, those rates would rise and narrow to 16.9, 13.3 and 10.9 percent respectively (Source: Urban-Brookings Tax Policy Center). There would continue to be differences, but over time, those differences narrow dramatically. The residents of all States would be faced with serious AMT problems.

Partial Repeal of Marriage Penalty Relief

The 2001Act provided marriage penalty relief by increasing the standard deduction and the size of the 15 percent rate bracket. However, the 2001 Act did not reduce the marriage penalty contained in the AMT. **As a result, for many married couples, the 2001 Act did not reduce their marriage penalty; it merely changed the name of the tax imposing the penalty.**

Revenue estimates from the Joint Committee on Taxation indicate that the AMT would eliminate more than half of the benefits promised in the big print of the 2001 Act. **Next year under the Committee bill, 30 percent of married couples would be subject to the AMT, whereas only 1.9 percent of single individuals would have AMT liability** (Source: Urban-Brookings Tax Policy Center).

Tax on Families With Children

The deduction for personal exemptions also is not allowed under the AMT. As a result, families with children would be the most likely to have AMT liability. Next year, under the Committee bill 34.5 percent of families with three or more children would pay the AMT, a fourfold increase from 2005.

Higher Dividend and Capital Gains Rates

Individuals subject to the AMT, and with incomes between $150,000 and $382,000 (between $112,500 and $273,500 for single individuals), face higher AMT marginal rates on capital gain and dividend income than the rates under the regular tax. Those AMT taxpayers face marginal rates of 21.5 and 22 percent compared to the 15 percent rate in the regular tax. The Ways and Means Committee bill would dramatically increase the number of taxpayers subject to the AMT and, therefore, facing those higher marginal rates.

The Committee bill purports to choose capital gain and dividend tax relief over AMT relief. Actually, it chooses the interests of the very wealthy over middle-income taxpayers. **Many Americans would face higher marginal rates on capital gains and dividend income next year, because of the Ways and Means Committee bill.**

Conclusion

I am confident that the Democratic Members of the House will be unified in their opposition to the unfair tax legislation reported by the Committee on Ways and Means. I am hopeful that enough Republicans will place the interests of their constituents above the interests of their party to join with me in supporting a Substitute that would eliminate the threatened tax increase on over 17 million American families.

Sincerely,

Charles B. Rangel
Ranking Member
Committee on Ways and Means