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The Downward Creep: An Overview of the AMT and Its Expansion to the Middle Class

Michael D. Kim*

The AMT was first put in place in 1969 to ensure that the wealthiest among us weren't able to find enough loopholes in the tax code to avoid paying taxes entirely. But it has grown in the years since. This year alone, it is threatening 23 million taxpayers, including firefighters, teachers and others who were never intended to fall under its grasp.¹

I. INTRODUCTION

Recently, the Alternative Minimum Tax's profile raised a once obscure section of tax code to the forefront of media attention by threatening to affect the lives of ordinary Americans. The Alternative Minimum Tax ("AMT"), originally intended for the extraordinarily wealthy, developed over time as a kind of second line of defense to ensure taxpayers cannot overuse various incentive provisions to escape paying a portion of their income to the federal government.² However, the AMT will increasingly reach into the pool of middle-income taxpayers over the next few years. "This is in large part due to the 2001 and 2003 tax cuts, which significantly lowered tax rates, and the lack of indexation of the AMT rate brackets and exemption amount."³ Taxpayers with incomes of less than $100,000 may account for as many as 52% of the entire pool of AMT taxpayers in 2010, up

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2. Linda M. Beale, Congress Fiddles While Middle America Burns: Amending the AMT (And Regular Tax), 6 FLA. TAX REV. 811, 813 (2004).
3. Id. at 814.
from about 9% in 2003. In 2007, approximately 23 million households may face the AMT—about 19 million of them for the first time.

The increase in taxpayers subject to the AMT creates a dilemma—the longer Congress waits to limit the scope of the AMT, the more it will cost to do so. It has been projected to cost more to repeal the AMT in 2008 than it would cost at that time to repeal the regular income tax.

No clear solution exists to solve this AMT predicament. Regular tax repeal would further benefit taxpayers at the very highest income brackets, who now pay regular tax at high marginal rates compared to the AMT. Alternatively, AMT repeal is strongly urged by a number of commentators. They note the “stealth” nature of the AMT, whereby many ordinary taxpayers are unaware of its existence or the relationship among its various provisions.

Another clear problem is the lack of consistency with regular income tax policy. For instance, the AMT conflicts with and abrogates benefits of specific provisions targeted by Congress for particular tax statuses, such as the state tax or medical expense deductions. Additionally, the complexity of multiple computations to determine tax liability and the internal complexity of the AMT provisions themselves clearly add to taxpayer confusion.

Those arguments, however, ignore the negative aspects of AMT repeal. When one accounts for the significant tax reductions wealthy taxpayers enjoy under the current federal tax scheme (including the decrease in taxation of capital gains and dividends, as well as the likely permanent reduction or elimination of estate taxes), it is apparent that a method to capture upper-bracket taxpayers is necessary. A repeal of the AMT would cause further problems for ordinary taxpayers because lost revenue would need to be offset with future tax increases or a reduction in benefits. At a time when there is significant and increasing disparity of incomes among taxpayers, AMT repeal would destroy one of the only ways the Internal Revenue Service has to snare high


6. Burman et al., supra note 4, at 106.

7. Beale, supra note 2, at 814.

income taxpayers adept at tax avoidance. As one scholar has observed:

Even prior to the 2002-2003 tax cuts, analysts noted that the benefit of AMT repeal would accrue to higher-income households: "the average tax cut for all households with income above $200,000 [roughly 3% of taxpayers] would rise by $11,000." AMT repeal would thus exacerbate the trend that is shifting the overall federal tax burden away from high-income taxpayers.\(^9\)

Before one can attempt to repair the current AMT predicament, we will have to explore the problem and its background. Part II surveys the history of the AMT.\(^10\) Part III defines the current state of the AMT, including its calculation and the problems it imposes to taxpayers.\(^11\) Part IV outlines various proposals for reform,\(^12\) with Part V detailing current legislative proposals.\(^13\) Overall, it is clear that Congress did not intend to impose the AMT on the middle-class, and steps must be taken to remedy the situation before it becomes an even larger burden.

II. The History of the Alternative Minimum Tax

A. The 1969 Add-on Minimum Tax and Predecessor to the Alternative Minimum Tax

The AMT has its roots in 1967 when 155 individuals with an adjusted gross income over $200,000 and 21 individuals with gross income over $1,000,000 paid no federal income tax.\(^14\) Then, like today, the Internal Revenue Code ("Code") contained many tax breaks that functioned as economic incentives to encourage some and discourage other taxpayer behaviors.\(^15\) A number of wealthy individuals and tax professionals took extreme advantage of these tax "loopholes," which resulted in minute tax liability relative to their income.\(^16\) Such legal tax avoidance seemed inequitable to lawmakers, and many feared that

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10. See infra notes 14-43 and accompanying text.
11. See infra notes 44-107 and accompanying text.
12. See infra notes 108-39 and accompanying text.
13. See infra notes 140-63 and accompanying text.
15. Id.
16. Id.
this inequality would adversely affect individual taxpayer compliance, crucial to the American self-reporting tax scheme.\textsuperscript{17}

Congress responded with the enactment of an add-on minimum tax in 1969\textsuperscript{18} which, according to one scholar:

\begin{quote}
[I]ntended to defend against the ability of the superrich to avoid a fair share of the federal tax burden through “extreme concentrations of tax incentives.” Congress considered it “intolerable” that “taxpayers with substantial incomes have found ways of gaining tax advantages from provisions placed in the code primarily to aid some limited segment of the economy.”\textsuperscript{19}
\end{quote}

The relatively straightforward system required an add-on tax equal to ten percent of the amount, if any, to which the taxpayer’s tax preferences exceeded $30,000.\textsuperscript{20} This amount was added to the taxpayer’s regular income tax liability to determine his total income tax liability. Aside from one rate increase to 15\% in 1976,\textsuperscript{21} the add-on minimum tax remained relatively unchanged until 1982.\textsuperscript{22}

The add-on minimum tax was expected to reach about one in 500,000 taxpayers, those with incomes of at least $200,000 (more than $1 million in 2004 dollars).\textsuperscript{23} As explained in the legislative history of the 1986 Tax Reform Act:

\begin{quote}
[T]he minimum tax should serve one overriding objective: to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits. Although these provisions may provide incentives for worthy goals, they become counterproductive when taxpayers are allowed to use them to avoid virtually all tax liability. The ability of high-income individuals \ldots to pay little or no tax undermines respect for the
\end{quote}


entire tax system. . . . Even aside from public perceptions, . . . it is inherently unfair for high-income individuals . . . to pay little or no tax due to their ability to utilize various tax preferences.24

B. The 1979 Alternative Minimum Tax

The AMT's current incarnation originated with the Revenue Act of 1978 and the revision of Section 55 of the Code. According to Brian O'Shaughnessy, "unlike the add-on minimum tax, the AMT is an entirely separate tax system"—a parallel tax with its own base and rate schedules and separate exemption amount.25 O'Shaughnessy further asserted, "From 1979 to 1982, the high-income taxpayer would compute his minimum tax using three systems: the regular tax, the AMT, and the add-on minimum tax. The greatest of the three tax liabilities determined the amount owed."26 In 1982, Congress revised the 1979 AMT and removed the 1969 add-on tax27 via the Tax Equity and Fiscal Responsibility Act ("TEFRA").28 The 1983 version of the AMT was "far simpler and more administrable than the current system,"29 since it did not yet incorporate the "parallel world" concept found today.30 The 1983 AMT was calculated by imposing a twenty percent tax on the excess, if any, of Alternative Minimum Taxable Income ("AMTI") over regular taxable income.31 "The AMT created under TEFRA lasted from 1984 to 1986."32

C. The 1986 Alternative Minimum Tax

The 1986 Code massively overhauled the federal tax system and among the changes, a new AMT was enacted.33 The 1986 AMT was arguably a fairer tax, but the trade-off was simplicity. The 1986 AMT incorporated three new concepts: "the 10 percent minimum tax or

25. O'Shaughnessy, supra note 14, at 69.
26. Id. at 69-70 (citing I.R.C. § 55 (West 1981)).
28. Id.
29. Karlinsky, supra note 20, at 144.
30. Id.
31. O'Shaughnessy, supra note 14, at 70 n.25 ("AMTI was determined by reducing the taxpayer's adjusted gross income (AGI) by the aggregate of: the alternative tax net operating loss deduction, the alternative tax itemized deductions, and any other amount included in income under I.R.C. § 667 (1983); then increasing that number by the amount of items of tax preference.").
32. Id. at 70.
floor concept, the prepayment concept, and the parallel world concept.\footnote{34}

The "floor" concept created a 10% tax floor below which a taxpayer affected by the AMT may not reduce his tax liability. "This is accomplished through the 90 percent limitations on net operating losses in section 56(d)(1) and on foreign tax credits in section 59(a)(2)."\footnote{35} As one commentator noted:

The prepayment concept allows the taxpayer to use his minimum tax credit to offset future regular tax liability with AMT paid-for deferral items. For example, suppose that an individual exercises an incentive stock option (ISO) creating an AMT liability of $10,000 greater than his regular tax liability. If in a subsequent year that same taxpayer's regular tax liability would be greater than his AMT liability, the $10,000 AMT previously paid may be used as a credit against his regular tax liability in that subsequent year.

