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CTJ Citizens for Tax Justice

Rep. Ryan's House GOP Budget Plan

Federal Government Would Collect $2 Trillion Less Over a Decade and Yet Require Bottom 90 Percent to Pay Higher Taxes

Congressman Paul Ryan (R-WI), the ranking Republican on the House Budget Committee, has put forward a detailed budget plan that he claims will balance the budget over several decades. If the extensive tax proposals in his plan were fully in effect in 2011:

- **The federal government would collect $183 billion less in 2011 and more than $2 trillion less over a decade than it would if Congress adopted President Obama's tax proposals.**
- **Federal taxes would be lower for the richest ten percent, and higher for all other income groups, than they would be if President Obama's proposals were enacted.**
- **The bottom 80 percent of taxpayers would pay about $1,700 _more_, on average, than they would if President Obama's proposals were enacted.**
- **The richest one percent would pay about $211,300 _less_ on average than they would if President Obama's proposals were enacted.**
- **The poorest 20 percent would pay 12.3 percent of their income _more_ than what they would pay under the President's proposal, while the richest one percent would pay 15 percent of their income _less_ than they would pay under the President's proposal.**

Effects of Rep. Paul Ryan's House GOP Tax Plan at 2011 Levels

			Average Differences Compared to President Obama's Tax Proposal				
Income group	Income Range	Average Income	Changes to Personal Income Tax	Repeal Corporate & Estate Taxes	Sales Tax (VAT)	Net Difference Compared to Obama Proposal	Net Difference as % of Income
Lowest 20%	Less than $20,063	$ 13,100	$ +47	$ –78	$ +1,636	$ +1,605	12.3%
Second 20%	$20,063 – 33,171	26,300	–257	–244	+2,533	+2,032	7.7%
Middle 20%	$33,171 – 53,175	42,300	–739	–480	+3,112	+1,894	4.5%
Fourth 20%	$53,175 – 88,658	69,200	–1,768	–776	+3,911	+1,367	2.0%
Next 10%	$88,658 – 127,769	105,300	–2,803	–1,096	+4,109	+210	0.2%
Next 5%	$127,769 – 178,384	148,000	–5,156	–2,363	+5,217	–2,301	–1.6%
Next 4%	$178,384 – 460,700	258,100	–10,695	–6,386	+6,335	–10,746	–4.2%
Top 1%	$460,700 or more	1,405,600	–135,463	–93,546	+17,695	–211,314	–15.0%
Bottom 80%		$ 37,700	$ –679	$ –399	$ +2,814	$ +1,736	4.6%

Total Revenue Loss Compared to Obama Proposal = $ –182.9 billion

Source: Institute on Taxation and Economic Policy (ITEP) Tax Model, March 2010
Note: Figures do not include impact of replacing exclusion for employer-provided health benefits with credit for health insurance.
Obama baseline excludes temporary extension of the Making Work Pay Credit.

Similar to the radical changes in tax and spending policies that Congressman Ryan has offered in previous years, this plan would reduce Social Security benefits and partially privatize the program, replace Medicare and Medicaid with gradually declining subsidies for private health insurance, and dramatically slash other types of non-military spending.

His long-term goal is to reduce government outlays to levels not seen since before Medicare and Medicaid existed and before Social Security became a significant factor in American life.

Rep. Ryan's Changes to the Personal Income Tax

The changes to the federal tax system included in Congressman Ryan's plan are equally dramatic. First, he would make all of the Bush tax cuts permanent, whereas President Obama would do so only for unmarried taxpayers with adjusted gross income (AGI) below $200,000 and married couples with AGI below $250,000. Congressman Ryan would repeal the Alternative Minimum Tax (AMT). He says his plan "promotes work, savings and investment" by eliminating income taxes on capital gains, stock dividends and interest while continuing to tax income that comes from work.

The Ryan plan would not make permanent the expansion in the refundable Child Tax Credit and Earned Income Tax Credit that was included in the 2009 recovery act, as President Obama's plan would. (These differences are the reason why the poorest fifth of taxpayers would pay more, on average, under the Ryan plan even if Congress only enacted his proposed changes to the personal income tax.)[1]

Rep. Ryan's Alternative "Simplified" Tax

The plan would also allow people to choose to continue to pay under the regular personal income tax (with the alterations already described) or pay under an alternative "simplified" income tax. The "simplified" tax would include a 10 percent bracket for the first $100,000 of a married couple's taxable income (the first $50,000 of a single taxpayer's income), and a 25 percent bracket for taxable income in excess of that amount. Taxable income would equal gross income minus a standard deduction of $25,000 for married couples ($12,500 for others) and personal exemptions of $3,500 for each filer and dependent. Capital gains, stock dividends and interest income would not be taxed under the simplified tax.

But this alternative tax really has nothing to do with simplification. People would naturally feel compelled to calculate their taxes twice — first under the traditional income tax, then under the "simplified" tax — to see which results in lower tax liability. Making taxpayers feel that they need to calculate their taxes under two different systems would hardly make anyone feel that their taxes are simpler.

Congressman Ryan attempts to address this problem by locking taxpayers into whichever of the two systems they choose, with only one chance to change their mind over the course of

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[1] Our estimates do not include Congressman Ryan's proposal to replace the exclusion for employer-provided health benefits with a credit for the purchase of health insurance (which is explained on the following page). This is because the tax credit would be indexed only for overall inflation, while health costs are expected to grow much more rapidly than that. Because of this fact, evaluating the health insurance component of the plan at 2011 levels would dramatically distort its long-term impact.

their lives. (Taxpayers could also change over when marriage, divorce or the death of a spouse changes their filing status.) If Congress would be so unbending as to not allow more frequent changeovers (which seems doubtful), this would just create brand new complexities as taxpayers attempt to predict their circumstances and possible tax liability under the two systems several years into the future (or arrange to marry or divorce to get additional chances to change their minds).

