

## THE TAXONOMIST

**Tax Complexification**

By Robert S. McIntyre

**D**oes the Bush administration have a secret plan to impose a flat tax? The Bushies may not realize it, but under the President's tax program adopted last year, by the end of this decade most of the personal income tax will come not from the regular, graduated-rate system, but from the essentially flat-rate, individual alternative minimum tax.

This isn't supposed to be how the alternative tax—first adopted in 1969 to address horror stories about very wealthy people who sheltered all their income from tax—was supposed to work.

As recently as 1999, only a million taxpayers, almost all of them very well off, actually paid the alternative tax, which added just \$6.5 billion to federal revenues. But absent legislative change, by the time the Bush tax cuts are fully in place in 2010, 36 million families will have to fill out the complicated alternative tax forms, and cough up an extra \$140 billion on top of their regular taxes.

By 2010, some 28 million families, just under a fifth of all taxpayers, will earn between \$100,000 and \$750,000 a year (averaging \$177,000). Astonishingly, a staggering 24 million of these families will pay the alternative tax.

Even at less elevated income levels, the alternative tax will become a big deal by 2010, affecting more than 10 million of the 29 million families making between \$60,000 and \$100,000. Altogether, by 2010 taxpayers subject to the alternative tax will pay almost two-thirds of all income taxes. In fact, if all the regular income tax rates were cut to zero that year and everyone paid only the alternative tax, personal income tax payments would fall by only 10 percent.

As its name implies, the alternative tax makes potentially affected taxpayers figure their taxes twice. First, they do the calculations using the regular deductions and rates. Then they recompute their taxable income without certain write-offs, most notably for state and local taxes. After subtracting a flat exemption, what's left is multiplied by 26 percent (28 percent above \$175,000) to get the alternative tax. Whichever is bigger, the regular or alternative tax, is what they have to pay.

Why does the alternative tax threaten to engulf the personal income tax? Part of the reason is that its exemptions—\$45,000 for couples and \$33,750 for singles—haven't been adjusted since 1993. But much more important is the fact that Bush didn't accompany his cuts in the regular income tax rates with corresponding reductions in the alternative tax rates—creating a ticking alternative-tax time bomb.

When Bush kicked off his presidential campaign at the end of 1999 by trumpeting his tax-cut plan, I quickly put out an analysis of its likely cost and (regressive) distribution. Relying on what turned out to be disingenuous tax-cut

examples that Bush's campaign circulated, it seemed clear to me that the plan envisioned lowering the alternative rates along with the regular rates.

Bush's staff bitterly took issue with my analysis, insisting that I had overstated the tax plan's cost and that Gov. Bush had absolutely no intention of adjusting the alternative tax. Okay, fine, was my response, and I quickly put out new numbers reflecting the "clarification." That change did indeed make Bush's plan look somewhat less expensive, since it meant that people in the upper-income ranges—excluding the very best-off—wouldn't actually get most of the tax cuts that Bush was promising them.

**B**y mitigating their revenue problem, however, Bush's staff inadvertently hoisted themselves (and him) on a different petard. Even after Bush's tax cuts, the alternative tax will have only minor effects on the very rich, whose regular rates would usually still be higher than the 28 percent top alternative rate. So the upshot was that my revised estimates showed that the richest one percent's share of Bush's tax reductions would be even larger.

When Bush's tax plan reached Congress in early 2001, Democrats tried to make an issue of its vast alternative tax expansion. But the President and his congressional allies, struggling to squeeze Bush's \$2.5 trillion ten-year tax cut into a \$1.3 trillion budget target by manipulating effective dates, had no interest in seriously addressing an additional problem that would cost well over \$300 billion over the upcoming decade to fix.

As things now stand, the well-intentioned alternative tax is evolving into a complicated monstrosity that doesn't seriously affect the truly wealthy, but instead hits hardest on upper-middle-income families in states with relatively high public services and taxes. As a result, tens of millions of American taxpayers face the prospect of filling out their tax forms twice, only to discover that most of their promised Bush tax cuts were a lie. And so far, our Texas-bred, super-rich-coddling President seems unconcerned.

To paraphrase the late economist Herb Stein, if something can't happen, it probably won't. In that spirit, I have little doubt that public pressure to fix the alternative tax will force a solution in the not-too-distant future. The question is, how do we pay for it? I'd say that any reasonable answer must include scaling back some of the unaffordable, unfair Bush tax cuts that created the problem in the first place.

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