The third concept is that of the parallel world. The 1986 Code effectively creates three separate tax systems: the regular tax, the AMT, and the adjusted current earnings (ACE) component of the AMT. As an example, depreciation of an asset must be calculated separately for regular tax and for the AMT. A third system of depreciation must be considered for ACE if the asset was placed in service before 1994. Additionally, the taxpayer must calculate a different basis in the asset for each of the systems. When the asset is sold or exchanged, the character of the gain or loss may be different when calculated under the three systems. Thus, the impact on capital gains or losses under each system may also be different.

In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act.\footnote{36}

Commonly known as the "Bush tax cuts," the Act made no changes to the AMT system.

D. The Expansion of the AMT

Perhaps the most contentious result of the 2001 and 2003 tax cuts is the impending applicability of the individual AMT to many ordinary taxpayers.\footnote{37} Simply put, lowering the regular tax rates while leaving the AMT rates as they were prior to the tax cuts (applying on a

\footnotesize{\begin{itemize}
  \item \footnote{34} Karlinsky, \textit{supra} note 20, at 146.
  \item \footnote{35} \textit{Id.}
  \item \footnote{36} O'Shaughnessy, \textit{supra} note 14, at 70-71.
\end{itemize}}
broad AMT base) ensures that the AMT will require more taxpayers to pay additional tax compared to their regular tax computation. As Professor Beale has noted:

Although the AMT originally targeted tax-avoidance possibilities of the superrich (e.g., the net capital gain exclusion) and thus affected “less than 1 percent [of taxpayers] in any year before 2000,” the individual AMT is now poised to affect a much broader group of taxpayers. This is in part because the AMT exemption amount and rate brackets are not indexed to inflation, but even more because the regular income tax cuts are not matched by similar permanent cuts in the AMT. The AMT is projected to affect approximately 29 million taxpayers in 2010, up from 3 million in 2004. A quirk of the interrelationship between the tax cuts and the AMT is that the AMT will gradually eliminate the benefit of the tax cuts for middle income taxpayers on the upper end of the scale – what one commentator calls the AMT “take-backs.” A 2003 statistical analysis by Burman, Gale and Rohaly at the Urban Institute suggested that by 2010 the AMT would eliminate 70% of the tax cut for taxpayers with gross income between $100,000 and $500,000 and 42% of the tax cut for taxpayers with gross income between $75,000 and $100,000. A more recent study suggests that 97% of taxpayers with two children and incomes of $75,000 to $100,000 will be affected by the AMT by 2010, and 44 million will be affected by 2014.

Congress has not acted to deal comprehensively with the interaction of the regular tax cuts and the AMT. Instead, it has passed annual [stop gap] fixes[ or “patches,”] that increase the AMT exemption to prevent, for the few years during which the patch is applicable, [AMT encroachment on] the vast majority of middle-income and unintended taxpayers from having to pay the tax. Congress’ [sic] failure to do more is due to the enormous costs of simultaneously making the tax cuts permanent and eliminating the extended reach of the AMT into lower tax brackets. The Congressional Budget Office has estimated that full AMT repeal would reduce tax revenues by roughly $600 billion over ten years, even assuming that the 2001-2003 tax cut sunsets take effect as planned. [Scholars] estimate that indexing the AMT under current law would cost $428 billion, while the combined cost of indexing the AMT and making the tax cuts permanent would be $1.76 trillion. Even repeal advocates such as the National Taxpayers Union admit it could cost as much as $800 billion over ten years to repeal the AMT and make the 2001-2003 tax cuts permanent. These estimates make clear that the cost of repeal would be significant, and that cost will be substantially increased if the 2001-2003 tax cuts are made permanent. Full repeal would, of course, have other implications for the overall federal tax system, especially for progressivity. Congress’ [sic] approach has therefore been one of piecemeal reform to prevent the
worst combined effects of the AMT and new tax cuts while “post-
poning hard choices.”

Most recently, a patch was passed at the 11th hour for 2007 (on
December 20, 2007), aimed to minimize the impact of the AMT.
Since 2001, Congress temporarily increased income exemption levels
and allowed some personal credits to be used. The 2006 patch put
the exemption levels at $62,550 for joint filers and $42,250 for single
filers. Without the 2007 patch, the 2007 exemption amounts would
have fallen to $45,000 for joint filers and $33,750 for single filers.

Despite the 2007 patch, the Joint Committee on Taxation estimates
that 5.4 million tax filers are likely subject to the AMT in 2007, up
from around 4 million last year.

III. THE CURRENT STATE OF THE ALTERNATIVE MINIMUM TAX

A. Calculation of the Alternative Minimum Tax

The current alternative minimum tax (“AMT”) is a “back-up” tax
system with flatter rate brackets and a broader tax base than the regu-
lar income tax. The base (AMTI) is derived from the regular income
tax base by making certain “adjustments” and adding back in certain
“preference” items that are disallowed for AMT purposes. These ad-
justments and disallowed tax preferences (“AMT preferences”) in-

38. Beale, supra note 2, at 845-47 (citing CONG. BUDGET OFF., REVENUE AND TAX POLICY
doc5368/04-15-AMT.pdf; Alan J. Auerbach, William G. Gale & Peter Orszag, Bush Administra-
tion Tax Policy: Introduction and Background, 104 TAX NOTES 1291, 1294 (2004); Nina E. Olson,
2004 Annual Report to Congress, NAT’L TAXPAYER ADVOC., Dec. 31, 2004, at 383; Al Davis,
New Household Tax Cuts are Strongly Affected by AMT and Vary Over Time, 92 TAX NOTES, 293
(2001); Robert S. McIntyre, Bush’s Most-Favored Taxpayers, AM. PROSPECT, July 1, 2002, at 17;
Leonard E. Burman, William G. Gale & Jeffrey Rohaly, The AMT: Projections and Problems,
100 TAX NOTES 105, 105 (2003); Leonard E. Burman et al., AMT Relief in the FY2005 Budget: A
also Dustin Stamper, House Clears ‘Tax Cut of the Week’ - A Short-Term AMT Fix, 103 TAX
NOTES 625 (2004); William L. Watts, Timing Uncertain on Major Tax Overhaul, MARKETWATCH,
Oct. 17, 2007; Floyd Norris, Help Grandparents of Rich Kids Now, Deal with Real Problems
Later, N.Y. TIMES, Feb. 6, 2004, at C1 (noting the Bush administration does not seem “eager to
deal with the prospect of the alternative minimum tax . . . harming many middle-class
taxpayers”).

