

THE TAXPAYER CHOICE ACT

DETAILED DESCRIPTION

The Alternative Minimum Tax

- **AMT Repeal.** The section of the Internal Revenue Code [IRC] relating to the Alternative Minimum Tax [AMT] is amended by adding a statement that prohibits the imposition of the AMT on individual taxpayers (i.e. non-corporations) in any taxable year after 2006.

The Taxpayer Choice Act

- **Establishment of the Simplified Tax.** A new section is added to Subchapter A, Part 1 of the IRC – which covers the individual income tax – establishing the Simplified Tax.
- **Taxpayer Election.** The new section allows an individual taxpayer to pay federal income taxes in either of two ways: 1) under the new Simplified Tax, or 2) under the existing tax code.
 - The election must be made within 10 years from the time that the Simplified Tax is established.
 - Individuals are not allowed to switch between tax systems on a year-by-year basis. After the initial choice is made, however, individuals are allowed *one* additional changeover between the two tax systems over the course of a lifetime. Individuals are also allowed to change tax systems when a major life event (death, divorce, marriage) alters their tax filing status.
- **Other Taxes Unchanged.** The Taxpayer Choice Act applies solely to federal individual income taxes. Other federal taxes – such as corporate taxes, payroll taxes, and excise taxes – are not affected.

Details of Simplified Tax

- **Income Tax Rates.** The system has two income tax rates: 10 percent on taxable income (as defined below) up to \$100,000 for joint filers, and \$50,000 for single filers; and 25 percent on taxable income above these amounts. These tax brackets are adjusted each year by a cost-of-living adjustment, as measured by increases in the consumer price index [CPI]. (See Table 1 and Table 2 on the next page for a comparison with current tax brackets.)
- **Taxable Income.** Taxable income equals gross income minus a standard deduction and personal exemption.
 - *Standard Deduction.* The standard deduction is \$25,000 for joint tax filers, \$12,500 for single filers.

- *Personal Exemption.* The personal exemption is \$3,500.
- The combination is equivalent to a \$39,000 exemption for a family of four. There are no additional credits or itemized deductions.

Table 1: Tax Rate Comparison - Single Filers

Current Tax Code		Taxpayer Choice Act	
Marginal Rate	Taxable Income	Marginal Rate	Taxable Income
10 percent	\$0 - \$7,825	10 percent	\$0 - \$50,000
15 percent	\$7,825 - \$31,850		
25 percent	\$31,850 - \$77,100	25 percent	\$50,000 and over
28 percent	\$77,100 - \$160,850		
33 percent	\$160,850 - \$349,700		
35 percent	\$349,700 and over		

Table 2: Tax Rate Comparison - Joint Filers

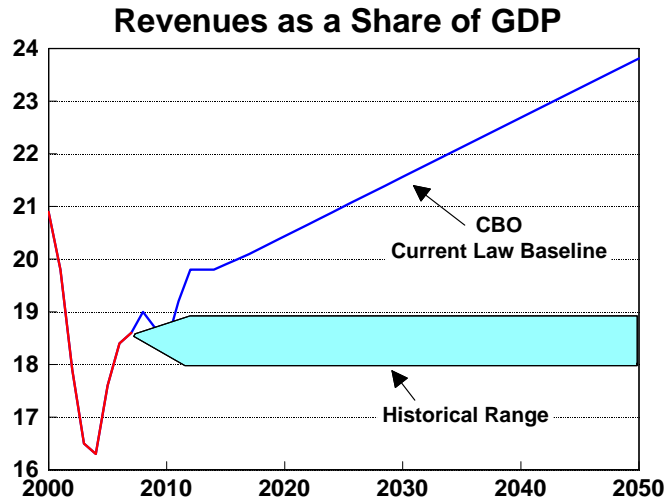
Current Tax Code		Taxpayer Choice Act	
Marginal Rate	Taxable Income	Marginal Rate	Taxable Income
10 percent	\$0 - \$15,650	10 percent	\$0 - \$100,000
15 percent	\$15,650 - \$63,700		
25 percent	\$63,700 - \$128,500	25 percent	\$100,000 and over
28 percent	\$128,500 - \$195,850		
33 percent	\$195,850 - \$349,700		
35 percent	\$349,700 and over		

- **Capital Gains and Dividends.** The Taxpayer Choice Act makes permanent the capital gains and dividend tax relief provisions of 2003. Capital gains and dividends will continue to be taxed at a maximum of 15 percent after 2010.

