THE HISTORY AND FUTURE OF ALTERNATIVE MINIMUM TAX

Michelle Erzsebet Phillips
B.S., California State University, Sacramento, 2000

PROJECT

Submitted in partial satisfaction of
the requirements for the degree of

MASTER OF SCIENCE

in

BUSINESS ADMINISTRATION
(Taxation)

at

CALIFORNIA STATE UNIVERSITY, SACRAMENTO

FALL
2009
THE HISTORY AND FUTURE OF ALTERNATIVE MINIMUM TAX

A Project

by

Michelle Erzsebet Phillips

Approved by:

____________________________, Committee Chair
Professor Stephen R. Crow

Date: ______________________
Student: Michelle Erzsebet Phillips

I certify that this student has met the requirements for format contained in the University format manual, and that this Project is suitable for shelving in the Library and credit is to be awarded for the Project.

____________________________    _________________
Monica Lam, Ph.D.      Date
Associate Dean for Graduate and External Programs
College of Business Administration
Abstract

of

THE HISTORY AND FUTURE OF ALTERNATIVE MINIMUM TAX

by

Michelle Erzsebet Phillips

Statement of the Problem

Alternative minimum tax has become a tax that affects millions of middle-class Americans when it was intended to tax the higher-income taxpayer who doesn’t pay any taxes.

Sources of Data

The sources of data come from the Internal Revenue Service, House Ways and Means Committee, the Congressional Budget Office, the United States General Accounting Office and other articles from business periodicals

Conclusions Reached

Congress will need to find a solution to the growing burden of alternative minimum tax, but finding the correct solution may be difficult.

_______________________________, Committee Chair
Professor Stephen R. Crow

__________________________
Date
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>HISTORY OF ALTERNATIVE MINIMUM TAX</td>
<td>1</td>
</tr>
<tr>
<td>HOW ALTERNATIVE MINIMUM TAX IS COMPUTED</td>
<td>4</td>
</tr>
<tr>
<td>WHO IS AFFECTED BY ALTERNATIVE MINIMUM TAX?</td>
<td>5</td>
</tr>
<tr>
<td>CRITICISMS AND CONTROVERSIES</td>
<td>8</td>
</tr>
<tr>
<td>COMPLEXITY AND COSTS OF COMPLIANCE</td>
<td>9</td>
</tr>
<tr>
<td>THE FUTURE OF AMT</td>
<td>13</td>
</tr>
<tr>
<td>SOLUTIONS TO AMT</td>
<td>14</td>
</tr>
<tr>
<td>CONCLUSION</td>
<td>18</td>
</tr>
<tr>
<td>WORKS CITED</td>
<td>20</td>
</tr>
</tbody>
</table>
INTRODUCTION

Alternative minimum tax (AMT) is becoming a taxing burden on the middle class. Originally, it was created to tax the wealthy individual taxpayers that were not paying any tax at all. The minimum tax was created to rectify and tax the wealthy individuals. Over the years, the minimum tax was modified and eventually became what we know as alternative minimum tax. Over the years, the tax has started to creep up the tax brackets and affect millions of taxpayers. The taxpayers are middle-class individuals that have become burdened by compliance and additional costs of preparation. In addition, the middle-class has seen an increase in overall tax burdens. This paper will discuss the history of alternative minimum tax, how it is computed, who is affected, the burden and costs of compliance, the future and solutions to alternative minimum tax.

HISTORY OF ALTERNATIVE MINIMUM TAX

The Tax Reform Act of 1969 introduced, for the first time, a minimum tax on high-income households. It was put into effect to close loopholes. The tax was intended to target 155 high-income households with adjusted gross income over $200,000 that owed little or no taxes due to the many tax benefits claimed on their 1967 tax returns. Adjusted for inflation, $200,000 in 1967 equals about $1,100,000 in today’s dollars. In 1967, the number of tax returns filed was approximately 71.7 million with 15,669 having over $200,000 adjusted gross income. The minimum tax only affected about one in every half-million taxpayers (Saxton). In 1975, the minimum tax had collected over $144
million in taxes from approximately 20,000 taxpayers. The minimum tax was an ‘add-on’ tax of ten percent. Taxpayers paid a ten percent tax on the amount that their reduction of tax preferences exceeded $30,000. For example, if a taxpayer’s tax preferences, or reduction of tax liability was $40,000, the additional tax due would be ten percent of $40,000 - $10,000, or $1,000. The calculation of the minimum tax was not a separate set of rules or list of reductions, as it is today. In 1976, Congress found that 244 taxpayers during 1974 with adjusted gross income exceeding $200,000 had not paid any taxes. It decided to raise the minimum tax to 15 percent to broaden the tax base and capture more tax dollars. (Saxton).

