ALTERNATIVE MINIMUM TAX

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

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HEARING ON ALTERNATIVE MINIMUM TAX

WEDNESDAY, MARCH 7, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:00 p.m., in room 1100, Longworth House Office Building, Hon. Richard E. Neal (Chairman of the Subcommittee), presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SELECT REVENUE MEASURES

FOR IMMEDIATE RELEASE
February 28, 2007
SRM–1

CONTACT: (202) 225–5522

Neal Announces Hearing on the Alternative Minimum Tax

House Ways and Means Select Revenue Measures Subcommittee Chairman Richard Neal (D–MA) announced today that the Subcommittee on Select Revenue Measures will hold a hearing on the Alternative Minimum Tax (AMT). **The hearing will take place on Wednesday, March 7, 2007, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

The Subcommittee will examine the growing scope of the AMT and its interaction with individual-based tax provisions, including the tax cuts enacted since 2001. In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Alternative Minimum Tax (AMT) is a parallel income tax originally designed to ensure that taxpayers with substantial economic income pay at least some minimum level of tax. However, the AMT was never intended to reach middle-income taxpayers nor to become the tax system applicable to most taxpayers.

To calculate the AMT, taxpayers first determine tax liability under the regular income tax, and then add back certain "preference" items to taxable income. After deducting an exemption amount under AMT, taxpayers pay whichever is higher under the regular income tax or AMT. Personal exemptions, the itemized deduction for state and local taxes, and miscellaneous itemized deductions together account for 90% of the preference items added back under the AMT, with state and local taxes almost half of that amount.

There are two main reasons for the increase in the number of taxpayers affected by the AMT. First, the tax cuts under the regular income tax that were enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, and the Working Families Tax Relief Act of 2004 have narrowed significantly the differences between regular and AMT tax liabilities for middle and higher income individuals. Second, regular income tax brackets are indexed for inflation but the AMT thresholds are not. This has, over time, reduced further the differences between regular income tax liabilities and AMT liabilities at lower income levels.

The combination of the two factors stated above means that, absent Congressional action on this issue, the number of taxpayers that will be affected by the AMT will grow significantly. The number of taxpayers subject to the AMT is expected to jump from 4.2 million in 2006 to 23 million in 2007. Taxpayers filing joint returns with no dependents could be subject to the AMT at income levels as low as 75,395 in 2007, assuming that temporary protections for personal non-refundable credits and the higher exemption levels are not extended. By 2016, if the recently enacted tax cuts are extended, tax experts estimate that the number of taxpayers paying the AMT will increase to more than 48 million. High income states such as New Jersey, New York, Connecticut, the District of Columbia, and California have the highest percentage of taxpayers subject to the AMT.

In announcing the hearing, Chairman Neal said, **"The AMT was originally enacted to ensure that a small group of high-income individuals who man-**

aged to avoid paying any income tax would pay at least a minimum amount of tax. The role of the AMT today has changed significantly. The AMT has become a stealth tax on far too many working families. We are committed to fully understanding the scope of this problem so that we can find a solution and prevent millions of working families from a massive and unexpected tax increase."

FOCUS OF THE HEARING:

This hearing will explore the history of the AMT and how it has grown to affect many more taxpayers than at its inception.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "110th Congress" from the menu entitled, "Committee Hearings" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the hearing for which you would like to submit, and click on the link entitled, "Click to provide a submission for the record." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You MUST REPLY to the email and ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Wednesday, March 21, 2007.** Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman NEAL. I call this meeting of the Subcommittee on Select Revenue Measures to order, and would have everybody please take their seats.

This is the first hearing of the Select Revenue Measures Subcommittee, and I think it's appropriate that the subject we will discuss today is the alternative minimum tax (AMT), or as some refer to it, the ATM machine for our Federal Government.

The AMT is an issue that I have been battling for almost a decade. That's right, almost ten years. I first filed legislation trying to protect middle income families from the reach of the AMT back in 1998. I would note that the ranking Republican on this Subcommittee, my friend Mr. English, has also filed legislation to repeal AMT, reaching back to 1999.

As Ambrose Bierce once wrote, "A patience is a minor form of despair, disguised as virtue." I think, as it relates to AMT, Mr. English and I have both proved our virtue.

The AMT is a bipartisan problem, and we are seeking bipartisan solutions. It is a parallel and stealth tax system, estimated to hit 23 million taxpayers this year, if we do not extend a $50 billion patch to the system. Can you imagine a $50 billion patch?

For those of you who appreciate classic, or older cars, like I do, you know how expensive it is to keep them up and running each year. At some point, though, you wonder if it's worth the effort. Many car owners simply resort to cheaper fixes—from a different day and age, it was called Bondo—to patch up the car, but it's never pretty, and eventually you have to commit to major overhaul. We are at that point with the AMT.

The coat of Bondo that we put on year after year is just delaying the inevitable conclusion that this is a system that doesn't run very well. The testimony we will hear today on that point is quite dramatic. This year, a family of four earning just $66,000 could be hit by AMT. By the end of the decade, virtually all families earning between $75,000 and $100,000 a year with 2 children will be paying higher taxes, due to the AMT.

At my direction, the Committee staff prepared for each Member today specific estimates showing the growth of AMT, by Congressional district, for 2007. It's important to see how this will be impacting our constituents. State and local taxes and personal exemptions—that is, children—are the top reasons taxpayers get pushed into a family—unfriendly AMT.

This system, originally designed to catch millionaires who were avoiding taxes with excessive deductions, has gone seriously awry. It is my intention to offer a permanent solution to AMT, and not just another coat of Bondo.

This series of hearings will assist the Subcommittee in finding and potentially recommending that solution. Today's hearings will explore the history, the background, and policy reasons for AMT. At our next hearing, two weeks from now, we will hear more of a firsthand experience from those impacted by AMT.

I am pleased to welcome our witnesses today. From the Treasury Department, we have Mr. Eric Solomon, the assistant secretary for tax policy, who will explain the position of the Administration, surely a partner in any ultimate solution.

We are very fortunate, also, to have Ms. Nina Olson, the National Taxpayer Advocate, who is exactly what her title says: our advocate. She has recommended for years that AMT be repealed, because of the burden it places on individual taxpayers.

We are also pleased to welcome today Dr. Len Burman, the director of the Tax Policy Center. If you read pretty much any article or paper on the AMT, you will see Len Burman quoted, or his work cited, in the footnote. We are fortunate to have his expertise today, as well.

I also want to welcome Dr. Alan Viard, resident scholar at the American Enterprise Institute (AEI). Dr. Viard has written on the problems in the AMT, both at AEI and at his former position as an economist with the Federal Reserve Bank in Dallas.

St. Augustine said that, "Patience is the companion of wisdom," and I know Mr. English, from previous get-togethers, we are both acolytes of St. Augustine. Today we await your wisdom, and we certainly expect to find common ground for a solution. At this time I would like to recognize my friend, Mr. English, for an opening statement.

Mr. ENGLISH. I want to thank you, Mr. Chairman, and I particularly want to thank you for calling today's hearing on the AMT, and assembling this panel, which I think offers a diversity of informed viewpoint on how to address this problem.

This initial examination is enormously timely, and hopefully will yield a dialog that can point us in the direction for a possible solution in this Congress, or in the near future, to deal with this growing monster of an AMT.

The most recent attempts with the AMT have been through the use of patches. Yes, that's been a temporary expedient, which has yielded bigger and bigger problems each time. The AMT still remains a source of complexity for American taxpayers, and in my view, a drag on economic growth. I believe a comprehensive solution is the most desirable outcome.

The AMT is a classic example of the rule of unintended consequences. Created in the 1960s, it was created by a majority that insisted it would only affect the rich. The tax was dramatically broadened again in the 1980s and 1990s. Tax increases, masquerading as reform, is what gives this legislative process a bad name. I hope that we can avoid similar mistakes in the weeks and the months to come.

In my view, the policy challenge facing this Subcommittee and this Congress is the desperate need to reform the entire tax code. One of the strongest arguments for doing that is the continued existence of the AMT.

I understand we may hear an argument being made today that the AMT is falling on more families because of the tax cuts enacted in 2001 and 2003. This logic would maintain that if income taxes are increased, less people would be subjected to the AMT. That's not my approach to reform. I would argue that this line of thinking abandons the facts. The AMT is growing so significantly because the tax brackets were never indexed for inflation. No American is worse off under recent tax relief, and fewer taxpayers are subject to the AMT than otherwise would have been the case.

After—and I approached this hearing today with an open mind—after today, I think we may be able to conclude that the real solution is tax reform and, above all, abolishing the AMT. I am sorry to see that we missed an opportunity to do that in 1999, as a result of a Presidential veto, but it is my hope that this Subcommittee will play a central role in developing a creative policy response that will point us in the right direction.

Again, I am grateful to you, Mr. Chairman, for initiating this process. Thank you.

Chairman NEAL. Thanks, Phil. Without objection, any other Members wishing to insert statements as part of the record may do so. All written statements written by the witnesses will be inserted into the record as well.

Mr. Solomon. Thank you.

STATEMENT OF ERIC SOLOMON, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. SOLOMON. Mr. Chairman, Ranking Member English, and distinguished Members of the Committee, thank you for the opportunity to discuss the issue of the individual AMT.

The AMT was intended to deal with a relatively small but important issue. Unfortunately, the AMT illustrates how a good faith attempt to address an issue in the income tax system can have enormous, undesirable consequences. Today, the AMT is imposing burdens on millions of taxpayers who are not its intended targets. It is complex, and it frustrates millions of taxpayers who have to calculate their taxes twice, once under the regular tax system, and a second time under the AMT tax system.

The predecessor of the AMT, the minimum tax, was first enacted in 1969 to ensure that a small group of high-income individuals who had managed to avoid paying Federal income tax would pay at least a minimum amount of tax. More than 37 years of changes to the tax code have transformed the original minimum tax into the current AMT.

The AMT is a second income tax that operates parallel to the regular income tax. The AMT has its own tax base, exemption amounts, tax rates, and usable tax credits. The AMT tax base starts from taxable income, as defined under the regular income tax, but the base is broadened by adding back certain tax preferences, such as itemized deductions for State and local taxes, the standard deduction, and personal exemptions. The AMT tax base is reduced by an AMT exemption, which varies by filing status but not by family size. The AMT exemption is phased out above certain income levels. Beginning with the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107–16), Congress has included provisions in its tax relief bills to extend and increase the AMT exemption temporarily, thus preventing a large increase in the number of AMT taxpayers.

For 2006, the AMT exemption was $62,550 for married taxpayers filing jointly, and $42,500 for unmarried taxpayers. Since 1993, the first $175,000 of taxable income for AMT purposes is taxed at a 26 percent rate, and amounts above $175,000 are taxed at a 28 percent rate. However, because the AMT exemption is phased out, some taxpayers face a marginal effective AMT tax rate of up to 35 percent.

The temporary extensions of the higher AMT exemptions and allowance of the full use of most personal tax credits—which have come to be known as the AMT patch—expired at the end of 2006. The President's Fiscal Year 2008 budget includes a proposal to extend the AMT patch through 2007, with the AMT exemptions increased for 2007 to hold the number of taxpayers affected by the AMT at approximately four million.

The AMT exemption in effect through 2006 has kept the vast majority of taxpayers from being subject to the AMT. However, if the AMT patch is not extended, or the AMT is not otherwise addressed, the number of taxpayers projected to be affected by the AMT will rise sharply from 4 million in 2006 to 25 million in 2007. The AMT will increasingly affect middle-income taxpayers unless action is taken.

The AMT also increasingly affects families with children, because it does not allow deductions for personal exemptions. Moreover, the AMT exemption includes a significant marriage penalty, which can worsen the effect of AMT on married couples.

Unlike the regular tax, the AMT tax system is not indexed for inflation. The AMT exemption, the exemption phase-out, and the boundary between the two AMT tax rates are all fixed in nominal terms. Since these AMT parameters are not indexed, whereas the main parameters of the regular income tax are indexed annually for the effects of inflation, over time the AMT itself has become a significant issue.

If the AMT exemption had been indexed to inflation beginning in 1984, when the regular income tax brackets were indexed, the exemption in 2007 would be almost $81,000 for married taxpayers filing jointly, and $61,000 for unmarried individuals. With these indexed exemption amounts, only about two million taxpayers would be affected by the AMT in 2007.

We share the concerns of taxpayers and Congress about the increasing scope of the AMT. We believe that a permanent solution is essential for the continued functioning of our individual income tax system. We look forward to working with this Committee and others in the Congress on a permanent solution to this difficult and important issue. However, until a long-term solution has been enacted, it is essential that we prevent an ever-larger share of taxpayers from being affected by the AMT. We are committed to helping ensure that middle-income taxpayers are not affected by the AMT this year or in the future.

Thank you, again, Mr. Chairman, Ranking Member English, and Members of the Committee, for the opportunity to appear before you today. I would be pleased to answer any questions that you might have.

[The prepared statement of Mr. Solomon follows:]

Statement of Eric Solomon, Assistant Secretary for Tax Policy, U.S. Department of the Treasury

WASHINGTON, D.C.—Mr. Chairman, Ranking Member English, and distinguished Members of the Committee, thank you for the opportunity to discuss the issue of the individual alternative minimum tax.

The individual alternative minimum tax, or AMT, was intended to deal with a relatively small but important issue. Unfortunately, the AMT has created a far larger issue than the one it was intended to address.

The Administration is very concerned about the adverse effects of the AMT. It is complex and frustrates the millions of taxpayers who have to calculate their taxes twice—once under the regular tax system and a second time under the AMT tax system. Taxpayers find that benefits otherwise provided under the regular tax system are taken away by the AMT, or they do the double calculations only to find that they are not subject to the AMT.

History of the AMT

The predecessor of the AMT—the minimum tax—was first enacted in 1969 to ensure that a small group of high-income individuals who had managed to avoid paying federal income tax would pay at least a minimum amount of tax. In 1969, Treasury Secretary Barr noted in his testimony before the Joint Economic Committee of Congress that 155 taxpayers with incomes over $200,000 paid no tax in 1966. Even though the minimum tax reduced the number of high-income taxpayers who otherwise would have paid no income tax, it has never been completely successful in attaining the original goal of ensuring that all high-income taxpayers pay at least some tax. More than 37 years of legislative changes to the tax code have transformed the original minimum tax into the current AMT.

Structure of the AMT

The AMT is a second income tax that operates parallel to the regular income tax. The AMT has its own tax base, exemption amounts, tax rates, and usable tax credits. A taxpayer's AMT liability is essentially the excess of the liability calculated under the AMT tax system over the liability calculated under the regular income tax.

The AMT tax base starts from taxable income as defined under the regular income tax, but the base is broadened by adding back certain tax preferences. Preferences include, for example:

- the itemized deduction for State and local taxes,
- the itemized deduction for certain miscellaneous expenses exceeding two percent of adjusted gross income (AGI),
- the itemized deduction for medical expenses to the extent it represents medical expenses of less than 10 percent of AGI,
- the standard deduction, and
- personal exemptions.

A number of other items are treated as AMT preferences totally, or to the extent they are AMT preferences, must be calculated differently for AMT purposes. These include items such as incentive stock options, the net operating loss deduction, and investment interest expenses. The largest AMT preference items are the regular tax State and local tax deduction and personal exemptions.

The AMT tax base is reduced by an AMT exemption which varies by filing status but not by family size. From 1984 through 1992, the AMT exemption was $40,000 for married taxpayers and $30,000 for unmarried taxpayers. In 1993, it was increased to $45,000 for married taxpayers and $33,750 for unmarried taxpayers. Beginning with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Congress has included provisions in each of the major tax relief bills to increase the AMT exemption temporarily, thus preventing a large increase in the number of AMT taxpayers. For 2006, the AMT exemption levels were $62,550 for married taxpayers filing joint returns and $42,500 for unmarried individuals.

The AMT exemption begins to be phased out at $150,000 of AMT income for married taxpayers filing joint returns, at $112,500 for unmarried individuals, and at $75,000 for married filing separately returns. The exemption is reduced by 25 percent of AMT income above those thresholds until they are completely phased out.

Since 1993, the first $175,000 of taxable income for AMT purposes is taxed at a 26 percent rate, and amounts above $175,000 are taxed at a 28 percent rate. However, capital gains and qualified dividends are taxed under the AMT at the lower tax rates that apply under the regular income tax. Because the AMT exemption is phased out, it results in four effective AMT marginal tax rates of 26 percent, 32.5 percent (for taxpayers phased out of the 26-percent AMT tax bracket), 28 percent, and 35 percent (for those phased out of the 28-percent AMT tax bracket). Consequently, because of the phase-out of the exemption, some taxpayers face a marginal effective AMT tax rate of 35 percent.

Generally, the AMT can prevent some tax credits from being claimed against the regular tax because credits are disallowed if they reduce regular tax below the tentative amount of the AMT tax. Since 1998, Congress has repeatedly extended temporary legislation that has permitted most personal tax credits to reduce the otherwise applicable AMT. However, general business credits (most importantly the low-income housing credit) can be limited by the AMT.

The temporary extensions of the higher AMT exemptions and allowance of the full use of most personal tax credits (which have come to be known as the "AMT patch") expired at the end of 2006. The President's fiscal year 2008 Budget includes a proposal to extend the AMT patch through 2007, with the AMT exemptions increased for 2007 to $65,350 for married taxpayers filing joint returns and $43,900 for unmarried individuals. The Budget proposal is designed to hold the number of taxpayers affected by the AMT constant at approximately 4 million.

Does AMT Eliminate Nontaxable High Income Returns?

In spite of the AMT, each year a very small percentage of high-income tax returns are filed reporting no income tax liability. The reasons for high-income returns reporting no income tax liability are varied. Certain itemized deductions and exclusions from income could cause this result. High-income returns with no income tax liability often result from a combination of factors, none of which, by itself, would completely eliminate income tax liability. Some items that singly or in combination may eliminate regular income tax liability cannot eliminate AMT liability because these items give rise to adjustments or preferences for AMT purposes. However, due to the AMT exemption and the fact that the starting point for alternative minimum taxable income is taxable income for regular tax purposes, which could be negative, a return could report no regular income tax and no AMT even though it included some items that produced AMT adjustments or preferences.

Tax-exempt bond interest, itemized deductions for interest expense, miscellaneous itemized deductions not subject to the two-percent-of-AGI floor, casualty or theft losses, and medical expenses (exceeding 10 percent of AGI) could, by themselves, completely eliminate income tax liability because they do not generate AMT adjustments or preferences. More typically, combinations of these items together with deductions for charitable contributions completely eliminate tax liability without generating AMT liability.

Complexity of the AMT

The complexity and burden of the AMT result from the necessity that taxpayers understand and comply with two parallel tax systems. Moreover, because many taxpayers become subject to the AMT for reasons that are not the result of tax-motivated planning, many taxpayers are not aware that they will be affected by the AMT until they complete their tax returns. Even then, some taxpayers who complete their returns manually may not be aware that they are required to do the calculations for the AMT, creating a compliance problem.

