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2010 Budget Resolution Raises Taxes and Hurts Economic Recovery

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Congress recently passed the fiscal year (FY) 2010 budget resolution, which sets broad guidelines for specific policies that it will formulate in the coming months. The resolution includes several provisions that will significantly raise taxes and hurt economic recovery.

These provisions include:

- Allowing the 2001 and 2003 tax cuts to expire for couples making over $250,000 and singles earning over $200,000. This includes increases of rates on income, capital gains, and dividends.
- Extending the Alternative Minimum Tax (AMT) patch, but for only three years.
- Making permanent the death tax at its 2009 level.
- Eliminating the Making Work Pay Credit after 2010.

Each of these provisions is a substantial tax increase that would hurt the economy in good times but will devastate it in its current weakened state. Congress should reject these provisions and instead pursue pro-growth policies that will help the sputtering economy.

Make 2001 and 2003 Tax Cuts Permanent for All Taxpayers. The budget resolution calls for extending the 2001 and 2003 tax cuts for taxpayers earning under $250,000 if they are married and $200,000 if single. Congressional Democrats claim this is a tax cut since under current law the tax cuts expire. But simply preventing a massive tax hike is not a tax cut.[1]

The resolution also calls for the repeal of the tax cuts for upper-income earners. The top income tax rates are currently 33 and 35 percent for married filers earning over $208,850 and $372,950, respectively. For singles, the same rates apply to incomes over $171,550 and $372,950, respectively.

If the policies in the budget resolution become law, these rates will rise to their pre-2001 levels. The 33 percent rate will increase to 36 percent and the 35 percent rate to 39.6 percent. The brackets will likely be set so the 36 percent rate kicks in at $250,000 for couples and $200,000 for singles. The 39.6 percent rate will likely kick in slightly above $372,950 after accounting for inflation.

According to President Obama's own budget, raising these rates will take $339 billion out of the pockets of upper-income taxpayers and many small businesses over the next 10 years.[2] Taxpayers could save or invest this money to fuel economic recovery, but instead Congress will take it and undoubtedly use it in a less productive fashion.

The budget resolution also increases the tax rates on dividends and capital gains from 15 to 20 percent for taxpayers earning more than $250,000. These

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tax hikes would raise the cost of capital and reduce investment, further hampering economic recovery.

America is currently in the midst of a terrible economic crisis. This is not the time to raise taxes on anyone. Higher taxes on small businesses and higher taxes on investment capital are policies that would weaken the economy under any circumstances. Congress should instead extend the 2001 and 2003 tax cuts for all taxpayers.

Extend AMT Patch Permanently. The AMT's exemption level is not indexed for inflation, so each year it threatens to raise taxes on millions of middle-income earners. Congress passes a one-year patch every year to prevent this, but so far it has resisted making it permanent.

The budget resolution extends the patch for three years to stop the yearly exercise—for now. After 2012, the patch expires and Congress will again have to pass it annually; otherwise taxes will increase for millions of taxpayers, including millions of middle-income earners.

Congress should stop this budgeting charade and finally make the patch permanent. Once they finally make the patch permanent, they should start work to abolish the AMT altogether.[3]

Kill the Death Tax. Under current law, the death tax expires in 2010 but comes back to life in 2011. If the budget resolution becomes law, Congress would permanently extend the death tax at its 2009 levels. This includes an exemption of $7 million for couples—$3.5 million for singles—and a 45 percent rate.

The death tax is a drag on productivity because it discourages saving and investing and undermines job creation and wage growth.[4] These activities should never be discouraged, especially during an economic crisis. Congress should repeal the death tax once and for all instead of extending it at 2009 levels.

Substitute Tax Rate Cuts for Making Work Pay Credit. The Making Work Pay Credit is a refundable $400 credit for singles, $800 for couples, passed as part of the stimulus legislation. It applies only against earned income, so taxpayers who receive their income from investments and Social Security—such as retirees—cannot claim it.[5]

Although a centerpiece of President Obama's campaign, Congress chose not to extend the credit past 2010, when it is due to expire. This provides an excellent opportunity to substitute pro-growth tax policies that would lower tax rates and encourage economic growth.