Over the years, Congress has changed the tax in significant ways, evolving into the current alternative minimum tax. In 1973, Congress became concerned that changes made to the minimum tax were delaying capital formations. Changes slowly evolved and significant changes were made in 1978, 1982, 1986, 1990 and 1993. During the change process, Congress decided to created a new tax, the alternative minimum tax and repeal the minimum tax (Saxton). The Tax Equity and Fiscal Responsibility Act of 1982 was introduced and is what our current AMT structure is based on. The changes have created a parallel tax system with its own definition of taxable income, exemptions and rates. This tax system applies to both individual taxpayers and also corporate taxpayers. Tax is generally computed under the regular tax system and it is also calculated under the alternative minimum tax system. In the AMT rules, the taxpayer is disallowed a deduction for state and local taxes, a deduction for personal exemptions, the standard
deduction and the deduction for interest on the home. As we shall see, the taxpayer calculates both taxes and pays whichever tax is higher (Saxton).

The Tax Reform Act of 1986 changed definitions and created further reorganization. A quote from the New York Times stated “A law for untaxed rich investors was refocused on families who own their homes in high tax states” (Wikipedia). Due to the disallowed personal exemption, state and local taxes and the standard deduction, the tax was starting to affect families in high tax states. The Omnibus Budget Reconciliation Acts of 1990 & 1993 raised AMT rates to 24% and to 26% and 28%. The prior AMT rate was 21%. The significant modifications to the AMT computation changed the target of the tax, now including those who did not have high incomes exceeding $200,000 (Saxton).

The current alternative minimum tax is imposed under Title 26, Section 55 of the Internal Revenue Code. Taxpayers now pay either 26% or 28% on the adjusted alternative minimum taxable income (AMTI). The tax preferences used to adjust the income are (a) state and local tax; (b) sales and property taxes; (c) accelerated depreciation; (d) the bargain element in exercised incentive stock options; (e) percentage depletion; (f) certain tax-exempt income; (g) certain credits; (h) personal exemptions; (i) standard deduction; (j) at times, capital gains (Service).
HOW ALTERNATIVE MINIMUM TAX IS COMPUTED

All taxpayers potentially subject to alternative minimum tax must fill out and file Form 6251, even if they do not end up paying alternative minimum tax. In 1997, 4.4 million people filed Form 6251, but only 20% of those who filed the form actually paid any alternative minimum tax (Saxton). In order to determine if one owes alternative minimum tax, a taxpayer must follow four steps. First, he must calculate his regular income tax. Second, the he must then determine if he is automatically subject to the tax or he can fill out the 13-line worksheet with Forms 1040 and 1040A. Third, the taxpayer fills out Form 6251 to recalculate taxable income using the AMT rules. The form is fifty lines long, and the end result is the tentative minimum tax. Lastly, the taxpayer compares the regular tax with the tentative minimum tax to see which is larger. If the tentative minimum tax is larger, the taxpayer pays the regular tax, plus the difference as the alternative minimum tax (Saxton).