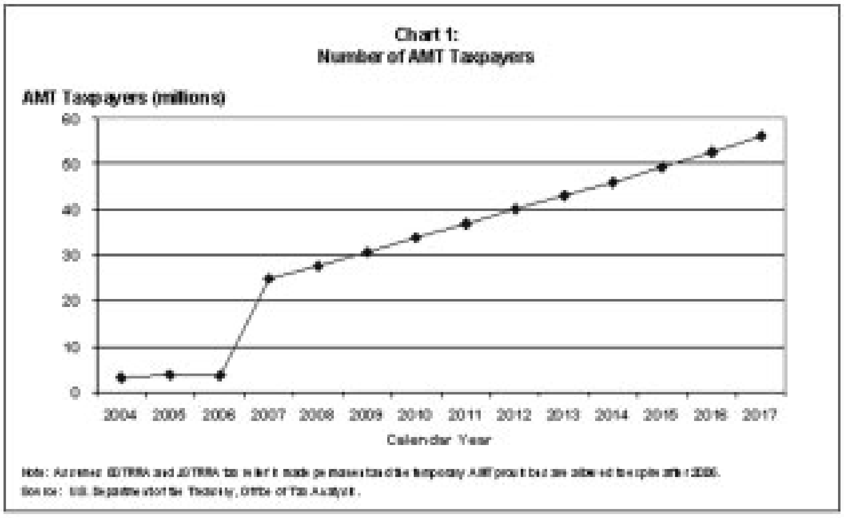
The Growing Ranks of AMT Payers

Unlike the regular tax, the AMT tax system is not indexed for inflation. The AMT exemption, the exemption phase-out, and the boundary between the two AMT tax rates are all fixed in nominal terms. Consequently, with the passage of time, the effects of inflation will steadily increase the number of taxpayers subject to AMT and the amount of revenue from the AMT. When relatively few taxpayers were affected, the AMT arguably was achieving its policy objective. However, serious tax policy issues arise when the AMT affects millions of taxpayers who were never intended to be the target of this separate tax.

The AMT exemption in effect through 2006 has generally kept the vast majority of taxpayers from being subject to the AMT. If the AMT exemption had been indexed to inflation beginning in 1984 when the regular income tax brackets were indexed, the exemption in 2007 would be about $81,000 for married taxpayers filing jointly and $61,000 for unmarried individuals. With these indexed exemption amounts, only about 2 million taxpayers would be affected by the AMT in 2007.

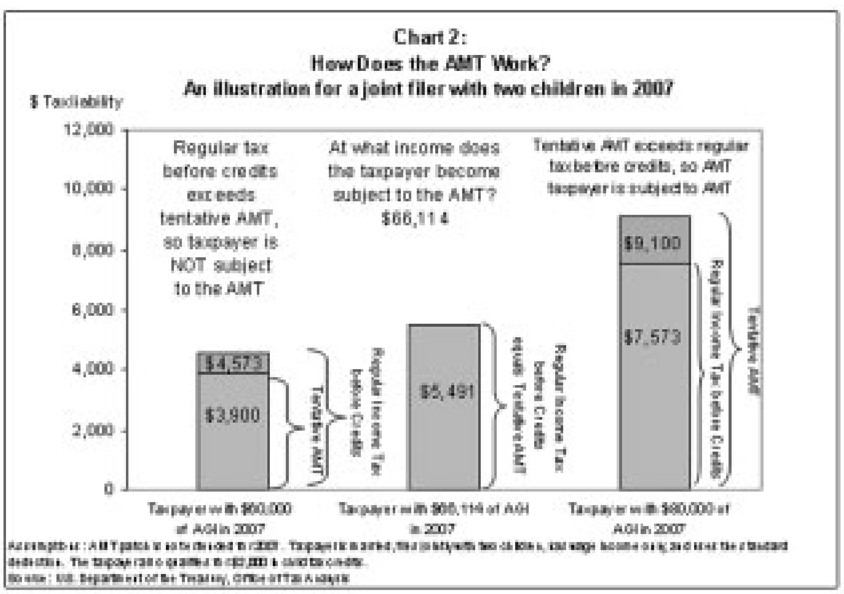
Growth of the AMT

If the AMT patch is not extended or the AMT is not otherwise addressed, the number of taxpayers projected to be affected by the AMT will rise sharply, from 4 million in 2006 to 25 million in 2007 (Chart 1). If no further changes are made to the AMT, the number of taxpayers affected by the AMT is expected to grow to over 56 million by 2017. By 2017, almost one-half of all taxpayers with income tax are projected to be affected by the AMT.



The AMT will increasingly affect middle-income taxpayers unless action is taken. If the Administration's proposed extension and expansion of the AMT patch is enacted for 2007, about 7 percent of taxpayers with incomes between $100,000 and $200,000 will be subject to the AMT for 2007. However, if the AMT patch is not extended beyond its current expiration in 2006, when taxpayers file their tax returns in the spring of 2008 for tax year 2007, over 80 percent of taxpayers with income between $100,000 and $200,000 will be subject to the AMT.

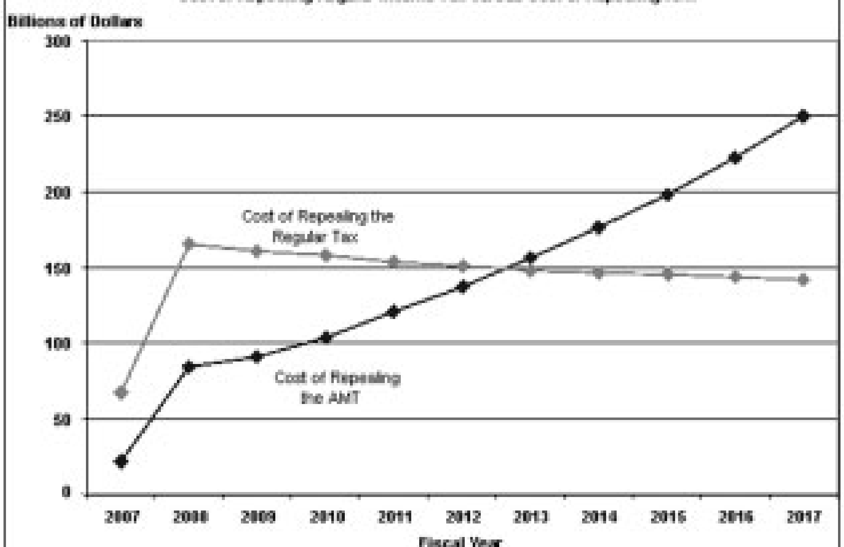
To put this into perspective, consider how the AMT would affect a hypothetical joint filer with two children in tax year 2007 if the Congress does not extend the AMT patch as proposed in the Administration's 2008 Budget (see Chart 2). The taxpayer calculates tax liability under both the regular tax and the AMT and pays whichever is larger. The illustration shows that in 2007 the hypothetical taxpayer becomes subject to the AMT when his income exceeds $66,114. The AMT is no longer a tax that applies only or predominantly to high-income taxpayers.



The AMT also increasingly affects families with children because it does not allow deductions for personal exemptions. Moreover, the AMT exemption includes a marriage penalty, which can worsen the effect of the AMT on married couples.

Assuming no AMT patch extension for 2007 or other action with respect to AMT, the increase in the number of AMT taxpayers over the next decade will be accompanied by a dramatic increase in tax revenues from the AMT. AMT revenue will increase from $22 billion in fiscal year 2006 to $67 billion in fiscal year 2007 and to $250 billion in 2017 (roughly 12 percent of total individual income tax revenue).[1] AMT revenue will become so large that by 2013 the cost of repealing the AMT would exceed the cost of repealing the regular tax (Chart 3).

Chart 3:
Cost of Repealing Regular Income Tax Versus Cost of Repealing AMT



Note: Assumes EGTRRA and JGTRRA tax relief is made permanent and the temporary AMT provisions are allowed to expire after 2006.
Source: U.S. Department of the Treasury, Office of Tax Analysis

[1] This estimate uses a baseline that includes the President's fiscal year 2008 Budget proposal to extend permanently the 2001 and 2003 tax relief.

Addressing the AMT Issue

In many respects, the AMT illustrates how a good-faith attempt to address an issue in the income tax system can have enormous unintended and undesirable consequences. Today the AMT is imposing burdens on millions of taxpayers who were not its intended targets. Because the AMT parameters are not indexed, whereas the main parameters of the regular income tax are indexed annually for the effects of inflation, over time the AMT itself has become a significant issue.

The Administration shares the concerns of taxpayers and Congress about the increasing scope of the AMT. A permanent solution is essential for the continued functioning of our individual income tax system.

We look forward to working with this Committee and others in the Congress on a permanent solution to this difficult and important issue. However, until a long-term solution has been enacted, it is essential to prevent an ever-larger share of taxpayers from being affected by the AMT. We are committed to helping ensure that middle-income taxpayers are not affected by the AMT this year or in the future. In the past, generally the AMT has been dealt with on a year-by-year basis, and the Administration's proposal in the President's fiscal year 2008 Budget for a one-year AMT patch reflects that experience.

Thank you again, Mr. Chairman, Ranking Member English, and Members of the Committee for the opportunity to appear before you today. I would be pleased to answer any questions you might have.

Chairman NEAL. Thank you, Mr. Solomon. Now, Ms. Olson.

STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE

Ms. OLSON. Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee, thank you for inviting me to testify today about the AMT for individual taxpayers. Since I became the national taxpayer advocate six years ago, I have repeatedly called attention to the deficiencies in the AMT. In my 2006 annual report to Congress, I designated the AMT as the most serious problem facing taxpayers today.

Indeed, if I were given the opportunity to make just one change to the Internal Revenue Code, I would use it to eliminate the individual AMT. With the concept of a—when the concept of a minimum tax first came into the Code in 1969, the intent was to prevent wealthy taxpayers from using tax preferences to avoid paying their fair share of taxes.

Congress has changed the tax laws many times since the inception of the AMT, and it has long since shut down many of the tax avoidance opportunities that existed in the 1960s and 1970s. Today, the AMT affects millions of taxpayers with no tax avoidance motives at all, unless one considers choosing to live in a high-tax State, or choosing to have children to be a tax avoidance motive.

For 2004, the Treasury Department found that fully 68 percent of aggregate AMT tax preference dollars are attributable to the disallowance of the State and local tax deduction, and 19 percent of these dollars are attributable to disallowance of personal exemptions. Thus, about 87 percent of the additional income subject to tax under the AMT results simply because of taxpayers' place of residence, or family composition.

Moreover, the AMT is now affecting increasing numbers of middle-income taxpayers, because the amount of income exempt from the AMT is not indexed for inflation. When Congress first enacted a minimum tax in 1969, the exemption amount was $30,000 for all taxpayers. If Congress had indexed that amount, it would be equal to $165,000 today. Instead, the exemption amount, after temporary increases that expired in December, stands at $45,000 for married taxpayers, and $33,750 for most other taxpayers.

At the same time, many of the so-called tax preferences claimed by middle-income taxpayers are indexed for inflation, and they are added back into the income under the AMT. As a result of these diverging trends, more income becomes subject to the AMT each year. In 2007, absent a change in law, it is projected that about 23.4 million individual taxpayers, or 26 percent of individual filers who pay income tax, will be subject to the AMT.

Among the categories of taxpayers hardest hit, 89 percent of married couples with adjusted gross incomes between $75,000 and $100,000, and 2 or more children, will owe AMT. The burden that the AMT imposes is substantial. In dollar terms, it is estimated that each AMT taxpayer will owe, on average, an additional $6,782 in tax for 2006.

Sometime very soon—by Mr. Burman's estimate, as early as this year—we will reach a point where it will cost more for Congress to repeal the AMT, than to repeal the regular tax and leave the AMT intact. That's astonishing. In a very real sense, then, the AMT has ceased to fulfill its intended mission of preventing tax avoidance by the wealthy, and is, instead, becoming the de facto tax system for millions of Americans.

The obvious challenge in repealing the AMT is that its increasing revenue stream has been built into revenue estimates. So, if it is repealed, Congress will have to raise tax revenue in other ways, reduce spending, or allow the budget deficit to balloon. These alternatives, admittedly, are not appealing, but I have no doubt there are solutions that are far preferable to the status quo. Significantly, the longer Congress waits to act, the more dependent the Government will become on AMT revenue, and the harder, therefore, it will become to repeal it.

To be viewed as fair, a tax system must be transparent. While the concept of a minimum tax is not unreasonable, the AMT, as currently structured, has morphed into something that was never intended. It is hitting taxpayers it was never intended to hit. It is taking large numbers of taxpayers by surprise, and subjecting them to estimated tax penalties. It is imposing onerous compliance burdens. It is altering the distribution of the tax burden that exists under the regular tax system. It is changing the tax incentives built into the regular tax system, and it is neutralizing the effects of changes to tax rates imposed under the regular tax system.

Taxpayers subject to this treatment may wonder whether their Government is dealing fairly with them. My opinion is they have a right to ask that question. I strongly urge Congress to act before the AMT explosion occurs. Thank you, and good luck.

[The prepared statement of Ms. Olson follows:]

Statement of Nina E. Olson, National Taxpayer Advocate, Internal Revenue Service

Mr. Chairman, Ranking Member English, and distinguished Members of the Subcommittee:

Thank you for inviting me to testify today about the Alternative Minimum Tax (AMT) for individuals taxpayers.[1] In my 2006 Annual Report to Congress, I designated the AMT as the most serious problem facing taxpayers and recommended that it be repealed.[2] Indeed, if I were given the opportunity to make just one change to the Internal Revenue Code, I would use it to eliminate the individual AMT.[3]

Why? Because the AMT is frustrating for taxpayers and bad for the tax system. It is frustrating for taxpayers for many reasons, including the difficulty in determining whether one is subject to the AMT, the difficulty in computing the AMT, the inaccurate and off-putting implication that the AMT applies because the taxpayer has escaped his or her rightful tax obligations by engaging in tax-avoidance techniques, and the fact that otherwise compliant taxpayers are often subject to penalties for failure to pay enough estimated tax during the year when they didn't properly anticipate their AMT liabilities.

The AMT is bad for the tax system because the disillusionment felt by taxpayers subject to the tax can erode their willingness to comply in the future. Moreover, the AMT negates the effect of tax rates and other tax provisions that apply under the regular tax rules and almost invisibly alters the distribution of the tax burden that exists under the regular tax system.

In my testimony today, I will provide an overview of the AMT, describe its history, explain how it is computed, and detail its key deficiencies. I will also provide several examples to show how it operates.[4]

Overview

The AMT was originally designed to prevent wealthy taxpayers from using tax shelters to avoid paying their fair share of taxes. However, Congress has changed the tax laws many times since the inception of the AMT and shut down many of the tax-avoidance opportunities that existed in the 1960s and 1970s. Today, the AMT affects millions of taxpayers with no tax-avoidance motives at all—unless one considers choosing to live in a high-tax state or choosing to have children to be a tax-avoidance motive. For 2004, the Treasury Department found that fully 68 percent of aggregate AMT tax preference dollars were attributable to the disallowance of the state and local tax deduction and 19 percent of aggregate AMT tax preference dollars were attributable to the disallowance of personal exemptions.[5] Thus, about 87 percent of the additional income subject to tax under the AMT results simply because of taxpayers' place of residence or family composition.

Moreover, the AMT is now affecting increasing numbers of middle-income taxpayers, because the amount of income exempt from the AMT (the AMT "exemption amount") is not indexed for inflation. When Congress first enacted a minimum tax in 1969, the exemption amount was $30,000 for all taxpayers. If Congress had

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[1] The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. The statute establishing the position directs the National Taxpayer Advocate to present an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Accordingly, Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

[2] I have highlighted problems with the AMT in prior reports as well. In my 2001 Annual Report to Congress, I recommended that the AMT be repealed or, at a minimum, substantially revamped to accomplish its original objective of preventing high-income taxpayers from escaping taxation through the use of tax-avoidance techniques. National Taxpayer Advocate 2001 Annual Report to Congress 166–177. In my 2003 Annual Report to Congress, I designated the AMT as the most serious problem facing taxpayers. National Taxpayer Advocate 2003 Annual Report to Congress 5–19. In my 2004 Annual Report to Congress, I reiterated my recommendation that the AMT be repealed. National Taxpayer Advocate 2004 Annual Report to Congress 383–385.

[3] As a matter of fairness, the repeal of the AMT would require that Congress address the treatment of unused prior-year minimum tax credits, perhaps simply by retaining section 53 of the Code.

[4] The Taxpayer Advocate Service does not possess a revenue-estimating function. When we have written about the AMT in the past, we have generally used data developed by the Treasury Department's Office of Tax Analysis, the Joint Committee on Taxation, or the Tax Policy Center, a joint venture of the Urban Institute and the Brookings Institution. Economists from each of these entities have told us that the modeling the others use is similar and generally produces similar results. Because the Tax Policy Center has published the most extensive data on the AMT, my testimony today generally cites to Tax Policy Center data.

[5] Office of Tax Analysis, Department of the Treasury (unpublished tabulation), cited at http://www.taxpolicycenter.org/TaxFacts/TFDB/Content/PDF/amt__preference.pdf.

indexed that amount, it would be equal to about $165,000 today.[6] Instead, the exemption amounts, after temporary increases that expired at the end of 2006, are $45,000 for married taxpayers and $33,750 for most other taxpayers.[7] As a result, it is now projected that in 2007, absent a change in law, 23.4 million individual taxpayers—or about 26 percent of individual filers who pay income tax—will be subject to the AMT.[8] Among the categories of taxpayers hardest hit, 89 percent of married couples with adjusted gross incomes between $75,000 and $100,000 and two or more children will owe AMT.[9]

The burden that the AMT imposes is substantial. In dollar terms, it is estimated that each AMT taxpayer will owe, on average, an additional 6,782 in tax in 2006.[10] In terms of complexity and time, taxpayers often must complete a 16-line worksheet,[11] read ten pages of instructions,[12] and complete a 55-line form[13] simply to determine whether they are subject to the AMT. Thus, it is hardly surprising that 77 percent of AMT taxpayers hire practitioners to prepare their returns.[14]

Perhaps most disturbingly, it is often very difficult for taxpayers to determine in advance whether they will be hit by the AMT. As a result, many taxpayers are unaware that the AMT applies to them until they receive a notice from the IRS, and some discover they have AMT liabilities that they did not anticipate and cannot pay. To make matters worse, the difficulty of projecting AMT tax liability in advance makes it challenging for taxpayers to compute and make required estimated tax payments, which often results in these taxpayers being subject to penalties.