40. Id.
41. Id.
42. Sahadi, supra note 5.
43. Id.
45. Id. § 55(b)(2) (requiring adjustments and disallowing tax preference items); id. § 56 (set-
ting out adjustments); id. § 57 (listing tax preference items).
clude such items as a reduction in the amount of accelerated depreciation that may be taken into account for AMT purposes, the disallowance of the deduction for interest on certain home equity loans, and required inclusion of otherwise excluded tax-exempt interest on certain private activity bonds.\footnote{46}{Id. §§ 56(a)(1), 56(e), 57(a)(5).}

The AMT creates a unique tax that is parallel to the regular tax. Calculation of the AMT begins with the calculation of one’s income tax liability under the regular system.\footnote{47}{Income tax liability under the regular tax system is calculated by applying the tax rates found at I.R.C. § 1 against the individual taxpayer’s taxable income. Taxable income is calculated as the individual taxpayer’s gross income defined at I.R.C. § 61, less deductions defined at I.R.C. § 63.} That amount is then subtracted from the individual taxpayer’s tentative minimum tax to calculate AMT tax liability.\footnote{48}{I.R.C. § 55(a)(1) (2006).}

The tentative minimum tax is the sum of “26 percent of so much of the taxable excess as does not exceed $175,000, plus 28 percent of so much of the taxable excess as exceeds $175,000.”\footnote{49}{Id. § 55(b)(1)(A)(i).} Taxable excess is that amount of the taxpayer’s AMTI for the taxable year “as exceeds the exemption amount.”\footnote{50}{Id. § 55(b)(1)(A)(ii).}

The taxpayer’s AMTI is his regular taxable income reduced or increased by adjustments provided in Code Sections 56 and 58, and increased by tax preference items found in Code Section 57.\footnote{51}{Id. § 55(b)(2).} Adjustments and preferences found in Code Sections 57 to 58 “can be categorized into two groups: deferral and exemption provisions.”\footnote{52}{Griffin, supra note 17, at 266.} The exemption provisions are relatively simple, requiring that the taxpayer add back exemptions by which the regular income tax was reduced.\footnote{53}{I.R.C. § 57.} Deferral provisions are considerably more difficult as they require the taxpayer to recalculate income and costs using different schedules that that used to calculate regular income tax liability.\footnote{54}{Griffin, supra note 17, at 267.}

Finally, the exemption amount—the amount by which the AMTI is reduced before applying one of the two tentative minimum tax brackets—is $44,350 for a single individual and $66,550 for married taxpayers filing joint returns or for a surviving spouse.\footnote{55}{I.R.C. § 55(d)(1) (2006).}
B. Problems with the Current Alternative Minimum Tax

1. Overview—Classical Approach

Adam Smith’s “canons of taxation” provides one framework to analyze the problems with the current AMT. Smith believed:

[T]axes should be levied in proportion to the respective financial abilities of the taxpayers ("fairness"), . . . be certain and predictable ("stability"), . . . be made convenient for the taxpayer ("economic efficiency"), and . . . be levied in a manner that takes as little out of the pockets of the taxpayer as possible in relation to the actual amount of revenue the state receives by way of taxation ("administrative efficiency").56

First, the fairness of the AMT comes into question as AMT tax liability begins to fall onto the middle class taxpayers. For instance, in 2000, only 1.1 million taxpayers were subject to the AMT.57 By 2010, the AMT will reach 7.6 million taxpayers.58 To compound this problem, the AMT has only two tax brackets, and it lacks the progressivity of the regular tax.59 In effect, a larger burden of taxation will fall on the middle class and tax rates will peak for those with income in the range of $200,000 to $500,000.60 If unabated, the United States may well return to a time where the superrich pay a miniscule amount of tax relative to their income, a situation which led to the public outcry resulting in the first add-on or alternative minimum tax in 1969.61

Other inequities encountered through the AMT are attributable, in part, to the limitations on deductions.62 For example, a taxpayer’s calculated AMTI disallows certain miscellaneous itemized deductions.63 One such deduction is that for state and local taxes.64 This means taxpayers in states with high income, property, and sales taxes who would normally claim a deduction for state and local sales tax on their regular tax return cannot claim such deduction against the AMT. This in-

58. Id.
59. The regular tax has six tax brackets ranging from 10 percent to 35 percent in an attempt to shift the tax burden progressively onto those with greater income. The goal of progressiveness has long been a hallmark of the federal tax system.
60. Griffin, supra note 17, at 260.
61. See id. at 260-61.
63. Id. § 67(b).
64. See id. § 56(b)(1)(A)(i) (prohibiting miscellaneous itemized deductions as defined in I.R.C. § 67(b)). See also id. §§ 67(b)(2), 164(b)(2).
equity hurts not only by the individual taxpayer, but also the state whose citizens' financial abilities are reduced as they lose deductions. Further, citizens of a state will likely be more resistant to a state's attempt to raise taxes, as fewer of the state's citizens may claim that tax as a deduction against their federal tax.

Additionally, the AMT exemption for couples is less than double the exemption for singles. Unlike the regular tax system, the AMT does not have a separate set of tax brackets for marital status. Thus "the AMT imposes significant marriage penalties." Stability becomes a more important consideration as more taxpayers become familiar with and are affected by the AMT. Taxpayers' uncertainty grows as the AMT's existence and proposals for reform are proposed and debated upon without resolution. Even without comprehensive reform, the AMT exclusion amount must periodically be adjusted via annual patches and without an index for inflation or a set schedule for adjustment, taxpayers have no idea when the next adjustment will be pushed through Congress.

Economic efficiency is compromised when a tax is imposed without a taxpayer realizing any financial gain. Many taxpayers find themselves subject to the AMT without ever realizing the income considered in calculating the AMTI.

Next, administrative efficiency is directly related to simplicity. The AMT, however, is notoriously complex. The AMT's complexity results in increased costs to taxpayers and the IRS in its compliance and enforcement. Additionally, the complexity of AMT calculation virtually requires taxpayers to enlist the help of tax professionals and other preparation resources. Since the cost of tax advice is out of the reach of most average Americans, wealthy taxpayers have more opportuni-

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65. Id. § 55(d)(1)(A)-(B) (prescribing $33,750 as the exemption amount for non-married taxpayers and $45,000 as the exemption amount for married taxpayers); see also Leonard E. Burman, William G. Gale & Jeffrey Rohaly, The Expanding Reach of the Individual Alternative Minimum Tax, 17(2) J. ECON. PERSP. 173, 174-75 (2003).
66. Burman et al., supra note 66, at 175.
67. Id.
69. Id. § 1001(b) ("[T]he amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.").
70. Jeffrey Rohaly, Leonard E. Burman & Matthew Hall, Key Points on the Alternative Minimum Tax, BROOKINGS, Jan. 21, 2004, http://www.brookings.edu/views/op-ed/gale/20040121amt.htm ("[T]he Internal Revenue Service and the Taxpayer Advocate have flagged the AMT as one of the most complicated tax provisions to comply with and administer. Most people required to fill out the AMT forms end up owing no additional taxes. The AMT also creates complicated interactions with the regular income tax.").
ties to manipulate tax laws, adding to actual and perceived inequity between the rich and the poor. Finally, as tax computations become more complicated, there is simply a higher chance that mistakes will be made by a taxpayer that undertakes AMT calculations alone.

The costs of compliance are not bourn by the taxpayer alone. The IRS itself will incur much of the cost of providing for taxpayer assistance and in the clear costs of auditing taxpayers facing the AMT, further reducing administrative efficiency.

Finally, another immense problem with the AMT is that it will become increasingly more expensive to roll back or repeal the tax as the AMT tax base snowballs every new year. By 2008, a repeal of the AMT would cost more than a repeal of the regular tax.\[71\]

2. Specific Issues

Within Smith's framework, we can focus in on the main criticisms faced today with the AMT.