Alternative minimum tax uses a different set of rules to determine taxable income and deductions. The tax preferences, as listed above, are added back. The AMT exemption is then subtracted to calculate AMT taxable income (AMTI). The AMT exemption is phased-out 25 cents per dollar for every dollar over $150,000. For example, the exemption limit for 2008 was $69,950 for married filing joint. If the couple’s income was $175,000, the exemption would phase-out as follows: $25,000 multiplied by 25 cents, equals $6,250. The couple’s exemption would be $69,950 minus $6,250, leaving $63,700 as an exemption. The phase out has not been adjusted for inflation since 1986.
Congress has continued to ‘patch’ AMT over the years. For tax year 2007, the AMT Exemption fully phases out at $415,000 for married filing joint taxpayers, causing true tax rates to be 32.5% and 35%. Once AMTI is established, the taxpayer then calculates the tentative minimum tax (TMT) by multiplying AMTI by 26%, up to $175,000. Any AMTI over $175,000 is multiplied by 28%. If the TMT is greater than the regular tax, the taxpayer pays the regular tax, plus the additional amount (Saxton).

Alternative minimum tax can affect taxpayers in two ways. As discussed above, taxpayers can be affected directly by calculating an AMT tax liability greater than regular tax liability. In addition, taxpayers can be affected indirectly, by a reduction of tax credit allowed under regular income tax calculations. In essence, the indirect affect is just as worrisome as the direct effect of AMT. Taxpayers who would usually receive certain tax credits that become disallowed because of AMT are impacted with higher taxes (U. S. Office).

WHO IS AFFECTED BY ALTERNATIVE MINIMUM TAX?

There are two main reasons why increasingly more taxpayers are becoming subject to AMT. First, three legislative acts that created tax cuts, the “Economic Growth and Tax Relief Reconciliation Act of 2001, Jobs and Growth Tax Relief Reconciliation Act of 2003, and the Working Families Tax Relief Act of 2004 have narrowed significantly the differences between regular and AMT tax liabilities for middle and high income individuals” (Committee). Second, alternative minimum tax has not been indexed...
for inflation. This has caused many problems for the middle class, as they have become subject to the tax more and more.

Corporations are also subject to alternative minimum tax. In 1997, corporate taxpayers paid AMT on 25,000 tax returns, compared to individuals, who paid AMT on 618,000 tax returns. Corporate taxpayers generated almost as much tax as individuals, approximately $4 billion. In 2000, an estimated 1.3 million people paid AMT and it is estimated that by 2010, an estimated 17 million people will pay AMT. Since AMT has not been indexed for inflation, people will be moving into higher tax brackets, causing “real bracket creep” (Saxton). In 2006, the National Taxpayer Advocate reported that AMT was “the single most serious problem with the tax code” (Leonard E. Burman).

Most sophisticated upper bracket taxpayers are aware they are subject to AMT; however, the majority of the middle class has never heard about AMT. The middle class is being punished for having children, living in a high-tax state or having an expensive home. Many taxpayers are surprised to find they are subject to AMT since they are not aware of it until they prepare their tax returns. In addition, the complexity of AMT leads to errors in completing returns or the need for additional professional help to file the tax return. Often, the taxpayer is not aware of the AMT until the IRS has made contact with the taxpayer and told him there is additional tax due (Committee). A brief by the Congressional Budget Office (CBO) (No. 4, April 15, 2004), concludes:

Over the coming decade, a growing number of taxpayers will become liable for the AMT. In 2010, if nothing is changed, one in five taxpayers will have AMT liability and nearly every married taxpayer with income between $100,000 and $500,000 will owe the alternative tax. Rather than affecting only high-income
taxpayers who would otherwise pay no tax, the AMT has extended its reach to many upper-middle-income households. As an increasing number of taxpayers incur the AMT, pressures to reduce or eliminate the tax are likely to grow.

It is estimated that married taxpayers are fifteen times more likely to be affected by AMT than single taxpayers. Even more staggering, by 2010 it is projected that eighty percent of taxpayers with incomes between $100,000 and $200,000 will be subject to AMT. It is estimated that a higher percentage of middle income taxpayers with income between $75,000 and $100,000, over fifty percent, will pay AMT compared to thirty-nine percent of taxpayers with income exceeding $1 million (Committee).