At some point very soon, by one estimate as early as in 2007, *we will reach a point where it will cost more for Congress to repeal the AMT than to repeal the regular tax and leave the AMT intact.*[15] In a very real sense, then, the AMT is ceasing to fulfill its intended mission to prevent tax avoidance by the wealthy and is instead becoming the *de facto* tax system for millions of Americans. The obvious challenge in repealing the AMT is that its increasing revenue stream has been built into revenue estimates, so if it is repealed, either Congress will have to raise tax receipts in other ways or budget deficits will balloon. These alternatives admittedly are not appealing, but I have no doubt there are solutions that are far preferable to the sta-

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[6] Department of Labor, Bureau of Labor Statistics, *Consumer Price Index—All Urban Consumers (CPI–U)* (as of Oct. 31, 2006). Congress acted after hearing testimony that 155 taxpayers with adjusted gross incomes above $200,000 had paid no federal income tax for the 1966 tax year. *See* The 1969 Economic Report of the President: Hearings before the Joint Economic Comm., 91st Cong., pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury). The consumer price index has increased more than six fold since 1966, so the kinds of taxpayers who caught Congress' attention back then would be making over 1.25 million today. *See* Department of Labor, Bureau of Labor Statistics, *Consumer Price Index—All Urban Consumers (CPI–U)* (as of Oct. 31, 2006). Yet the AMT today is not primarily affecting taxpayers with incomes over $1.25 million. By 2010, it has been estimated that 82 percent of all taxpayers affected by the AMT will have incomes under $200,000—and 36 percent will have incomes under $100,000. Greg Leiserson & Jeffrey Rohaly, The Individual Alternative Minimum Tax: Historical Data and Projections updated November 2006, table 5 (Nov. 10, 2006) (available at www.taxpolicycenter.org or on Lexis/Nexis at 2006 TNT 219–50).

[7] IRC § 55(d).

[8] Greg Leiserson & Jeffrey Rohaly, The Individual Alternative Minimum Tax: Historical Data and Projections updated November 2006, table 1 (Nov. 10, 2006) (available at www.taxpolicycenter.org or on Lexis/Nexis at 2006 TNT 219–50).

[9] Greg Leiserson & Jeffrey Rohaly, The Individual Alternative Minimum Tax: Historical Data and Projections updated November 2006, table 3 (Nov. 10, 2006) (available at www.taxpolicycenter.org or on Lexis/Nexis at 2006 TNT 219–50).

[10] Greg Leiserson & Jeffrey Rohaly, The Individual Alternative Minimum Tax: Historical Data and Projections updated November 2006, table 4 (Nov. 10, 2006) (available at www.taxpolicycenter.org or on Lexis/Nexis at 2006 TNT 219–50).

[11] IRS Form 1040, *Individual Income Tax Return,* Instructions at 39 (2006).

[12] IRS Form 6251, *Alternative Minimum Tax—Individuals,* Instructions (2006).

[13] IRS Form 6251, *Alternative Minimum Tax—Individuals* (2006).

[14] IRS Compliance Data Warehouse, Individual Returns Transaction File (IRTF), Tax Year 2004.

[15] Because of differing assumptions, estimates of when this crossover point will occur vary. The most recent modeling by the Tax Policy Center (TPC), a joint venture of the Urban Institute and the Brookings Institution, projects it will occur in 2007. Greg Leiserson & Jeffrey Rohaly, The Individual Alternative Minimum Tax: Historical Data and Projections updated November 2006, at 4 (Nov. 10, 2006) (available at www.taxpolicycenter.org or on Lexis/Nexis at 2006 TNT 219–50). The Treasury Department is projecting the crossover will occur in 2013. Office of Tax Analysis, Department of the Treasury (unpublished tabulation). Based on our conversations with Treasury and TPC economists, we understand that the TPC model assumes that tax credits that can be used against the AMT, including the child tax credit and the earned income tax credit, would be repealed along with the regular income tax. The Treasury Department did not assume these credits would be repealed along with the regular income tax.

tus quo. Significantly, the longer Congress waits to act, the more dependent the government will become on AMT revenue and the harder it therefore will become to repeal it.

While the concept of a minimum tax is not unreasonable, the AMT as currently structured has morphed into something that was never intended: It is penalizing taxpayers for such nontax-driven behavior as having children or selecting a state of residence; it is hitting taxpayers it was never intended to hit because its exemption amount has not been indexed for inflation; it is taking large numbers of taxpayers by surprise—and subjecting them to penalties to boot; it is imposing onerous compliance burdens; it is altering the distribution of the tax burden that exists under the regular tax system; it is changing the tax incentives built into the regular tax system; and it is neutralizing the effects of changes to tax rates imposed under the regular tax system.

Background of the AMT

The concept of a minimum tax was initially developed in response to reports that a small, wealthy group of taxpayers was avoiding taxes altogether through the use of tax avoidance techniques.[16] In 1969, the House of Representatives adopted recommendations of the Treasury Department and passed a bill to impose a minimum tax by limiting certain tax preference items, in the aggregate, to 50 percent of gross income.[17] This approach required the use of a complex formula designed to allocate itemized deductions between taxable income and non-taxable income and to disallow those deductions allocated to non-taxable income.[18]

The Senate changed the bill, adopting instead a tax on specified preference items in excess of a $30,000 exemption amount.[19] The final bill followed the Senate's approach and imposed an add-on tax of 10 percent on nine specific tax preference items when the sum of the preference items exceeded $30,000.[20]

The Tax Reform Act of 1976 and the Revenue Act of 1978 both made modifications to the add-on tax. The 1976 Act, among other things, increased the add-on tax rate to 15 percent and lowered the exemption amount from $30,000 to the greater of $10,000 or one-half of regular tax liability.[21] The 1976 Act also added a new preference item for "excess itemized deductions" equal to the amount by which itemized deductions (other than medical and casualty deductions) exceeded 60 percent of adjusted gross income.[22] The 1978 Act went a step further, restructuring the tax into two components. The add-on tax was retained for all tax preferences except the capital gains deduction and excess itemized deductions, and a new alternative minimum tax was established to adjust the taxpayer's income for these two items of tax preference. This new alternative minimum tax (AMT) imposed a progressive three-tiered rate structure on AMT: 10 percent on AMT income between $20,001 and $60,000; 20 percent on AMT income between $60,001 and $100,000; and 25 percent on AMT income over $100,000.[23]

In 1982, Congress repealed the add-on tax but left the AMT intact.[24] Although Congress has enacted many technical changes over the past 25 years, the basic structure of the AMT rules has remained intact.

How the AMT Is Computed

The AMT's method of calculation vividly demonstrates its complexity. The AMT requires a separate set of computations from the regular income tax, with unique rules governing the recognition of income and the timing of deductions and credits. Taxpayers are often required to maintain two sets of records—one for regular income tax purposes and one for AMT purposes.

The determination of AMT liability, if any, involves an eight-step process:

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[16] *The 1969 Economic Report of the President: Hearings before the Joint Economic Comm.*, 91st Cong., pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury); Committee on Ways and Means of the U.S. House of Representatives and Committee on Finance of the U.S. Senate, 91st Cong., *Tax Reform Studies and Proposals, U.S. Treasury Department*, pt. 1, p. 132 (Comm. Print 1969).

[17] H.R. 13270, § 301(a) (version passed by the House of Representatives on Aug. 8, 1969).

[18] *See* H.R. Conf. Rep. No. 91–782, p. 301 (1969).

[19] H.R. 13270 (substituted version passed by the Senate on Dec. 11, 1969).

[20] Tax Reform Act, Pub. L. No. 91–172, § 301 (1969). The nine specified tax preference items were (1) excess investment interest income, (2) accelerated depreciation on personal property, (3) accelerated depreciation on real property, (4) amortization of certified pollution control facilities, (5) amortization of railroad rolling stock, (6) tax benefits from stock options, (7) bad debt deductions of financial institutions, (8) depletion, and (9) the deduction for capital gains.

[21] Tax Reform Act, Pub. L. No. 94–455, § 301 (1976).

[22] *Id.*

[23] Revenue Act, Pub. L. No. 95–600, § 421 (1978).

[24] Tax Equity and Fiscal Responsibility Act, Pub. L. No. 97–248, § 402(a) (1982).

1. The taxpayer must calculate his regular tax liability. The regular income tax rules provide preferred treatment for certain types of income and allow taxpayers to claim certain exemptions, deductions, exclusions and credits.
2. The taxpayer must determine whether he is subject to additional tax under the AMT regime. The IRS provides a 16-line worksheet (Worksheet To See if You Should Fill in Form 6251—Line 45)[25] to help taxpayers determine whether they may be subject to the AMT. If the worksheet indicates that a taxpayer is *potentially* subject to the AMT, the taxpayer must complete Form 6251 (Alternative Minimum Tax—Individuals), which contains 55 lines. Many taxpayers are required to complete Form 6251—only to find that they do not have an AMT liability.
3. The taxpayer must compute his alternative minimum taxable income (AMTI) on Form 6251. This computation generally requires taxpayers to give up the benefit of tax preference items to which they are entitled under the regular tax system (*e.g.,* dependency exemptions, a standard deduction, and itemized deductions for state and local taxes, employee business expenses and legal fees).[26]
4. The taxpayer must determine an "exemption amount" to which he is entitled based on filing status. After temporary increases in the AMT exemption amounts in recent years that have now expired, the AMT exemption amounts for 2007 stand at $45,000 for married taxpayers and 33,750 for most other taxpayers.[27] The exemption amounts are phased out for married taxpayers with AMTI exceeding $150,000 and non-married taxpayers with AMTI exceeding $112,500.[28]
5. The taxpayer must compute his "taxable excess" by subtracting the exemption amount from his AMTI.
6. A taxpayer with a positive "taxable excess" must compute his "tentative minimum tax." A "taxable excess" of $175,000 or less is taxed at a 26 percent rate and any additional "taxable excess" is taxed at a 28 percent rate. The sum of the two amounts, minus the alternative minimum tax foreign tax credit, is the "tentative minimum tax."[29]
7. The taxpayer must compute his "alternative minimum tax" or "AMT." The AMT is equal to the excess of the taxpayer's tentative minimum tax, if any, over his regular tax liability (reduced by any tax from Form 4972 (Tax on Lump Sum Distributions) and any foreign tax credit from Form 1040). If the net result is a negative number or zero, the taxpayer does not owe AMT.
8. If the taxpayer owes AMT, he computes his tax liability by adding his regular tax liability and his AMT liability.[30]

A taxpayer's AMT liability may result in an AMT credit.[31] In general, an AMT credit may be used in the future when the taxpayer's regular tax liability, reduced by other nonrefundable credits, exceeds the taxpayer's tentative minimum tax for the year.[32] However, a taxpayer who owes AMT generates an AMT credit only to the extent the credit is caused by "deferral" items and not by "exclusion" items. Deferral items are those that are accounted for in different tax years in the regular tax and AMT systems. For example, the AMT in some instances requires taxpayers to depreciate property over a longer period of time. Exclusion items are adjustments and tax preference items that result in the permanent disallowance of certain tax

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[25] IRS Form 1040, *Individual Income Tax Return,* Instructions at 39 (2006).

[26] Required adjustments listed on Form 6251 include adjustments for medical and dental expenses, state and local taxes, certain non-allowable home mortgage interest, miscellaneous itemized deductions, tax refunds, investment interest, depletion, certain net operating losses, interest from specified private activity bonds, qualified small business stock, the exercise of incentive stock options, estates and trusts, electing large partnerships, property dispositions, depreciation on certain assets, passive activities, loss limitations, circulation costs, long-term contracts, mining costs, research and experimental costs, income from pre-1987 installment sales, intangible drilling costs, certain other adjustments and alternative tax net operating loss deductions. *See* IRC §§ 56 and 57; IRS Form 6251 (Alternative Minimum Tax—Individuals), Part I.

[27] IRC § 55(d).

[28] IRC § 55(d)(3).

[29] IRC § 55(b)(1)(A).

[30] In many cases, the taxpayer's final tax liability is simply the greater of his regular tax liability or his tentative minimum tax liability. But because the Code requires adjustments for credits and other taxes, the Seventh and Eighth steps are required to ensure that taxpayers with these tax items obtain the correct result.

[31] IRC § 53.

[32] Beginning in 2007, an individual with a long-term unused AMT credit may be able to use a portion of his AMT credit in a taxable year in which he, as a result of the tentative minimum tax limitation, otherwise could not use it. For 2007, a long-term unused AMT credit is an AMT credit that was generated before 2004. IRC § 53(e).

benefits such as the standard deduction, personal exemptions and certain itemized deductions. Thus, many individual taxpayers who owe AMT will never be able to use an AMT credit.

Problems with the AMT

At the risk of some redundancy, the following is a concise list of some of the most significant problems relating to the AMT:

- *Impact on "Wrong" Taxpayers.* The AMT no longer targets just wealthy taxpayers engaged in tax avoidance. The number of AMT filers is projected to grow to 32.4 million by 2010.[33] Among taxpayers with incomes between $100,000 and $200,000, a staggering 80 percent will be subject to the AMT.[34] Even more notable, the AMT will affect a higher percentage of taxpayers with incomes between $75,000 and $100,000 (50 percent) than taxpayers making more than $1 million (39 percent).[35]
- *Lack of AMT Knowledge.* Taxpayers often file their returns not knowing about the AMT or expecting to be subject to it, but then receive bills relating to the AMT that they are not prepared to pay. In fiscal year 2005, the IRS closed more than 21,500 examinations that were initiated because of suspected AMT liabilities. These examinations resulted in additional tax assessments of nearly $39 million—about $1,700 per return.[36]
- *Complexity.* The individual AMT computations are completely separate from the regular income tax computations. As described above, taxpayers may need to fill out a 16-line worksheet and then a 55-line form (IRS Form 6251, Alternative Minimum Tax—Individuals) just to determine whether they are subject to AMT. Other complexities of the AMT include the re-computation of the foreign tax credit,[37] its effects on incentive stock options[38] and capital gains rates,[39] and the treatment of income of minor children (the so-called "kiddie tax").[40]
- *Failure to Index AMT Exemptions for Inflation.* Regular income tax standard deductions, exemptions and filing thresholds are all adjusted for inflation. As discussed above, however, the AMT exemption amounts are not. The absence of an AMT indexing provision is largely responsible for the increasing numbers of middle-class taxpayers who are subject to the AMT regime.[41]
- *Adverse Impact on Families.* Married taxpayers will be almost 15 times as likely as single taxpayers to pay AMT in 2007.[42] One study projected that approximately 5.7 million taxpayers will pay AMT in 2010 simply because they lose the benefit of personal exemptions under the AMT.[43]
- *Loss of Itemized Deductions.* An individual taxpayer must add back certain itemized deductions when computing the AMT.[44] This adjustment causes particular difficulties for taxpayers with large expenditures such as medical bills, legal fees in court settlements, state and local taxes, or employee business expenses.
- *Unpredictability of Estimated Tax Payments.* Because the law is so complicated, it is difficult, if not impossible, to predict whether an individual will be subject to the AMT. This uncertainty causes problems in paying the correct estimated tax for the year and can result in penalties for underpayment. In tax year 2004,

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[33] Greg Leiserson & Jeffrey Rohaly, The Individual Alternative Minimum Tax: Historical Data and Projections updated November 2006, table 1 (Nov. 10, 2006) (available at www.taxpolicycenter.org or on Lexis/Nexis at 2006 TNT 219–50).

[34] *Id.* at table 3.

[35] *Id.* at table 3.

[36] IRS Wage & Investment Operating Division, Audit Information Management System (FY 2005 data).

[37] IRC § 59(a).

[38] IRC § 56(b)(3).

[39] IRC § 55(b)(3).

[40] IRC § 59(j).

[41] The effect of the absence of AMT-exemption indexing is compounded by the fact that key tax preference items that are included in AMTI—*e.g.,* the standard deduction and personal exemptions—are indexed annually.

[42] Greg Leiserson & Jeffrey Rohaly, The Individual Alternative Minimum Tax: Historical Data and Projections updated November 2006, table 3 (Nov. 10, 2006) (available at www.taxpolicycenter.org or on Lexis/Nexis at 2006 TNT 219–50).

[43] Leonard E. Burman, William G. Gale & Jeffery Rohaly, *The AMT: Projections and Problems*, Tax Notes, July 7, 2003, pp. 105–106 (available at www.taxpolicycenter.org).

[44] IRC § 56(b) & (e). Common itemized deductions that must be added back to income include, but are not limited to, state and local taxes, real estate and personal property taxes, mortgage interest not used for the purchase or improvement of a personal residence, medical expenses exceeding 7.5 percent but less than 10 percent of adjusted gross income, and certain miscellaneous itemized deductions such as employee business expenses and legal fees.

for example, 17.1 percent of AMT returns reported an estimated tax penalty on the return as compared with 3.7 percent of non-AMT returns.[45]

- *Taxation of Incentive Stock Options.* A taxpayer's exercise of incentive stock options creates a paper (phantom) gain in the year the stock is purchased (*i.e.,* the option exercise). This gain is not taxed under the regular tax rules but is taxed for AMT purposes. The gain is the difference between the option price and the market value of the stock on the date the option is exercised to purchase the shares.
- *Limitation on Availability of General Business Credits.* Most general business tax credits are limited by the taxpayer's tentative minimum tax.[46] To illustrate, assume a taxpayer has a regular tax liability of $10,000 prior to credits, tentative minimum tax of $9,000, and a $2,000 credit under IRC § 44 for constructing an access ramp to his business for disabled individuals. Absent the credit, the AMT has no effect on this taxpayer because his regular tax liability exceeds his tentative minimum tax. However, the disabled access credit would reduce the taxpayer's regular tax liability to $8,000, which is below his tentative minimum tax. Therefore, the taxpayer is only entitled to a credit amount of $1,000 and must carry back or carry forward the $1,000 credit balance. Under these circumstances, the taxpayer is required to complete Form 6251 and attach it to his return—even though the taxpayer does not have an AMT liability—to substantiate his entitlement to a portion of the credit. The Treasury Department estimates that taxpayers will lose nearly $13 billion in tax credits, mostly business credits, in 2010 because of the AMT.[47]
- *Timing Issues Resulting from AMT Tax Credit Regime.* The portion of AMT attributable to timing items reflects the difference between when certain deductions are allowable under the AMT and when the same deductions are allowable under the regular income tax. The taxpayer can claim an AMT credit only in subsequent years when the regular tax exceeds the AMT.
- *Requirement of Two Sets of Records.* Taxpayers often must keep separate records for regular tax and AMT purposes. For example, assume a taxpayer placed an office building into service prior to 1999 and is claiming straight-line depreciation on the building. The taxpayer must depreciate the building over a 39-year period for regular tax purposes,[48] but for AMT purposes the depreciation period is 40 years.[49]
- *Inconsistent Treatment of Carryover Items.* When a taxpayer loses a tax benefit because of the AMT, the taxpayer may or may not be entitled to carry the benefit to another tax year, and the carryover periods vary from item to item. For example, an unused credit otherwise allowable for placing an alternative motor vehicle into service may not be carried over if the motor vehicle is not used in a trade or business.[50] Thus, if the vehicle is for personal use, any credit that cannot be used in the year in which the vehicle is placed into service is permanently lost. Unused general business credits, on the other hand, generally may be carried back one year and carried forward 20 years.[51] By contrast, unused foreign tax credits generally may be carried back one year and carried forward ten years.[52]
- *Two Computations of Capital Gains Tax.* Capital gains are taxed for regular tax purposes at lower rates than the AMT rates. Because Congress wanted to preserve tax-favored capital gains treatment under the AMT regime, a taxpayer with capital gains who owes AMT must complete 20 lines on Form 6251 after having already completed a Schedule D (Capital Gains and Losses) for regular tax purposes.

