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The Individual Alternative Minimum Tax

For the past four decades, the individual income tax has consisted of two parallel tax systems: the regular tax and an alternative tax, which was intended to impose taxes on high-income individuals who use tax preferences to greatly reduce or eliminate their liability under the regular income tax.[1] The current version of the alternative tax, the alternative minimum tax (AMT), requires people to recalculate their taxes under rules that include in their taxable income certain types of income that are exempt from the regular income tax and that do not allow certain exemptions, deductions, and other preferences. (For details on the calculation of the AMT, see Box 1.) That second set of rules raises marginal tax rates (the tax on an additional dollar of income) for some taxpayers; modifies or limits various credits, deductions, and exclusions that apply to regular income taxes; and adds to the complexity of the tax system.

For most of its existence, the AMT has played a minor role in the tax system, accounting for less than 2 percent of individual income tax revenues (or 1 percent of total revenues) and affecting less than 1 percent of taxpayers in any year before 2000.[2] Since then, the tax would have reached more and more taxpayers (because, unlike the parameters of the regular income tax, those of the AMT are not indexed for inflation), but lawmakers have intervened each year to slow that expansion. In addition, a series of reductions in the regular income tax enacted starting in 2001 would have caused even more returns to be subject to the AMT were it not for the series of temporary adjustments (often called "patches") that lawmakers made to the alternative tax.

The most recent AMT patch expired at the end of calendar year 2009. Without further adjustments, the impact of the AMT will expand quickly this year and continue to expand in subsequent years, becoming a more significant source of future revenues. As the reach of the AMT grows under current law, many taxpayers will face a fundamentally altered tax structure. If nothing is changed this year, one in six taxpayers will be affected by the AMT, paying on average an additional $3,900 in tax, and nearly every married taxpayer with income between $100,000 and $500,000 will owe some alternative tax. Because of the particular tax preferences and exemptions disallowed under the AMT, that tax structure is more likely to affect married couples, large families, and taxpayers in states with high state and local taxes.

As an increasing number of taxpayers incur the AMT, pressures to permanently reduce, eliminate, or otherwise modify the tax are likely to grow. However, restructuring the AMT to limit its impact would reduce federal revenues and alter the distribution of tax burdens. If the resulting revenue losses were offset by other tax increases or spending reductions, some taxpayers would benefit and others would be disadvantaged. If the revenue losses were not offset, federal budget deficits would rise and the cost would be shifted onto future taxpayers.

The Expanding Scope of the AMT

If current law remains unchanged, the role of the AMT in the tax system will expand rapidly over time. With the expiration of a temporary increase in the AMT's exemption amounts, the number of taxpayers affected by the AMT will jump from 4 million in calendar year 2009 to

1. From the committee report accompanying the Tax Equity and Fiscal Responsibility Act of 1982: "The committee has amended the present minimum tax provisions applying to individuals with one overriding objective: no taxpayer with substantial economic income should be able to avoid all tax liability by using exclusions, deductions, and credits." Tax Equity and Fiscal Responsibility Act of 1982, S. Rpt. No. 97-494, Vol. 1, at 108 (July 12, 1982).

2. For additional historical data, see Joint Committee on Taxation, *Present Law and Background Relating to the Individual Alternative Minimum Tax* (JCX-10-07), March 5, 2007; and Katherine Lim and Jeff Rohaly, *The Individual Alternative Minimum Tax: Historical Data and Projections, Updated October 2009* (Washington, D.C.: Urban-Brookings Tax Policy Center, October 5, 2009).

Box 1.

Calculating the Alternative Minimum Tax

The alternative minimum tax (AMT) is defined as the addition to regular income taxes, equal to the amount, if any, by which AMT liability exceeds regular tax liability (after applying appropriate credits). Taxpayers who potentially owe the AMT must recalculate their taxable income as defined by the AMT, apply alternative tax rates, allow for credits and other factors, and compare the resulting tentative AMT liability against their regular tax liability. Even though the AMT is technically the excess of AMT over regular tax liability, taxpayers effectively calculate their taxes under two systems and pay the higher of the two liabilities.

For the two-thirds of tax filers who claim the standard deduction, the process is fairly simple.[1] If taxpayers elect not to itemize their deductions, they just subtract the AMT exemption—$70,950 for married taxpayers filing jointly and $46,700 for most other taxpayers in 2009—from adjusted gross income and apply the two-step tax rates of 26 percent on the first $175,000 and 28 percent on any excess. If that amount exceeds their regular tax liability (before credits), they owe the excess as the AMT.