For several years now, Congress has ‘patched’ AMT at the end of the tax year to minimize the impact of the tax since it has not been adjusted for inflation. The Alternative Minimum Tax Relief Act of 2008 is a one-year extension of the tax exemptions and credits. The act prevents AMT from burdening over 25 million middle-class taxpayers. This ‘patch’ has helped reduce the affect of AMT, but more and more taxpayers are still becoming subject to it (TheMiddleClass.org). A quote from Leonard E. Burman from the Tax Policy Institute summarizes the issues with AMT:

In a tax code with no shortages of ironies, the alternative minimum tax (AMT) stands out. Created by Congress in 1969, it was aimed at millionaires, but relatively few millionaires pay it. It is billed as a low-rate levy, but most of its victims face higher taxes because of it. It undermines two widely lauded reforms of the income tax – restoring both bracket creep and the marriage penalty. At first glance, AMT may seem simple and fair. But for reasons nobody imagined when it was created, the AMT bull’s-eye hangs not on the folks with Cayman Islands bank accounts, but on the upper-middle-income families with lots of kids who happen to live in high-tax states. And it doesn’t just raise their taxes. It plagues them with mind-numbing complexity (TheMiddleClass.org).
CRITICISMS AND CONTROVERSIES

Alternative minimum tax is not looked upon favorably by many individuals and organizations. The following organizations have suggested that Congress appeal alternative minimum tax – IRS’s National Taxpayer Advocate; American Institute of Certified Public Accountants; American Bar Association’s Section on Taxation; and the Tax Executives Institute and Congress’ own Joint Committee on Taxation. These organizations claim that without AMT, a relatively small number of high-income taxpayers would pay no federal income tax compared to the total number of returns filed. The IRS estimates that without AMT, approximately 14,000 taxpayers would pay no federal income tax. In tax-year 1998, 125 million tax returns were filed, with more than 93 million taxpayers paying regular income tax after tax credits. If 14,000 is divided by 93 million resulting in 0.015 percent, this means that 99.985 percent of taxpayers paid regular income tax without AMT. Therefore, AMT only added one additional taxpayer for every 6,600 taxpayers already paying taxes (Saxton). Even with alternative minimum tax, the goal of making everyone with high income pay some taxes is not achieved. There are still a number of taxpayers with adjusted gross income exceeding $200,000 that do not pay federal income tax. Unadjusted for inflation, it is estimated that the number of taxpayers has not exceeded 1,500 (C. B. Office).

Additional criticisms are made of alternative minimum tax:

- AMT is distorts the actual tax rates
• AMT exemption and AMT exemption phase-out threshold are not indexed for inflation, causing more taxpayers to be subject to the tax
• AMT disallows the deduction for state taxes
• AMT disallows a portion of the foreign tax credit, creating double taxation for citizens living abroad
• Tax planning can be quite complex for businesses and individuals wanting to start a business or sell assets
• Taxes are often owed when a taxpayer exercises an ISO stock option because the bargain element of the exercise is considered income under AMT

Most of the organizations that want AMT repealed believe that it is too complex and creates a large burden on taxpayers (Wikipedia). An IRS National Taxpayer Advocate, Nina Olson gave her testimony on March 7, 2007 before the House Ways and Means Committee, stating:

The burden that AMT imposes is substantial. In dollar terms, it is estimated that each AMT taxpayer will owe, on average, an additional $6,782 in tax in 2006. In terms of complexity and time, taxpayers often must complete a 16-line worksheet, read 10 pages of instructions, and complete a 55-line form simply to determine whether they are subject to the AMT. Thus, it is hardly surprising that 77 percent of AMT taxpayers hire practitioners to prepare their returns (Committee).

COMPLEXITY AND COSTS OF COMPLIANCE

For a taxpayer, trying to determine whether AMT is applicable can be difficult. A taxpayer, if preparing his own return, would have to read 9 pages of instructions,
complete a 16 line worksheet and a 55 line form. Once the taxpayer determines he is going to be affected by AMT, he may have to calculate carry-forwards since he may be treated differently than on the regular tax calculation (Wikipedia). The complexity of the IRS code has increased over the years. Originally, the minimum tax legislation was 19 pages long. By 1999, the alternative minimum tax legislation was 56 pages in small type (Saxton).