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[45] IRS Compliance Data Warehouse, Individual Returns Transaction File (IRTF), Tax Year 2004.

[46] IRC § 38(c)(1).

[47] Office of Tax Analysis, Department of the Treasury (unpublished tabulation); IRC § 55(c)(2).

[48] IRC § 168(c).

[49] IRC § 56(a)(1)(A)(i) (referencing IRC § 168(g)).

[50] A credit may be carried to another taxable year only if the Code expressly provides for it. In the case of the credit for alternative motor vehicles, carryovers are authorized only if the vehicle is used in a trade or business and is subject to depreciation. *See* IRC § 30B(g).

[51] IRC § 39(a).

[52] IRC § 904(c).

- *Increased Use of Paid Preparers*. Approximately 60 percent of taxpayers without AMT liabilities pay to have their returns prepared.[53] Where a taxpayer has an AMT liability, the use of paid preparers jumps to 77 percent.[54]
- *High AMT Marginal Tax Rates Due to Phase-out of AMT Exemption*. As described above, the AMT rules impose tax at a rate of 26 percent on a "taxable excess" (i.e., AMTI reduced by the applicable AMT exemption amount) up to $175,000 and 28 percent on higher amounts. However, the AMT exemptions phase out at a 25 percent rate for married taxpayers with AMTI exceeding $150,000 and non-married taxpayers with AMTI exceeding $112,500.[55] Therefore, the AMT marginal tax rate can reach 35 percent.

Examples of AMT Impact

The following examples illustrate the impact of the AMT in four situations:[56] These examples illustrate common AMT issues we have seen in the Taxpayer Advocate Service, but they do not represent the facts of any particular case.

AMT Penalty for Having Children: The (modified) Brady Bunch. Mr. and Mrs. Brady live in California in a rented home with their six children, ages 5–16. They claim the "married filing jointly" filing status and take the $10,300 standard deduction in 2006. Mr. Brady, an architect, made $73,160. Mrs. Brady worked part-time as a teacher and earned $25,000. The Bradys owe $2,424 in taxes under the regular tax system, but their tax bill rises to $3,199 with the AMT because the tax benefits of the personal exemptions for their children are phased out under the AMT.

AMT Marriage Penalty. Assume the same facts as in the prior example except that Mr. and Mrs. Brady did not marry. If each used the "Head of Household" filing status and claimed their own three children, the AMT would not apply to either of them and their combined tax bill would be lower. Mrs. Brady would pay no tax and get $4,500 in refundable credits (a $2,385 EITC credit, a $2,055 child tax credit, and a $60 credit for federal telephone excise tax paid), and Mr. Brady would pay tax of $5,404. Their combined tax liability would be $904 (*i.e.*, $5,404 minus $4,500)—or $2,295 less than their tax liability if they were married. Part of the difference in tax in these two examples is attributable to the general marriage penalty, but a significant portion is attributable solely to the AMT.

AMT Penalty for High State and Local Taxes. A taxpayer filed a joint return claiming two dependent children for 2006. The taxpayer had an adjusted gross income of $190,000 and paid state income and property taxes totaling $28,000. The taxpayer had 90 percent of his regular tax liability withheld from his paycheck. When the taxpayer prepared his return, he discovered that he had an additional tax liability of $4,448 due to the AMT. Because of the additional AMT tax liability, he also owed a penalty for failure to pay estimated tax in the amount of $210.

AMT Penalty Due to Combination of Having Children and Using "Married Filing Separately" Filing Status. A mother of five earned $57,500 in 2006. She is seeking a legal separation from her husband and lived apart from him during the final months of the year and thus claimed "married filing separately" filing status. Because she was entitled to claim the children as her dependents and to claim the child tax credit, she had no tax liability under the regular tax rules. She therefore did not have any tax withheld from her paychecks. When she prepared her tax return, however, she discovered that she had a tax liability of $1,909 due to the AMT. Because of the AMT tax liability, she also owed a penalty for failure to pay estimated tax in the amount of $93.

Conclusion

To be viewed as fair, a tax system must be transparent. Yet the complexity of the AMT is such that many if not most taxpayers who owe the AMT do not realize it until they prepare their returns. It adds insult to injury when many of these taxpayers discover that they also owe a penalty for failure to pay sufficient estimated tax because they did not factor in the AMT when they computed their withholding exemptions or estimated tax payments. Taxpayers subjected to this treatment may wonder whether their government is dealing fairly with them. To say the least, "gotcha" taxation is not good for taxpayers or the tax system.

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[53] IRS Compliance Data Warehouse, Individual Returns Transaction File (IRTF), Tax Year 2004.

[54] IRS Compliance Data Warehouse, Individual Returns Transaction File (IRTF), Tax Year 2004.

[55] IRC § 55(d)(3).

[56] These examples illustrate common AMT issues we have seen in the Taxpayer Advocate Service, but they do not represent the facts of any particular case.

Clearly, there are many practical, policy, and political challenges to repealing the individual AMT. But these challenges will continue to grow over time as the government, absent congressional action, becomes increasingly dependent on AMT revenue. With all the problems inherent in the AMT, I don't think taxpayers will stand for it when the AMT begins to hit tens of millions of taxpayers within the next few years. The AMT is a time bomb, and it is set to detonate very soon. I strongly urge Congress to act before the AMT explosion.

Chairman NEAL. Thank you very much, Ms. Olson. Dr. Burman.

STATEMENT OF LEONARD E. BURMAN, PH.D., DIRECTOR, TAX POLICY CENTER, A JOINT VENTURE OF THE URBAN INSTITUTE AND BROOKINGS INSTITUTION

Mr. BURMAN. Thank you, Mr. Chairman. Chairman Neal, Ranking Member English, Members of the Subcommittee, thank you for inviting me to share my views on the individual AMT, and thank you, Mr. Chairman and Mr. Ranking Member, for your leadership on this issue.

In January 1969, Treasury Secretary Joseph Barr testified that 155 high-income individual taxpayers had paid no Federal income tax in 1966. The news created a political firestorm. Members of Congress received more constituent letters about those 155 taxpayers than about the Vietnam War.

Law makers could have responded in one of three ways. They could have explained that the non-taxpayers were taking advantage of tax incentives that advanced worthwhile social objectives, and thus, should not have to owe tax. That would have been a hard sell.

They could have closed the loopholes that allowed rich people to avoid tax, but those loopholes had some pretty powerful constituencies, so that didn't happen either.

Instead, Congress decided to create an extra tax for high-income people who didn't pay enough under the regular income tax system to avoid such embarrassing disclosures in the future. Thus was born the AMT.

It was a bad choice. The AMT doesn't do much to reign in tax shelters. Given the poor design, millionaires are actually less likely to owe AMT than middle income people with kids. It's inefficient, and it undermines support for the tax system because it's the poster child for pointless complexity. Taxpayers can't understand it, but they think it's unfair.

Before getting into how to fix the AMT, I would like to address a couple of shibboleths. One, the AMT is virtually a flat tax with low rates of 26 and 28 percent. No. Those are the rates written into the law, but because the AMT exemption phases out with income, as Eric mentioned, the effective rates actually go as high as 35 percent, and they don't even apply to the highest-income taxpayers. Since the highest rates don't apply to the highest income people, the AMT hits almost everyone with incomes between $200,000 and $500,000, but not many millionaires.

Another one. Since the AMT is becoming the de facto tax system, why not just eliminate the regular income tax? The AMT would be a terrible tax system. First, high tax rates apply at relatively modest incomes, and high-income people would get a big rate cut from 35 percent to 28 percent.

Second, there are horrendous marriage and child penalties.

Third, it isn't indexed for inflation, so it causes people's average tax bills to increase every year, even if their real incomes weren't changing.

Another one is that software and paid preparers make AMT complexity no big deal. There are at least three problems with this argument. First, as the AMT consumes the middle class, it will hit more and more people who do their taxes by hand—or try.

Second, even with software, it's complex, as I explained in my written testimony.

Third, you might want people to understand how the tax system affects them. With the AMT, the tax system becomes an inscrutable black box.

It's not the Bush tax cuts that have pushed people under the AMT, but the failure to index for inflation. Actually, it's both. It's certainly true that the AMT was on a path to cause problems even before the 2001 tax cuts were enacted, but EGTRRA doubled the problem. Without the tax cut, 16 million people would be on the AMT in 2010, which is way too many, but with the tax cut, the number balloons to 32 million. Cutting the regular income tax without fixing the AMT at the same time is the tax policy equivalent of throwing gasoline on a fire.

The AMT is a blue state tax. Although in 2006, it's true that taxpayers in relatively high-income high-tax coastal States are more likely to owe AMT than those in the interior, the AMT is going to hit people in all States hard if it isn't fixed. It might be better to call it a soccer mom tax, or a swing voter tax.

It's in all of your interests to do something about it. So, what should we do?

A serious fix to the AMT would, at a minimum, adjust it for inflation and retarget it at the higher income people who are intended to pay it. The ideal solution might be to repeal the tax, and include any valid anti-tax shelter provisions in the regular income tax.

The problem, as you're all painfully aware, is that any of these solutions would reduce Federal tax revenues dramatically, and repeal would be very regressive—96 percent of the benefits would go to the top fifth of the income distribution.

We have looked at a number of options to pay for reform, including an increase in top income tax rates, elimination of the AMT tax preference for capital gains and dividends, or repeal of the deduction for State and local taxes under the regular income tax.

Eliminating the tax break for capital gains and dividends has considerable merit. Prior to 1987, the tax break on capital gains was the single largest tax preference under the AMT. If the purpose of the AMT is to limit tax shelters, this makes sense, since virtually any individual income tax shelter you can imagine involves converting ordinary income into lightly taxed capital gains or dividends. Taxing gains and dividends under the AMT would also be highly progressive.

The President's tax reform panel proposed eliminating State and local tax deduction. I know that causes shudders of horror among people who live in high tax States, but your constituents are losing this break anyway because of the AMT, and it's becoming increasingly just a tax deduction for very high-income people who aren't subject to the AMT.

Any of these changes would make the tax system more progressive, and they wouldn't add to the deficit. I understand that fixing the AMT isn't easy. If it were, it would have happened a long time ago, but I applaud the Subcommittee for taking the first steps toward what I hope will be a permanent solution.

[The prepared statement of Mr. Burman follows:]

Statement of Leonard E. Burman, Ph.D, Director, Tax Policy Center, a joint venture of the Urban Institute and Brookings Institution

Chairman Neal, Ranking Member English, Members of the Subcommittee: Thank you for inviting me to share my views [1] on the individual alternative minimum tax.

A precursor to the current individual alternative minimum tax (AMT) was originally enacted in 1969 to limit the amount of tax sheltering that taxpayers could pursue and to assure that high-income filers paid at least a minimal amount of tax.[2] The current AMT, however, has strayed far from those original goals. Under current law, the tax will affect more than 23 million taxpayers in 2007, mainly for reasons that have little or nothing to do with what most people would consider tax sheltering. The AMT is expected to generate more than 800 billion in revenue over the next ten years under current law, a figure that rises to 1.5 trillion if the 2001–2006 tax cuts are extended. In short, the AMT threatens to grow from a footnote in the tax code to a major component affecting tens of millions of taxpayers every year.

My testimony will outline how the AMT works, whom it affects, and why it demands attention. I will also discuss possible ways of reforming the AMT and why financing AMT reform or repeal is important. I finish with some concluding observations.

How does the AMT Work?

The individual AMT operates parallel to the regular income tax with a different income definition, rate structure, and allowable deductions, exemptions, and credits. In short, after calculating regular tax liability, taxpayers must calculate their "tentative AMT" under the alternative rules and rates and pay whichever amount is larger. To calculate tentative AMT, taxpayers must first determine their alternative minimum taxable income (AMTI) and then subtract the applicable AMT exemption amount (which is subject to phase-out), calculate tax under the AMT rate schedule, and subtract any applicable credits. Technically, AMT liability is the excess, if any, of tentative AMT above the amount of taxes due under the regular income tax alone.

Alternative minimum taxable income is the sum of three components: regular taxable income for AMT purposes, AMT preferences, and AMT adjustments. Regular taxable income for AMT purposes is basically the same as taxable income used for regular tax purposes, except it is allowed to be negative if deductions exceed gross income.

An AMT preference is an item identified as a potential tax saving in the regular income tax that is not permitted in the AMT. An AMT adjustment is simply any other exclusion, exemption, deduction, credit, or other treatment (such as a method for computing depreciation) in the regular income tax that is either restricted or disallowed in the AMT. Because there is generally no interesting economic distinction between preferences and adjustments, I will refer to both as preferences.

Interesting distinctions emerge among the various preferences themselves, however. Preferences are of two types: exemptions or deferrals. Exemption preferences broaden the AMT tax base and include the disallowance of personal exemptions, the standard deduction, and itemized deductions for miscellaneous expenses and state and local taxes. Deferral provisions change the timing of the recognition of income and deductions, typically to accelerate income and postpone deductions. Thus, they

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[1] My testimony draws heavily on joint work with my Tax Policy Center colleagues, Jeff Rohaly, Greg Leiserson, and Bill Gale. Views expressed are my own.

[2] The original minimum tax was an addition to regular income tax. The current AMT is a floor on total tax liability. For details, see Joint Committee on Taxation (2007) or Burman, Gale, and Rohaly (2005).

tend to raise the current-year tax base—and hence revenues—but only at the expense of future tax bases and tax collections.

Middle-income AMT taxpayers are primarily affected by the exemption preferences, which are added to taxable income. The exemption measures might be interpreted as an effort to reduce tax incentives generally and move toward an alternative tax base that is broader than the regular income tax base.

Deferral preferences outnumber exemption preferences, but they are used much less frequently, tend to be used by high-income taxpayers, and generate much less revenue. Deferral items tend to be complex; taxpayers generally need to recalculate income and costs using different schedules and keep separate books for regular tax and AMT purposes. Also, taxpayers may use AMT liability created by deferral provisions—but not by exemption provisions—as a credit against future years' regular tax liability in excess of the tentative AMT. The deferral provisions, coupled with the credit they create, are consistent with a policy goal of having every high-income filer pay some positive tax in each year, even if his or her overall multiyear tax liability does not change.

The Joint Committee on Taxation (2007) estimates that the three largest AMT preference items in 2006 were exemption preferences that few would consider to be aggressive tax shelters: deductions for state and local taxes (59 percent); personal exemptions, including exemptions for dependent children (22 percent); and miscellaneous itemized deductions for items such as unreimbursed business expenses (11 percent). The share of these preference items—already more than 90 percent—will rise further over the next several years as the AMT encroaches on more and more middle-income taxpayers.

After adding back their preference items and determining alternative minimum taxable income, taxpayers may then subtract an AMT exemption amount of $45,000 for couples or $33,750 for singles and heads of household. That exemption is limited, however, for taxpayers filing joint returns with AMTI over $150,000 ($112,500 for singles and heads of household).[3] AMTI less any applicable exemption is taxed at two rates—26 percent on the first $175,000 and 28 percent on any excess above that amount. As under the regular income tax, capital gains and dividends are subject to lower tax rates. If the resulting "tentative AMT" is greater than tax before credits calculated under the regular income tax, the difference is payable as AMT.[4]

That comparison means that anything that reduces the regular income tax relative to the AMT or that increases the tentative AMT relative to the regular income tax will move taxpayers onto the AMT. For example, a reduction in regular income tax rates that is not matched by a comparable change in the AMT would make more taxpayers subject to the AMT. The converse is also true: increasing regular income taxes or cutting AMT taxes would move some taxpayers off the AMT. If the 2001 and 2003 tax cuts are allowed to sunset after 2010 as scheduled, for example, fewer taxpayers will owe AMT, albeit only because their regular tax bills will have increased.

The Congress has limited the AMT's reach in recent years by temporarily increasing the AMT exemption and allowing the use of personal nonrefundable credits against the AMT.[5] For the 2006 tax year, for example, Congress raised the exemption from $45,000 to $62,550 for couples and from $33,750 to $42,500 for single filers and heads of household. Those changes kept 16.5 million taxpayers from falling into the AMT's clutches. Because those adjustments were temporary, the Congress will need to pass additional legislation to prevent a sharp rise in the number of taxpayers subject to the AMT, from about 4 million in 2006 to more than 23 million in 2007.

[3] The exemption is reduced by 25 percent of the amount that AMTI exceeds the relevant threshold. As a result, married couples filing joint returns can claim no exemption if their AMTI exceeds $330,000; single filers and heads of household get no exemption if their AMTI is greater than $247,500.

[4] To be precise, the foreign tax credit is calculated before calculating the AMT and incorporated into the comparison between regular tax liability and AMT liability. Most credits, however, are calculated after both regular tax and AMT liability and do not affect the taxpayer's direct AMT liability.

[5] Other personal credits, such as the Earned Income Tax Credit, were allowed against the AMT by tax law changes included in the Economic Growth and Tax Relief Reconciliation Act of 2001 and will remain in place through 2010.

Box 1. Calculating the AMT in 2007

A married couple with four children has an income of $75,000 from salaries and interest on their savings account. Under the regular income tax, the family can deduct $20,400 in personal exemptions for themselves and their children. They can also claim a $10,700 standard deduction. For the regular tax, their taxable income of $43,900 places them in the 15 percent tax bracket, and they owe $5,803 in taxes before calculating the AMT or tax credits. Some, but not all, tax credits are allowed against both the AMT and the regular tax in 2007. Most importantly for this family, the child tax credit is allowed against both.

To calculate AMT liability, the couple adds their preference items—personal exemptions of $20,400 and the standard deduction of $10,700—to taxable income and subtracts the married-couple exemption of $45,000, yielding $30,000 in income subject to AMT. That amount is taxed at the first AMT rate of 26 percent, for a tentative AMT liability of $7,800. The AMT equals the difference between the couple's tentative AMT and their regular income tax, or $1,997.

Several points about this example are worth noting. First, the family is on the AMT because they have four children, not because they are rich or aggressive tax shelterers. Second, this tax situation is about as simple as it gets; the family has no deferral preferences, no itemized deductions, no capital gains, no AMT credits from previous years, and no other complicating factors. Third, the couple will receive no long-term benefit from regular tax rate reductions, because their income tax liability is set by the AMT, not the regular income tax. Finally, as long as the AMT is not indexed to inflation, the couple's future tax payments as a share of their income will rise, even if their real (inflation-adjusted) income does not change.