The process is more complicated for the one-third of taxpayers who itemize their deductions. They calculate taxable AMT income by adding back to regular taxable income their personal exemptions and specific deductions—for state and local taxes, unreimbursed business expenses, other miscellaneous deductions, and otherwise deductible medical expenses up to 2.5 percent of adjusted gross income—and then subtracting the appropriate AMT exemption. Applying AMT rates yields their tentative AMT liability, before credits. The AMT is the excess, if any, of tentative AMT liability over regular tax liability, prior to applying any applicable credits.

1. Some taxpayers claiming the standard deduction under the regular income tax would find it advantageous to itemize under the AMT, making the process more complicated.

Consider the example of a married couple with four children and income of $160,000, all in wages, in 2009 (see the table at right). The couple pays $10,000 in mortgage interest and $25,000 in state and local taxes. Under the AMT, the couple loses their six personal exemptions and their deduction for state and local taxes. They are allowed the AMT exemption of $70,950. Under the AMT, their tax is 26 percent of AMT taxable income. The tax liability for that family would be $18,150 under the regular tax system and $20,553 under the AMT.

In recent years, although the use of business tax credits was limited by the AMT, personal tax credits—including the earned income tax credit and child tax credit—were not affected by the AMT. After 2010, however, the use of almost all personal and business tax credits will be limited by the AMT. After that year, taxpayers with AMT liability will not be able to use those credits, and other taxpayers may use business and personal credits only to the extent that their regular tax liability exceeds their AMT liability.[2] Any unused business credits may be carried forward or backward for use against regular taxes.

For some taxpayers, AMT calculations are even more complicated. People who incur net operating losses, deduct accelerated depreciation of business assets, receive particular kinds of stock options, or engage in other selected activities that get preferential tax treatment face complex rules that determine whether they owe the AMT. Some additions to and subtractions from income may be shifted forward or backward in time, thus requiring additional recordkeeping. Other preferences may apply for a relatively small number of taxpayers and require calculations under alternative accounting rules.

2. In 2010, under current law, the child credit, adoption credit, and saver's credit are not limited by the AMT, but certain other personal credits are limited. The disallowed personal credits for 2010 might become allowed if an AMT patch is enacted for that tax year.

Continued

Box 1. **Continued**

Calculating the Alternative Minimum Tax

Impact of the Alternative Minimum Tax on One Hypothetical Family, 2009

(Dollars)

Regular Tax		Alternative Minimum Tax	
Income	160,000	Income	160,000
Minus exemptions: 6 x 3,650	-21,900	Minus AMT exemption	-70,950
Minus mortgage interest	-10,000	Minus mortgage interest	-10,000
Minus state and local taxes	-25,000		
Equals: Taxable Income	**103,100**	**Equals: AMT Taxable Income**	**79,050**
Tax[a] (Top rate of 25 percent)	18,150	Tentative AMT[a] (26 percent of taxable income)	20,553
		Minus regular tax[a]	-18,150
		Equals: AMT Liability	**2,403**
Average Tax Rate on Income (Percent)	11.3	Average Tax Rate on Income (Percent)	12.8

Source: Congressional Budget Office calculations based on 2009 parameters.

a. Before applying any personal tax credits, which would apply under both the regular tax and the AMT and would not affect the difference in tax.

27 million in 2010 (see Figure 1).[3] Sixteen percent of all taxpayers—and 36 percent of married couples—will be affected by the AMT in 2010. Because taxpayers must pay whichever liability is greater (that owed under the regular tax or that owed under the AMT), the number of taxpayers affected by the AMT will fall between 2010 and 2011, when regular tax liabilities will rise as a result of the scheduled expiration of tax reductions enacted earlier this decade. After 2011, however, the number of taxpayers affected by the AMT will continue to rise, growing to nearly 35 million by 2019.

The AMT accounted for just $32 billion, or 3 percent, of individual income tax revenues in fiscal year 2009, but under current law, AMT receipts will increase to $102 billion in 2011, or 8 percent of the total. The AMT's share of all federal receipts will climb from about 1.5 percent in 2009 to about 3.8 percent in 2011. (For the most part, receipts from the AMT in a particular fiscal year reflect tax liabilities for the previous calendar year because taxpayers generally pay the AMT when they file their tax returns for a given calendar year in April of the following year.) After falling sharply in 2012, AMT receipts will gradually rise again to $93 billion in 2019 and continue growing thereafter (see Figure 1).

Two factors are responsible for the path of AMT receipts in the next few years and beyond: inflation and recent reductions in regular income taxes. The impact of those factors has been muted in recent years by a series of temporary increases in the amounts of income exempt under the AMT. But the cumulative effects of those factors will return suddenly in 2010 as the AMT's exemption amounts fall back to their pre-2001 levels.

