RSC
Republican Study Committee
Rep. Jeb Hensarling (R-TX), Chairman
Russ Vought, Executive Director
132 Cannon House Office Building
Washington, DC 20515
www.house.gov/hensarling/rsc
ph (202) 226-9717 / fax (202) 226-1633

Legislative Bulletin……………………………………………June 25, 2008

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H.R. 6275—Alternative Minimum Tax Relief Act

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Order of Business: The bill is scheduled to be considered on Wednesday, June 25th, likely subject to a closed rule (allowing no amendments). The RSC will summarize the rule, if necessary, in a subsequent document.

Summary: H.R. 6275 would impose **$61.6 billion** in permanent tax increases on businesses and individuals over eleven years in order to prevent for just one year a huge, unintended tax increase. The main purpose of this bill is to place a one-year "patch" on the exemption level for the Alternative Minimum Tax (AMT), without which more than 25 million taxpayers would be subject to a large tax increase beginning in tax-year 2008.

NOTE: Last year, Congress and the President enacted a "clean" AMT patch for tax-year 2007 (Public Law 110-166) without any tax increases, after several attempts to patch the AMT with accompanying tax increases.

Highlights of H.R. 6275 are as follows:

- AMT "Patch". Provides for a $69,950 AMT exemption amount for married couples in 2008 (it was $66,250 in 2007 and would drop to $45,000 without a "patch"), for a $46,200 exemption amount for singles (it was $44,350 in 2007 and would drop to $33,750 without a "patch"), and the current-law relief for certain nonrefundable personal AMT credits. ***Saves taxpayers $61.52 billion over eleven years.***

- Carried Interest. Requires investment fund managers to treat carried interest as ordinary income (and thus be taxed at a higher rate) and increases the penalty for underpayments. Currently, carried interest is taxed at the capital gains rate, since carried interest is a capital gain. Carried interest is the name given to the compensation that fund managers earn based on the performance of the fund which they manage. This compensation is the main performance incentive driving fund managers to do better—but such compensation only comes from capital gains. It is by no means "ordinary" income. In fact, this capital gain revenue is already subject to the 35 percent corporate tax rate before it is distributed to investors as capital gains or dividends, meaning that it is already double-taxed when

the manager receives it, even at the 15 percent capital gains rate. Note: The bill would continue to tax carried interest at the capital gains tax rates to the extent that carried interest reflects a "reasonable" return on invested capital, as defined in the bill. The carried interest provisions would also apply to real estate partnerships and trusts, which had previously been excluded. ***Costs taxpayers $30.98 billion over eleven years.***

- Special Carve-Out for Oil and Gas. Denies a corporate tax deduction for income attributable to the production, refining, processing, transportation, and distribution of oil, natural gas, or any primary product thereof, beginning in 2009, for the five largest oil and gas companies. For any other (i.e. smaller) oil and gas manufacturing activity that would still qualify for the deduction, the rate would be permanently frozen at 6%, instead of rising to 9%, as scheduled under current law. According to the Joint Committee on Taxation, this provision would amount to a ***$13.57 billion tax increase*** on oil and gas companies over eleven years.

- Increased Taxes on Domestic Subsidiaries of Multinational Corporations. Denies certain U.S. subsidiaries of multinational companies the benefits of tax treaties in certain circumstances. When a U.S. subsidiary of a foreign-owned company makes certain tax-deductible payments (like interest, rents, and royalties) to a related party located in another country, the U.S. imposes a tax on those payments. The default rate is 30%, but this rate can be reduced, sometimes down to 0%, by tax treaties. The U.S. has 58 tax treaties with 66 different countries. H.R. 6275 would deny the U.S. subsidiary the benefits of the negotiated treaty rate when those tax-deductible payments are made by the subsidiary to a related foreign company, if the ultimate parent of the multinational company is based in a country that does not have a tax treaty with the U.S. ***Costs taxpayers $6.94 billion over eleven years.***

- Credit Card Reporting to the IRS. Requires banks and other institutions that make payments to domestic merchants in settlement of credit and debit card transactions to file information on such transactions with the Internal Revenue Service. This provision is aimed at closing the "tax gap" and is based on the assumption that merchants are underreporting their credit and debit transactions. ***Costs taxpayers $9.80 billion over eleven years.***