Estimated Revenue Effects

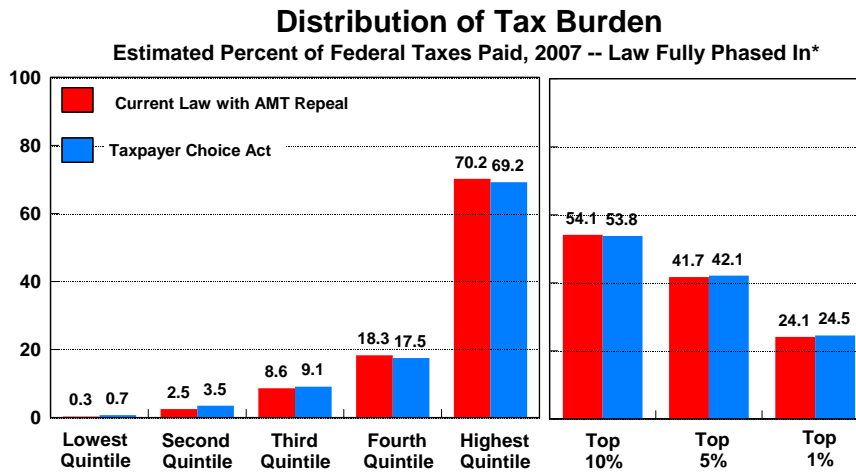
- **Revenue Comparison.** Provisions of the Taxpayer Choice Act are constructed to raise – in combination with existing corporate, payroll, and other taxes – approximately the same revenue total in the first year as would be raised under the current tax code excluding AMT revenue. This amount is approximately 18.5 percent of gross domestic product [GDP], roughly equivalent to average annual federal revenue over the past 40 years.
- **Revenue Trend.** No tax increases are assumed in the revenue estimates for the Taxpayer Choice Act in combination with other, unchanged, federal taxes.
 - Total federal revenue is expected to range between 18.5 percent and 19 percent of GDP. (Federal revenue as a percentage of GDP tends to drift upward because incomes generally grow slightly faster than real GDP, pushing taxpayers into higher brackets.)

- In comparison, the currently assumed path of tax law would consume increasing shares of the economy, reaching an unprecedented level of nearly 24 percent of GDP by mid-century (see chart below).



Sources: CBO Long-Term Budget Outlook, December 2005; Budget and Economic Outlook, January 2007; and House Budget Committee Republican Staff

- **Distribution of Tax Burdens.** The distribution of total tax burdens after application of the Taxpayer Choice Act is roughly equivalent to those under the current tax system excluding AMT, as shown in the chart below. For instance, taxpayers in the third income quintile (those earning between \$29,000 and \$50,000) would pay about 9 percent of overall taxes under the Simplified Tax, similar to the 8.6 percent under current law. (Note that these distribution tables are in 2007 income levels, but assume that the new tax law has been fully phased in.)



Note: Quintiles begin at: Second \$13,310; Third \$28,507; Fourth \$50,448; Highest \$87,758
 Top 10% \$128,676; Top 5% \$177,816; Top 1% \$432,275

* 2007 income levels assuming taxpayers were fully acclimated to the new law

Source: House Budget Committee Republican Staff

Staff Contacts

Paul Teller – House Republican Study Committee..... paul.teller@mail.house.gov
 Tim Flynn – House Budget Committee, Republican Staff..... Phone: 202-226-7270