The credit does nothing to promote economic expansion because it does not lower tax rates to encourage working, saving, or investing.[6] Congress should allow the credit to expire, replacing it with a reduction in all income tax rates. This would boost the economy by increasing the incentives for investing in businesses.

More Trouble Ahead. The tax policies included in the budget resolution are a harbinger of higher and more economically damaging taxes to come. The budget resolution increases taxes $1,500 billion over the next 10 years.[7]

1. J. D. Foster, "Fair Tax Policy Requires a Fair Revenue Baseline," Heritage Foundation *WebMemo* No. 1848, March 13, 2008, at *http://www.heritage.org/Research/Budget/wm1848.cfm*.
2. U.S. Office of Management and Budget, *A New Era of Responsibility: Renewing America's Promise* (Washington, D.C.: U.S. Government Printing Office, 2009), pg. 123, Tables S-6, at *http://www.whitehouse.gov/omb/assets/fy2010_new_era/A_New_Era_of_Responsibility2.pdf* (April 30, 2009).
3. J. D. Foster and Stephen Keen, "Senate Tax Extenders: Another Sneaky Tax Hike," Heritage Foundation *WebMemo* No. 2006, July 30, 2008, at *http://www.heritage.org/Research/Taxes/wm2006.cfm*.
4. William W. Beach, "Now Is (Still) the Time to Permanently Repeal Federal Death Taxes," Heritage Foundation *WebMemo* No. 720, April 12, 2005, at *http://www.heritage.org/Research/Taxes/wm720.cfm*.
5. Curtis S. Dubay, "'Making Work Pay Credit' Will Not Stimulate the Economy," Heritage Foundation *WebMemo* No. 2240, January 26, 2009, at *http://www.heritage.org/Research/Taxes/wm2240.cfm*.
6. Stuart M. Butler, "Permanent Tax Relief—Not Tax 'Holidays'—Stimulates Economic Growth," Heritage Foundation *WebMemo* No. 2152, December 3, 2008, at *http://www.heritage.org/Research/Taxes/wm2152.cfm*.

But this is likely not the end of tax hikes: The deficits projected in President Obama's Budget Blueprint, and adopted by the budget resolution, average just shy of $1,000 billion each year over the next 10 years. And this does not include the revenue shortfalls in Social Security, Medicare, and Medicaid that will occur in the next few years and further increase these massive deficits.[8]

Congress will inevitably raise taxes on all Americans—not just the top 5 percent of income earners—to try to reduce these growing deficits. These tax hikes will discourage economic activity and put a damper on economic growth once the U.S. economy recovers from this severe recession.

Wrong Policies. As the economy continues to falter, pro-growth tax policy is more important than ever. The tax policy provisions in the budget resolution do not promote economic growth but instead discourage it.

The most effective way to spur economic recovery is to increase incentives that drive economic recovery. To do so, Congress should abandon the policies in the budget resolution and reduce tax rates on work, saving, investment, risk taking, and entrepreneurial activity.[9]

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7. Republican Caucus Committee on the Budget, "The Conference Report on S. Con. Res. 13: The Obama Plan for Spending, Taxes, and Debt," April 28, 2009, at *http://www.house.gov/budget_republicans/press/2007/pr20090428_demplan.pdf* (May 4, 2009).
8. Brian M. Riedl and Alison Acosta Fraser, "How to Reform Entitlement Spending: A Memo to President-elect Obama," Heritage Foundation *Special Report* No. 43, January 13, 2009, at *http://www.heritage.org/Research/Budget/sr0043.cfm*.
9. J. D. Foster and William W. Beach, "Economic Recovery: How Best to End the Recession," Heritage Foundation *WebMemo* No. 2191, January 7, 2009, at *http://www.heritage.org/Research/Economy/wm2191.cfm*.