- Expansion of Levy Authority. Expands to property the types of things on which the federal government could place a levy when a taxpayer owes money to the federal government. Currently, the federal government may attach a continuous levy to payments made by the federal government to "vendors of goods or services sold or leased to the Federal Government," if such vendors owe the government taxes. H.R. 6275 would clarify that the federal government may attach a continuous levy to vendors of property. ***Costs taxpayers $301.0 million over eleven years.***

- Estimated Corporate Tax Payments. Increases the estimated tax payments that certain corporations must remit to the federal government. Corporations with assets of at least $1 billion would have to make estimated tax payments for the third quarter of calendar-year 2013 that are 159.5% of the estimated quarterly payment otherwise due. The

payment due for the fourth quarter of calendar-year 2013 would be reduced accordingly so that the corporations pay no net increase in estimated payments in calendar-year 2013. This large increase would force applicable companies to increase their estimated payments by ***$46.63 billion*** in the last quarter of fiscal year 2013 (though they would be offset by a corresponding reduction in the subsequent quarter). **NOTE:** This provision is merely a revenue timing shift, a budget gimmick used to comply with the House's PAYGO rules and has no net budget effect over eleven years. Without this gimmick, the bill would fail the PAYGO test for the six-year period.

Additional Background:

AMT: The AMT was created in 1969 as a mandatory add-on to the existing tax code to prevent 155 of the very wealthiest taxpayers from lowering their tax bills using the available deductions and credits. The AMT's reach has since grown dramatically through bracket creep.

The AMT has a two-tiered rate structure, 26% and 28%, and an exemption, so that most people do not currently pay the AMT (which is always a higher tax than the tax calculated under the regular tax system).

Unlike other exemptions in the tax code, the AMT exemption (currently $45,000 for joint returns in tax-year 2008) is not adjusted for inflation. As a result, though meant for the wealthiest of taxpayers, 3.5 million taxpayers were subject to the AMT in 2006, and tax organizations estimate that over **25 million taxpayers may be subject to the AMT in 2008**, absent congressional action.

Another important reason the AMT is negatively impacting more and more taxpayers is the 1993 tax increase, written by a Democrat Congress and signed into law by President Clinton. The Democrats raised the then-24% rate to 26% on the first $175,000 of AMT-taxable income above the exemption and 28% on the AMT-taxable income in excess of $175,000.

Section 199 Tax Deduction: Current law (26 U.S.C. 199), passed as part of the "FSC-ETI" bill (Public Law 108-357), provides for a (phased-in 9%) corporate tax deduction for **nearly all** domestic economic manufacturing and production (except retail food sales and the transmission or distribution of electricity, natural gas, or drinkable water). This tax deduction was a replacement for the extraterritorial income ("ETI") exclusion deemed noncompliant with requirements of the World Trade Organization. This bill would add oil and gas production and distribution as an **exception** to this broad deduction so that they could not deduct such expenditures (and thus be subject to a substantial tax increase). This would amount to a multi-billion-dollar tax increase on oil and gas companies that could yield higher energy prices for consumers.

Disincentives for domestic energy production and investment naturally make foreign energy investment and reliance more attractive.

Democrats have cited increasing oil-industry profits as the prime motivation behind this legislation. Thus, Democrats believe it is the federal government's responsibility to determine

which American companies' profits are too high and to subsequently try to reduce them. Furthermore, Americans for Tax Reform has noted that, "Almost all large oil and gas companies are publicly-traded entities, whose shares are owned by millions of investors through their 401(k) plans, retirement plans and pension funds. Taxing away the earnings of those companies negatively impacts the ability of hard-working Americans to achieve a more financially secure future."

On January 16, 2007, the *Wall Street Journal* editorialized about H.R. 6, which contained the Section 199 carve-out for oil and gas by noting that "the biggest winner may be OPEC." On the same day, even the *New York Times* cast doubt on the repeal of tax incentives in H.R. 6: "Fair enough, but that's not an energy policy."

According to the American Petroleum Institute (API), citing information from the Department of Energy's Energy Information Administration (EIA), in 2006, the top 27 energy producing companies accounted for about 44% of the total U.S. crude oil and natural gas production, and 81% of U.S. refining capacity. In that same year, these companies paid about $81.5 billion in income taxes (**an 82% increase in just two years**), resulting in an overall effective tax rate of 37%— more than the top U.S. corporate income tax rate of 35%.