Calls for AMT reform or repeal are not new, as the debate began soon after the 1978 enactment of the current version of the add-on tax. As early as 1980, commentators recognized the need to address excessive tax avoidance by high-income taxpayers as an important way to improve the overall equity of and compliance with the tax system, but argued that the AMT was "ill-conceived in every respect" because of its cumbersomeness and inequitable application.\[72\] They argued that Congress could have achieved the same (or better) results through less cumbersome fine-tuning of the regular tax system.\[73\] The same thoughts are echoed today and evidenced by a recent report of the National Taxpayer Advocate that considers the AMT one of the most serious problems taxpayers face and labels AMT repeal a "Key Legislative Recommendation."\[74\]

According to Linda Beale:

Critics attack the AMT on five main grounds: (i) its failure to adequately target the superrich and instead to take back the tax cuts from middle- and upper-income taxpayers (the downward creep argument); (ii) its lack of transparency for ordinary taxpayers who are often inadequately informed (if not totally unaware) of the potential applicability of the AMT to their situation (the transparency ar-

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71. Burman, supra note 4, at 106.
73. See, e.g., Coven, supra note 73, at 1108.
argument); (iii) its lack of consistency with regular income tax policy (the consistency argument); (iv) its addition of a layer of complexity, both in terms of the initial determination of whether the AMT may be applicable and the particular mechanisms of AMT applicability (the complexity argument), and (v) its apprehension of taxpayers with various kinds of lump sum payments, such as stock options and contingent attorney fee awards (the "accidental taxpayer" argument).75

Many of these arguments overlap and interconnect. For instance, the complexity of the AMT contributes to the lack of transparency. Additionally, some of the arguments are directly targeted at the current structure of the AMT, while others are general concerns about fairness for AMT taxpayers.

The following Sub-subsections address the three strongest arguments against the AMT: (a) the downward creep of the tax, (b) the lack of transparency, and (c) the overwhelming complexity of the AMT.

a. Downward Creep

Arguments made about the downward creep of the AMT are based on the original purpose of the tax. The downward creep of the AMT into the middle class is inconsistent with the original purpose of a minimum tax—that is, capturing revenue from high income taxpayers who would otherwise avoid their share of tax liability. Although the AMT's failure to be indexed with inflation is a major cause of the AMT's expanding reach, it can also be argued that it simply is not capturing enough high-income taxpayers. This Sub-subsection explores those arguments.

Many have criticized the AMT, noting:

The AMT's lack of an indexation [for inflation] is widely conceded as a flaw across the political spectrum. In 2005, the Urban-Brookings Tax Policy Center and the Treasury Department estimated that around 15% of households with incomes between $75,000 and $100,000 must pay the AMT, up from only 2-3% in 2000, with the percentage increasing at high incomes. That percentage is set to increase quickly over the coming years if no change is made such as indexing for inflation. Currently, households with incomes below $75,000 are subject to the AMT only very rarely (and thus most tax advisors do not recommend computing AMT for such households). That is set to change in only a few years, however, if the AMT remains unindexed.

The median household income in the United States was $44,389 in 2005, and households making over $75,000 per year made up the

75. Beale, supra note 2, at 848.
top quartile of household incomes. Because those are the households generally required to compute the AMT (though only a fraction currently have to pay), some argue that the AMT still hits only the wealthy or the upper middle class. However, some counties, such as Fairfax County, VA ($100,318), and some cities, such as San Jose, CA ($71,765), have local median incomes that are considerably higher than the national median and approach or exceed the typical AMT threshold. The cost-of-living index is generally higher in such areas, which leads to families who are "middle class" in that area having to pay the AMT, while in poorer locales with lower costs of living, only the "locally wealthy" pay the AMT. In other words, many who pay the AMT have incomes that would place them among the wealthy when considering the United States as a whole, but who think of themselves as "middle class" because they are not wealthy due to the cost of living in their locale.76

Today, the AMT fails to achieve its original purpose of ensuring that the wealthiest taxpayers pay some federal income tax.77 As described above, when the original minimum tax legislation was enacted, Congress focused on the ability of 154 individuals with adjusted gross incomes exceeding $200,000 to pay no 1966 income tax at all.78 The AMT was designed to limit very high income taxpayers' use of a few preferences that could literally wipe out their tax liability in spite of their considerable economic income, resulting in an unfair sharing of the tax burden.79 Congress made further changes in 1976, again reacting to a study that indicated 244 high-income taxpayers paid no tax in 1974, even with the AMT system in place.80

Despite of all the tailoring of the AMT to capture high-income tax avoiders, many argue the AMT has not succeeded in capturing those targeted. One calculation indicates the AMT system adds about one high-income taxpayer for every 1,000 high-income taxpayers already paying some amount of income tax under the regular tax system.81 Since the AMT appears to be missing its mark, critics argue that a

77. See, e.g., Olson, supra note 75, at 383 ("While the AMT was originally designed to prevent wealthy taxpayers from escaping tax liability through the use of tax avoidance transactions, it now affects large groups of middle-class taxpayers with no tax avoidance motives at all.").
79. Id. at 234 ("Only by sharing the tax burden on a fair basis is it possible to keep the tax burden at a level which is tolerable for all taxpayers").
81. Id. at 6-8 (using 1998 return numbers and results of a 2001 GAO study to calculate these numbers).
more efficient way to deal with high-income tax evaders is to simplify
the tax code and reduce taxes.\textsuperscript{82}

Although the AMT is clearly not the best way to ensure high-in-
come taxpayers pay at least some tax, it can be argued that the AMT
still does manage to trap some and repealing the AMT will result in
some taxpayers owing nominal or no tax. In 2003, about 2,700 taxpay-
ers with incomes more than $1 million who would not otherwise have
paid any tax were caught by the AMT.\textsuperscript{83} This number is not insignifi-
cant, especially if one considers the deterrent effect of the AMT.
Without an AMT system, considerably larger numbers of high-income
taxpayers might engage in aggressive tax-avoidance planning around
the very items currently made difficult to use in tax sheltering because
of the AMT.\textsuperscript{84}

The primary reason the failure of purpose justification of the down-
ward creep argument raised is the increasing encroachment of the
AMT on middle class taxpayers. One reason for the expanding scope
of the AMT is the constant change in the treatment of preference
items under the AMT by Congress since the original alternative tax’s
enactment. According to Beale:

The original AMT focused on deductions that might be taken by
owners of property, a group that we have seen can be expected to
be made up predominantly of the wealthy. . . . Thus, AMT prefer-
ences under the 1969 legislation included the portion of net capital
gains excluded under the pre-1986 Code regular tax and excess de-
preciation or amortization deductions permitted under the regular
tax. The 1976 amendments, however, added a tax preference for
itemized deductions, essentially limiting itemized deductions other
than medical and casualty losses to no more than 60% of adjusted
gross income. Further amendments over the years, in 1986, 1993,
and 1997, eliminated some of the preferences that could be ex-
pected to be used predominantly by the very wealthy (e.g., the ulti-
mately short-lived AMT preference for untaxed appreciation on
charitable deductions). The amendments, while providing a specific
ability-to-pay exemption amount for AMT purposes, also resulted
in treating as AMT preferences a number of items that we think of,
at least in part, as ability-to-pay exemptions - the standard deduc-
tion, miscellaneous itemized deductions, state and local tax deduc-
tions, a larger portion of medical expenses, and various credits.\textsuperscript{85}

82. Id. at 14.
83. Burman, supra note 4, at 106.
84. David Cay Johnston, The Loophole Artist, THE CONTRARIAN REVIEW, Dec. 21, 2003,
http://www.contrarianreview.com/helping.html (quoting tax lawyer Jonathan Blattmachr of
Milbank, Tweed, Hadley & McCloy, who said, "There are lots of things you would not even
think about because of the alternative minimum tax, . . . [b]ut if you repeal it, then there are all
sorts of things to start thinking about.").
All in all, the widening reach of the AMT cannot be disputed; however, the policy justifications for retaining the AMT remain a topic for debate.

b. Transparency

A self-assessment tax system, like the one in the United States, relies upon a taxpayer desire to report all item's of income fairly. In such a self-reporting system, transparency is paramount since the accuracy of the tax earned is dependant upon the knowledge of the taxpayers. Prior to 2000, most ordinary taxpayers were probably unaware of the alternative tax system. After the 2001-2003 tax cuts, however, many ordinary taxpayers were now obligated to do extra calculations in order to make sure that they did not fall under the AMT's grasp.