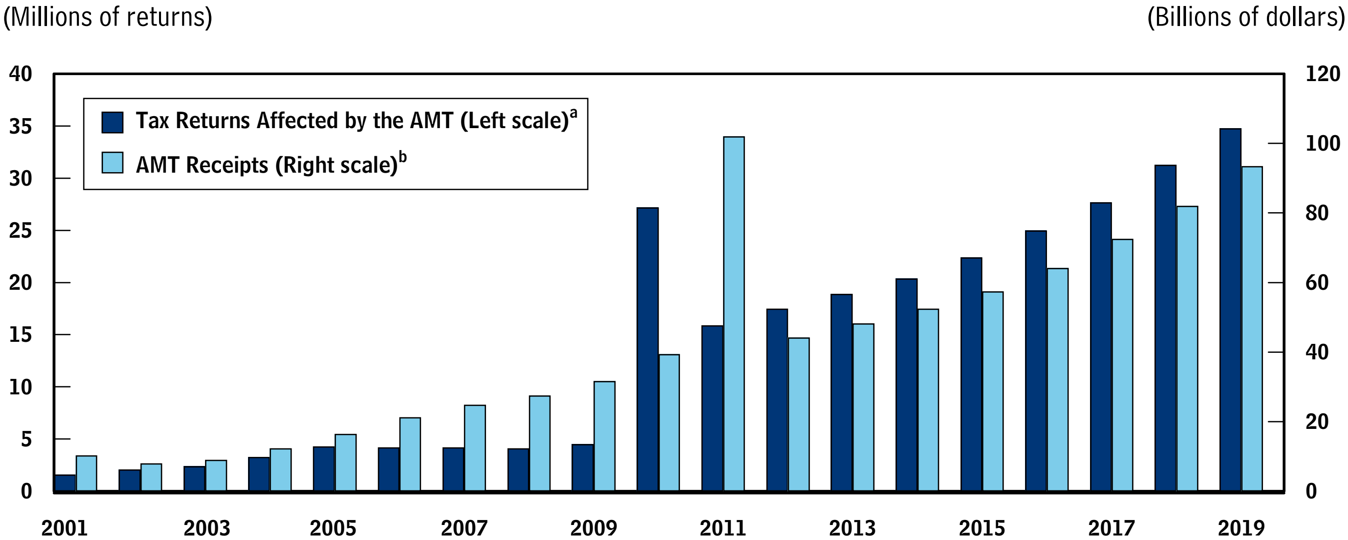
Inflation

Inflation is the most important driver of the long-term growth in receipts from the AMT. Under the regular individual income tax, the tax rate brackets, exemptions, and certain deductions and credits are adjusted automatically to keep pace with inflation. By contrast, the exemption

3. The AMT's exemption amounts for 2009 were $70,950 for married taxpayers filing jointly and $46,700 for most other taxpayers. Those amounts reverted to $45,000 and $33,750, respectively, in 2010.

Figure 1.

Effects of the Individual Alternative Minimum Tax



Source: Congressional Budget Office.

Note: Projections are based on CBO's baseline projections issued in August 2009. Some taxpayers without liability under the alternative minimum tax (AMT) are still affected by it because, for example, it limits their credits taken under the regular income tax.

a. Based on calendar year.

b. Based on fiscal year.

amounts and rate brackets used to calculate the AMT are not indexed. If income grows at the rate of inflation, regular tax liability also rises with inflation; AMT liability grows faster, however, because income is rising but the AMT's exemption amounts and rate brackets are not. Therefore, as prices rise over time, more and more taxpayers owe the alternative tax. The temporary increases in the AMT's exemption amounts enacted since 2001 have effectively indexed the AMT for inflation. The most recent adjustment expired at the end of 2009, however. As a result, the exemption amounts have reverted to the amounts in effect before 2001 and, because of the cumulative effect of inflation over the intervening years, the number of people affected by the AMT will increase dramatically.

The effects of inflation on the AMT build up over time. Even though recent declines in inflation have contributed to slower projected growth in receipts from the AMT, the Congressional Budget Office (CBO) has estimated that if current laws remained in effect, the AMT would affect more than 30 percent of taxpayers in 2030 and 60 percent by 2050. Additional receipts attributable to the AMT would account for 8 percent of individual income taxes collected by the government in 2030 and 14 percent by 2050.[4]

Legislation

Because taxpayers must pay the higher of their liability as computed under the regular and alternative tax systems, changes made to the regular income tax without corresponding adjustments to the AMT often affect the number of taxpayers liable for the alternative tax. A decrease in regular income taxes for taxpayers who are close to, but not yet at, the point at which they pay the AMT will push some of them onto the alternative tax if their reduced regular tax liability no longer exceeds their AMT liability. Those taxpayers would experience a reduction in

4. Congressional Budget Office, *The Long-Term Budget Outlook* (June 2009). The increase in the share of taxpayers and revenues attributed to the AMT would not persist indefinitely under current law, however. Rising real (inflation-adjusted) income would eventually cause more of taxpayers' income to be taxed at higher rates under the regular tax, including rates above the top 28 percent AMT rate. That process would eventually slow the expansion of the AMT under current law. By 2065, in CBO's estimation, the share of individual income tax revenues generated by the AMT would level off and begin to decline.

