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The AMT Patch: A Few Months Late and $51 Billion Heavy

J.D. Foster, Ph.D.

As the 2007 session of Congress draws to a merciful close, the Senate and the House of Representatives remain at loggerheads over extension of the patch for the Alternative Minimum Tax (AMT). The AMT patch may be the most important of many unresolved end-of-year fiscal policy issues. The issue is not the wrongness of the AMT, which is no longer in question; nor is it one of fiscal responsibility, as some coyly suggest. The immediate issue is whether Congress is going to enact a major tax hike. While important in its own right, the significance of this debate is magnified many times when considering that Congress might enact a vastly greater tax hike for 2011. Congress must prevent this unnecessary AMT tax hike and should reform the budget rules to eliminate the threat of similar tax hikes in the future.

Substituting One Tax Hike for Another. On December 12, the House of Representatives passed H.R. 4351, its latest attempt to extend the AMT patch and thereby prevent the AMT from falling on 21 million additional taxpayers.[1] Unwisely, the House opted to use the occasion to raise taxes by $51 billion.

The Senate is expected to act before adjourning for its Christmas holiday break. Thus far, the Senate has agreed with the Administration that the AMT patch should be extended and that it should not be used as an excuse to raise taxes. The Senate should stick to that position. If the Senate falters, then the Administration should not hesitate to sustain its position. If the Administration stands its ground, then the prospect of millions of additional taxpayers facing an AMT tax hike should be scary enough to convince the House to give up its taxing ambitions.

Symmetric Baselines: Fair and Accurate. Normally, one might think that cutting taxes through tax legislation means that some group of taxpayers would pay less in taxes and that aggregate tax receipts would be lower. But this is not how it works in Washington. In Washington, if a tax provision that provides tax relief expires, then restoring that tax provision is treated as a new tax cut. This, of course, is absurd.[2]

This is not just a matter of semantics. Washington budget games are played according to exacting rules. One such rule is called "Pay-As-You-Go," or PAYGO. Under PAYGO, a tax cut must be offset with a tax increase, a cut to entitlement spending, or some combination of the two. The baseline against which tax changes are measured is therefore critical. If the revenue baseline more sensibly reflected current policy—thereby ignoring whether a current tax provision is set to expire at some point—then extension of that provision would not "trigger" PAYGO's requirement for offsets.

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(202) 546-4400 • heritage.org

In contrast to the revenue baseline, the spending baseline reflects current policy. The State Children's Health Insurance Program (SCHIP) is one example. This program expired earlier in 2007. Its annual cost at the time was $5 billion. The spending baseline Congress uses for PAYGO purposes assumes the program will be extended. Thus, legislation to extend SCHIP neither raises nor reduces spending relative to the baseline, and so it need not be offset with other spending reductions or tax increases. Only by increasing SCHIP spending above $5 billion does Congress trigger PAYGO consequences.

If SCHIP were treated in the spending baseline analogously to how the AMT patch is treated in the revenue baseline, then an extension of SCHIP would trigger a PAYGO violation. Even an SCHIP extension below $5 billion would have to be offset.

The revenue baseline should be formulated in the same manner as the spending baseline. Congress has two options for doing this. It could opt to treat spending the same way it treats taxes: When a spending program expires, drop it from the baseline. But a better option is to treat taxes like spending: Include a tax provision in the baseline even if it expires at some point in the future. The second option is better for two reasons.

First, it provides a more accurate picture to the nation and to policymakers as to what is most likely to happen in fiscal policy: Spending programs tend to be extended; revenue provisions tend to be extended. Accurate budget projections are important, because they signal to policymakers when a change in direction is needed or possible.

Second, treating revenues like spending is the far more politically achievable option. While lower spending would be welcome, it is far more likely that Congress will do the right thing and correct the asymmetry in the baseline formulations if current spending programs are presumed to continue.

Other Revenue Baseline Victims. The baseline issue that arises with the AMT patch shows up in other areas of tax policy. For example, the tax code has included a temporary Research and Experimentation (R&E) tax credit for decades. Typically, when the credit is about to expire, Congress extends it for another year or two. Because the credit then expires after a year or two, the revenue baseline increases immediately thereafter to reflect this fact. Thus, each time, PAYGO requires the extension of a long-standing R&E credit to be paid for with offsetting tax increases.

Numerous other tax provisions are included in the traditional "tax extenders" package, including the low-income housing tax credit and the work opportunity tax credit. Every time these provisions expire, they are eventually extended. And almost every time they are extended, Congress couples the temporary tax relief provisions with permanent tax hikes. While as a group they lack the tax revenue effect of the AMT patch, the basic message is the same for these tax extenders. Tax provisions that expire should not be dropped from the revenue baseline, and their extension should not require offsetting tax increases to satisfy the PAYGO rules.

Conclusion. At 18.8 percent of GDP, federal tax collections are above the modern historic average of 18.3 percent. The budget deficit in fiscal year 2007 was 1.2 percent of GDP, well below the historic average. All in all, there is neither need nor justification for Congress to raise taxes. Also, as the economy is slowing, with some talk of recession, tax hikes for any reason would be irresponsible and foolish. Congress should pass the AMT patch without sneaking a $51 billion tax increase into the bargain.

Congress should also correct the asymmetric treatment of taxes and spending in the formulation

1. The AMT patch is an increase in the AMT exemption amount. First enacted in 2001, the patch is a stopgap measure to protect most taxpayers from having to pay the AMT.
2. For a more complete discussion of the tax increase/baseline issue, see J.D. Foster, "Making Good Policy Out of a Bad AMT," Heritage Foundation *Backgrounder* No. 2082, October 31, 2007, at *www.heritage.org/Research/Taxes/bg2082.cfm*, and J.D. Foster. "AMT Fix Becomes Massive Tax Hike Via Misleading CBO Baselines," Heritage Foundation *WebMemo* No. 1695, November 7, 2007, at *www.heritage.org/Research/Taxes/wm1695.cfm.*

of the baseline forecasts. The better choice is to treat expiring tax provisions as expiring spending programs are treated currently. Preserving the status quo in how the baselines are formulated is unjustifiable on a policy basis and is simply unfair.

—J.D. Foster, Ph.D., is Norman B. Ture Senior Fellow in the Economics of Fiscal Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.