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Obama Tax Hikes: McConnell–Grassley Tax Hike Prevention Act Would Help Taxpayers and Economy

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The 2001 and 2003 tax relief packages are set to expire at the end of this year. If these packages are allowed to expire, on January 1, 2011, taxes will go up automatically for American taxpayers—without a single piece of legislation ever crossing the President's desk.

President Obama's plan, which is nearly identical to the blueprint adopted by Congress earlier this year, is to hike taxes on families, small businesses, and investors earning over \$250,000 while preserving the tax relief for families earning less than that threshold. Although the President has offered his plan for more than two years now and the expiration date of current law has been known for years, there still is no pending legislation in Congress to prevent tax hikes for any taxpayers. With the expiration of the tax relief fast approaching, the absence of actual legislation increases the likelihood that Congress will do nothing and simply allow all the tax relief to expire.

Senate Minority Leader Mitch McConnell (R–KY) and Senator Charles Grassley (R–IA) have stepped into the breach and offered the Tax Hike Prevention Act, a plan that would, as its name says, prevent these forthcoming tax hikes for all taxpayers—permanently. Their plan is the right move for the economy because it would give families, small businesses, seniors, and investors the certainty and right policies needed to prevent a steep tax hike that would cause Americans to cut back on work and investing as the economy continues to struggle.

McConnell–Grassley Plan Good for Economy.

The McConnell–Grassley plan makes permanent all the 2001 and 2003 tax relief. Below is a list of the most important provisions that the plan makes permanent and what the economic impact would be if Congress allows them to expire.

- **Maintains all income tax rates at their current levels.** The 2001 and 2003 tax relief reduced all tax rates and introduced a new 10 percent tax bracket for low incomes. If Congress allows the tax rates to increase or passes President Obama's plan, the top two rates will increase from 33 and 35 percent to 36 and 39.6 percent, respectively. The McConnell–Grassley plan keeps tax rates where they have been for the past decade and prevents a reduction of the incentives for small businesses to invest and create new jobs.
- **Maintains tax rates on capital gains and dividends.** The 2001 and 2003 tax relief set the tax rates on both capital gains and dividends at 15 percent. The rate on capital gains will rise to 20 percent and the rate on dividends to 39.6 percent without legislative action. The McConnell–Grassley plan keeps the tax rate on both at 15 percent. Higher rates on capital gains and divi-

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dends would cause businesses and investors to scale back investing. Higher rates would also hit seniors particularly hard, because such rates would confiscate a substantial portion of their income. Moreover, higher taxes on dividends would also undermine American companies' ability to compete internationally.¹ Maintaining these rates at their current levels is vital for aiding economic recovery.

- **Sets death tax at 35 percent.** The death tax is not in effect in 2010. In its place heirs pay capital gains on the assets they acquire from a decedent. In 2011, the death tax returns at a punitively high 55 percent rate and only a \$1 million exemption. A death tax at those levels would threaten the existence of countless family-owned businesses that cannot afford to protect themselves from the scourge of the death tax like the estates of wealthier families. Although full repeal of the death tax would be best for the economy, the McConnell-Grassley plan adopts the proposal long championed by Senators Jon Kyl (R-AZ) and Blanche L. Lincoln (D-AR) of setting the death tax rate at 35 percent and exempting estates worth less than \$5 million. This compromise would be far better for the economy than a 55 percent death tax, though killing it once and for all would be superior.²
- **Permanent AMT patch.** The Alternative Minimum Tax (AMT) is a secondary tax system that Congress originally designed to make sure the tax bills of the very highest-income taxpayers were not too low. Even though it is supposed to affect

only high-income families, the AMT threatens to increase the tax bills of middle-income families each year because the threshold for the AMT does not increase with inflation. As Congress has failed to fix the AMT's creeping reach, it must pass a patch each year to prevent middle-income families from paying the AMT. The McConnell-Grassley plan would patch the AMT permanently so it does not annually threaten middle-income families with higher taxes.

- **Continues tax relief for families.** The 2001 and 2003 tax relief reduced the marriage penalty that caused married couples to pay higher taxes than two singles earning the same amount. They also increased the child tax credit from \$500 to \$1,000. If Congress fails to act this year, married couples will pay higher tax rates than singles again starting next year, and families with children will see their child tax credit cut in half. The McConnell-Grassley plan prevents these family-unfriendly changes from taking place.

Keep Tax Rates Where They Are. Raising taxes during a struggling economy makes no sense. Doing so now would slow this lagging recovery even further. Raising taxes on investment, work, and savings would diminish all three—hardly a recipe for creating jobs.³

The McConnell-Grassley plan recognizes that preventing steep tax rates permanently is good policy any time but especially in a struggling recovery.

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1. See Rea Hederman, Jr., *and* Patrick Tyrrell, "Obama Tax Hikes: Dividend Tax Increase Hurts Seniors and the Economy," Heritage Foundation *Backgrounder* No. 2460, September 10, 2010, at <http://www.heritage.org/Research/Reports/2010/09/Obama-Tax-Hikes-Dividend-Tax-Increase-Hurts-Seniors-and-the-Economy>.
2. See Curtis S. Dubay, "The Economic Case Against the Death Tax," Heritage Foundation *Backgrounder* No. 2440, July 20, 2010, at <http://www.heritage.org/Research/Reports/2010/07/The-Economic-Case-Against-the-Death-Tax>.
3. See J. D. Foster, "Obama Tax Hikes Defended by Myths and Straw Men," Heritage Foundation *Backgrounder* No. 2454, August 26, 2010, at <http://www.heritage.org/Research/Reports/2010/08/Obama-Tax-Hikes-Defended-by-Myths-and-Straw-Men>.