We assume that in 2011, taxpayers would choose the simplified tax only if it will save them money that year.

Repeal of Estate Tax and Corporate Tax, Introduction of a National Sales Tax (VAT)

Congressman Ryan would repeal the federal estate tax, which affects only the very largest estates (less than one percent of estates, in recent years). He would also repeal the corporate income tax and replace it with an 8.5 percent "business consumption tax," the same thing as a value-added tax (VAT).

Retail businesses would collect the full VAT from consumers, so it would have the same regressive effects as a sales tax. Low- and middle-income families spend most or all of their income on consumption, since they have little or no money left to save after paying for basic necessities. High-income families are able to save much more of their income. This means that if Congress enacts a tax that applies only to consumption (like a VAT or national sales tax), it would eat up a much larger percentage of total income for poor and middle-class families than for wealthy families.

The table on the first page illustrates that the 8.5 percent VAT is (almost) the entire reason why the bottom 90 percent of taxpayers would pay more under Congressman Ryan's plan than under President Obama's plan.[2]

Health Tax Credit to Undermine Employer-Provided Health Insurance

The federal income tax excludes employer-provided health insurance from taxable income. This creates some problems, but it does have the advantage of encouraging large groups of people to pool their health risks together, which makes it possible for people with varying health situations to be insured for a reasonable price.

Congressman Ryan would eliminate the exclusion for employer-provided health insurance. He would replace it with a tax credit of $2,300 for individuals and $5,700 for families, for the purchase of health insurance regardless of whether it is an employer-provided plan or a plan purchased on the individual market. Anyone who purchases a plan that costs less than the amount of the credit would receive the leftover credit as a tax break.

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[2] While a VAT is essentially a tax on personal consumption, it is practically impossible for a tax to apply to *all* personal consumption. (For example, it would be difficult practically and politically to tax all consumption of health care services.) For states that apply a sales tax, the base of the sales tax is only 43 percent of total personal consumption expenditures (PCE), on average. Since Congressman Ryan believes his tax plan will not dramatically reduce revenue, we assume that the base for his VAT would be larger, but not unrealistically out of line with those of European countries that have a VAT. We therefore assume his 8.5 percent VAT would apply to 55 percent of PCE.

With the tax incentive for employer-provided health insurance gone, it's likely that many employers would stop providing it. Younger and healthier people would be tempted to purchase the cheapest, bare-bones health insurance possible, since they would receive any leftover credit as a tax break. This would leave older, sicker people in the more expensive, more comprehensive plans, which would then have to raise premiums to account for the fact that a larger fraction of their insured are likely to require expensive medical services. Eventually, health insurance could simply become too expensive for the people who need it most. This impact would be felt particularly in later years, since the credit would be indexed to overall inflation, but not to health care inflation (which is much higher).

Less Revenue and a Less Progressive Tax System

It's difficult to design a tax plan that will lose $2 trillion over a decade even while requiring 90 percent of taxpayers to pay more. But Congressman Ryan has met that daunting challenge.

His plan would also reverse most of the progressivity of the federal tax system, by requiring the poorest fifth of taxpayers to pay an additional 12.3 percent of their income in taxes (compared to the President's plan) while allowing the richest one percent to pay 15 percent of their income *less*.

These figures make obvious that Congressman Ryan's budget plan has nothing to do with balancing the budget, but has everything to do with creating a system that takes more from the poor and less from the rich.

Assumptions Used in Modeling Ryan Plan and the Obama Plan

These estimates assume that the House GOP plan (as presented by Congressman Paul Ryan) would:
1. Make permanent the Bush income tax cuts.
2. Eliminate income taxes on capital gains, dividends and interest.
3. Eliminate the Alternative Minimum Tax (AMT).
4. Create an optional, "simplified" tax that would include:
   a. A standard deduction of $12,500 ($25,000 for married couples).
   b. Personal exemptions of $3,500.
   c. Just two rates, 10% for the first $100,000 in taxable income for married couples ($50,000 for others) and 25% for taxable income beyond.
   d. No tax on capital gains, dividends and interest.
   e. No Alternative Minimum Tax (AMT).
   f. We assume that taxpayers will file under the "simplified" tax only when doing so saves them money.
5. Eliminate the estate tax.
6. Eliminate the corporate income tax.
7. Create an 8.5 percent value-added tax (VAT).

These estimates assume that President Obama's budget plan would:
1. Extend the Bush cuts in income tax rates except for the top two brackets.
2. Adjust the brackets so that no unmarried taxpayer with AGI below $200,000 or married taxpayer with AGI below $250,000 loses their rate reduction.
3. Extend the Bush cut in the special, low rate for capital gains except for the top two brackets.
4. Partially extend the Bush rate cut for dividends (keeping the rate for dividends equal to the special rate for capital gains).
5. Extend the Bush repeal of the personal exemption phase-out (PEP) and the limit on itemized deductions (Pease) only for taxpayers with AGI below $200,000 for unmarried taxpayers and $250,000 for married taxpayers.
6. Make permanent the expansion of the Earned Income Tax Credit in the American Recovery and Reinvestment Act of 2009 (ARRA).
7. Make permanent the expansion of the Child Tax Credit (CTC) in ARRA.
8. Limit itemized deductions to 28 percent of the amount deducted.
9. Make permanent the estate tax rules that were in effect in 2009 (a per-spouse exemption of $3.5 million and a rate of 45 percent).