In addition, the inconsistencies of the AMT and regular tax system increase the difficulties taxpayers face when trying to calculate their respective tax liabilities. For example, "because of the inconsistency between the AMT and regular tax systems and the failure of required interest reporting to make any distinctions among types of interest, some taxpayers may not understand or comply with the different AMT treatment of various types of interest." Further, the average additional tax liability for AMT taxpayers is $6,000, which is, in many cases, much greater than liability under the regular tax regime. This sticker shock may leave taxpayers in a bind if they did not budget tax liability in that range. Furthermore, "[a]s a result, new AMT taxpayers may be more likely to be subject to underpayment penalties." This lack of transparency in the tax system blindsides taxpayers and understandably creates frustration. Taxpayers may believe that extra calculations are an unreasonable burden and, if they end up paying the AMT or a related penalty, that they have been cheated without fair notice of its potential applicability.

Although the issue of transparency is a major concern of the AMT, it may not by itself be adequate to justify the total repeal of the

86. See, e.g., Tax Division of the American Institute of Certified Public Accountants: Hearing on the Revenue Provisions in the President's Fiscal Year 2000 Budget Before the H. Comm. on Ways and Means, 106th Cong. 6 (1999) (statement of David A. Lifson) ("Most sophisticated taxpayers understand that there is an alternative tax system, and that they may sometimes wind up in its clutches; unsophisticated taxpayers, however, may never have even heard of the AMT, certainly do not understand it, and do not expect to ever have to worry about it.").

87. Beale, supra note 2, at 853. "For example, the AMT allows a deduction for interest paid on mortgage loans that are used to purchase a home, but it does not allow a deduction for interest paid on home equity loans that are used for personal consumption." Id. at 853 n.166.

88. Beale, supra note 2, at 853.

89. Id.

90. Id.
AMT.\textsuperscript{91} Lawmakers often use taxation as a tool to address economic societal concerns. In their attempt to address one particular constituent's concerns, the effects often ripple across all the various taxation regimes employed by the United States (e.g. payroll taxes dedicated to Social Security and Medicare, transfer taxes governed by the gift and estate tax regimes, and income taxes governed by the regular and alternative tax regimes).\textsuperscript{92} One cannot evaluate overall distributional effects without "understanding the combined effects of all of these tax systems, and taxpayers also need to understand how these systems interrelate in order to participate in informed debate about tax policy."\textsuperscript{93} Although we would expect the average taxpayer to be familiar with the mechanics of the regular tax system, in time they may also become familiar with the nuances and applicability of the AMT. Indeed, given the recent delay in passing the 2007 patch, the profile of the AMT has been raised by the media and financial advisors resulting in taxpayers that may not know the details of the AMT, but know well enough to inquire about their own AMT liability.

c. Complexity

The complexity of the AMT has been noted:

The AMT is similar to a flat tax of about 28\% on adjusted gross income over $175,000 plus 26\% of amounts less than $175,000 minus an exemption depending on filing status after adding back in most deductions ($58,000 if using the standard deduction and married filing jointly). However, taxpayers must also perform all of the paperwork for a regular tax return and then all of the paperwork for Form 6251. Furthermore, affected taxpayers must file AMT versions of all carryforwards since the AMT carryforwards will be different than regular tax carryforwards. Once a taxpayer qualifies for AMT, he or she must file AMT versions of carryforward losses and AMT carryforward credits until they are used up in future years. The definitions of taxable income, deductible expenses, and exemptions differ on Form 6251 from those on Form 1040.

The burden of computing the AMT and the disallowance of deductions for state, local, and foreign income taxes magnify criticisms of the AMT, at least in the case of state and local taxes. The deduction for state and local taxes in the normal income tax code can encourage wealthy areas to raise taxes and, in effect, redirect monies that would normally go to the federal government (and hence to residents of poorer states) to their state and local governments, where it can be spent on their own citizens. The AMT removes this

\textsuperscript{91} Id.
\textsuperscript{92} Id.
\textsuperscript{93} Beale, \textit{supra} note 2, at 853.
incentive for wealthy states to increase their state and local taxes, and makes it more likely that citizens of areas with high costs of living will subsidize citizens of areas with lower costs of living.

[However, t]he AMT's disallowance of the foreign tax credit has no analogous counter-balancing effect. It continues to disadvantage even low-paid American citizens and green card holders who work abroad or who are otherwise paid in foreign currency. Particularly as the dollar falls around the world, those working abroad see their incomes (when reported to the IRS in terms of US dollars) skyrocket even if their actual incomes fall from year to year and even if their foreign tax liabilities increase. They are in effect being taxed solely on changes in the currency market, from which they have received no benefit.94

The AMT as it existed prior to the 2001-2003 tax cuts was already a highly complex system, requiring separate computations and careful reading of instructions to ensure that proper adjustments had been made.95 Now, it is more complex, requiring a four-step process:

... First, taxpayers calculate their regular income tax.

Second, [the taxpayer] determine[s] whether the AMT may apply [to them]. Some taxpayers are automatically subject to the AMT because the tax applies to everyone who claims certain kinds of adjustments to income, such as stock options not exercised in the same year they were received. [These taxpayers go straight to the third step.] Other taxpayers may be subject to the AMT if their taxable income plus certain other items exceeds $45,000 for married couples filing a joint return (half that for each spouse if they file separately), or $33,750 for a single filer or head of household [the then-current AMT exemption amounts].96

These exemption amounts are increased through yearly patches; had the 2007 patch not been passed, taxpayers would have faced the lower $45,000 / $33,750 exemption amounts.97 The process continues:

... Those taxpayers [who are calculating whether the AMT applies to them then] complete a 13-line worksheet [ ] provided in the instructions to IRS Forms 1040 and 1040A, the forms for the regular income tax. If the worksheet indicates that the AMT may apply, those taxpayers go on to the third step.


97. Id.
Third, taxpayers use IRS Form 6251, which is 50 lines long, to recalculate taxable income using the rules of the AMT instead of the rules of the regular income tax. The result of this calculation is called the tentative AMT.

Finally, taxpayers compare their regular tax before credits with their tentative AMT, and pay whichever is greater.\(^9\)

Since taxpayers first must determine whether the AMT applies to them by working through the AMT worksheet prior to filing out Form 6251, the AMT causes complexity for those who do not even face AMT liability; the process entails additional hours of tax return preparation time and hassles.\(^9\) Although repeal of the AMT would clearly solve this issue, it would come at the price of lost tax revenues.\(^1\) A simple solution, short of outright repeal, is the institution of a bright line income threshold for AMT applicability.\(^1\) A bright line test would save taxpayers that do not meet the income threshold the hassle of figuring out whether the AMT applies to them, while simultaneously exempting them from the alternative tax.\(^1\) This would also halt any downward creep issues, thereby ensuring that the AMT remains a tax for the high-income taxpayers.\(^1\)

If the AMT does end up being applicable to a taxpayer, that taxpayer faces a complex set of calculation to determine their tax liability. "Various items must be recomputed for AMT purposes, including home mortgage interest, investment interest, depletion deductions, and depreciation."\(^1\) The complex requirements of the AMT lead to wasted time, frustration and mistakes. A 1997 study "estimates that the overall cost of compliance with the AMT may have been as high as $360 million."\(^1\) The IRS estimated that the AMT system added 29 million hours to overall taxpayer return preparation time in


\(^9\) Id. (citing Dept. of the Treasury, Internal Revenue Serv., 1040 Instructions 2004, at 35 (2004) (providing that you should look to line 44 to see if you should fill in Dept. of the Treasury, Internal Revenue Serv., Form 6251: Alternative Minimum Tax - Individuals (2004))).

\(^1\) Id.

\(^1\) Id. (supra note 2, at 856).

\(^2\) Id.

\(^3\) Id.

\(^4\) Id.

2000."\textsuperscript{106} Even if these figures are discounted for possible error, they suggest a serious problem of administrative efficiencies and complexity that would benefit from AMT reform. Note that the complexity problem may be mitigated by the fact that many high-income taxpayers may already rely on tax professionals.