taxes that would be less than they might have expected had they remained under the regular tax. Conversely, an increase in regular taxes may reduce the number of taxpayers subject to the AMT, but it would not affect the total tax liability of those who remain under the AMT.[5]

Recent cuts in regular income taxes have contributed to the potential impact of the AMT. Major tax legislation enacted beginning in 2001, most notably the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the Jobs and Growth Tax Relief Reconciliation Act of 2003, and the Working Families Tax Relief Act of 2004, significantly reduced regular income tax liability through calendar year 2010 without providing commensurate reductions in AMT liability.[6] To keep the number of taxpayers who pay the AMT from expanding rapidly, lawmakers temporarily modified the AMT several times since 2001, primarily by raising the AMT's exemption amounts. Those temporary adjustments to the AMT expired at the end of calendar year 2009, whereas most of the regular income tax reductions are scheduled to expire at the end of 2010. As a result, CBO projects, the number of taxpayers subject to the AMT will rise by 23 million in 2010, then fall by 11 million the following year (when the regular income tax reductions expire).

Revenues from the AMT will follow a similar pattern, rising by $63 billion in fiscal year 2011 and falling by $58 billion in 2012. CBO expects nearly all of the additional AMT liability from 2010 will be paid in fiscal year 2011 because taxpayers are unlikely to increase their estimated payments or withholding in anticipation of the scheduled change in law. Many taxpayers are unaware of the change or expect lawmakers to continue raising the AMT's exemption amounts on a temporary basis (as they have done for the past several years). Even those taxpayers who anticipate and plan for the expiration of the AMT patch may use the safe-harbor provisions in the tax code to delay their payments until 2011 without penalty.[7]

Although most of the tax reductions enacted since 2001 are scheduled to expire at the end of 2010, lawmakers may choose to extend some or all of those provisions. If lawmakers chose to extend the lower tax rates and other expiring provisions of current tax law, the AMT's reach would grow even faster. If tax law as currently scheduled for 2010 was made permanent, the AMT would affect about 45 million, or one in four, taxpayers by 2019 (compared with 35 million under current law). In its fiscal year 2010 budget, the Administration proposed extending many of those expiring tax provisions but also permanently restructuring the AMT to limit the number of taxpayers it affects.

Changes in the Types of Taxpayers Affected by the AMT

As the AMT expands, it will reach taxpayers with different characteristics than those affected by the AMT in the past. Many of the taxpayers previously subject to the alternative tax were the relatively small number of higher-income filers who tended to itemize their deductions and used tax preferences that are available to itemizers but disallowed under the alternative tax. In the years to come, however, many taxpayers with lower income will move onto the AMT because it disallows some widely used features of the regular tax, such as the personal exemption (which all taxpayers use) and the standard deduction (which roughly two-thirds of filers use). In 2001, only about 6 percent of the 1 million taxpayers affected by the AMT claimed the standard deduction on their regular tax return. That share is projected to rise to nearly one-third of the projected 27 million taxpayers who will owe the AMT in 2010. The AMT tends to affect larger families and taxpayers with greater deductions for state and local taxes more than it affects other taxpayers.

As the impact of the AMT expands, it will increasingly affect taxpayers in lower income groups than has historically been the case. In 2009, taxpayers with adjusted gross

5. Thus, because of the AMT, increases in regular income taxes tend to yield less additional revenue, and tax cuts tend to reduce revenues less (and provide less relief to taxpayers), than they would without the AMT.