Every taxpayer who is potentially subject to AMT has some type of compliance cost. The IRS has acknowledged that the forms are complex and it has tried to make certain tax forms easier to fill out with ‘EZ’ forms. Taxpayers, however, do not always have the option of these easier forms. In 2000, Form 1040, excluding attachments, came with seventy pages of instructions and was estimated at thirteen hours of preparation time. If subject to AMT, a taxpayer is required to fill out two additional tax forms, with eight pages of instructions and an estimated six hours of preparation. Due to the complexity of the tax filings, many taxpayers have to rely on paid professionals to file proper tax returns (Saxton). In 1997, fifty-two percent of all taxpayers used a paid preparer to file their tax return. Of the total 4.4 million taxpayers who filed Form 6251, ninety-three percent of taxpayers used paid preparers (Saxton).

The Internal Revenue Service and the Department of the Treasury have created an Individual Taxpayer Burden Model to measure taxpayer burden as it relates to alternative minimum tax. The taxpayer model is based on tax-year 2000. The purpose of the model is to understand the compliance burdens imposed on taxpayers by AMT and to be able to
construct accurate and reasonable burden estimates for specific tax filing requirements. In this model, it is determined that AMT affects taxpayers in three ways: 1) there is no AMT; therefore, no Form 6251 is filed and taxpayer has no extra burden; 2) taxpayer is required to file Form 6251 but no AMT is owed; therefore, taxpayer incurs extra burden from filling out and filing the Form 6251; 3) taxpayer is subject to AMT and has the burden of filling out and filing the Form 6251 (Lee).

During 2000, data collected shows that 5.7 million taxpayers filed Form 6251. Of the total Form 6251 filed, 1.4 million filed because they owed additional taxes, 0.5 million filed because they were required to do so even though they did not owe additional taxes and 3.8 million filed the Form 6251 even though it appeared they were not required to file the form. The results of the data indicate that sixty-seven percent of the filed forms were filed in error. In addition to the number of forms filed, the data collected indicates that seventy-eight percent of the taxpayers filing Form 6251 used a paid professional. Paid professionals are in the profession of preparing tax returns and educating themselves. If so many of the forms were filed incorrectly and over half of them were prepared by paid professionals, what does that say about the complexity of the form (Lee)?

The taxpayer burden model also calculated the time and cost of compliance with alternative minimum tax. It determined that the cost and time of preparation was determined by the method of preparation. It was estimated that a taxpayer could prepare Form 6251 without software and it would take approximately 4.6 hours and cost $17 for
the manual. It was estimated that a taxpayer could prepare Form 6251 with software costing $15 in 2.4 hours. It was also estimated that a taxpayer could use a paid preparer to file Form 6251 and it would cost $107 and 1.7 hours. The average cost of the three possible situations was $88 and 1.9 hours of time (Lee). This model does not take into account that when a taxpayer hires a paid preparer, the preparer will charge the client for the preparation of the entire tax return, not just Form 6251. When a taxpayer suspects they are subject to AMT or other complex tax issues, they usually seek professional help when they might not have in other cases.

By analyzing the data for 2000, we can calculate the tax burden on the taxpayer. If we used the data from above, the 1.4 million taxpayers who filed Form 6251 because they owed additional taxes incurred $123 million in compliance costs. There were an additional 0.5 million taxpayers required to file Form 6251, at a cost of $44 million to remain in compliance. The most staggering number is the 3.8 million taxpayers who spend a total estimated $334 million to file Form 6251 when it was not needed (Lee). The time and money spent on filing Form 6251 will only increase as the tax law becomes more complex. In addition, if no reform is passed to fix the problems with the current legislation, the middle class will be hit even harder economically.

In addition to taxpayer burden, the alternative minimum tax system creates extra work and complications for the Internal Revenue Service (IRS). Even though most taxpayers that are affected by alternative minimum tax use a paid professional to help file their taxes, the IRS faces increased call volumes on their help lines related directly with
AMT issues. In 1999, the IRS responded to over 6,400 calls from taxpayers regarding AMT issues and it dealt with numerous errors, over 10 percent, on tax returns with direct AMT liability. The errors are created by both taxpayers who self-prepare tax returns and also by paid professionals. Since alternative minimum tax is not an add-on tax related to the existing tax system, it cannot easily be verified with computer-checking calculations. In many instances, the only way to verify that a tax return with alternative minimum tax is calculated correctly is through a field or desk audit. An audit by the IRS costs the taxpayer more money due to the time and inconvenience and it also costs the IRS more due to precious staff time being committed time consuming audits. “According to IRS, the frontline employees who do such verification work consistently rank AMT as one of the most complex provisions with which they deal (U. S. Office).”