Overall, in light of the unfavorable cost-to-benefit ratio, many have called for AMT reforms. The imminent explosion of AMT applicability, the burdens imposed by the AMT’s complexity, the high costs of compliance, and the AMT’s unpredictability suggest the problem the AMT was designed to attack is sufficiently important; the AMT is not sufficiently targeted to merit retention of the supplemental tax system.\textsuperscript{107}

IV. Proposals for Reform

Policy analysts are divided over the best course of action when it comes to the AMT. The Tax Policy Center, a joint program of the Urban Institute and Brookings Institution, has proposed a revenue-neutral, highly progressive replacement for the AMT.\textsuperscript{108} Len Burman and Greg Leiserson of the Center suggest an “option [that] would repeal the AMT and replace it with an add-on tax of 4 percent of adjusted gross income above $100,000 for singles and $200,000 for couples. The thresholds would be indexed for inflation after 2007.”\textsuperscript{109} This plan, the authors contend, would share the original goal of the AMT, that is, to ensure a certain level of taxation for high earners.\textsuperscript{110}

Some policy groups say that, rather than reform the AMT, the best solution would be to repeal it. Among its reasons for calling for repeal, the Cato Institute notes: many “tax loopholes that the AMT [was] originally designed to correct have since been closed”; the AMT is needlessly complex and burdensome to taxpayers; and a full repeal would leave federal revenues at 18% of GDP, which has been about average in recent decades.\textsuperscript{111} The National Taxpayers Union also sup-

\textsuperscript{106} Beale, \textit{supra} note 2, at 856 (citing Dep't of the Treasury, Internal Revenue Serv., \textit{Annual Report from the Comm'r of the Internal Revenue on Tax Law Complexity} 26 (2000)).


\textsuperscript{109} Id.

\textsuperscript{110} Id.

port repeals. "It is wholly unfair for policymakers to promote certain social and fiscal ideas through exemptions, credits, and deductions, only to take these incentives away when a taxpayer takes advantage of them too well."\textsuperscript{112}

The Tax Foundation says that the AMT can be effectively repealed simply by correcting the deficiencies in the regular tax code. Economist Patrick Fleenor argues:

"[I]t is usually the unjustifiable limitations on taxable income... that cause the AMT backstop to kick in. If income were taxed comprehensively by the regular tax code, there would be no way of legally avoiding taxation, and not one taxpayer would have to file the AMT form even if the law were still on the books.\textsuperscript{113}"

Criticism of the AMT is justified. The system is complicated both to the taxpayer and to the Internal Revenue Service. Further, the system can be incredibly inequitable, as in the case of contingency fees and ISOs discussed above. However, the AMT has some merit.

The goal of recapturing those individuals with substantial economic income who could otherwise lawfully avoid tax liability is more than fair; it is practical and necessary. The AMT was the first substantial attempt to sharpen the bite of a tax code worn dull and ineffective through exclusions, deductions, and credits. To simply repeal the AMT without substantially repairing or reforming the Code is akin to removing the patch covering a hole in a sinking boat without further attempting to repair the hull.

Proposals for AMT reform can be categorized generally either as attempts to repair or to totally repeal the AMT system, both with accompanying reform of the regular tax system.

A. Amending the Current AMT

1. Establishment of Gross Income Threshold

It is clear the AMT was not intended to apply to ordinary taxpayers that are not considered high-income. These taxpayers who may fall under (or think they may fall under) the AMT should be able to ascertain their exemption from the AMT without having to perform preliminary worksheet calculation. The simple modification of establishing a gross income threshold indexed to inflation would eliminate the frustrating preliminary worksheet calculation from many tax-

\textsuperscript{112} Bailey, \textit{supra} note 96.

payers.114 "If the threshold test were not satisfied, the taxpayer would be automatically exempt from AMT liability."115

The question that naturally arises is at what income level the AMT should be triggered. The triggering level should be high enough to leave ordinary taxpayers clear from any AMT calculations, yet low enough to fully capture taxpayers that would otherwise pay less than their relative fair share. "The primary goal of the income threshold test is to provide a convenient and easily determined line for those who on fairness grounds should not have to worry about the AMT."

The median income per household in the country is approximately $47,845.117 The gross income threshold for AMT applicability should be well above that level to ensure that the AMT cannot reach into ordinary taxpayer ranks. As previously mentioned, without the 2007 patch, the AMT exemption amounts would have fallen to $45,000 for joint filers and $33,750 for single filers, clearly below the median income level of the United States.118 Certainly the AMT, which was first envisioned to tax superrich citizens avoiding tax liability, was not intended to reach these ordinary taxpayers. One source suggests a feasible income threshold might exempt married taxpayers with gross incomes of less than $150,000 (in 2004 dollars) and other taxpayers with incomes of less than $75,000.119 Whatever sum is proposed, all can agree that although less tax revenue will be generated with the establishment of a gross income threshold, the AMT will be become more congruent with the purpose of the original alternative tax.

114. Beale, supra note 2, at 878.
115. Id.
116. Id.
118. Sahadi, supra note 5.
119. Beale, supra note 2, at 879. Beale further asserted:

It is difficult to determine the cost of this change, but the National Taxpayer Advocates notes that use of a $150,000 threshold would have eliminated about 40% of taxpayers in 2001 who paid approximately $800 million in AMT. . . . Lowering the threshold could lower the cost of reform, but the threshold probably should not drop below $100,000 for married taxpayers filing jointly and $50,000 for others (i.e., approximately twice the median earnings for single individuals).

Id. at 879 n.252.
2. Indexing the AMT to Inflation

Even proponents of the current AMT cite the lack of indexation of the AMT exemption as one of the most significant problems.\textsuperscript{120} Indexation is essential in preventing future downward creep of the AMT into ordinary taxpayer brackets and countering the lack of transparency for individual taxpayers who are unaware of the potential applicability of the AMT. “Some studies (based on indexing the existing AMT exemption amount, without an income threshold) have suggested that indexing alone could cost as much as $658 billion over ten years.”\textsuperscript{121}

Related to the gross income threshold is the idea that the AMT exemption amount also could be indexed for inflation. Additionally, limitations on deductions that most directly impact the middle class could be eliminated completely.\textsuperscript{122} Examples of such limitations include taxes deductible on Schedule A,\textsuperscript{123} interest on home equity indebtedness, miscellaneous deductions that survive the two percent floor under the regular tax,\textsuperscript{124} and the deduction for personal and dependency exemptions.\textsuperscript{125} Finally, the AMT tax brackets could be improved further by also adding additional brackets.\textsuperscript{126}

All of these changes would improve the equity of the AMT by increasing progressivity and removing a considerable amount of the AMT burden that now rests on the middle class.\textsuperscript{127} Eliminating certain limitations on deductions would also improve equity by decreasing the federal tax liability of taxpayers with higher state tax liability. Economic and administrative efficiency would remain constant, or minimally increase, because Congress would no longer need to pass periodic adjustments to the AMT.

\textsuperscript{120} See, e.g., Mark A. Luscombe, \textit{TAX TRENDS – Alternative Minimum Tax – Our Future Flat Tax?}, CCH J., \textit{TAXES}, Nov. 2003, at 4 (“It is hard to get too excited about an AMT problem when the AMT has largely achieved its purpose but has a principal defect of not having been adjusted for inflation. We just start adjusting it for inflation, and the problem goes away.”).

\textsuperscript{121} Beale, \textit{supra} note 2, at 882.

\textsuperscript{122} Daniel S. Goldberg, \textit{To Praise the AMT or to Bury It}, 24 Va. Tax Rev 835, 841 (2005).

\textsuperscript{123} State and local taxes. I.R.C. § 164(a) (2006).

\textsuperscript{124} Id. § 67.

\textsuperscript{125} Goldberg, \textit{supra} note 130, at 841.

\textsuperscript{126} The AMT has only two tax brackets, while the regular tax system currently has six brackets.