RSC Bonus Fact: In 1999, the Republican Congress sent legislation to the President fully repealing the AMT, yet President Clinton vetoed that bill.

Committee Action: On June 17, 2008, H.R. 6275 was introduced and referred to the Ways & Means Committee, which, on June 18th, marked up the bill and ordered it reported to the full House by a party-line vote of 22-16.

Possible Conservative Concerns: Consensus is building around the need to repeal, not just "patch" for one year, the AMT for individuals, which is a mandatory recalculation of the tax bill of certain taxpayers that always leads to higher taxes for these taxpayers. Repealing the AMT would save taxpayers billions of dollars immediately and thereafter.

One significant point of controversy is whether the repeal of the AMT should be "offset" by tax increases or spending cuts elsewhere. In short, the offset approach is based on the notion that the government ***is entitled to*** the increasingly higher tax revenues from the AMT (even though these higher revenues were never intended to be collected). That is, this approach is based on the philosophy that the correction of tax mistakes should be offset with tax increases so that there is no net loss of revenue to the federal government, even if the tax increases apply to different people than do the tax mistakes. The offset approach takes a government-first perspective; it views revenues from the vantage point of the federal government, rather than from the individual taxpayer.

Most conservatives have grave concerns with the offset (i.e. tax-increase) approach and thus with the legislation summarized above, since it offsets temporary tax relief with permanent tax increases.

Many conservatives believe on principle that no tax relief, especially income tax relief, *needs* to be offset, since tax relief is savings to taxpayers. Most tax relief allows taxpayers to keep more of their own money; it does not "cost" the government anything. If, however, tax relief must be offset, it should be offset with spending reductions, not tax increases.

Many conservatives would argue that the principled opposition to offsetting tax relief *especially* applies in instances where the tax relief is being provided to correct a mistake or oversight by the federal government, as it does in the case of the AMT. The correction of tax mistakes applicable to one set of people should never be offset with tax increases on a different set of people, as would be the case under H.R. 6275. That is, most conservatives believe that it is improper for the federal government to punish some people and businesses with higher taxes just because the federal government unintentionally increased taxes on other people.

Under current law, the Congressional Budget Office projects that federal revenues will increase faster than economic growth. In other words, the tax burden (measured as a percentage of Gross Domestic Product) is expected to increase. This would still be true, just to a smaller extent, if the AMT were reduced or even eliminated. Thus, the only rationale for "paying" for an AMT reduction with any offsetting tax increase is the belief that the tax burden *should be higher* than it currently is or than what it has historically been. Conservatives believe in a lower tax burden for all Americans.

Many conservatives have expressed strong objections to some of the particular tax increases and other provisions included in H.R. 6275, including:

- Carried Interest: "Carried interest" is just another phrase for gains made from investments. It is by no means "ordinary" income since it is incentive compensation based solely on capital gains that may or may not be realized. Should capital gains not be taxed at the capital gains rate? Changing the carried interest taxation rates would both remove a huge incentive for investment fund managers to make their funds more profitable to investors and force partners to offer high pre-tax compensation to fund managers, thereby lowering returns for millions of investors who rely on capital gains or dividend income.

- Marriage Penalty: The AMT "patch" contains a large marriage penalty (since the exemption for married couples filing jointly is not double that for singles). Note: The existing exemption already contains a marriage penalty, but this "patch" does nothing to correct that.

- Energy Tax Increases. The bill would carve oil and gas companies out of a broad domestic manufacturing tax deduction available to nearly all manufacturing in the United States, yielding disincentives for domestic energy production and investment and making foreign energy investment and reliance more attractive. At a time when gas prices are soaring and energy supplies are artificially constrained, increasing taxes on energy companies will make it even less likely that energy prices can come down.

- Credit Card Reporting. The credit/debit card reporting requirement raises concerns over increased administrative and cost burdens on merchants (to reconcile the information provided by the banks and third-party payment reconcilers with their own books, records, and tax returns) and the banks and payment reconcilers (to compile the required information). Concerns have also been expressed about whether the IRS can even use the huge volume of information it would receive to properly find underreporting merchants. Lastly, the approach taken by this provision violates the "voluntary" tax system in which the taxpayer is trusted to provide accurate information, unless information arises to cause suspicion to the contrary. This provision would assume all merchants guilty until proven innocent and would require banks and third-party payment reconcilers to essentially "tattle" on their customers (the merchants).

