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NEWS ANALYSIS

By Howard Gleckman

The Swamp Known as Tax Reform

Killing the hated alternative minimum tax seems easy -- easy, that is, until politicians have to find ways of making up the shortfall

The alternative minimum tax is the levy everyone loves to hate. The mysterious parallel tax system will require more than 3 million mostly upper-middle class families to pay thousands of dollars in unanticipated taxes this year. And if Congress doesn't fix some serious problems with the tax, up to 30 million taxpayers could be hit with it by the end of the decade.

That's why a tax-reform commission appointed by President Bush is looking for a way to repeal the dreaded tax. Yet the panel, which is due to complete its work Nov. 1, is coming to grips with a much tougher question: In an era of already-big federal budget deficits, how will it make up the money the Treasury will lose if the AMT is repealed. "We have a concept of where we want to go," says commission Co-chairman John Breaux, a former Democratic Senator from Louisiana, "We just don't have the details."

Ah, those pesky details. Repealing the AMT will be staggeringly expensive. The tax is expected to bring in \$1.3 trillion over the next decade. In 2010 alone, it will generate \$112 billion, according to the Urban-Brookings Tax Policy Center, which provides nonpartisan analysis of tax issues. Even in a tax system that generates nearly \$2 trillion a year, that kind of dough isn't easy to come by.

WHAT'S LEFT? Tax rates could be raised, but that's not in the cards as long as George W. Bush is President. The only other alternative is to target a handful of popular deductions that save taxpayers hundreds of billions of dollars each year. On Oct. 11, panel members said they wanted to expand -- not cut -- one biggie: tax breaks for charitable giving.

Tax-free pension contributions and earnings are worth another \$100 billion per year. But trimming them hardly fits Bush's vision of an ownership society -- which is largely built on tax-advantaged savings.

That leaves three immensely precious tax breaks: mortgage interest and other incentives aimed at homeownership, state and local taxes, and the value of employer-provided health insurance. At its Oct. 11 meeting, commission members expressed a willingness to tackle at least two of these -- housing and health insurance. And with that, they have begun to wade into very deep water.

"IMPOSSIBLE" POLITICS. Tax breaks for home ownership have been nearly sacred. Almost 40 million taxpayers claim the mortgage-interest deduction. And these extremely generous write-offs are built into housing prices, especially at the top end. That's because high-bracket taxpayers can write off up to a third of their monthly interest cost. Sellers know that and reflect those lower after-tax monthly payments in higher asking prices.

The panel could recommend a couple of ways to limit those tax breaks. It may suggest turning the deduction into a fixed credit of, say, \$2,000 a year, or it could lower the current \$1 million cap

on deductible interest. MIT tax economist James Poterba, a panel member, concedes that messing with the mortgage deduction could give the housing markets a short-term jolt, but he says the pain could be eased if changes are phased in over a decade or more.

Still, such a idea is political dynamite. "The politics are impossible," says Leonard Burman of the Tax Policy Center. "Politicians do this at their peril."

HEALTH-INSURANCE HIT? Curbing the state and local tax deduction may be a little easier, but not much. President Reagan tried to do it in his landmark 1986 tax reform -- and failed. But AMT reformers say things have changed. The big difference: Taxpayers who are hit by the AMT lose the benefit of their state and local tax deduction anyway. They ought to be willing to give up that break if they can end the rest of their AMT nightmare. Perhaps. But it would still be a tough vote if the idea ever gets to Congress.

The most complicated of the tax breaks is aimed at the value of employer-sponsored health insurance. Today, companies take a tax deduction for the health coverage they provide their workers, just as they do for the wages they pay. But even though workers pay tax on wages, they don't pay on the value of their health benefits. And it is real money: this year, a typical employer-sponsored family policy will cost about \$10,000.

The Bush panel is considering a plan to limit that tax break. While details are still being worked out, employees could only exclude from tax the value of policies worth about \$11,000. If they have a gold-plated plan worth, say, \$15,000, they would owe tax on the \$4,000 difference.

CLOUDY FUTURE. This would be a dramatic change. Backers say it would help workers understand the true costs of health care and might cause them to buy medical care more prudently. Critics say it would raise the already-high cost of health care by pushing companies to offer less-generous plans.

And businesses worry that, rather than boosting taxes on workers, Washington could limit the deduction for companies. Economists say it makes no difference whether the change hits workers or employers. But try telling that to a CFO.

By next year, an embattled President Bush will have to decide whether to accept some or all of the panel's proposals and make tax reform the centerpiece of his domestic agenda. But if the debate over the AMT is any indication, even getting rid of a hated tax may prove a lot tougher than the White House hoped.