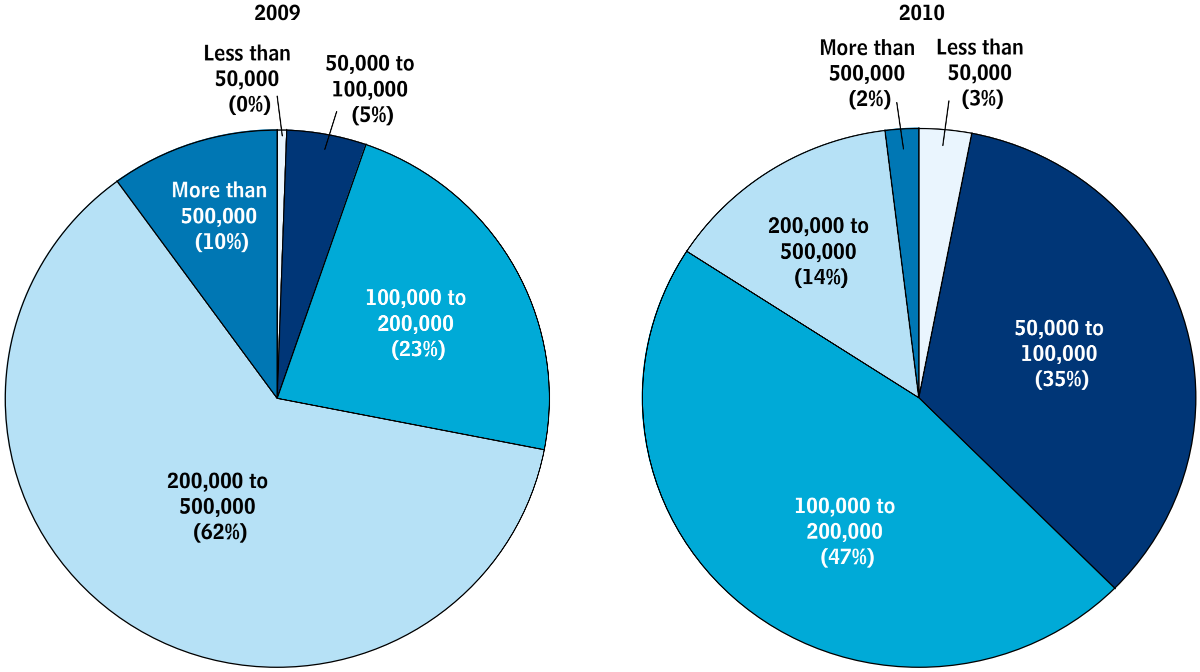
6. In the past, increases in regular income tax rates were often accompanied by increases in the AMT rate (for example, in the Omnibus Budget Reconciliation Acts of 1990 and 1993—Public Law 101-508, 104 Stat. 1388-406; and Public Law 103-66, 107 Stat. 461).

7. To avoid penalties, taxpayers must generally remit 90 percent of their tax liability for a given tax year either through withholding or through estimated payments before filing their tax returns in the following spring. However, taxpayers may estimate their required payments based on 100 percent (110 percent for high-income taxpayers) of their liability from the previous tax year.

Figure 2.

Composition of Taxpayers Affected by the Alternative Minimum Tax in 2009 and 2010, by Adjusted Gross Income

(2009 dollars)



Source: Congressional Budget Office.

Note: The total number of taxpayers affected by the alternative minimum tax in 2009 is estimated to be 4.5 million; in 2010, under current law, it is projected to reach 27.2 million.

income (AGI) of less than $200,000 (in 2009 dollars) accounted for less than 30 percent of all AMT filers; in 2010, they will account for more than 84 percent (see Figure 2).[8] The biggest change will be for taxpayers with income between $100,000 and $200,000. The share of those taxpayers with AMT liability will rise from 17 percent in 2009 to 85 percent in 2010, and those affected will pay an estimated additional $2,900 in tax, on average.

Taxpayers with AGI between $200,000 and $500,000 will continue to be hit the hardest by the AMT. More than 77 percent of those taxpayers had AMT liability in 2009, and that share will grow to 98 percent in 2010. Those affected can expect to pay an additional $10,700 in tax, on average.

Much of the income of taxpayers with income in the $100,000 to $500,000 range is taxed at rates of 25 percent and lower under the regular tax, compared with rates of 26 percent and 28 percent under the AMT. As inflation erodes the value of the AMT's exemption, more of their income will be subject to the alternative tax. In addition, the AMT's exemption phases out starting at $150,000 of alternative minimum tax income (AMTI) for married couples filing jointly, raising their effective marginal AMT rates by one-fourth (to 32.5 percent and 35 percent) until AMTI exceeds $433,800.[9] The AMT has less effect on the highest-income taxpayers (because

8. Adjusted gross income is used to determine income tax liability. It is total income from taxable sources minus certain exempted amounts, such as contributions to deductible individual retirement accounts and interest on student loans.

9. AMTI equals AGI plus AMT preferences (which are actually regular tax preferences disallowed under the AMT) and adjustments. Because capital gains are included in AMTI, the effective marginal rates on income from capital gains for taxpayers in the phaseout range also increase to 21.5 percent and 22 percent. The phaseout of the exemption occurs for single taxpayers with AMTI between $112,500 and $286,500 and for married couples filing separately with AMTI between $75,000 and $191,000, raising their effective tax rates in those income ranges.

the top rate of 35 percent under the regular tax is higher than the top statutory rate under the AMT) and the lowest-income taxpayers (because the AMT's exemption shields most of them from the alternative tax).