\textsuperscript{127} See Leonard E. Burman et al., \textit{The Individual AMT: Problems and Potential Solutions}, NAT'L TAXPAYER ADVOC., Sept. 2002 (relating specific economic outcomes to several proposals to reform the AMT, including indexing the AMT. In one model, the Urban-Brookings Tax Policy Center found that indexing the AMT tax brackets, exemptions, and threshold for the exemption phase-outs for inflation would result in 94 percent relief of AMT liability among taxpayers with annual incomes between $15,000 and $75,000.).
3. Elimination of Second Depreciation Schedule

Another simple attempt to repair the AMT may involve the elimination of the second set of depreciation calculations currently required to determine AMT tax liability. The elimination of a second set of books for every depreciable asset would greatly increase the economic efficiency of the AMT. Economic efficiency would bring further administrative efficiency, like fewer and shorter audits. However, inequities would remain, and this change alone would do nothing to alleviate much of the instability of the current AMT.

B. Adopting Prior Schemes

1. Reenactment of the Pre-1986 Add-on Minimum Tax

If the sum of tax preferences exceeded an amount that would be designated in the Code, the Internal Revenue Service could again assess an add-on tax to the taxpayer's regular tax owed. This would eliminate the parallel tax system and much of the complexity it creates. This solution would preserve the AMT's foundational goal of including those taxpayers who have both substantial economic income and little or no tax liability under the regular system. The most obvious criticism would be that an add-on minimum tax has already been tried and was viewed as a failure.

2. Reenactment of the Original 1969 Minimum Tax Proposal

The minimum tax, as originally proposed, would limit the amount of tax preferences a taxpayer could claim each year. For example, the Internal Revenue Service could limit preferences to a percentage of the taxpayer's tax liability. Such a minimum tax would make sense if viewed through the classical framework outlined above. Equity would be assured as the limit on preferences would be a percentage rather than a dollar amount assigned to tax brackets. Stability would be less of a concern as the limitation would not need an adjustment for inflation. The tax itself would only change as tax preferences were added to the Code. Finally, the simplicity of such a single tax system would increase economic and administrative efficiency.

128. O'Shaughnessy, supra note 14, at 77.
129. Id.
130. Karlinsky, supra note 20, at 153.
131. Id.
132. Id.
133. See supra notes 56-71 and accompanying text.
C. Harmonize the Regular and AMT Tax Systems

Another "middle of the road" approach to reform may be the harmonization of the current AMT tax with the regular tax system. This solution may be the most cost effective and legislatively simple method of improving the current hodgepodge of taxation.

1. Treatment of Phase-outs for Exemptions and Itemized Deductions[^134]

A modest regular tax reform that is consistent with the proposals for reform of the AMT is the reinstatement of the regular tax phase-outs for exemptions and itemized deductions. For example, the Internal Revenue Code currently provides for a reduction in the total amount of permitted itemized deductions, by the lesser of 3% of the excess of adjusted gross income over $145,950 (for 2005) or 80% of the itemized deductions otherwise allowable.[^135] Reinstating these phase-outs would offset some of the cost of AMT reforms and at the same time improve consistency and remove complexity caused by the conflicts between the regular and AMT system when one system has a phaseout and the other does not. Phase-outs take into account the decreasing marginal utility of each dollar to high-income taxpayers. Retaining phase-outs ensures that the benefits of exemptions and deductions accrue to those who have the most need for them and provide further assurance that higher-income taxpayers cannot avoid all taxes on their economic income.

2. Harmonization of Medical Expense Deductions[^136]

The current penalizing approach of limiting medical expenses for AMT purposes is exceedingly problematic for taxpayers. It would be far better for tax administrators to carefully review provisions for the deductibility of medical expenses under the regular tax system in order to restrict further the ability of wealthy taxpayers to deduct items that may be more personal than medically necessary. Regardless, if medical expenses are deductible for purposes of the regular tax system, they should be deductible for the AMT system. This is one area where anything other than consistency between the two systems appears senseless.

[^134]: See generally Beale, supra note 2.
[^136]: See generally Beale, supra note 2.
3. Additional Harmonizing Changes\textsuperscript{137}

Several of the current AMT preferences might be eliminated through harmonization of those items with the regular income tax by eliminating them as an AMT preference or by shifting the regular tax to the AMT approach. The result would be consistency between the AMT and regular tax, and lessened complexity for both systems. Items that might be most appropriate, though most likely difficult to change due to public and political pressures, include the mortgage interest deduction for home equity loans, a limitation on interest deductions on acquisition indebtedness, and accelerated cost recovery deductions that currently require recomputation for AMT purposes.

The regular income tax deduction for home equity loans runs against the stated purpose for mortgage interest deductions of extending home ownership to ordinary Americans. It introduces a wealth-based distinction that disadvantages the less wealthy since it permits existing home owners to deduct borrowing costs for personal consumption expenses that are not deductible to non-home owners. Eliminating the home equity loan interest deduction in the regular tax would make the AMT and regular tax more consistent and simpler. In addition, limitation of the acquisition debt interest deduction to interest payments on mortgages under a reasonable threshold that is more proportionate with home purchases by ordinary taxpayers, and elimination of any interest deduction for mortgages on non-principal residences would further return the mortgage interest deduction to its original purpose.

Similarly, the simplified cost recovery deductions could be adopted for both AMT and regular income tax systems. Accelerated depreciation rewards capital investments that flourish without such incentives, and it encourages over-investment in unproductive endeavors. Reducing the recovery options simplifies both systems.

D. Total Repeal of the AMT\textsuperscript{138}

The AMT, although of questionable effectiveness, is the result of a continuing effort to provide equity in a tax system that may otherwise be avoided by those with the means to acquire effective tax counsel. For that reason, assuming arguendo that the AMT were repealed, the equitable aspects of its function would need to be transferred to the regular tax system. The easiest method for accomplishing this would

\textsuperscript{137} See generally O'Shaughnessy, \textit{supra} note 14.

\textsuperscript{138} See generally Burman et al., \textit{supra} note 4.
be to incorporate the equitable AMT provisions and limitations into the regular tax code.

While, many in Congress are likely weary to the idea of such aggressive reform, eliminating the AMT would require Congress and advisors from the Treasury Department to analyze the AMT item by item and incorporate the desirable AMT provisions into the regular tax code. The decision to cull certain tax preferences over others is likely to become a political quagmire. However, Congress must address the fact that certain tax preferences, particularly those created to encourage specific taxpayer behavior, contribute to inequities in tax liability and erode the tax base. If Congress takes action to phase out the AMT, it must do so quickly, as the cost of its repeal will soon be prohibitively expensive. Outright repeal is estimated to cost between one and two trillion dollars over 10 years.\textsuperscript{139}

Collapsing those AMT provisions and limitations most favorable to equity into the regular tax system will require considerable effort and discussion. If carried over into the regular tax system, many AMT limitations on deductions must be either indexed for inflation or eliminated so as to achieve greater equity among taxpayers.

If the limitations and deductions incorporated by the regular tax system are indexed for inflation, stability issues would be generally resolved. Additionally, the economic efficiency of a merged system surpasses the current AMT, most obviously because of the elimination of an entire tax system. The Internal Revenue Service would no longer require the taxpayer to recalculate income or maintain two sets of books for depreciation. High income taxpayers still would need to understand their limitations, but the Internal Revenue Service would not require them to understand an alternate system of taxation.

Economic efficiency would translate into greater compliance and fewer taxpayer errors. This would greatly increase administrative efficiency. Additionally, a single tax system would reduce the resources needed to educate the public and tax employees.

V. CURRENT LEGISLATIVE PROPOSALS

No fewer than a dozen bills on the subject of AMT reform have been introduced and considered by the House of Representatives during 109th Congress; many more are being considered by the current

110th Congress. Current legislative proposals are as varied as those suggested above.

Several bills suggest adjusting the AMT exemption amount. Referred to as patches, these exemption adjustments do very little to alleviate the long term AMT dilemma. Since 2001, Congress temporarily increased income exemption levels and allowed some personal credits to be used. The Tax Increase Prevention and Reconciliation Act of 2005, enacted in May 2006, raised the exemption amount for joint and single returns to $62,550 and $42,500, respectively. Unless Congress enacts a similar bill allowing for greater exemptions in every new tax year, the Tax Increase Prevention and Reconciliation Act of 2005 will not fix the AMT. The Act also sets a bad example. It allows Congress to draft one-year fixes, avoiding its responsibility of enacting long-term solutions.

