
The Alternative Minimum Tax (AMT)

Background:

- Created in 1969 and first implemented in 1970
- 155 people with incomes above \$200,000 had avoided paying any income tax two years earlier

How does it work?

Under current law, taxpayers must calculate income tax liability under two sets of rules:

- First, under regular income tax rules
- Second, under AMT rules
- AMT disallows certain benefits and uses different exemption amounts

Calculating the AMT

AMT Calculation
Married couple filing jointly with four children, 2007

Calculate Regular Tax

Gross income	\$75,000
<i>Subtract deductions</i>	
Personal exemptions	\$20,400
(6 x \$3,400)	
Standard deduction	\$10,700
Taxable income	\$43,900
Tax before credits*	\$5,803
 (Tax bracket) 15%	
First \$15,650 taxed at 10%	
Next \$48,050 taxed at 15%	

Calculate Tentative AMT

Taxable income	\$43,900
<i>Add preference items</i>	
Personal exemptions	\$20,400
Standard deduction	\$10,700
AMTI	\$75,000
 <i>Subtract AMT exemption</i>	
AMT exemption	\$45,000
Taxable under AMT	\$30,000
Tax (tentative AMT)*	\$7,800
 (AMT bracket) 26%	
First \$175,000 taxed at 26%	

AMT = the excess of tentative AMT over regular income tax
AMT = \$7,800 - \$5,803 = \$1,997

Calculating the AMT

- The AMT: tentative AMT – regular income tax
- This case is as simple as it gets
- No long-term benefit from regular tax rate reduction because income tax liability set by AMT
- As long as the AMT is not indexed to inflation, future tax payments as a share of income will rise

Who is hit by the AMT?

- High state and local taxes
- Large families
- Marriage
- Standard deduction
- High medical expenses
- Legal fees for taxable damages
- Incentive stock options

The AMT is Exploding

- In 1970, 20,000 taxpayers paid the AMT
- In 2006, 4.2 million taxpayers paid about \$25 billion in AMT: Average tax liability: \$6,782
- In 2007, 23 million taxpayers will pay about \$73 billion in AMT: Average tax liability: \$3,161
- If the 2001-2006 tax cuts expire, 39 million taxpayers will be hit by the AMT in 2017
- If the tax cuts are extended, the number jumps to 53 million taxpayers (49%)

AMT Encroaching on the Middle Class

- In 2006, tax units with \$500,000 or more in income will pay 47% of the tax
- By 2010, tax units with \$500,000 or more in income will pay 16% of the tax
- By 2010, 80% of households with incomes between \$100,000 and \$200,000 will pay the tax
- By 2010, 50% of households with incomes between \$75,000 and \$100,000 will pay the tax
- Compared to 4.8% and 0.7% in 2006

No Need for Added Revenue

- Federal revenue increased by 12% in FY2006
- Federal revenue on track to rise 8% in FY2007
- If AMT fully repealed, and Bush tax cuts remain in place, federal revenue would still be 18% of GDP in FY2007

Anti-Growth Effects of the AMT

AMT is not a desirable flax tax:

- Punishes savings and investments and retains all of the income tax's complexities such as capital gains, depreciation and complicated rules on personal savings vehicle

AMT raises effective marginal tax rates:

- In 2006, 71% of AMT taxpayers face *higher* effective tax rates because of the AMT
- In 2010, 89% of AMT Taxpayers will face higher rates

Complexity

- IRS national taxpayer advocate:
“AMT is the poster child for tax complexity.”
- Taxpayers get surprised and can't pay
- 3.9 hours average annually doing AMT paperwork
- With 23 million people set to pay the AMT in 2007, the total waste of time is 90 million hours
- Additional burden for small businesses
- People who don't have to pay it still have to calculate it

Explosive Growth in AMT

Two Main Causes:

- AMT is not indexed for inflation
- The 2001-2006 tax cuts cut regular income tax without a permanent AMT fix

AMT claws back 2001 – 2006 tax cuts

- In 2010, the AMT will take back almost 28% of the regular income tax cut that taxpayers otherwise would have received
- 3% of taxpayers will have their tax cuts completely eliminated by the AMT

AMT Hits Some Taxpayers Harder

Disallows certain deductions and credits

- Families with children
- Married couples (12 times more likely than singles)
- Residents in high tax states: 50% percent of people paying the tax in recent years live in one of four states: California, New York, Massachusetts, and New Jersey
- Accounts for almost 25% of the nation's population

Reform or Abolish the AMT?

- Most tax experts favor repeal:
 - Joint Committee on Taxation,
 - ABA
 - American Institute of certified Public Accountants
 - The Tax Executives Institute
 - National Taxpayers Union
 - IRS national taxpayer advocate
- However, some experts claim that simple reforms could spare most AMT taxpayers
- Paying for reform is a key issue