Because married couples are more likely to have AMT liability than unmarried taxpayers with similar income, as the AMT begins to reach taxpayers in lower income groups it will disproportionately affect couples. CBO estimates that married couples filing a joint tax return with AGI between $100,000 and $200,000 will be 20 times more likely to owe the AMT in 2010 than in 2009 (paying an additional $2,900 in tax, on average), compared with other filers in the same income category, who are about 3 times more likely to owe the AMT in 2010 than in 2009. Married couples face the same AMT tax brackets as other taxpayers, and their AMT exemption after 2009 is only one-third larger than that of their unmarried counterparts. (In contrast, the regular tax brackets and standard deduction for married couples are at least two-thirds larger than those for single taxpayers, in most cases.) Furthermore, the loss of personal exemptions under the AMT hits larger households harder because, under the regular tax, families can generally claim a personal exemption for both spouses as well as for each dependent.

As the reach of the AMT expands, it will also affect taxpayers who live in places with high state and local taxes more than their otherwise similar counterparts living in low-tax areas, because the alternative tax disallows a deduction for those taxes. The value of that deduction varies widely by jurisdiction because of large differences in tax rates. For example, the average state and local tax deduction claimed by taxpayers with AGI between $100,000 and $200,000 in 2007 in New York (a high-tax state) was $14,400, while the average deduction claimed by taxpayers in the same income group in Florida (a state with no income tax) was just $6,800.[10]

Effects of the AMT on Tax Incentives and Complexity

In addition to raising tax liabilities for affected taxpayers, the AMT replaces some incentives embedded in the regular tax system and changes marginal tax rates. As a result, the AMT can alter the distribution of taxes across different households and affect people's behavior. The AMT also increases the complexity of the calculations required for many taxpayers, in turn reducing the transparency of the tax system and complicating tax planning decisions.

The AMT Modifies or Limits Regular Income Tax Incentives

The regular income tax system provides for a variety of specific tax deductions, exclusions, and credits—for state and local taxes paid, larger families, medical expenses, and housing expenses, for example—intended to encourage certain behavior or to provide relief to taxpayers in certain situations. In cases where the AMT's treatment differs from that under the regular income tax, those preferences may be reduced or eliminated. Whether the regular or alternative tax treatments are preferable depends on the goals and priorities of policymakers.

Deduction for State and Local Taxes. The regular income tax allows a deduction for state and local taxes paid on income and property.[11] The deduction provides a considerable subsidy to residents in those jurisdictions because it decreases the net cost to taxpayers of paying deductible state and local taxes. By lowering the net cost of those taxes, the deduction allows state and local governments to impose higher taxes and provide more services than they otherwise could.

The deduction is disallowed under the AMT, so the AMT is more likely to affect taxpayers in higher-tax states, for whom the deduction is more valuable. In 2007, for example, 18 percent of taxpayers in New York (a high-tax state) with AGI between $100,000 and $200,000 paid the AMT, while fewer than 5 percent of taxpayers in the same income group in Florida (a state with no income tax) paid the alternative tax. By curtailing the use of the deduction, the AMT limits the implicit subsidy to state and local governments. The AMT also treats otherwise similar taxpayers in different locations more comparably because it does not distinguish among taxpayers on the basis of the amount and type of state and local financing where they live (in contrast to the regular tax, which does).[12]

10. See Congressional Budget Office. *The Deductibility of State and Local Taxes* (February 2008).

11. Since 2004, taxpayers have also been allowed to deduct state and local sales taxes in lieu of state and local income taxes. However, that provision expired on December 31, 2009.

12. See Congressional Budget Office, *The Deductibility of State and Local Taxes*.

Exemptions for Dependents. The regular tax system offers benefits to larger families, allowing taxpayers to take child tax credits and personal exemptions for themselves and each of their qualifying dependents. Even though the AMT allows child tax credits, it replaces the personal exemptions with a single exemption amount based only on filing status, thereby reducing the tax benefit provided for larger families relative to smaller ones. For example, in 2006, married couples with three dependents and income between $100,000 and $200,000 were three times as likely to have AMT liability as couples with similar income and no dependents.

Other Tax Preferences. The AMT limits other regular income tax preferences, including deductions for medical expenses and for certain mortgage interest. The regular income tax allows taxpayers to deduct medical expenses in excess of 7.5 percent of AGI if they itemize their deductions, but the AMT limits the deduction to expenses exceeding 10 percent of AGI. As a result, the AMT reduces the amount of relief given to taxpayers with large medical expenses in a given year (although that limitation applies only to taxpayers subject to the AMT, who generally have higher income and may be in less need of relief). Similarly, although taxpayers may deduct mortgage interest paid to acquire, build, or improve a primary residence under both the regular and the alternative taxes, the AMT disallows the deduction for mortgage interest paid on secondary residences and interest paid on certain other mortgage debt.

The AMT Alters Marginal Tax Rates

The different incentives provided by the alternative tax may affect taxpayers' behavior when they are aware of how the AMT applies to them. The AMT can subject taxpayers to higher marginal tax rates—which, in turn, influence decisions about how much to work and save, potentially reducing economic efficiency. Although some taxpayers face lower marginal tax rates under the AMT, most face rates that are higher than those imposed under the regular income tax.