AMT Calculation
Married couple filing jointly with four children, 2007

Calculate Regular Tax		**Calculate Tentative AMT**	
Gross income	$75,000	Taxable income	$43,900
Subtract deductions		*Add preference items*	
Personal exemptions (6 x $3,400)	$20,400	Personal exemptions	$20,400
		Standard deduction	$10,700
Standard deduction	$10,700	**AMTI**	**$75,000**
Taxable income	**$43,900**	*Subtract AMT exemption*	
Tax before credits*	**$5,803**	AMT exemption	$45,000
(Tax bracket)	15%	**Taxable under AMT**	**$30,000**
		Tax (tentative AMT)*	**$7,800**
First $15,650 taxed at 10%		(AMT bracket)	26%
Next $48,050 taxed at 15%			
		First $175,000 taxed at 26%	

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

* If the children are under age 17 the family could reduce its tax liability by $4,000 because of the child tax credit. This credit is allowed against both the regular income tax and the AMT

Box 1 shows the calculation of AMT for a married couple having four children and earning $75,000 in 2007. It illustrates how the AMT will ensnare even middle-class families with very straightforward tax returns if Congress does not act.

Who is Affected by the AMT?

Under current law, about 4 million taxpayers were affected by the AMT in 2006.[6] With the expiration of the temporary AMT "patch" at the end of last year, the number of AMT taxpayers will increase dramatically in 2007 to 23 million, and continue to grow through 2010, eventually reaching 32 million, or more than one-third of all taxpayers. With the expiration of most of the 2001–2006 tax cuts in 2011, the number of AMT taxpayers will fall to 18.5 million, before again marching steadily upward to hit 39.1 million by 2017. If the 2001–2006 tax cuts are extended, 52.6 million taxpayers—almost half of all taxpayers—will pay the AMT by 2017.

Although most AMT taxpayers are moderately well off, the tax is steadily encroaching on families that most would consider solidly middle-class. By 2010, half of all tax filers making between $75,000 and $100,000 will pay the AMT, up from 36 percent this year and less than 1 percent in 2006, when the temporary AMT fix was still in place (table 1).[7]

Although the AMT may have originally been intended to prevent high-income individuals from sheltering all of their income and paying no tax, it now affects more tax filers in lower income classes than it does at the very top of the income scale. Since the 35 percent top rate of the regular income tax exceeds the 28 percent top statutory rate of the AMT, individuals with very high incomes who do not shelter a substantial portion of it will end up in the regular tax system. In 2006, only 31 percent of filers with incomes above 1 million were affected by the AMT, compared to 51 percent of those with incomes between $200,000 and $500,000. By 2010, the difference is even starker: only 39 percent of millionaires will pay the AMT, but 94 percent of those in the $200,000 to $500,000 income class will.

What's more, many tax shelters exploit the difference in tax rates between long-term capital gains, which face a maximum tax rate of 15 percent, and ordinary income, which can be taxed at rates as high as 35 percent under the regular income tax. However, the lower capital gains tax rate is not considered an AMT preference item, so high-income taxpayers who report a large amount of capital gains receive the same tax break under the AMT as under the regular income tax. In contrast, before 1987, the lower tax rate on capital gains was considered a preference item and was, in fact, the largest one.

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[6] Unless otherwise noted, estimates in this testimony are based on the Urban-Brookings Tax Policy Center's microsimulation model of the federal tax system. Taxpayers affected by the AMT include those with direct AMT liability, those whose credits are limited by the AMT, and those who choose to take itemized deductions that are lower than their standard deduction in order to reduce or eliminate their AMT liability. Our estimates differ slightly from those reported by the Joint Committee on Taxation (2007) because of differences in underlying datasets, assumptions about growth of income over time and other factors, and definitions of what it means to be affected by the AMT. (I present our estimates rather than the JCT's simply for purposes of internal consistency, since the JCT did not report all of the statistics I refer to in my testimony.) See Rohaly and Leiserson (2006) for further details on the Tax Policy Center's methodology.

[7] Tax filers include all nondependent tax units filing an income tax return, regardless of whether they owe income tax. Taxpayers include all nondependent tax units with positive income tax liability after credits. The Joint Committee on Taxation (2007) reports estimates for "taxpayers," which they define as all tax-filing units, including those that do not file tax returns and dependent returns.

Table 1
AMT Participation Rate (percent) by Individual Characteristics

Group	Current Law				Current Law Extended[a]	Pre-EGTRRA Law	
	2006	2007	2010	2017	2017	2007	2010
All Taxpayers[b]	4.0	25.9	33.6	34.7	48.6	10.6	16.0
All Tax Filers	2.8	18.4	24.3	27.8	37.4	8.8	12.4
Tax Filers by Cash Income (thousands of 2006$)[c]							
Less than 30	*	*	*	0.1	0.1	*	*
30-50	*	1.3	3.0	12.2	13.0	1.4	2.9
50-75	0.2	9.0	17.1	30.1	30.8	6.9	13.1
75-100	0.7	38.2	49.9	53.7	67.2	10.1	26.1
100-200	4.8	78.8	80.4	61.7	92.3	25.4	32.0
200-500	30.9	89.7	94.3	77.7	96.8	41.3	34.2
500-1,000	49.2	57.2	72.2	27.0	73.8	22.8	22.6
1,000 and more	31.4	33.0	30.8	20.3	40.1	20.3	19.1
Tax Filers by Number of Children[d]							
0	1.9	11.4	16.8	13.9	20.5	2.4	3.8
1	2.7	28.8	32.4	40.9	48.4	7.1	16.0
2	3.0	38.3	42.8	34.8	36.6	20.2	34.0
3 or more	7.4	39.6	46.6	65.3	64.4	39.8	50.3
Tax Filers By State Tax Level							
High	4.6	21.8	27.7	31.6	40.7	10.9	16.2
Middle	2.3	18.5	25.0	28.3	37.9	7.7	12.0
Low	1.6	15.3	21.1	23.8	33.9	5.7	9.2
Tax Filers by Filing Status							
Single	0.9	2.4	3.8	4.7	10.3	1.1	1.7
Married Filing Joint	5.1	36.7	47.9	48.7	67.2	14.5	22.2
Head of Household	2.3	10.4	17.8	33.1	35.0	9.2	14.5
Married Filing Separate	5.7	36.5	47.4	48.7	62.9	12.8	17.6
Married Couple, 2+ Kids, 75k<Cash Income<100k	0.2	59.1	73.6	92.3	92.8	37.5	74.3
Married Couple, 2+ Kids, 75k<AGI<100k	0.8	70.2	80.6	97.7	97.8	60.8	86.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).
Notes:
Includes returns with AMT liability on Form 6251, with lost credits, and with reduced deductions. Tax units who are dependents of other tax units are excluded from the analysis.
* Less than 0.05 percent.
(a) Includes all 2010 sunset provisions in current law.
(b) Taxpayers are defined as returns with positive income tax liability net of refundable credits.
(c) Tax units with negative cash income are excluded from the lowest income class. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.
(d) Number of children is defined as number of exemptions taken for children living at home.

In addition to being in certain income classes, taxpayers with any of several common situations are more likely than others to find themselves on the AMT:

Large Families. Personal exemptions are allowed against the regular income tax, but not the AMT. Taxpayers with large families have many personal exemptions, which significantly reduce their regular income tax liability relative to tentative AMT. In 2006, taxpayers with three or more children were almost four times as likely to owe AMT as those with no children (table 1). By 2010, almost half of families with three or more children will find themselves on the AMT, compared to only 17 percent of those without children.

High State and Local Taxes. State and local taxes are deductible under the regular income tax, but not the AMT. Thus, high state and local taxes reduce regular tax liability relative to AMT, increasing the likelihood that a taxpayer will owe AMT. This helps explain why, in 2004, taxpayers in the New York area, the District of Columbia, and California were most likely to owe AMT (Burman and Rosenberg 2006). They not only faced higher-than-average state and local tax burdens, but they also had higher than average incomes, making them substantially more likely than the average taxpayer to be subject to AMT. In 2006, households in high-tax states were almost three times more likely to be on the AMT than those in low-tax jurisdictions (table 1). With the dramatic growth of the AMT over the rest of this decade, however, this differential is slated to fall dramatically. By 2010, residents of high-tax states will only be about 30 percent more likely to fall prey to the AMT than those in low-tax states (28 percent of households in high-tax states will face the AMT compared to 21 percent in low-tax states.)

Marriage. Most married couples pay less tax under the regular income tax than they would if they were single. (That is, most "marriage penalties" have been eliminated and many couples receive "marriage bonuses.") This is not true under the AMT. AMT tax rate thresholds are identical for married and single taxpayers and the AMT exemption is only 33 percent larger for couples than for singles (except for those for whom the exemption has been phased out). In contrast, the standard deduction for couples under the regular income tax is twice that for singles. The combination of the AMT marriage penalties, the fact that married couples often have children, and the fact that married couples tend to have higher household incomes resulted in married couples being more than five times as likely to owe AMT as singles in 2006. In 2007, with expiration of the temporary AMT fix, married couples are 15 times more likely to owe AMT than singles (table 1).

Taxpayer characteristics can combine to create very high probabilities of falling prey to the AMT. For example, absent a change in law, the AMT will become the de facto tax system for upper-middle-class families with children. In 2006, less than 1 percent of married couples with two or more children and adjusted gross income between $75,000 and $100,000 were affected by the AMT, but by 2010 that share will rise to 89 percent (table 1).

Other common situations that make a taxpayer more likely to incur the AMT include having high medical expenses or simply taking the standard deduction. Taxpayers may deduct medical expenses in excess of 7.5 percent of AGI under the regular income tax, but the threshold is 10 percent of AGI under the AMT. Thus, taxpayers with both high incomes and high medical expenses can be hit hard by the AMT. Even claiming the standard deduction can force an individual into AMT territory. Although most AMT taxpayers itemize deductions, the standard deduction under the AMT is worthless for the few who claim it: it reduces regular tax liability without affecting tentative AMT.

Finally, current AMT rules allow for the possibility of some very perverse outcomes. Under the regular tax, filers may deduct legal fees incurred in cases that generate taxable damages (such as punitive damages or damages for nonphysical injuries) as miscellaneous itemized deductions to the extent that they exceed 2 percent of adjusted gross income. However, the AMT disallows miscellaneous deductions. As a result, a taxpayer with substantial legal fees will have much less taxable income under the regular tax than under the AMT. If the legal fees are high relative to the damage award, the taxpayer can actually owe more AMT than her net gain from a lawsuit (Johnston 2003).

The exercise of incentive stock options generally creates income that is immediately taxable under the AMT, but that is not taxable under the regular income tax until the stock is actually sold. Individuals must include in AMTI the excess of the fair market value of the stock over the purchase price of the stock at the date of exercise (JCT 2006). This can cause taxpayers with very modest cash incomes to owe substantial AMT. If the stock is ultimately sold at a profit, the AMT paid earlier can be taken as a credit against the regular income tax owed. But if the stock price falls, the taxpayer can end up with a substantial AMT liability even though no income is ever realized.[8]

Why is the AMT Becoming a "Mass Tax"?

Although the factors described above help explain why individual taxpayers are affected by the AMT, they do not explain the dramatic growth in the AMT. Two factors reduce regular income tax liabilities relative to tentative AMT over time and largely explain the explosive growth in AMT projected through 2010 and beyond.

Inflation. The AMT is not adjusted for inflation whereas the regular income tax is. This means that if an individual's income just keeps pace with inflation each year, his or her regular income tax would remain constant (in real terms) while AMT liability would rise. The Joint Committee on Taxation (2007) estimates that

[8] The Tax Relief and Health Care Act of 2006 allows certain taxpayers to claim a refundable credit for 20 percent of their unused long-term alternative minimum tax (AMT) credits (up to $5,000) per year. The refundable credit phases out for high-income taxpayers; the phase-out is based on the personal exemption phase-out. The refundable AMT credits can generally only be claimed for tax years 2007–2012 (JCT 2006 and personal communication from Jerry Tempalski).

the number of AMT taxpayers in 2010 would be reduced by about 88 percent (26 million) if the exemption had been indexed for inflation since 1987.[9]

The 2001–2006 Tax Cuts. The tax cuts reduced regular income tax liability, but made only temporary changes to the AMT. As a result, regular income tax declined relative to AMT liability, dramatically increasing the number of taxpayers subject to the AMT. In 2007, about 23 million taxpayers will be subject to the AMT under current law, more than double the 10.2 million that would have been affected had the tax cuts not been enacted.

Should We Care About the Dramatic Growth of the AMT?

While many people decry the expanding reach of the AMT, others assert that there is no cause for concern. Some argue that the complexity taxpayers face in calculating their taxes twice is not a reason to do away with the AMT, but rather cause to eliminate the regular tax. Others assert that the growing prevalence of tax preparation software negates any problems of complexity. In fact, both of those arguments have significant flaws.

Some people, observing the complexity of having two parallel methods of calculating taxes, argue that the best solution is to repeal the regular income tax. This option would have several advantages according to its proponents. They claim that the AMT is nearly a flat-rate tax with only two statutory rates, 26 and 28 percent, both of which are significantly lower than the top statutory rate of 35 percent under the regular income tax. In addition, the AMT applies those lower rates to a broader income base, since it eliminates various special tax breaks that exist in the regular tax system. Since the AMT applies lower marginal rates to a broader tax base, it is a more efficient way of raising revenue than the regular tax system.

This analysis is incorrect for several reasons.[10] First, the AMT actually imposes four marginal tax rates, not two. The phase-out of the AMT exemption creates higher phantom tax rates of 32.5 and 35 percent, the latter equal to the top rate under the regular income tax.[11] And in fact, significantly more taxpayers face higher effective marginal tax rates under the AMT than they would under the regular income tax. In 2006, 71 percent of AMT taxpayers faced a higher marginal rate under the AMT; that figure will rise to 89 percent by 2010 as the AMT ensnares more and more middle-income filers who would have faced statutory rates of 15 or 25 percent under the regular income tax (Leiserson and Rohaly 2006).

Second, as described above, some of the base broadeners in the AMT have questionable validity as policy. In addition, the relatively high AMT exemption actually means that the AMT tax base is often smaller than the regular income tax base because the AMT exemption is larger than the total of all preference items for most taxpayers. In 2006, 63 percent of AMT taxpayers had more income subject to tax under the regular tax than they did under the AMT. That number will rise to 87 percent by 2010 (Leiserson and Rohaly 2006).

Thus the conventional wisdom that the AMT applies a lower marginal tax rate to a broader income base and is therefore more efficient than the regular tax system is incorrect. In fact, exactly the opposite is true. Most AMT taxpayers face a higher marginal rate applied to a more narrow tax base than they would if they were in the regular tax system.

Other people assert that the complexity of calculating taxes under both the regular tax and the AMT does not pose a real problem. Relatively few taxpayers actually prepare their own tax returns, they argue, and instead rely on tax preparation

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[9] Real income growth also causes more taxpayers to become subject to the AMT over time because *effective* AMT tax rates are much higher than regular income tax rates for most taxpayers. (See Burman, Gale, and Rohaly 2005 for a discussion.) Thus, in most cases, the more income that is subject to AMT, the more likely it is that tentative AMT will exceed regular income tax. This is especially a problem for taxpayers in the phase-out range for the AMT exemption who are effectively taxed at rates 25 percent higher than the statutory AMT rate. The 26 percent rate becomes 32.5 percent; the 28 percent rate becomes 35 percent. This explains why almost all taxpayers with incomes between $200,000 and $500,000 are affected by the AMT (table 1). Real income growth is a minor factor in projected AMT growth compared to the lack of indexation and the impact of the tax cuts, however. Only 777,000 taxpayers would be subject to the AMT in 2011 if the AMT were indexed back to 1987 levels, according to the Joint Committee on Taxation. If the tax cuts are extended, about five times as many people would be affected, even with indexation.

[10] For more detailed discussion, see Burman and Weiner (2005).

[11] Although the AMT generally preserves the lower statutory tax rates on capital gains and qualified dividends that exist under the regular tax system, the effect is diminished by the phase-out of the AMT exemption. Rather than the advertised 15 percent rate, taxpayers with incomes in the phase-out range can face effective marginal tax rates as high as 22 percent on gains and dividends. See Leiserson (forthcoming) for details.

software, which calculates the AMT automatically, or paid tax preparers. It is true that the AMT is less complex for filers who use tax preparation software or a paid preparer, but at the cost of the income tax system's transparency. The fact that the tax system is a black box for so many people is something to regret, not champion.

In order to make informed decisions about work, saving, retirement, education, and other important matters, people should understand how the tax system affects those choices, but the AMT leads to endless confusion. Taxpayers will have a hard time predicting their marginal tax rate if they do not know whether they will be on the AMT. What's more, many people may be confused about what constitutes an AMT preference item. For example, *Consumer Reports* magazine reported in the February 2007 issue that the AMT is "snagging middle-income taxpayers with big families, people who pay lots of state tax, and those with high mortgage interest." Mortgage interest, of course, is not an AMT preference item (except on home equity lines and second mortgages used to pay for nonhousing expenses). And needless complexity contributes to public perceptions that the income tax system is unfair.

In any case, computer software has its limitations. For example, individuals who were on the AMT in the previous year must figure out the state tax deduction that would have been allowed on their prior-year tax return before they were subject to the AMT. This is necessary in order to figure out how much of their state tax refund in the current year is taxable. This calculation is so complex that my tax software doesn't do it. It recommends that I go back to my prior-year return, and keep refiguring my state tax deduction over and over until the AMT gets down to zero. This is complex even with software. Without it, the computation would be mind-numbing.

A second example involves the choice between itemizing and taking the standard deduction. Under the regular income tax, taxpayers claim the standard deduction as long as it exceeds the amount of itemized deductions. But taxpayers on the AMT should itemize even if their standard deduction is greater, as long as their itemized deductions exceed the portion of the standard deduction that makes their regular tax less than the AMT. Even though the AMT disallows the standard deduction, some taxpayers who do not owe much AMT (i.e., whose tentative AMT is not that much more than their tax under the regular system) get a partial benefit from the standard deduction. That is, they would not be on the AMT if they did not take the standard deduction. Does that sound complicated? It is. The last time I checked, my tax software did not deal with that issue either. Taxpayers should not have to figure this out for themselves.

Is there anything positive to say about the AMT? Over the long run, the AMT in its current form will become a more effective revenue generator than the regular income tax. The AMT will raise federal revenues by more than $800 billion over the next ten years under current law and by $1.5 trillion if the 2001–2006 tax cuts are extended. Indeed, our estimates show that in 2007, it would cost less to eliminate the regular income tax than to eliminate the AMT. Over a longer time horizon, the Congressional Budget Office (2003) estimates that, primarily because of the AMT, federal taxes will claim 25 percent of GDP by 2050, compared with just 17 percent today. That huge influx of revenue could help fund growing entitlement programs such as Social Security and Medicare as the baby boom generation retires.

But the AMT's power as a revenue generator stems entirely from the fact that its parameters are not indexed for inflation. In consequence, people whose incomes only just keep pace with inflation will face higher and higher average tax rates over time (a phenomenon sometimes referred to as bracket creep). And more and more people will find themselves in this situation as they become subject to the AMT over time. That is clearly not a sustainable path.

Given this and all the other design flaws inherent in the AMT—marriage and family penalties, higher marginal tax rates that are likely to discourage working and saving and encourage inefficient tax avoidance behavior, and needless complexity—reforming or repealing the AMT in conjunction with reforming the regular income tax is far preferable to making the AMT the basis of our tax system.

