

## THE ALTERNATIVE MINIMUM TAX

### WHAT IS THE ALTERNATIVE MINIMUM TAX?

In rare cases, the lawful use of the U.S. tax code's many credits and deductions can actually reduce an individual's total income tax liability to zero, even for top earners. The idea of a "minimum tax" arose as a response in the late 1960s, purportedly to guarantee that everyone with significant income paid at least some income taxes. Public resentment over news that 155 high-income people had paid no federal income tax on their 1967 returns led to the enactment of a minimum tax in 1969. Several restructurings and reforms later, the current minimum tax regime is called the Alternative Minimum Tax (AMT).

The AMT is a parallel system alongside the regular individual income tax. As the Congressional Budget Office explains, "taxpayers effectively calculate their taxes under two systems and pay the higher of the two liabilities" (2). If the tax liability is higher under the traditional income tax, taxpayers pay that amount. But if the tax liability is higher under the AMT's special formula (with a reduced number of deductions and credits), then taxpayers must pay that higher amount to the IRS instead.

### PROBLEMS WITH THE ALTERNATIVE MINIMUM TAX

Both political parties in Congress dislike the AMT, and the accounting industry, lawyers associations, and the IRS' National Taxpayer Advocate have all called for its repeal.<sup>3</sup> Democrats have particular reason to oppose the tax since 48 percent of total AMT revenue comes from taxpayers in California, New York, New Jersey, and Massachusetts -traditional Democratic strongholds with hefty state and local tax burdens that cannot be deducted when the AMT applies (4).

The AMT is also economically inefficient. The tax has proven ineffective at its stated purpose: ensuring that high-earners pay some minimum amount in income taxes. Official estimates show that only 14,000 taxpayers would pay no federal income tax in the absence of the AMT, and not all of them are high-earners (5). In other words, 99.983 percent of taxpayers would still pay income tax even without the AMT. That's very little impact for a tax that has high compliance costs: even those who are only "potentially" subject to the AMT still have to fill out two additional tax forms each year, with an IRS-estimated preparation time of over six hours. Nearly 4 million taxpayers were forced to file AMT returns in 2009, the last year for which IRS has data, at an estimated compliance cost of \$550 million (6).

Perhaps the most widely-cited problem, however, is the threat the AMT presents to middle-class taxpayers. Whereas income tax brackets were permanently adjusted for inflation in 1981, the AMT never was. As a result, it reaches further into the middle class each year while inflation causes fewer and fewer Americans to fall under the exemption threshold. Until a permanent solution is agreed to, every year Congress must pass an AMT "patch" which temporarily adjusts the AMT for inflation to avoid having it impact average taxpayers.

### QUICK FACTS

- Originally intended to target 155 high-income Americans, many as a quarter of the 82 million American taxpayers, unless Congress acts.
- Nearly 4 million American taxpayers, many of whom didn't even have an AMT tax liability, spent 25 million hours filing out additional IRS forms to comply with the AMT's requirements in 2009.

### NOTABLE & QUOTABLE

"The AMT has now grown so big and complex that it is becoming a tax on the middle class. The quest to catch a few additional big fish in the tax net has enmeshed hundreds of thousands, even millions, of small fish."

- **Nicholas Furtwengler**, 2008 Fellow at the Center for the Study of the Presidency and Congress (1)

## WHAT'S STOPPING REFORM?

Continually patching a tax law every year is unbelievably inefficient. It not only creates a political football out of average Americans' tax liability, but it also wastes Congress' time. Attempts to reform the AMT have been considered, but little progress has been made. For example, in 1999 the House and Senate passed a bill to repeal the AMT all together, but it was vetoed by President Clinton (7).

While full repeal remains elusive, Congress has made some headway recently in reining in some of the issues inherent with the AMT by passing the American Taxpayer Relief Act of 2012. The American Taxpayer Relief Act made permanent most of the tax cuts enacted in 2001 and 2003, permanently patches the alternative minimum tax, and temporarily extends certain other tax provisions (8).

While the permanent and indexed patch eliminates the need for Congress to revisit the issue every year or so, it's not a truly permanent fix – the AMT will still hit three to four million often unsuspecting taxpayers each year. It's projected to hit more and more people over time due to the fact that indexing AMT parameters doesn't protect taxpayers as their real income grows. The Tax Policy Center estimates “the number of AMT taxpayers will jump 35 percent by 2018” even with the ATRA's provisions in place.

## CONCLUSION

Capital is the lifeblood of modern economies. A dynamic free-market economy requires efficient and flexible capital markets to support it. High capital gains taxes make markets both less efficient and less flexible, creating troubling incentives that discourage innovators and entrepreneurs. Politicians should reconsider the effects of taxing capital gains and eliminate the barriers it creates to economic growth.

### Endnotes:

1. Nicholas M. Furtwengler, *The Alternative Minimum Tax: Wealth Tax or Middle Class Burden?*, CENTER FOR THE STUDY OF THE PRESIDENT AND CONGRESS (2008) (online at <http://www.thepresidency.org/storage/documents/Fellows2008/Furtwengler.pdf>) (hereinafter “Furtwengler”)
2. CONGRESSIONAL BUDGET OFFICE, *Revenue and Tax Policy Brief: The Alternative Minimum Tax* (April 15, 2004) (online at <http://www.cbo.gov/doc.cfm?index=5386&type=0>).
3. Furtwengler, at 5. See also JOURNAL OF ACCOUNTANCY, *AICPA's Call for AMT Repeal, Simplification Strikes Chord with Lawmakers* (April 14, 2011) (online at <http://www.journalofaccountancy.com/Web/20114069.htm>).
4. Veronique de Rugy, *The Facts About the Alternative Minimum Tax*, REASON FOUNDATION (June 10, 2011) (online at <http://reason.org/news/show/the-facts-about-the-alternative-min>); GOVERNMENT ACCOUNTABILITY OFFICE, *Alternative Minimum Tax: Overview of Its Rationale and Impact on Individual Taxpayers*, at 15-16 (March 8, 2001) (online at <http://www.gao.gov/archive/2000/d01500t.pdf>) (hereinafter, “GAO Report”).
5. Government Accountability Office, *Alternative Minimum Tax: Overview of Its Rationale and Impact on Individual Taxpayers*, at 15-16 (March 8, 2001) (online at <http://www.gao.gov/archive/2000/d01500t.pdf>) (hereinafter “GAO Report”).
6. Justin Bryan, *Individual Income Tax Returns, 2009*, INTERNAL REVENUE SERVICE, *Statistics of Income Bulletin*, at 6 (Fall 2011) (online at <http://www.irs.gov/pub/irs-soi/11infallbulincome.pdf>).
7. *Taxpayer Refund and Relief Act of 1999*, H.R. 2488, 106th Congress (online at [http://thomas.loc.gov/cgi-bin/bdquery/z?d106:H.R.2488:](http://thomas.loc.gov/cgi-bin/bdquery/z?d106:H.R.2488:;)).
8. TAX POLICY CENTER, “TAX PROVISIONS IN THE AMERICAN TAXPAYER RELIEF ACT OF 2012 (ATRA)” (April 2014) (online at <http://www.taxpolicycenter.org/uploadedpdf/412730-tax>)

*The real problem is that Congress has created a tax code so complex that not even the IRS understands it. Instead of singling out individuals, Congress should eliminate the tangled web of credits, exemptions, and other loopholes.*

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