WebMemo
Published by The Heritage Foundation
No. 1679
October 25, 2007

The Rangel Tax Bill: Roses Among the Thorns

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Representative Charlie Rangel (D–NY), chairman of the House Ways and Means Committee, introduced his long-awaited tax reform proposal on October 25. As with most attempts to reshape the tax policy landscape, this one contained some roses and some thorns. The roses were exceptional, and the thorns would hurt.

In the current Congress, the Rangel proposal has no chance of enactment, neither in its current form nor in any recognizable variant. Its importance is as a policy statement of the chief Democratic tax policy writer in the House of Representatives, expressed in black and white. As such, it offers a useful glimpse of where tax policy is likely to go in the next Congress if the chairman is allowed to work his will with a more sympathetic resident occupying the White House.

While the details are still trickling out, the basic roadmap is clear enough. Under the chairman's bill, taxes would increase by about a half-trillion dollars over the next 10 years. Much of that increase would fall on small businesses, especially on small manufacturers. The bottom line: higher taxes, fewer jobs, and lower wages.

While the overall bill is badly flawed, it nevertheless includes some excellent features that ought to be highlighted and included in future legislation. Subsequent analyses will delve into the Rangel plan in greater depth, but there are important issues to consider up front.

A Hidden Tax Hike. As part of his tax reform plan, Chairman Rangel is proposing a one-year extension of the Alternative Minimum Tax (AMT) patch. The AMT patch has been extended every year since its adoption in 2001, sparing millions of unsuspecting taxpayers a huge tax hike. Breaking with prior practice, Mr. Rangel proposes paying for the patch by raising taxes on other taxpayers. In the past, Congress extended the patch without raising taxes. Chairman Rangel proposes to extend the patch and raise taxes, too.

Beyond 2007, Chairman Rangel would continue this pattern of raising taxes year after year. No doubt he will argue the contrary, pointing to Joint Tax Committee tables for support. However, the Congressional Budget Office revenue baseline scores *current law* with respect to taxes, and *current services* with respect to spending. Thus, the revenue baseline is assumed to be higher when a six-year-old AMT patch expires, but the spending baseline is not reduced when a nine-year-old SCHIP program expires. This asymmetric treatment of revenues and spending is unreasonable and unjustified. Its effect is that extending the AMT patch is shown as a tax cut according to JTC scoring, while allowing the patch to expire is not a tax increase. This is absurd.

This paper, in its entirety, can be found at:
www.heritage.org/Research/Taxes/wm1679.cfm

Produced by the Thomas A. Roe Institute
for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

The Heritage Foundation
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Chairman Rangel is proposing a net tax increase on the order of a half-trillion dollars over 10 years. But if Congress continues with these illogical scoring rules as they apply to taxes, then according to analysis by the Republican staff of the House Ways and Means Committee, the chairman is on course to raise taxes a whopping $3.5 trillion. That would be a crushing blow for the American economy, jobs, and wage growth.

The Roses. The Rangel bill is not all bad news. It also includes some excellent elements that ought not be lost in the avalanche of opposition. While the bill uses the confusion over the AMT patch and the revenue baseline as a screen for raising taxes, it also takes the excellent step of repealing the whole AMT system. This reform is long overdue. The AMT is today a tax policy without purpose, a complication without virtue. The problem with the Rangel bill is not the repeal of the AMT but the manner and extent to which the repeal is offset with other tax increases.

The Rangel bill also reduces the corporate income tax rate from the current 35 percent to 30.5 percent. The U.S. corporate tax rate hike is among the highest of the industrialized countries. It must come down significantly if American companies are to remain competitive at home or abroad. The only criticism of this portion of the bill is that the rate should come down further.

And the Thorns. In addition to the tax hike generally, the Rangel bill includes some terrible provisions. The worst of these is the new 4 percent surtax on married filers with adjusted gross incomes (AGIs) above $200,000 (4.6 percent for higher income taxpayers). Having recognized the importance of lower marginal tax rates, Mr. Rangel would cut the corporate tax rate with his bill. But then he raises tax rates on individuals and small businesses, indicating a serious condition of economic policy schizophrenia.

Also, the surtax applies to AGI, not taxable income. So while jacking up tax rates, Mr. Rangel has also found a backdoor way to phase down the number of itemized deductions taxpayers can take. Perhaps Mr. Rangel can explain what he has against charitable contributions; or the deduction for state and local taxes; or the home mortgage deduction at a time when the housing industry is reeling.

Another problem is that the bill increases the amount of the child credit that is refundable. In effect, this is another spending hike run through the tax code and paid for with a tax increase on other taxpayers. This Congress has excelled at the game of "tax and spend." Chairman Rangel has managed to propose an increase in both taxes and spending in a single tax bill.

The Rangel bill also eliminates the deduction introduced in 2004 specifically for manufacturing activities. This provision effectively lowers the tax rate on manufacturers. Eliminating the manufacturing deduction is fine when accompanied by a lower corporate tax rate. But manufacturers that operate as partnerships, sole proprietorships, or S corporations would not get a rate cut under the Rangel bill; they would get a new 4 percent to 4.6 percent surtax. This provision would be a hammer blow to all the manufacturing companies in America (and their workers) that are not traditional C corporations.

Conclusion. Raising taxes either overtly or covertly, under the cloak of revenue baseline games, is neither needed nor appropriate. With taxes already above the modern norm, Congress should be looking for opportunities to bring the level of taxes down.

The Rangel bill has other serious problems that are immediately apparent; others may appear as the bill is further scrutinized. Raising tax rates and weakening non-corporate manufacturers certainly moves in the wrong direction in terms of maintaining a healthy economy.

For all its flaws, the bill has some virtues that ought not be lost. Repealing the AMT and cutting the corporate tax rate are very high priorities for tax policy. Hopefully, someone in Congress will introduce legislation to achieve these goals without the thorns of the Rangel proposal.

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