Financing AMT Reform or Repeal

Reforming or repealing the AMT is costly and financing that cost is important. Outright repeal of the AMT, without any other offsetting changes, would reduce tax revenues by more than $800 billion through fiscal year 2017, *assuming that the 2001–2006 tax cuts expire after 2010*. If the tax cuts are extended, the 1one-year revenue loss nearly doubles to almost $1.6 trillion.

Some have argued that since everyone is aware that this AMT revenue should never have been collected in the first place, it is not necessary to offset the cost of repeal. The real baseline, they assert, should assume no AMT. That is a misleading argument. In fact, the AMT masked the true cost of the 2001 tax act. Congressional leaders understood that the AMT would "take back" a significant portion of the tax cuts and therefore keep their estimated cost down to the tax bill's advertised $1.35 trillion. By 2010, the AMT will reclaim almost 28 percent of the individual income tax cuts, including more than 70 percent of the cut that would have gone to taxpayers making between $200,000 and $500,000 (Leiserson and Rohaly 2006).

Repeal of the AMT would be not only prohibitively expensive but also extremely regressive. Nearly 96 percent of the tax cut in 2007 would go to the top fifth of income earners and 80 percent would go to the top tenth. More than half would go to taxpayers with incomes greater than $200,000.[12] After-tax incomes of taxpayers with incomes between $200,000 and $500,000 would rise by 2.7 percent, or an average of nearly 6,000. In contrast, taxpayers in the middle quintile of the income distribution would receive less than 1 percent of the benefits and would see their after-tax income rise by an average of only $5.

Reforming the AMT to Spare the Middle Class

Rather than outright repeal, the AMT could be reformed in order to shield middle- and upper-middle-income taxpayers from its effects.[13] The simplest reform would be to extend the exemption increase in place for 2006 and index the AMT for inflation. This would prevent inflation from increasing tentative AMT (in real terms) and conform the AMT treatment with that under the regular income tax.[14] If indexation were applied to rate brackets and the phase-out as well as the exemption, only 3.6 million taxpayers would be subject to the AMT in 2007, down from 23.4 million under current law (table 2). The number of AMT taxpayers with incomes less than $100,000 would fall by more than 98 percent. By 2010, real income growth would increase the number of AMT taxpayers to 4.6 million, still significantly lower than the projected 32.4 million under current law.

A more comprehensive reform would also allow dependent exemptions, state and local tax deductions, the deductions for miscellaneous expenses and medical expenses, and the standard deduction for AMT purposes. This would reduce the number of AMT taxpayers to fewer than 500,000 in 2007 and would spare virtually all taxpayers with incomes below $200,000 from the AMT.

These reforms would, however, substantially reduce federal tax revenues. We estimate that indexing the AMT for inflation from 2006 levels would reduce revenues by about $0.5 trillion over the ten-year period from 2007–2016 assuming the 2001–2006 tax cuts expire as scheduled. If the tax cuts are extended, the cost rises to $0.9 trillion. The comprehensive reform package would reduce revenues by $0.7 trillion if the tax cuts expire and $1.2 trillion if they are extended.

Table 2. Effect of AMT Reform Options on Number of AMT Taxpayers (millions) by Cash Income Class, 2007[1]

Reform Option	Cash Income Class ($ thousands) All	0-100	100-200	200-1,000	More than 1,000
Extend and index 2006 law	3.6	0.1	0.7	2.6	0.1
With financing					
Increase top three regular tax rates by 12%[3]	2.4	0.1	0.7	1.5	0.1
Increase AMT rates by 20%	9.3	0.4	4.6	4.5	0.3
Disallow preferential rates on capital gains and qualifying dividends in the AMT, increase top three regular tax rates by 2%	4.3	0.2	1.3	2.8	0.2
Broad reform: extend and index 2006 law; allow dependent exemptions; allow standard and itemized deductions[4]	0.4	0.0	0.1	0.3	0.1
With financing					
Increase top three regular tax rates by 14%	0.3	0.0	0.1	0.2	0.0
Increase AMT rates by 38%	6.2	0.1	1.6	4.2	0.4
Disallow preferential rates on capital gains and qualifying dividends in the AMT, increase top three regular tax rates by 7%	1.2	0.0	0.3	0.8	0.1
Addendum: Current law baseline	23.4	7.0	11.8	4.4	0.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).
(1) Calendar years. Baseline is current law. Plans take effect 1/1/07. Excludes dependent returns.
(2) AMT taxpayers are defined as those with an AMT liability from form 6251, with lost credits, or with reduced deductions.
(3) Unless otherwise noted, increases in tax rates are applied to rates before and after the sunset of the 2001-2006 tax cuts separately.
(4) Includes state and local tax, miscellaneous, and medical deductions.

[12] The JCT estimates that slightly less than half of the AMT is paid by taxpayers with adjusted gross income (AGI) over $200,000 in 2007. The smaller share arises because AGI is often lower than the cash income measure used by the Tax Policy Center. Cash income, which is similar to the income measure used by the Department of the Treasury in its distributional analysis, includes items such as contributions to IRAs and 401(k) plans and tax-exempt bond interest that are excluded from AGI.

[13] For more information on these options, and others, see Burman et al. (2007).

[14] The AMT exemption was increased between 2005 and 2006 as an ad hoc inflation adjustment, but it has never been formally indexed for inflation. The allowance of personal non-refundable credits against both the regular tax and the AMT would also be extended under all reform options considered here.

Both options would also be regressive. Indexing the AMT for inflation would provide a tax cut of 1.4 percent of after-tax income to those in the top quintile in 2010 (table 3). It would provide an increase of less than one-tenth of one percent to those in the middle fifth of the income distribution. The broad reform package would increase the after-tax incomes of those in the top quintile by 1.9 percent in 2010 while those in the top ten percent would see an increase of 2.1 percent. Again, those in the middle of the income spectrum would receive virtually nothing.

Offsetting the Revenue Cost of the Middle-Class Reforms

The revenue cost of the reforms outlined above could be offset in a variety of ways. All the offset options described below are intended to be roughly revenue neutral over the 2007–2016 budget window, and assume that the 2001–2006 tax cuts expire as scheduled.[15] If the tax cuts are extended, each of the options would generally lose substantial amounts of revenue over the budget window, and many more people would be subject to the AMT after 2010.

Although there are myriad ways in which the revenue cost of the reforms could be financed, I will discuss three illustrative options: (a) increasing the top three income tax rates under the regular tax; (b) increasing the AMT rates; or (c) combining (a) with disallowing the preferential rates on capital gains and dividends under the AMT.

Financing the reforms by increasing AMT rates rather than by raising regular income tax rates leaves more individuals subject to the AMT, particularly those with incomes over $200,000. Since both of the reforms mentioned above involve substantial increases in the AMT exemption, they tend to shield those with incomes under $100,000 from the AMT. In addition, raising regular income tax rates and thus regular income tax liability reduces the number of people for whom tentative AMT is greater than regular tax and thus further reduces the number of AMT taxpayers. In contrast, raising AMT rates tends to increase the number of people for whom tentative AMT is greater than regular tax.

Eliminating the preferential rates for capital gains and dividends under the AMT allows smaller increases in either regular or AMT tax rates. These options also tend to retarget the AMT toward those with very high incomes—since those taxpayers tend to have a higher share of their income in the form of capital gains—which is more consistent with the AMT's original intent. Moreover, since many tax shelters exploit the lower tax rate on capital gains, eliminating preferential gains rates would likely do more to stem tax sheltering than any of the existing AMT preferences.[16]

Extending the exemption and indexing the AMT for inflation would require a 12 percent increase in the top three regular income tax rates. (We raise only the top rates because it is primarily taxpayers in the upper brackets who are affected by the AMT.) Under this option, the top rate would increase from 35 to 39.1 percent through 2010 and from 39.6 to 44.3 percent for 2011 and thereafter. The number of AMT taxpayers would fall to 2.4 million in 2007; only 100,000 of them would have incomes below $100,000. The change in tax burdens by income quintiles would be small, never more than one percent of income. The highest-income taxpayers, however, would pay more tax. By 2011, the top one percent pays additional tax equal to about three percent of income.

[15] Tax Policy Center estimates are *not* revenue estimates because they do not account for the behavioral responses that would be considered by the JCT. JCT estimates, however, are not available for these options.

[16] See Burman (1997) for a discussion of the connection between capital gains tax preferences and tax shelters.

Table 5. Distributional Impact of AMT Reform Options, 2007 and 2010[1]

Reform Option	2007 Middle Quintile	2007 Fourth Quintile	2007 Top Quintile	2007 Top 1%	2010 Middle Quintile	2010 Fourth Quintile	2010 Top Quintile	2010 Top 1%
	Percent Change in After-Tax Income[3]							
Extend and index 2006 law	0.0	0.2	1.0	0.1	0.0	0.4	1.4	0.1
With financing:								
Increase top three regular tax rates by 12%[4]	0.0	0.2	0.1	-2.1	0.0	0.4	0.6	-1.9
Increase AMT rates by 20%	0.0	0.2	-0.4	-2.2	0.0	0.4	-0.4	-2.6
Disallow pref. rates on capital gains and qualifying dividends, increase top three regular tax rates by 2%	0.0	0.2	-0.5	-4.0	0.0	0.4	0.1	-3.6
Broad reform: extend and index 2006 law; allow dependent exemptions; allow standard and itemized deductions[5]	0.0	0.2	1.3	0.7	0.0	0.4	1.9	1.0
With financing:								
Increase top three regular tax rates by 14%	0.0	0.2	0.2	-2.1	0.0	0.4	0.8	-1.8
Increase AMT rates by 38%	0.0	0.2	-0.7	-3.4	0.0	0.4	-0.5	-3.8
Disallow preferential rates on capital gains and qualifying dividends, increase top three regular tax rates by 7%	0.0	0.2	-0.3	-4.0	0.0	0.4	0.4	-3.3
Repeal the AMT	0.0	0.2	1.5	1.1	0.0	0.4	2.1	1.4
With financing:								
Repeal, increase top three regular tax rates by 23%	0.0	0.2	0.2	-2.1	0.0	0.4	0.8	-1.7
Repeal, repeal state and local tax deduction, reduce regular tax rates by 2%	0.0	-0.1	0.2	-0.2	0.0	0.2	0.9	-0.2
Repeal, roll back rates on capital gains and qualifying dividends, roll back top three regular tax rates and increase by 8 percent above pre-EGTRRA levels	0.0	0.1	-1.0	-5.2	0.0	0.3	-0.4	-4.6

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0306-1).
(1) Calendar years. Baseline is current law. Plans take effect 1/1/07. Includes both filing and non-filing units but excludes those that are dependents of other tax units.
(2) AMT taxpayers are defined as those with an AMT liability from Form 6251, with lost credits, or with reduced deductions.
(3) After-tax income is cash income less individual income tax net of refundable credits, corporate income tax, payroll taxes, and estate tax. For a description of cash income see http://www.taxpolicycenter.org/TaxModel/income.cfm.
(4) Unless otherwise noted, increases in tax rates are applied to rates before and after the sunset of the 2001-2006 tax cuts separately.
(5) Includes state and local tax, miscellaneous, and medical deductions.

If AMT rates were raised instead, to 31.1 and 33.5 percent, 9.7 million taxpayers would be affected by the AMT in 2007; the number of AMT taxpayers with incomes of $200,000 and over would actually rise relative to current law. AMT liabilities would also increase for higher-income households and so they would pay higher taxes on average. Households in the top ten percent would experience a tax increase of about 1 percent of income through 2010, and those in the top one percent would pay additional taxes equal to more than 2 percent of income. After 2010, the tax increases are much smaller because the higher AMT exemption in combination with the pre-EGTRRA regular income tax rates results in fewer upper-income households owing AMT.

If the preferential rates on capital gains and dividends were disallowed for AMT purposes, the required increase in the top three regular income tax rates would be only 2 percent. The top rate, for example, would need to rise from 35 to 35.8 percent through 2010 and from 39.6 percent to 40.4 percent thereafter. This option would reduce the number of AMT taxpayers by about 80 percent in 2007, to 4.5 million. The AMT would be much more targeted at those with high incomes; taxpayers with incomes greater than $1 million would actually be more likely to owe AMT under this option than under current law. This option has very small effects on average tax burdens by quintiles—in all cases, tax changes are less than 1 percent of income. The tax change is much more significant for those at the very top, however. The top one percent would see an average tax increase of about 4 percent of after-tax income in 2007, although the size of that tax increase would decline over time.

Since broad reform of the AMT costs substantially more, financing it would require larger increases in either regular or AMT rates. The required increase in the top three regular rates would be 14 percent, resulting in a top rate of 39.9 percent through 2010 and 45.2 percent thereafter. This option reduces the number of AMT taxpayers to only 300,000 in 2007, including only 100,000 with incomes less than $200,000. Since this option reduces tax revenues in the first five years and increases it thereafter, the largest tax increases occur after 2010. The average tax increase is about 3 percent of income for those in the top one percent after 2010.

Financing the broad reform package would require a 38 percent increase in AMT rates, to 36 and 38.7 percent. As a result, 6.2 million taxpayers would face the AMT in 2007. Although only 100,000 taxpayers with incomes under $100,000 would be on the AMT, there is little reduction compared to current law for those making between $200,000 and $1 million. And virtually all taxpayers with incomes greater than $1 million would be on the AMT.

Finally, broad reform could be financed by disallowing the preferential rates on capital gains and dividends under the AMT combined with an increase in the top three regular income tax rates. The required rate increase would be 7 percent resulting in a top rate of 37.4 percent through 2010 and 42.3 percent thereafter. This option would reduce the number of AMT taxpayers by about 95 percent in 2007, to just 1.2 million, with only 300,000 of them having incomes less than $200,000. This option would have very small effects on the distribution of tax burdens by quintile. But disallowing the lower capital gains rates under the AMT, combined with the regular tax rate increases, results in significant tax increases for those at the very top of the income scale—over 3 percent of income for those in the top one percent before 2010.

Offsetting the Revenue Cost of Repeal

Full repeal of the AMT could also be financed in a variety of ways. Obvious candidates include: (a) increasing regular income tax rates; (b) repealing the state and local tax deduction; and (c) repealing the reduced tax rates for capital gains and dividends.

The required increase in the top three rates required to offset the revenue loss from repeal would be 15 percent, resulting in top rates of 32.3, 38.1, and 40.4 percent through 2010 (from 28, 33, and 35 percent) and 35.8, 41.5, and 45.7 percent in 2011 and thereafter (from 31, 36, and 39.6 percent).[17] This option cuts taxes in the first five years and increases them in the second five-years, after the 2001–2006 tax cuts expire. Most of the net tax increases are experienced by taxpayers in the top five percent of the income distribution. The top one percent face the largest tax increases, averaging over 3 percent of income after 2010. This occurs because very high income earners are most affected by the rate increases and do not tend to benefit as much from repeal of the AMT since they tend not to be on the AMT in the first place.

Another option to finance AMT repeal would be to broaden the tax base significantly by repealing the deduction for state and local taxes, as recommended by President Bush's tax reform advisory panel. The deduction is not allowed for AMT purposes. And since most taxpayers in the bottom 60 percent of the income distribution take the standard deduction, the primary beneficiaries of the deduction are those at the very top of the income scale who escape the AMT. More than 70 percent of those in the top 1 percent of the income distribution will benefit from the deduction in 2007, with an average tax savings of almost $12,000 or 1.3 percent of income. Repealing the state and local tax deduction raises more than enough revenue to pay for repeal of the AMT, although it would not if the 2001–2006 tax cuts are extended. This allows for income tax rates to be *reduced* across-the-board by 2 percent.[18]

The option has very small effects on overall tax burdens by income group—amounting to less than 1 percent of income in any year. Middle-income taxpayers receive a very small benefit from the tax rate reduction and are not much affected by the elimination of the deduction since few taxpayers itemize in that income range. Itemizers in the fourth quintile lose more than they gain in 2007, because most itemize, but many have not become affected by the AMT in that year. By 2010, that group overall experiences a modest tax cut. Within the top quintile, elimination of the AMT is more significant than the loss of the state and local tax deduction until 2010. After that, this income group loses more than they gain, but the net losses are never large, even within the top 1 percent. Overall, this option makes the tax system modestly more progressive.[19]

Finally, AMT reform could be financed by rolling back the 2003 reductions in the tax rates on capital gains and qualified dividends combined with an 8 percent increase in the top three income tax rates above their pre-2001 levels, resulting in a top rate of 42.8 percent. This option would cut taxes by a modest amount for middle- and upper-middle-income taxpayers. It would increase taxes significantly for high-income taxpayers, especially before 2011 when current law allows for substantial reductions in the rates on capital gains and dividends. Taxpayers in the top one percent of the income distribution would, on average, pay additional taxes equal to more than 5 percent of after-tax income in 2007. These households lose out for three reasons—they are most affected by the income tax rate increases, they have a large amount of capital gains and dividends, and many taxpayers in this group do not owe AMT (and thus receive no benefit from repeal).

This option would increase revenues by about $100 billion in the first five years of the budget period and reduce revenues by the same amount in the second five. Beyond the budget period, it would lose increasing amounts of revenue.

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[17] It would also be possible to raise rates in 2007 and keep them at that level permanently, rather than increasing them again in 2011 when the tax cuts expire. In that case, the revenue-neutral rates would be 34.8, 41, and 43.5 percent. This option is roughly revenue neutral over both the first and second five-year periods of the budget window.

[18] Alternatively, the bottom rates could remain the same and the top three rates could be reduced by 5 percent, resulting in a top statutory rate of 33.1 percent through 2010 and 37.5 percent thereafter. By 2011, this option is effectively distributionally neutral.

[19] A number of other issues arise in considering whether to finance AMT repeal by eliminating the state and local tax deduction. See Rueben (2006) for a general discussion, or Burman and Gale (2005) in the context of the tax reform panel's proposal.

Conclusions

Lack of inflation indexing in the alternative minimum tax expands the reach of the tax each year. The 2001–2006 tax cuts have further exacerbated the problem by reducing regular income tax liabilities without corresponding permanent changes to the AMT. Caught amid these trends, one in three American taxpayers will soon face a tax that almost none of them were ever meant to pay. Although the goals of the AMT—ensuring high-income taxpayers pay at least some amount of tax each year, and reducing inefficient tax sheltering—may command public support, the AMT is a highly imperfect way of achieving those goals. In particular, under current law, the AMT will come to plague the middle- and upper-middle-income classes with undue complexity, a narrower tax base, and higher marginal tax rates than under the regular income tax.

As the AMT expands, the political benefits of achieving a solution increase as well. A number of sensible reform options are available. A significant barrier to AMT reform is the challenge of what to do about the lost revenues. Official budget estimates assume that the AMT will provide tax revenues of nearly one trillion dollars over the next ten years. Even modest reforms, such as extending the AMT "patch" and indexing the AMT for inflation, would reduce tax revenues over that period by more than half a trillion dollars. Given our fiscal situation, making up that lost revenue would seem to be a necessary pre-condition for reform.