As an example, consider the case of a married couple with three children. If, in 2009, the couple had wage income of $220,000, capital gains of $10,000, and deductions of $10,000 for mortgage interest and $16,000 for state and local taxes, they would have liability of $38,974 under the regular income tax and additional liability of $3,230 under the AMT. The couple would face effective marginal AMT rates of 32.5 percent on wages and 21.5 percent on capital gains, well above the 28 percent and 15 percent marginal rates they would incur under the regular income tax.

In 2006, more than 70 percent of taxpayers subject to the AMT faced a higher marginal tax rate than they would have under the regular tax. On average, the AMT raised the marginal tax rates for those taxpayers by about 4 percentage points. The higher marginal tax rates reduce after-tax wages, which might discourage work. But the additional tax also means that taxpayers have to work more to achieve the same after-tax income. On balance, it is not clear how the AMT influences incentives to work and save; the overall effect would depend on taxpayers' responsiveness to those incentives and others.

The AMT Increases Complexity and Reduces Transparency

The growing impact of the AMT will require more taxpayers to complete AMT forms in addition to their regular income tax returns. (Some taxpayers without any AMT liability must complete a worksheet to determine that the tax does not apply to them.) Although the basic AMT calculation appears to be simple, it is actually complex in various ways. (For details on the calculation of the AMT, see Box 1.) For example, it can complicate one of the most basic filing decisions—whether or not to itemize deductions. Under the regular income tax, the choice is easy: Sum up all deductions that may be itemized, adjust for the phaseout (if applicable), compare the result with the appropriate standard deduction, and claim the larger of the two amounts.[13]

In calculating AMT liability, however, taxpayers who would not have itemized under the regular tax need to calculate their itemized deductions if they wish to minimize their taxes, and those taxpayers who did itemize under the regular tax must recalculate their itemized deductions under different rules. The existence of the AMT increases the number of potential liabilities the taxpayer must calculate to determine whether he or she is

13. In 2009, taxpayers with AGI above $166,800 must reduce many of their itemized deductions by 1 percent of AGI in excess of that threshold amount, up to a maximum of 80 percent.

Table 1.

Selected Options for Changing the Alternative Minimum Tax

(Billions of dollars)

Restructuring Option	Change in Revenues, 2010 to 2019
Make the Current Exemption Amounts Permanent and Index the AMT for Inflation	-447
Apply Some Regular Deductions and Exemptions to the AMT	-532
Eliminate the AMT	-626

Source: Joint Committee on Taxation.

Note: AMT = alternative minimum tax.

liable for that tax and how to pay the lowest amount in taxes.[14]

The availability of computer software to prepare taxes lessens much of the burden of preparation imposed by the AMT. Programs available on the Internet or for installation on personal computers automatically determine whether taxpayers have AMT liability and generate the required forms. Approximately two-thirds of taxpayers filed electronic returns with the Internal Revenue Service in 2009, and many more filed paper returns prepared using computer software. Using software or a paid preparer may make tax filing faster and easier, but those methods can impose additional out-of-pocket costs and may reduce the transparency of the tax system.

If taxpayers rely on computer software and do not understand how their tax liability is calculated, they may be less responsive to the intended incentives in the tax code. In addition, taxpayers' potential liability for the AMT may complicate their tax planning decisions. For example, taxpayers must often predict whether they will be liable for the AMT when deciding when to earn income, when to pay for potentially deductible activities, and whether to make additional estimated tax payments throughout the year.[15]

Options for Changing the AMT

For most of the past decade, lawmakers have chosen to limit the number of taxpayers affected by the AMT by temporarily increasing the exemption amounts. Those amounts were initially increased by EGTRRA in 2001 and subsequently increased and extended for a year or two at a time, most recently by the American Recovery and Reinvestment Act of 2009 (ARRA). The 2009 AMT exemptions of $70,950 for married couples and $46,700 for unmarried filers revert in 2010 to the pre-2001 levels of $45,000 and $33,750, respectively. Policymakers could permanently limit the expansion of the AMT's impact in a number of ways. This brief examines three options that illustrate the range of choices policymakers face: indexing the AMT's parameters for inflation; allowing additional exemptions and deductions under the AMT; and eliminating the AMT.[16] (CBO does not make policy recommendations.)

Those options would involve revenue losses of several hundred billion dollars over the next 10 years relative to receipts projected under current law (see Table 1) and would affect varying numbers and types of taxpayers. The revenue estimates assume that the regular income tax reductions currently scheduled to expire at the end of 2010 do so. If they were extended before changes in the AMT were enacted, the revenue lost from restructuring the AMT would be considerably higher (roughly doubling under some options).