- Timing Shift Budget Gimmick. Some conservatives may be concerned about the use of a corporate estimated tax payment timing shift as a budget gimmick for complying with PAYGO rules on paper. This particular shift is quite large (most payment shifts used previously in other Democrat bills have been much smaller), forcing some companies to pay more than one-and-a-half times their normal estimated tax payment for the fourth quarter of fiscal year 2013 ($43.6 billion in shifted payments). American businesses should not be forced to come up with extra money in a quarter to remit to the federal government just because of Congress' desire for budget gimmickry.

Lastly, the Joint Committee on Taxation estimates that the costs required to comply with the bill's mandates would exceed the annual threshold established by UMRA for private-sector mandates ($136 million in 2008, adjusted annually for inflation) in each of the next 10 years (2009 through 2018), thereby yielding an UMRA point of order against the bill's consideration.

Administration Position: Although a Statement of Administration Policy (SAP) for H.R. 6275 was not available at press time, the SAP for H.R. 3996 last year, an AMT patch bill with accompanying tax increases, noted that, "the Administration does not believe the appropriate way to protect 21 million additional taxpayers from 2007 AMT liability is to impose a tax increase on other taxpayers. Accordingly, if H.R. 3996 were presented to the President in its current form, the President's senior advisors would recommend he veto the bill."

Cost to Taxpayers: The Joint Committee on Taxation (JCT) estimates that H.R. 6275 would save taxpayers $1.133 billion in FY2008 and $49.656 billion over the FY2008-FY2012 period. These net tax benefits would disappear over the ten-year period.

Does the Bill Expand the Size and Scope of the Federal Government?: The bill would permanently increase taxes on some businesses and individuals and temporarily offer tax relief to others.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: According to the JCT, H.R. 6275 contains no intergovernmental mandates, but does contain four private-sector mandates, as defined in the Unfunded Mandates Reform Act (UMRA):

- Carried interest;
- Oil and gas tax increase;

- The tax treaty provision; and
- The credit/debit card provision.

The JCT estimates that the costs required to comply with the mandates would exceed the annual threshold established by UMRA for private-sector mandates ($136 million in 2008, adjusted annually for inflation) in each of the next 10 years (2009 through 2018).

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: The Ways & Means Committee, in House Report 110-728, asserts that, "Pursuant to clause 9 of rule XXI of the Rules of the House of Representatives, the Ways and Means Committee has determined that the bill as reported contains no congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of that rule."

NOTE: This bill contains a limited tax **harm** (the special carve-out for oil and gas companies from the broad manufacturing tax deduction), though House Rules does not provide a point of order against limited tax harms—just benefits.

Constitutional Authority: The Ways & Means Committee, in House Report 110-728, cites constitutional authority in Article I, Section 8, Clause 1 (the congressional power to lay and collect taxes, duties, imposts, and excises to pay the debts and provide for the common defense and general welfare of the United States) and the 16th Amendment (the congressional power to tax incomes).

Outside Organizations: Opponents of H.R. 6275 at press time include, at a minimum:

- American Conservative Union;
- Americans for Prosperity*;
- Americans for Tax Reform* ;
- FreedomWorks*;
- National Taxpayers Union*; and
- Small Business and Entrepreneurship Council.

* = key-voting

The payment card reporting provision of the bill is being specifically opposed by:

- Air Conditioning Contractors of America;
- Alliance of Independent Store Owners and Professionals;
- American Bankers Association;
- Americans for Tax Reform;
- Associated General Contractors of America;
- Independent Community Bankers of America;
- Information Technology Association of America;
- National Association for the Self-Employed;
- National Electrical Manufacturers Association;
- National Federation of Independent Business;
- North American Retail Hardware Association;

- Petroleum Marketers Association of America;
- Printing Industries of America;
- Saturation Mailers Coalition;
- Small Business Legislative Council;
- Society of American Florists ;
- Specialty Tools and Fasteners Distributors Association;
- Tire Industry Association; and
- U.S. Chamber of Commerce.

RSC Staff Contact: Paul S. Teller, paul.teller@mail.house.gov, (202) 226-9718