THE FUTURE OF AMT

If alternative minimum tax stays the same, the number of taxpayers affected by it will increase substantially. The concept of “bracket creep” will continue to happen. Real bracket creep occurs when people move into higher tax brackets as the economy is growing over the long term and wages continue to grow as well. Since AMT is not indexed for inflation, people will move into higher tax brackets. Historically, inflation in the United States has been low. However, if nothing is done to change the current AMT tax law, most taxpayers will move out of their current tax brackets and become subject to
AMT because their AMT liabilities will increase faster than regular tax liabilities (U. S. Office).

Over the past ten years, the number of taxpayers affected by AMT has increased ten-fold. The estimated number of taxpayers in 2000 subject to additional AMT taxes was 1.4 million. By 2010, it is estimated that over 17 million taxpayers will be affected by alternative minimum tax. Of the 17 million, approximately 12.1 million will be directly affected by having to pay additional taxes and approximately 4.9 million will be indirectly affected by having their credits reduced. In both instances, taxpayers will be paying higher taxes, especially the middle class (Saxton). Under the current law, in 2007, taxpayers filing joint returns with no dependents could be subject to AMT with income as low as $75,395. By 2016, if tax cuts created in 2001 and 2003 are extended, over 48 million taxpayers could end up paying alternative minimum tax. Congress has continued to patch AMT at the last minute each year in order to minimize the current AMT affect (Committee).

SOLUTIONS TO AMT

The question that has been asked numerous times is “how do we deal with alternative minimum tax and fix it?” Many options have been suggested over the years. One suggestion is to leave it alone knowing it will eventually become a universal tax for everyone with tax rates at 26 and 28 percent. Many are not satisfied with leaving AMT alone because they do not want to pay higher taxes. The original goal of AMT was to
target the wealthy taxpayers who were not paying taxes. If left alone, the system would move to a universal tax that targets just the opposite, the struggling middle class. Another option would be to make technical changes to the tax code. Currently, the highest number of taxpayers becoming subject to AMT are those middle class families that have numerous children. Technical changes that could help relieve the tax burden on these taxpayers would be to eliminate both the limits on exemptions for children and the standard deduction (Saxton).

Others have suggested making additional changes to help slow down the effect of alternative minimum tax. If alternative minimum tax was indexed for inflation, it would considerably slow down the number of taxpayers becoming subject to AMT. This would not solve the problem because more people would still become affected over the long term due to real bracket creep. However, it would be a beginning step to help relieve the tax burden of a system currently not meeting its original goal. In addition, other modifications to the tax code that would help reduce liability, such as, changing the limits or exclusions for state and local taxes, would be helpful. Another item for discussion is reviewing and modifying the limits put on the exemption levels (Saxton).

The most far-reaching option would be to repeal alternative minimum tax. This option has been seriously considered in the past. There have been at least eight bills proposed to repeal AMT in Congress. The Taxpayer Refund and Relief Act of 1999 included a phase-out of alternative minimum tax during 2005 – 2007. The House of Representatives passed the bill, but it failed in the Senate because “By using project
surpluses to provide a risky tax cut, H.R. 2488 could lead to higher interest rates, thereby undercutting any benefits for most Americans by increasing home mortgage payments, car loan payments and credit card rates” (Saxton). A simple reform of AMT that would help shield the middle-class would be to extend the exemption increase and index AMT for inflation. “If indexation were applied to rate brackets and the phase-out as well as the exemption, only 3.6 million taxpayers would be subject to AMT in 2007, down from 23.4 million under current law” (Finance).