If policymakers wished to offset the deficit-increasing effect of limiting or eliminating the AMT, that goal could be accomplished by broadening the base for the regular income tax or raising its rates, by increasing revenues from other tax sources, or by reducing spending. Because

14. An additional complication caused by the AMT involves the question of when to incur deductible expenses. Because some deductions are denied under the AMT, taxpayers who know they will be subject to the AMT in a given year may be able to reduce their taxes in the following year by delaying deductible expenses into that next year. Alternatively, they may owe less tax if they advance deductible expenses into an earlier year. Either situation requires additional calculations on the taxpayer's part.

15. Software also does not eliminate all AMT complications. For example, the amount of state and local tax refunds that are included in current income depends on the extent to which the AMT limited the state and local tax deduction in the prior year. That amount may need to be calculated manually and requires recalculating prior-year income tax liability.

16. For further details on options regarding the AMT, including budget estimates prepared by the staff of the Joint Committee on Taxation, see Congressional Budget Office, *Budget Options, Volume 2* (August 2009), pp. 184–185.

under current law the AMT will account for approximately 4 percent of total individual income tax revenues by 2019, regular income taxes would have to rise by a similar magnitude to offset a full repeal, and somewhat less to offset more modest changes. All or some of the regular income tax rates, including tax rates on capital gains and dividend income, could be raised. Changes to the AMT could also be coupled with the elimination of various tax preferences that apply to the regular income tax. For example, if restructuring the AMT was combined with elimination of the deduction for state and local taxes, revenue neutrality could be maintained and regular income tax rates could actually be lowered. Some budget-neutral options would be less economically efficient and would alter the distribution of the tax burden as compared with keeping the AMT in place as scheduled under current law.[17]

Index the AMT's Parameters for Inflation

The AMT's reach will expand primarily because indexation under current law prevents regular tax liabilities—but not liabilities under the AMT—from growing as a result of income keeping pace with price inflation. As nominal income rises over time, more taxpayers become liable for the AMT. If the exemption amounts in effect for 2009 were made permanent and indexed for inflation after 2009, along with the AMT's brackets and the threshold at which the exemption phased out, 5 million taxpayers would pay the AMT in 2010—rather than the 27 million projected to pay under current law—and revenues would be about $450 billion lower from 2010 to 2019 than they would be otherwise. To the extent that lawmakers continue indefinitely their recent practice of temporarily raising the AMT's exemption amounts, that approach is similar to permanently indexing the AMT's parameters for inflation. However, one- or two-year adjustments to the exemption amounts create uncertainty for taxpayers, who are likely to make financial decisions with potential AMT tax consequences before legislators take action in any given calendar year.

Allow Additional Regular Tax Preferences Under the AMT

By disallowing exemptions for dependents and the deduction for certain state and local taxes, the AMT affects large families and people in high-tax jurisdictions, respectively. To provide some relief to taxpayers, lawmakers could allow them to use the standard deduction, personal exemptions, and deductions for state and local taxes (as they are used under the regular tax) when computing their tax liability under the AMT. The standard deduction and personal exemptions are both indexed for inflation, and state and local taxes also generally rise with prices. That approach would offset the erosion of the unindexed AMT exemptions caused by inflation and would provide relief similar to that offered by the previous option (indexing the AMT's parameters for inflation) for many taxpayers. This option would decrease the number of people affected by the AMT to 2 million in 2010 and lower revenues by about $530 billion over the 2010–2019 period.

Repeal the AMT

The most comprehensive approach would be to simply eliminate the individual AMT altogether, as proposed in the 2005 report of the President's Advisory Panel on Federal Tax Reform. The 27 million taxpayers who would be subject to the AMT in 2010 would revert to paying the regular individual income tax. At a revenue cost of more than $620 billion over 10 years, this option would free taxpayers from having to make a second set of tax calculations and would reduce tax liability for nearly everyone now subject to the AMT.[18] Eliminating the AMT altogether would repeal some provisions intended to prevent investment activities that are designed to avoid the regular income tax. Those provisions could be incorporated into the regular income tax as part of a repeal.

17. For further discussion of options to restructure the AMT, see Leonard E. Burman and others, *Options to Fix the AMT* (Washington, D.C.: Urban-Brookings Tax Policy Center, January 19, 2007).

18. For some taxpayers, however, future liabilities would rise. Under current law, people who pay the AMT because of timing issues—the treatment of incentive stock options, for example—may recoup those payments to the extent that their AMT is negative in future years. Unless special provisions were made, repealing the AMT might preclude such taxpayers from recovering previous AMT payments.

This brief was prepared by Joshua Shakin of CBO's Tax Analysis Division. It and other CBO publications are available at the agency's Web site (www.cbo.gov).

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