At the last minute, Congress passed the 2007 patch, without which the 2007 exemption amounts would have fallen to $45,000 for joint filers and $33,750 for single filers. Demonstrative of the confusion and never-ending debate regarding the AMT, the patch was passed on December 20, 2007, but only after the IRS had already designed its forms for 2007. The IRS had to reprogram its forms to accommodate the law change, creating potential delays in income tax refunds for 2007.

Despite the 2007 patch, the Joint Committee on Taxation estimates that 5.4 million tax filers were likely subject to the AMT in 2007, up from around 4 million last year.

The Stealth Tax Relief Act of 2005 and House Bill 1599 additionally address the AMT exemption amounts provided under Internal Revenue Code Section 55(d). The Stealth Tax Relief Act of 2005 and House Bill 1599, however, would index the exemption amounts for

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141. H.R. 5590; H.R. 4297; H.R. 1538.
142. H.R. 4297 § 301(a) (enacted) (showing that previous AMT exemption amounts were $58,000 for joint returns and $40,250 for single taxpayers); I.R.C. § 55(d).
143. Sahadi, supra note 5.
inflation. In contrast to the Tax Increase Prevention and Reconciliation Act of 2005, this proposal would provide longer lasting relief to taxpayers with similar regular income tax and AMT liabilities by providing the extra AMT exemption amount to reduce their tentative AMT; this would effectively eliminate their AMT liability. Because this proposal only adjusts the AMT exemption amount, it has the political advantage of appearing to benefit the middle class while retaining the steep AMT tax brackets that are beneficial to the wealthy.

However, these bills would only preserve the status quo. As the AMT already captures too much of the middle class, indexing the AMT exemption amount for inflation provides relief only to those who would otherwise pay the AMT in the near future. It does nothing to help those already paying the AMT. A proposal would be more vertically equitable and preserve the progressivity of the regular tax system if it increased the AMT exemption amounts before indexing them for inflation.

Both House Bill 2987 and the AMT Middle Class Fairness Act of 2005 add certain deductions back into the AMT. The two bills would allow deductions for state and local taxes, but the AMT Middle Class Fairness Act of 2005 differs from House Bill 2987 by additionally adjusting the AMT exemption amount for inflation. These two bills could increase horizontal equity under the AMT by ensuring that taxpayers would not be punished for choosing to live in a locality with higher taxes.

The Fair Flat Tax Act of 2006 and Freedom Flat Tax Act both propose wholesale overhaul of the regular income tax system and elimination of the AMT. The Fair Flat Tax Act of 2006, contrary to its name, would establish three tax brackets. The Act's most attractive feature is its attempt to broaden the tax base, thus eliminating the need for the AMT. The Freedom Flat Tax Act would allow the taxpayer to continue paying his current income tax or to make a one-time election to be liable for a flat tax under which the AMT would be abolished. Similar to the Fair Flat Tax Act of 2006, the Freedom Flat Tax Act would broaden the tax base by providing fewer deductions and exemptions than the current Code. The broader tax base would help eliminate the need for the AMT in two ways: (1) it would

148. H.R. 703 § 2(b).
150. Id. § 2.
151. Id. §§ 2, 60.
152. Id. § 60.
replace tax revenues lost through AMT repeal, and (2) fix loopholes or inequities in the Code that provided the original impetus for enactment of the AMT.

The Individual Tax Simplification Act of 2005 is another attempt to eliminate the AMT while offsetting lost tax revenues by reforming the regular tax system. This bill suggests a fairly simple minimum tax that would be based upon the taxpayer's adjusted gross income. The proposed minimum tax would have much greater administrative efficiency than the current AMT because the minimum tax in the Individual Tax Simplification Act of 2005 is more easily calculated and understood than the AMT. The Individual Tax Simplification Act of 2005's greatest problem lies in its failure to change the inclusion of ISOs as gross income, a major source of contention under the current AMT.

Most recently, on October 25, 2007, Rep. Charles Rangel, Chairman of the House Committee on Ways and Means, introduced a bill that would repeal the AMT (the "Tax Reduction and Reform Act of 2007"). He proposed to substitute the estimated $800 billion in lost revenue over ten years with a "replacement tax," a surtax that would kick in for couples with incomes more than $200,000 and singles making at least $150,000. This 4% surtax would rise to 4.6% on incomes more than $500,000, and would increase taxes an estimated 1.7 million households (mostly those with AGI of more than $500,000) according to an analysis by the Joint Committee on Taxation, the source of Congress's official tax estimates. "Those 1.7 million households would pay $71.1 billion in additional taxes... The highest increase would hit about 400,000 households with incomes of one million dollars or more."

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153. H.R. 2950, 109th Cong. § 311 (2005) (explaining that if the adjusted gross income of an individual exceeds the initial threshold amount defined in the Individual Tax Simplification Act of 2005, the taxpayer's income would be increased by an amount equal to the sum of "the applicable rate of so much of the adjusted gross income as exceeds the initial threshold amount but does not exceed the second threshold amount, and twice the applicable rate of so much of the adjusted gross income as exceeds the second threshold amount." The applicable rate would be "the rate estimated by the Secretary which will result in the Individual Tax Simplification Act of 2005 being revenue neutral over the first 10 years after its enactment.").


155. Id.

156. Id.

157. Id. These taxpayers would pay $55.4 billion in additional taxes in 2008.
Conversely, 91 million households would see tax reductions under the Rangel Plan, most with incomes below $100,000.\textsuperscript{158} The $55 billion reduction in 2008 would go to households with incomes between one hundred thousand dollars and five hundred thousand dollars, a group that includes many people who would otherwise have to pay AMT.\textsuperscript{159}

Rangel argues "[f]undamental tax reform must begin with a repeal of [the AMT] now hitting middle-class families and is threatening to grab back the benefits promised under the 2001 and 2003 tax cuts."\textsuperscript{160} Rangel claimed that his plan meets the Bush administration's call for a permanent repeal of the AMT while remaining revenue neutral.\textsuperscript{161}

The Tax Reduction and Reform Act of 2007 would repeal the AMT, thereby eliminating the complexity of filing multiple forms. The decreased confusion would allow for more efficient tax planning.

Although the plan was bold, Congress opted for the traditional and simpler solution of passing a patch for 2007.\textsuperscript{162} Further, Republican lawmakers see the 2007 incarnation of the patch as a victory since the bill is not revenue-neutral and the $53 billion revenue shortfall will not be addressed as Democratic leaders hoped.\textsuperscript{163}

VI. CONCLUSION

Recently, the Alternative Minimum Tax's profile has been raised from an obscure section of tax code to an often criticized policy that threatens difficulty for many ordinary Americans. Repeal of the AMT has even become a campaign pledge in this Presidential election year. Republican nominee John McCain stated, "I would call for the elimination of the AMT."\textsuperscript{164}

In 2007, approximately 23 million households may face the AMT, about 19 million of them for the first time.\textsuperscript{165}

Since the AMT thresholds were not initially indexed to inflation, Congress has been forced to pass a series of temporary stopgaps to ensure that the AMT didn't encroach on the growing number of tax-

\textsuperscript{159} \textit{Id.}
\textsuperscript{160} \textit{Id.} (quoting Charles Rangel).
\textsuperscript{161} \textit{Id.}
\textsuperscript{162} Sahadi, \textit{supra} note 39.
\textsuperscript{163} \textit{Id.}
\textsuperscript{165} Sahadi, \textit{supra} note 5.
payers for whom it was never intended.\textsuperscript{166} Despite the 2007 patch, the Joint Committee on Taxation estimates that 5.4 million tax filers are likely subject to the AMT in 2007, up from around four million last year.\textsuperscript{167}

If reform of the AMT is to be successful, its cost must be offset without simply shifting the tax burden to ordinary taxpayers (or by cutting spending). To maximize structural coherence and consistency between the AMT and regular tax system, the costs should be met by increasing AMT collections from higher-income individuals, by increasing regular tax collections from higher-income individuals, or by some combination thereof. Congress did not intend to impose the AMT on the middle class, and steps must be taken to halt its encroachment before it any further damage is sustained.


\textsuperscript{167} Id.