The alternative minimum tax repeal has failed for many reasons. First, most importantly, it would reduce federal tax revenues. In the current economic situation, the government is relying on every source of tax revenue possible to continue to fight against the ever-growing deficit. It is estimated that sixteen percent of tax revenues in 2010 will be from alternative minimum tax, half of which is from individual taxpayers. The figures are staggering. It is predicted that revenues from AMT will approach $38.2 billion in tax year 2010. The additional taxes generated by AMT are estimated to account for over $24 billion in additional tax revenues (U. S. Office).

On the other hand, the repeal would help individuals and corporations by eliminating a complex and convoluted parallel tax system. It would also reduce the cost that the taxpayer has for compliance and preparation of taxes. These positives will not be enough to create reasons for reform. Over the past ten years, the perception of fairness of who should be taxed has become distorted. The original purpose of alternative minimum tax was to make sure the higher income earners paid some federal taxes. Over the past ten
years, as AMT has begun to affect more middle-income taxpayers, the perception has become negative. However, as our government has continued to increase its deficit, it has become more reliant on the tax revenues and will probably not make significant changes that reduce its source of additional income even as it creates burdens on the wrong class of taxpayers (Saxton).

Overall, the repeal of alternative minimum tax is deemed too costly to institute. The Tax Policy Center states the repeal would actually reduce taxes for the top fifth of income earners by 74.5 percent. It would only reduce taxes by 0.1 percent for the lower two fifths of income earners. The Tax Policy Center suggests the best way to fix alternative minimum tax would be to permanently shield the middle class and to index for inflation (TheMiddleClass.org). If AMT stays in its current state, it could possibly neutralize the impact of future tax codes changes to the regular tax system. If future legislative changes are passed to cut taxes or add credits, the current alternative minimum tax system could counteract the benefits by its direct or indirect affect. For example, if tax cuts were put into place to help relive the tax burden, the separate calculation of the alternative minimum tax may disallow the tax cut in part or total; therefore, the taxpayer is in the same or worse tax situation (U. S. Office).

Other solutions have been offered to help reduce the effect of AMT without losing precious tax revenues. One solution outlined in a Committee on Finance meeting on June 27, 2007 included imposing a four percent adjusted gross income (AGI) surtax on couples with income exceeding $200,000 and individuals exceeding $100,000. Some
believe imposing a surtax would be ineffective because it would raise marginal tax rates and encourage tax avoidance. The Committee claimed that some would definitely pay higher rates; however, a significant number of these taxpayers would actually see a cut in their taxes because of the elimination of AMT exemption phaseout (Finance).

Another solution to the loss of tax revenues is to repeal the state and local tax deduction and lower income tax rates by two percent. The Committee claims that the repeal would raise more than enough tax revenues to cover the repeal of AMT, even with the two percent reduction in tax rates. The net effect of eliminating the state and local tax deduction and lowering taxes by two percent is small on the middle-income taxpayers. The reason for this is because even though the AMT repeal is regressive, the repeal of state and local income taxes is progressive as income increases. Most of the taxpayers in the bottom sixty percent are not able to itemize; therefore, they do not see the benefits of deducting state and local taxes (Finance).

CONCLUSION

Repealing alternative tax would eliminate the extra burdens and relieve some of the costs of compliance for taxpayers. However, it is very unlikely that AMT would be repealed since it would take such a large chunk of revenues out of the government’s pocket. The government relies on the tax revenues created by AMT. Official budget estimates that AMT will provide nearly $1 trillion in tax revenues over the next 10 years. If the solution to AMT is repealing it, it would have to include an increase in tax revenues
from other sources so that it wouldn’t increase the deficit. No matter what the solution, some taxpayers will benefit and some will pay the price. It is not possible to reform the system without affecting someone. What is definite is that alternative minimum tax needs to be reformed so that it can return to fulfill its original purpose of targeting the high income earners and not middle income taxpayers who are unfairly being punished with higher taxes. The tax system needs to be reformed and simplified if the government wants to reduce the tax gap, reduce the number of errors on tax returns and reduce the motivation of taxpayers looking for tax shelters.
WORKS CITED


Service, Internal Revenue. "Publication 17." Washington: Internal Revenue Service,
2008.
