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Democrats Seek Formula To Blunt AMT; One Plan Would Impose Surtax Of 4.3% on Richest Households

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House Democrats looking to spare millions of middle-class families from the expensive bite of the alternative minimum tax are considering adding a surcharge of 4 percent or more to the tax bills of the nation's wealthiest households.

Under one version of the proposal, about 1 million families would be hit with a 4.3 percent surtax on income over \$500,000, which would raise enough money to permit Congress to abolish the alternative minimum tax for millions of households earning less than \$250,000 a year, according to Democratic aides and others familiar with the plan.

Rep. Richard E. Neal (D-Mass.), chairman of the House subcommittee with primary responsibility for the AMT, said that option would also lower AMT bills for families making \$250,000 to \$500,000. And it would pay for reductions under the regular income tax for married couples, children and the working poor.

All told, the proposal would lower taxes for as many as 90 million households, and Neal said it has broad support among House leaders and Democrats on the tax-writing House Ways and Means Committee. "Everybody's on board," he said.

Neal has yet to release details of the plan, however, and others inside and outside the committee say major pieces of it are still in flux. Some Democrats say Neal's plan stretches the definition of the middle class too far, providing AMT relief to too many wealthy households. They argue that the cutoff for families to be spared from the AMT should be lower, at \$200,000, \$150,000 or even \$75,000.

"There is consensus to make sure that we have some responsible tax policy that will also treat taxpayers fairly. No one ever expected to be caught in the AMT making 75 grand," said Rep. Xavier Becerra (D-Calif.), a Ways and Means Committee member whose Los Angeles district is populated by working poor. "We're trying to come up with a fix that does right by the great majority of Americans who fall into the middle class."

The debate has focused attention on a different surtax proposed by the Tax Policy Center, a joint project of the Urban Institute and the Brookings Institution. That plan would eliminate the AMT and replace it with a 4 percent surcharge on income over \$200,000 for families and \$100,000 for singles, cutting taxes for 22 million households and raising them for more than 3 million.

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"Our plan is as simple as can be. And only 2 percent of the whole population would have to pay it," said Leonard E. Burman, director of the Tax Policy Center. The plan has the added benefit of abolishing the complicated AMT at all income levels, Burman said, an approach some lawmakers find attractive.

On the other hand, fewer families' taxes would be cut, diminishing the ability of Democrats to capitalize on the plan politically. Since they took control of Congress in January, Democrats have made repealing or scaling back the AMT a top priority in hope of establishing tax-cutting credentials and seizing the issue from Republicans for the 2008 campaign.

The alternative minimum tax is a parallel tax structure created in 1969 to nab 155 super-rich tax filers who had been able to wipe out their tax bills using loopholes and deductions. Under AMT rules, taxpayers must calculate their taxes twice -- once using normal deductions and tax rates and once using special AMT deductions and rates -- and pay the higher figure.

Because the AMT was not indexed for inflation, its reach has expanded annually, delivering a significant tax increase this spring to an estimated 4 million households. The AMT would have spread even more rapidly after President Bush's tax cuts reduced taxpayers' normal bills, but Congress enacted yearly "patches" to restrain its growth. The most recent patch expired in December, and unless Congress acts, the tax is projected to strike more than 23 million households next spring, many of them earning as little as \$50,000 a year.

House Democrats want legislation to spare those households while also lowering the bills of many current AMT payers. But they face numerous obstacles. In the Senate, Finance Committee Chairman Max Baucus (D-Mont.) favors AMT repeal but considers it too ambitious for this year. Baucus has said another year-long patch is more likely.

In the House, some Democrats argue that more time is needed to explain the issue to the public. The vast majority of households have yet to pay the AMT and may not fully appreciate the value of eliminating the tax, while the wealthy are sure to feel the bite of a new surtax.

"I don't think there's enough of an understanding right now that you've got this tidal tax wave about to hit everybody," said Rep. Chris Van Hollen (D-Md.), a Ways and Means Committee member who is also chairman of the Democratic Congressional Campaign Committee. "From a political perspective, we need to lay the groundwork."

Before the Memorial Day break, Ways and Means Committee Chairman Charles B. Rangel (D-N.Y.) said he hoped to announce an AMT proposal as soon as Congress returned to Washington. But his timetable has slipped to late June, Democratic aides said, with the issue set to go before the full House sometime in July.

Republicans generally oppose new taxes on the wealthy, saying they disproportionately affect small businesses, but are waiting to hear more before deciding whether to work with Democrats or offer their own plan to abolish the AMT.

"House Democrats are going to have to find their sea legs on this issue fast," said Rep. Phil English (R-Pa.), the senior Republican on the Ways and Means tax subcommittee. "Folks seem to be launching a lot of trial balloons, and it's all very festive. But I don't have enough really to react to yet."

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