I have illustrated a number of options for reforming or repealing the AMT without increasing the deficit over the ten-year budget period. The options show that it would be feasible to repeal or sharply scale back the AMT in a fiscally responsible manner with relatively minor dislocations. All of them produce winners and losers—it would be impossible to design a sensible revenue-neutral alternative to the AMT that didn't—but many would cut taxes modestly on the middle class and have relatively small effects on those with higher incomes.

There are untold numbers of other fiscally responsible options available, and some of them might be preferable to the ones displayed here. For example, Ways and Means Committee Chairman Rangel has proposed to improve tax compliance and collections as a way to raise revenue. To the extent that more of the tax that is due to the IRS could be collected, the revenue needs to finance AMT reform would be reduced. As a result, the options here could be implemented with smaller income tax rate increases or without the use of other offsets such as elimination of the deduction for state and local taxes.

The ideal solution would be to address the AMT in the context of a complete overhaul of the income tax, such as the proposal made by the President's Advisory Panel on Federal Income Tax Reform. Although the AMT is probably the best example of pointless complexity in the tax system, it is far from the only one. Addressing all of the sources of complexity, unfairness, and inefficiency in the tax system at the same time would strengthen the income tax—the major source of federal tax revenues—at a time when unprecedented demands are about to be placed on the federal government because of the impending retirement of the baby boomers.

That said, the perfect should not be the enemy of the good. Many of the incremental options I have outlined would significantly improve our tax system. I applaud the subcommittee for taking the first steps toward advancing this goal.

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Chairman NEAL. Thank you very much, Dr. Burman. Dr. Viard.

STATEMENT OF ALAN VIARD, PH.D., RESIDENT SCHOLAR, AMERICAN ENTERPRISE INSTITUTE

Mr. VIARD. Chairman Neal, Ranking Member English, distinguished Members of the Subcommittee, it is an honor to be invited to discuss the AMT today.

I would like to make four main points. First, the fundamental reason for the spread of the AMT is that the exemption amount is not indexed for inflation. The AMT spread rapidly before the 2001 and 2003 tax laws were adopted. It would have continued spreading without them, and it will spread further after 2010, even if those laws sunset.

Second, recent tax legislation slowed the spread of the AMT in 2001 through 2006, although it will accelerate that spread in 2007 through 2010.

Third, the taxpayers who move on to the AMT due to the 2001 and 2003 tax laws still enjoy a net tax cut from those laws.

Fourth, the spread of the AMT not only adds to complexity, but it also moves more taxpayers on to an ill-designed tax system. As the other witnesses have already stressed, the AMT exemption amount has never been indexed for inflation. As a result, inflation has always been a force that has pushed people onto the AMT.

From 1987 to 2000, the AMT rolls doubled every three or four years. The number of people on the AMT surged from a mere 140,000 to 1.6 million during that 13-year period.

During 2001 to 2006, inflation caused the AMT rolls to increase further. During that period, the AMT rolls grew from 1.6 million in 2000 to 3.5 million in 2006. It is sometimes suggested that the 2001 and 2003 tax cuts, and the other legislation adopted during those years, was responsible for this spread, but the opposite is true, for this time period.

If pre-2001 law had remained in place, the AMT rolls would have surged to 8.1 million in 2006. They would have grown by a factor of five, rather than a factor of about two. The tax legislation adopted in 2001 to 2006 slowed the spread of the AMT. The AMT relief that was offered in those laws—part of it in EGTRRA and JGTRRA themselves; part of it in three other laws—that AMT relief was more than enough to offset the regular tax relief that was offered.

Therefore, that legislation reduced the spread of the AMT during that time period.

Things are different in the 2007 to 2010 period. During these years, the 2001 and 2003 tax laws, and the other recent tax legislation, are expanding AMT rolls, because those laws offer regular tax relief without corresponding AMT relief. Nevertheless, inflation continues to be a significant factor behind the spread of the AMT. This year, more than 10 million taxpayers would be on the AMT, even if the 2001 and 2003 laws had not been adopted.

Let me also note that those taxpayers who move on to the AMT because of the 2001 and 2003 tax laws do not experience a net tax increase from those laws. The AMT does take back part of the tax cut that those laws would otherwise have offered, but it still leaves them with some net tax reduction.

If the tax laws do sunset after—in 2010, the AMT will continue to spread rapidly, growing to a staggering 39 million people on the AMT in 2017. Of course, the spread of the AMT would be even more rapid if EGTRRA and JGTRRA were extended without any long-term AMT relief or solution. It is important that an extension of those laws include AMT relief if no fundamental AMT reform has yet been adopted at the time of extension.

Let me say a few words about the consequences of the spread of the AMT. As other witnesses have mentioned, this is a source of complexity for millions of ordinary taxpayers, some who merely have large families, live in high-tax States, or are in a particular income range.

A bigger defect is that the spread of the AMT also puts a larger number of taxpayers on to an ill-designed tax system. I want to echo the criticisms that Len has just made of the AMT as an alternative tax system.

The notion that it is a low-rate, flat-rate, broad-based income tax that might be better than a regular income tax is fundamentally mistaken. The base broadening provisions are limited, they are highly selective, and many of them are misdirected.

Furthermore, effective marginal tax rates under the AMT are not systematically lower than those under the regular income tax. As Len has already mentioned to you, it is not the case that the AMT just has tax rates of 26 and 28 percent. Tax rates of 32.5 and 35 percent also exist.

In summary, Mr. Chairman, the fundamental reason for the spread of the AMT is the failure to index for inflation. Recent tax legislation slowed the AMT spread in 2001 through 2006, although it will accelerate it in 2007 through 2010. The AMT needs to be corrected, not only because of the complexity that it causes, but because it is exposing more taxpayers to an ill-designed tax system. Thank you, Mr. Chairman.

[The prepared statement of Mr. Viard follows:]

Statement of Alan Viard, Ph.D, Resident Scholar, American Enterprise Institute

Chairman Neal, Ranking Member English, Members of the Committee; it is an honor to appear before you today to discuss the alternative minimum tax (AMT). I would like to make four main points:

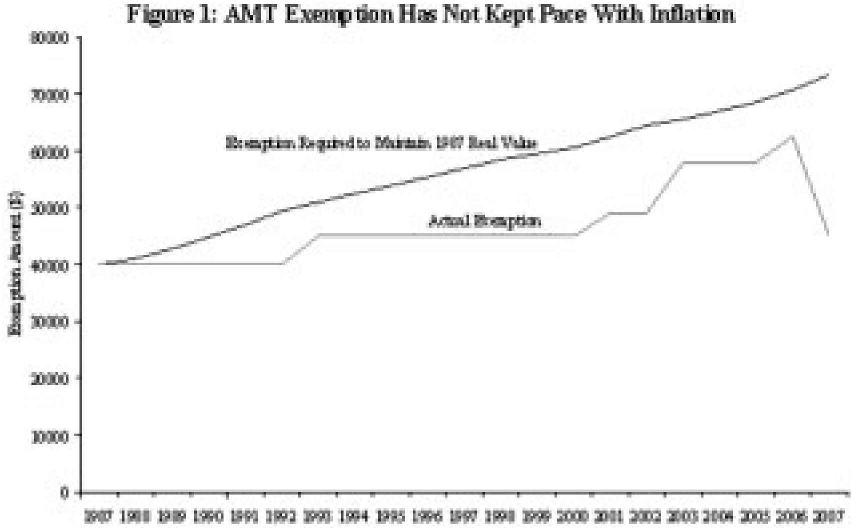
- The fundamental reason for the spread of the AMT is that the exemption amount has never been indexed to inflation. As a result, the AMT spread rap-

idly before the 2001 and 2003 tax laws were adopted, it would have continued spreading without those laws, and it is projected to spread further after 2010 even if those laws sunset.
- The 2001 and 2003 tax laws, in combination with other tax legislation adopted in 2001 through 2006, slowed the AMT spread in those years, but will accelerate the spread in 2007 through 2010.
- Taxpayers who move onto the AMT in 2007 through 2010 due to the 2001 and 2003 tax laws still enjoy a net tax cut from those laws.
- The spread of the AMT exposes more taxpayers to an ill-designed tax system.

AMT Exemption Amount Has Never Been Indexed for Inflation

The basic design of the AMT has remained largely unchanged since 1987, when the provisions of the Tax Reform Act of 1986 (enacted October 22, 1986) took effect. At that time, the exemption amount was $40,000 ($30,000 for unmarried taxpayers). No automatic inflation adjustment was provided for the AMT exemption, even though the regular tax brackets and exemption amounts were and are adjusted for inflation.

Figure 1: AMT Exemption Has Not Kept Pace With Inflation



Since that time, there has been only one permanent increase in the exemption amount. The Omnibus Budget Reconciliation Act of 1993 (OBRA93) (enacted August 10, 1993) increased the exemption amount to $45,000 ($33,750 for unmarried taxpayers), effective in 1993. As can be seen in **Figure 1**, the increase fell far short of the amount needed to offset the cumulative effects of inflation since 1987.

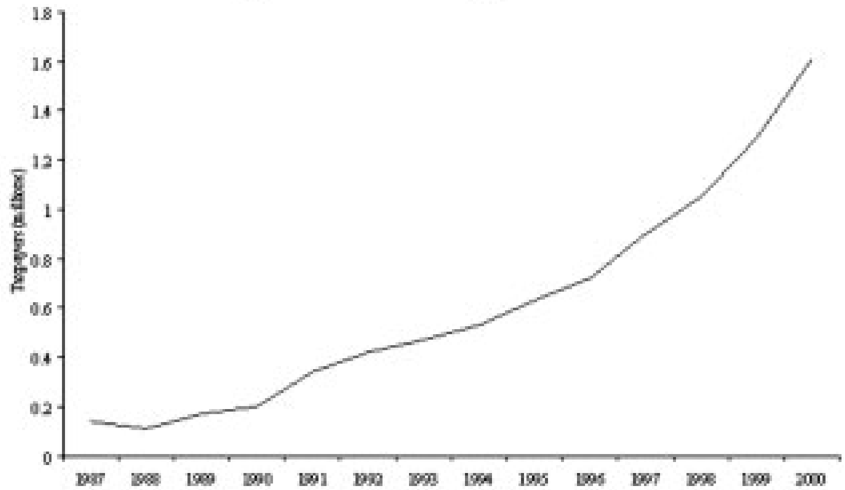
Moreover, OBRA93 also failed to provide for inflation indexation. By 2000, therefore, the exemption amount had fallen further behind what was needed to keep up with inflation.

Inflation Caused AMT to Spread Before 2001

When the regular tax system is indexed for inflation and the AMT is not, the effects of inflation are straightforward. Tax liability computed under AMT rules rises more rapidly than tax liability computed under regular tax rules. A larger number of people therefore find that their AMT-computed tax liability is the larger of the two and they then move onto the AMT.

As one would expect, the AMT spread relentlessly during the 13 years after 1987, as shown by the Brookings-Urban Tax Policy Center data displayed in **Figure 2**. The AMT rolls surged from a mere 140,000 in 1987 to 1.6 million in 2000. Throughout this period, the number of AMT taxpayers typically doubled every three or four years.

Figure 2: AMT Rolls Surged Before 2001



Source: Greg Leiserson and Jeffrey Rohaly "The Individual AMT: Historical Data and Updated Projections," Tax Notes, December 11, 2006.

Inflation Caused Further AMT Spread in 2001–2006; Tax Legislation Slowed the Spread

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) (enacted June 7, 2001) provided sweeping reductions in regular income tax rates in 2001 through 2010. The Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) (enacted May 28, 2003) provided further reductions in regular tax liability.

A common criticism asserts that these laws accelerated the spread of the AMT by lowering regular tax rates without providing AMT relief. As taxpayers' regular tax liabilities declined with no change in their AMT liabilities, the story goes, taxpayers moved onto the AMT.

That story does not accurately describe what happened in 2001 through 2006. EGTRRA and JGTRRA actually provided some AMT relief, and other laws signed by President Bush during this period provided additional relief. The net consequence of these laws was to *slow* the spread of the AMT in 2001 through 2006, relative to what would have happened under pre-2001 law.

EGTRRA increased the AMT exemption amount to $49,000 ($35,750 for unmarried taxpayers) for 2001 through 2004.[1] The higher exemption amounts duly took effect for 2001 and 2002. Subsequently, JGTRRA increased the exemption amount still further to $58,000 ($40,250 for unmarried taxpayers) for 2003 and 2004.

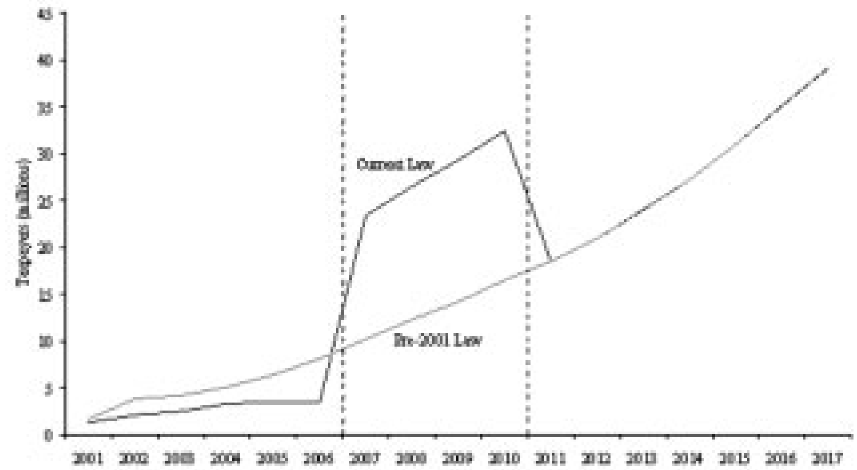
Three other laws also provided AMT relief during this time period:

- The Job Creation and Worker Assistance Act (enacted March 9, 2002) allowed personal nonrefundable credits to be claimed against the AMT in 2002 and 2003 (prior law allowed such credits only through 2001).
- The Working Families Tax Relief Act (enacted October 4, 2004) extended the 58,000 exemption amount for 2005. It also allowed personal nonrefundable credits to be claimed against the AMT in 2004 and 2005.
- The Tax Increase Prevention and Reconciliation Act (enacted May 17, 2006) raised the exemption amount to $62,550 ($42,500 for unmarried taxpayers) for 2006 and also allowed personal nonrefundable credits to be claimed against the AMT in that year.

According to Brookings-Urban Tax Policy Center data, the net effect of the legislation adopted in 2001 through 2006 was to reduce AMT coverage in those years. This reduction can be seen in the first part of **Figure 3**, the portion to the left of the first dashed horizontal line.

[1] EGTRRA also made the child credit and the earned income tax credit allowable under the AMT through 2010.

Figure 3: AMT Spread, 2001-2017



Source: Greg Leiserson and Jeffrey Rohaly, "The Individual AMT: Historical Data and Updated Projections," Tax Notes, December 21, 2006.

If the tax code had simply been left alone after 2000, the AMT rolls would have surged from 1.6 million in 2000 to 8.1 million in 2006. The surge would have occurred for the same reasons as the growth in the previous 13 years; inflation would have increased AMT liabilities relative to regular tax liabilities. The legislation adopted during this period *slowed* the spread of the AMT; the actual AMT rolls were smaller in each year than they would have been under prior law. Due to this legislation, there were 3.5 million taxpayers on the AMT in 2006, rather than 8.1 million.

The AMT relief adopted during this period, some of it provided in EGTRRA and JGTRRA and some added by the other three laws, was sufficiently generous that it had the net effect of moving taxpayers off of the AMT. (Because the legislation increased AMT revenue per AMT taxpayer, AMT revenue was roughly unchanged from the level that would have resulted from prior law.) These laws slowed the AMT spread that would otherwise have resulted from inflation.

Inflation Is Causing a Further Spread in 2007–2010, Reinforced by the Effects of the Tax Cuts

The story in which EGTRRA and JGTRRA move taxpayers onto the AMT does have some validity for 2007 through 2010. This can be seen from the middle part of Figure 3, the portion between the two dashed horizontal lines. With the recent tax legislation in place, the AMT rolls number 23.4 million in 2007, rising to 32.4 million in 2010. The spread would have been slower without the legislation; under pre-2001 law, the AMT rolls would have been 10.2 million in 2007, rising to 16.5 million in 2010.

The numbers also reveal, though, that a rapid inflation-driven spread was already programmed into the AMT, again due to its lack of indexation. Even if EGTRRA and JGTRRA had never been adopted, we would still be confronting an unacceptable spread of the AMT. We would be discussing a tax system that reached over 10 million people today, up from less than 1 million a decade earlier. The problem clearly involves more than the effects of those laws.

Still, it is true that the AMT spread is more rapid with EGTRRA and JGTRRA than it otherwise would have been. These laws provide substantial regular tax relief for 2007 through 2010, without providing accompanying AMT relief.

Taxpayers Who Move onto the AMT Still Have a Net Tax Cut

As discussed above, some taxpayers who would otherwise be on the regular tax are on the AMT in 2007 through 2010 due to EGTRRA and JGTRRA. It is important to understand how these taxpayers' tax liabilities are affected. Some observers claim that EGTRRA and JGTRRA constitute a "tax increase" for these taxpayers. In reality, however, these taxpayers still enjoy net tax cuts from those laws.

Consider an example. Suppose that, without EGTRRA and JGTRRA, a hypothetical taxpayer would have a $100 tax liability under regular tax rules and a $90 tax liability under AMT rules. The taxpayer would then be on the regular income tax and would have a $100 tax liability. Suppose that those laws reduce the taxpayer's liability under regular tax rules to $85 while leaving his or her liability under AMT rules unchanged at $90. Because liability under the AMT rules is now higher than the liability under the regular tax rules, the taxpayer moves onto the AMT and has a $90 tax liability.

Although these laws cause the taxpayer to move onto the AMT, they do not raise his or her tax liability, relative to prior law. On the contrary, the laws reduce the taxpayer's liability from $100 to $90. Moving onto the AMT merely reduces the size of the tax cut, which would have been $15 without the AMT, to $10. In colloquial terms, the AMT "takes back" one-third of this taxpayer's tax cut.

It is correct, therefore, to speak of the AMT taking back part of the tax cuts, but it is not correct to speak of the AMT turning the tax cuts into tax increases. The only taxpayers who do not receive any tax savings from the regular-tax-rate reductions in EGTRRA and JGTRRA are those who would already have been on the AMT, even without these laws.[2]

Inflation Will Cause AMT to Spread Still Further after 2010, Even if the Tax Cuts Sunset

Due to inflation, the AMT is projected to continue spreading after 2010. The AMT rolls during this period are shown in the third part of Figure 3, the portion to the right of the second dashed horizontal line. The rolls grow from 32.4 million in 2010 to 39.1 million in 2017.

As noted above, EGTRRA and JGTRRA expand the AMT rolls to some extent in 2007 through 2010 and their sunset therefore provides a respite from the spread of the AMT. But, the respite is short-lived, as inflation resumes its steady toll. The AMT spreads to absolutely unacceptable levels, even without EGTRRA and JGTRRA. Because those laws are scheduled to sunset, the AMT rolls under current law are essentially identical to those under pre-2001 law after 2010.

Of course, the AMT spread would be even more rapid if EGTRRA and JGTRA were extended without any long-term AMT relief or solution. An extension of these laws would need to include AMT relief, if no fundamental AMT solution had yet been adopted.

The Spread of the AMT Puts More Taxpayers on an Ill-Designed Tax System

Without relief, the AMT will spread to a wide range of taxpayers. Those most likely to be hit by the AMT include the following:

- Taxpayers with large families are more likely to owe AMT, because the AMT disallows the personal exemption ($3,400 per person in 2007) that the regular income tax allows for the taxpayer, spouse, and dependents. Under current law, in 2007, almost 40 percent of taxpayers with three or more children will owe AMT, compared to 11 percent of taxpayers without children.[3]
- Taxpayers who live in high-tax states are more likely to owe AMT, because the AMT disallows the regular tax system's itemized deduction for state and local income (or sales) and property taxes. Under current law, in 2007, 22 percent of taxpayers in high-tax states are on the AMT, compared to 15 percent in low-tax states.
- Taxpayers with incomes in the ranges in which the AMT rate schedule is closest to the regular tax schedule are most likely to be on the AMT. Under current law, in 2007, 90 percent of taxpayers with cash incomes between $200,000 and $500,000 (in 2006 prices) are on the AMT, compared to 34 percent of those with incomes above $1,000,000 and 36 percent of those with incomes of $75,000 to $100,000.

As these taxpayers move onto the AMT, they will experience a significant increase in complexity. It should be recognized, however, that they will also be moving onto an ill-designed tax system.

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[2] Even those taxpayers may enjoy tax savings from other provisions of EGTRRA and JGTRRA. To begin, EGTRRA provides some AMT relief that applies in 2007–2010, as mentioned in footnote 1, above. Also, many of the tax-reduction provisions in EGTRRA and JGTRRA apply under both the AMT and the regular tax, including the rate reductions for dividends and long-term capital gains and the expansion of tax-free savings accounts.

[3] All of the data on 2007 AMT coverage are Urban-Brookings Tax Policy Center data, taken from Greg Leiserson and Jeffrey Rohaly, "The Individual AMT: Historical Data and Updated Projections," *Tax Notes*, December 25, 2006.

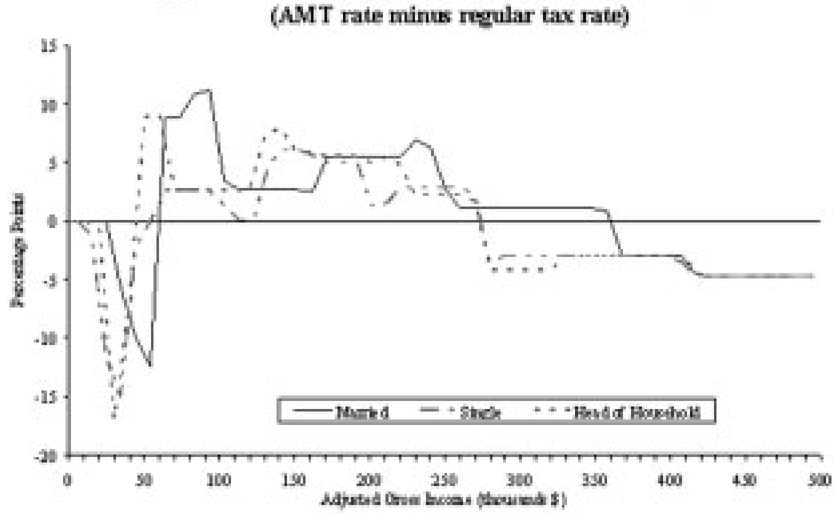
Some have argued that the AMT is a low-rate flat-rate broad-based income tax that would actually be a good replacement for the income tax. As I argued in the November 2006 *AEI Tax Policy Outlook*, that view is unconvincing.[4]

The AMT's base-broadening provisions are limited and highly selective, hampering any gains in economic efficiency. In some cases, the AMT is likely to induce taxpayers to shift from one tax-preferred activity to another tax-preferred activity (that the AMT does not address), with little or no gain in economic efficiency. Also, some of the base-broadening provisions are misdirected, because they deny people the ability to deduct costs of earning income. The AMT also features harsh treatment of some workers who exercise incentive stock options and some winners of taxable damage awards.

The redeeming feature of the AMT is supposed to be its low marginal rates, but that, too, do not stand up under scrutiny. Effective marginal tax rates under the AMT are not systematically lower than those under the regular income tax. A common misconception holds that the AMT has two brackets, 26 percent and 28 percent. In reality, however, the AMT features two other, higher-rate, brackets. The marginal rates are 32.5 and 35 percent in the interval in which the exemption amount is being phased out. Also, the effective tax rate on an additional dollar of wages is enhanced under the AMT because a smaller portion of that dollar is deductible from taxable income, since the AMT allows a narrower range of itemized deductions.

Figure 4 provides illustrative calculations of the difference in effective marginal tax rates between the two systems, for different types of returns and at different income levels, under a specific set of simplifying assumptions. It can be seen that the AMT rate is sometimes higher and sometimes lower than the regular tax rate. Although this calculation is only for a stylized example, it indicates that there is no inherent tendency for the AMT to have lower marginal tax rates.

Figure 4: Difference in Effective Marginal Tax Rate, 2007
(AMT rate minus regular tax rate)



Source: Alan D. Viard, "The Alternative Minimum Tax: A Better System?" *AEI Tax Policy Outlook*, November 2006, http://www.aei.org/publication25110. Assumptions are described in the source.

[4] Alan D. Viard, "The Alternative Minimum Tax: A Better System?" *AEI Tax Policy Outlook*, November 2006, www.aei.org/publication25110.

Summary

The fundamental reason for the spread of the AMT is that the exemption amount has never been indexed to inflation. As a result, the AMT spread rapidly before the 2001 and 2003 tax laws were adopted, it would have continued spreading without those laws, and it is projected to spread further after 2010 even if those laws sunset.

The 2001 and 2003 tax laws, in combination with other tax legislation, slowed the AMT spread in 2001 through 2006, but will accelerate the spread in 2007 through 2010. It should be recognized that taxpayers who move onto the AMT due to the 2001 and 2003 tax laws still enjoy a net tax cut from those laws.

The spread of the AMT not only causes complexity, but also exposes more taxpayers to an ill-designed tax system.

Chairman NEAL. Thank you very much, Doctor. Mr. Solomon, prior Treasury testimony stated that, "Nearly all the AMT taxpayers will lose some part of the benefit of the 2001 through 2004 tax cuts, including some who will lose all of the benefit."

CRS estimates this "take-back" effect of AMT peaks for those earning $100,000 to $150,000, who will lose two-thirds of the promised tax cut. Can you explain why the Administration continues to push for permanent 2001 and 2003 tax cuts without any permanent AMT solution? It seems that this income group will really be paying for everyone else's tax cut.

Mr. SOLOMON. Thank you, Mr. Chairman. In response to your question, there are two parts. First, the 2001 and 2003 tax relief provided benefits for virtually all Americans.

Second, with respect to your question of why the Administration urges that the tax relief be made permanent, the reason for that is because the tax relief has been very important for the economy. It has helped make the economy strong. The economy is strong, and we need to keep it strong.

For purposes of planning, it is important for taxpayers to know that, looking forward, they are going to have stable tax rates. For this reason, the Administration thinks it's important that the tax relief be made permanent.

With respect to the AMT, the Administration has proposed a one-year patch. We recognize that the AMT is a very important problem, and we look forward to working with this Committee and the Congress in finding a long-term solution for the AMT.

Chairman NEAL. Do you remember Bondo?

Mr. SOLOMON. Excuse me?

Chairman NEAL. Do you remember Bondo, how it was used for repairing automobile work?

Mr. SOLOMON. No, I'm sorry, I do not, Mr. Chairman.

Chairman NEAL. Well, I guess the question I would raise with you, would you agree at least with the premise that I offered, that there is a clawback provision that did, for people in the income groups that I described, they did lose a substantial part of the tax cuts of 2001 through 2003?

Mr. SOLOMON. I would phrase it that virtually all Americans have enjoyed the tax cuts.

Chairman NEAL. Okay.

Mr. SOLOMON. There has been some clawback.

Chairman NEAL. Okay.

Mr. SOLOMON, but virtually all Americans have enjoyed the tax relief.

Chairman NEAL. Okay, thank you. Dr. Burman, we have heard some testimony today about inflation, as Dr. Viard said, being the fundamental reason for the spread of AMT. Do you agree? If not, what other reasons would you point to as contributing factors?

Mr. BURMAN. It is certainly true that inflation is a factor in the spread of the AMT. It was never indexed for inflation. When the regular income tax was indexed in 1982, the AMT was left unadjusted.

As I noted in my testimony, the number of people on the AMT would have grown to 16 million by 2010, even without the tax cuts. That is why I think you have been so engaged in the issue for such a long time, and why, frankly, it has agitated me, as well.

The tax cuts doubled the size of the problem. Without the 2001 to 2003 tax cuts, the number of people on the AMT would be about half of what it is in 2007. Now, we have patched it every year. Congress has kept the damage from being too great, but the cost of that patch grows every year. If the tax cuts are allowed to expire at the end of 2010, the number of people on the AMT actually drops by nearly half.

The other thing is that real income growth pushes more people on to the AMT, but that is a relatively small factor. If it had been indexed for inflation and if there had been no tax cuts, the number of people on the AMT would be in the of hundreds of thousands, rather than millions, or tens of millions.

Chairman NEAL. Ms. Olson, during your testimony you criticize the AMT, as you have faithfully done, incidentally, during your previous appearances. You suggested that "it alters the distribution of the tax burden, and it neutralized the effects of changes to tax rates in the regular system." Could you briefly explain that?

Ms. OLSON. Well, one point that I have tried to make is that the AMT has so infected our entire tax system, that not only is there some clawback effect, as others have talked about, but if Congress has made a determination that the standard deduction and the personal exemptions reflect the basic expenses that taxpayers need to have before they're taxed, and yet the AMT is adding that back in, and people are being brought into the system solely because of dependency exemptions—as 19 percent of the income is attributable to that now—that's a serious problem.

I would make the point that whether you look at tax rates, or you just look at policy calls, if you were to decide to increase the standard deduction, or increase the personal exemptions, because you think it's not keeping up with cost of living allowances, you would be bringing more people into the AMT. When you have that kind of situation, it has affected our entire tax system.

Chairman NEAL. Thank you. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. This is very stimulating testimony. I note that the claim is being made that the 2001 and 2003 tax cuts, in effect, forced many Americans to pay the AMT. I am wondering if the panelists could give us a sense of how many taxpayers are paying more tax, both regular and AMT, as a result of the Bush tax relief, than they would if these measures had not been enacted. Mr. Solomon, could you give us some insight on that?

Mr. SOLOMON. Certainly, Congressman. In fact, there are no taxpayers who are paying more tax.

Mr. ENGLISH. None at all?

Mr. SOLOMON. No taxpayers paying more tax. Now, there may be perhaps an aberration in some situation, but as a result of the tax relief—and, the tax relief is, in fact, that, tax relief—it does not result in more taxpayers paying tax.

There may be more taxpayers who are on the AMT, but that's not the total consideration. The total consideration is the total tax liability measured under both the regular tax and the AMT. Taking both of those into account, and not just focusing on AMT, the tax relief was just that—tax relief.

Mr. ENGLISH. Isn't it also true that if the Bush tax cuts were allowed to expire, the number of people paying the AMT will, after a drop around 2011, continue to rise quickly and then soon surpass current levels?

Mr. SOLOMON. That's correct. It goes to the basic structure of the AMT. The real issue is the AMT itself, the structure of the AMT itself, the fact that it has amounts that are not indexed for inflation, the fact that it denies various deductions, the fact that it denies the personal exemption. The real issue lies in the structure of the AMT itself.

So, even if the tax relief was to expire, nevertheless, the basic circumstances that caused the expansion of the AMT would continue to exist, and the number of AMT taxpayers would continue to increase.

Mr. ENGLISH. Ms. Olson, I am struck by one element of your testimony, and that is the argument, "We recognize that the AMT was put in place as a solution to what were perceived as abusive tax shelters, but since the AMT was conceived, there has been a significant change in the character of the tax code."

Are you making the argument that the rationale for the AMT, those features of the tax code that could be so dramatically gained, have been rolled back or, if not, eliminated by past legislative action? In fact, if we repealed the AMT, would we be creating a return to the 1969 situation? Or, has most of that problem been addressed elsewhere?

Ms. OLSON. I wouldn't say that these problems have so much as been eliminated as they have been replaced by new tax avoidance techniques. Those tax avoidance techniques are not necessarily things that show up on the face of the return that you could easily add back as tax preferences—offshore havens, things like that—they don't show up on the return.

So, whereas you do have people sheltering income, they are not going to be affected by the AMT. I think both Treasury and the Tax Policy Institute have figures to show the number of taxpayers that make over $1 million that paid 0 tax. The AMT isn't doing what it originally was intended to do, in terms of bringing people back into the system, and it is harming people that it never intended to touch.

Mr. ENGLISH. So, it's fair to say that there are tax avoidance problems now, but most of them are problems of a sort that the AMT doesn't directly speak to, but instead, it creates its own problems, particularly in the area of complexity?

Ms. OLSON. I think that's correct.

Mr. ENGLISH. What impact has the AMT had on savings vehicles and the predictability of some of the policies that we have put in place in the code to increase economic growth?

Ms. OLSON. I am not sure that I am qualified to——

Mr. ENGLISH. Would any of the panelists like to speak to that? Dr. Burman?

Mr. BURMAN. I was actually thinking about that the other day, because we had something from our personnel office saying, "You should put your money in a Roth 403(b)." Actually, if you do that, and your income is at a certain level, it could put you into the phase-out range for the AMT. Effectively, you would be subject to a big tax penalty on the additional income you realize.

A Roth is a good deal if you expect your tax rate when you retire to be about what it is now or higher. For people who are pushed onto the AMT by their additional contributions, it could be a bad deal.

The big problem is that it makes it hard even for people to understand how the tax system is going to affect them. That's a problem, not just for savings incentives, but for charitable contributions. There was an article in Consumer Reports this week that said, "Watch out. Your mortgage interest deduction is going to be taken back by the AMT." It's not true, but people are just really confused by this.

Mr. ENGLISH. That changes the incentives. Thank you very much, Mr. Chairman.

Chairman NEAL. Thank you, Mr. English. Mr. McDermott will inquire.

Mr. MCDERMOTT. Thank you, Mr. Chairman. I appreciate your having us have an opportunity to finally discuss this issue. For the last six years it has been sort of off base to even bring it up, except to have a minor fix each year.

If I understand it correctly from this first chart that we have—it's called, "The Present Law and Background Related to Individual Alternate Minimum Tax"; I don't know whether you folks got that—but the first graph in there has a drop. If the Bush tax cuts are not extended, you have a drop from $120 billion down to something like $40 billion, and it goes down from 30 million taxpayers to 18 million.

It seems to me that there were no changes in the AMT tax rates when they made the tax rate cuts in the other tax system. Is that a fair description, Mr. Burman, if what has gone on?

Mr. BURMAN. Yes, that's true.

Mr. MCDERMOTT. It—the solution that's being offered—I don't know, I can't tell what you really think is the solution to this—but isn't the solution going back into those tax cuts of Mr. Bush of 2001 and 2003 and making some adjustments, and making some adjustments in the AMT tax rates?

Mr. BURMAN. There are actually a variety of solutions. You could roll back the Bush tax cuts, and that would make it easier to fix the AMT. It would raise some revenue that would offset some of the cost of repealing or reforming the AMT. You could just adjust income tax rates by themselves, as part of the current structure, or you could do other things to raise the revenue.

Mr. MCDERMOTT. But it sounds to me—and I have been here since 1989, and I heard there was a problem with Social Security, and I heard there was a problem with Social Security, and every year we hear there is a problem with Social Security. Congress has sat on its hands as we knew this bulge was coming of people to get on the Social Security system in 2010. It was almost as though they were trying to create a crisis to make it necessary to say, "Oh, we can't fund it, let's go to privatization."

I have the same feeling about this tax thing, that it was left alone to create a crisis that would get us in to do something to get rid of the income tax, or—I don't know what they're up to. Tell me. Am I misperceiving Congress sitting on its hands for the last 12 years, knowing this was getting worse?

Mr. BURMAN. I——

Mr. MCDERMOTT. For the last six years, making it worse by enacting tax cuts?

Mr. BURMAN. I'm not sure I want to comment on the motives, but it's certainly been true that the problem hasn't been fixed.

The biggest problem is that it's hard coming up with the revenue that you were pretending was going to come in from the AMT, and repealing it would cost $70 billion, according to the JCT.

Mr. MCDERMOTT. How about in 2001, how much would it have been?

Mr. BURMAN. I don't have that estimate right in front of me. The 2001 tax cuts about doubled the cost of fixing the AMT.

Mr. MCDERMOTT. So—and now it's three times? Four times?

Mr. BURMAN. Well, the estimate that's in my testimony is that if the tax cuts are extended, the cost of repealing the AMT would be about $1.6 trillion over ten years, rather than the $870 billion that was estimated, and that the cost would be growing over time.

Mr. MCDERMOTT. So, is it—suppose we don't do anything? What happens?

Mr. BURMAN. Well——

Mr. MCDERMOTT. Is it just going to be screaming from the public that's going to change this?

Mr. BURMAN. Well, if you don't do anything, 23 million people will be subject to the AMT, including more than a third of people with incomes between $75,000 and $100,000.

Mr. MCDERMOTT. So, you would have to think that the Republicans were setting up 33 million to scream about changing the tax structure?

Mr. BURMAN. I leave it to you to figure out the motives.

Mr. MCDERMOTT. Well, if you can explain some economic motive why they did it, I would be willing to listen to that. Can you think of any economic reason?

Mr. BURMAN. I think it's more like eating food you know you shouldn't be eating. You know it's not good for you, but you can't stop. We need the revenue, or we need to pretend the revenue is coming in. When the President says, "The budget is going to be balanced in 2012," he is counting on a lot of AMT revenue.

Mr. MCDERMOTT, but that line—they knew what that line was going to look like. They knew if they didn't fix it there—if you go to a doctor, and he says, "If you don't stop eating sugar, you're going to get diabetes," and you keep eating sugar, and get diabetes, what would you say about such a patient?

Mr. BURMAN. [No response.]

Mr. MCDERMOTT. Irresponsible. Never mind. Thank you very much.

Chairman NEAL. I thank the gentleman. The gentleman from Oregon, Mr. Blumenauer, will inquire.

Mr. BLUMENAUER. Thank you very much, Mr. Chairman, and I do appreciate your single-minded focus on this issue. It has been my number one tax issue since I joined Congress and had an opportunity to try, in a small way, to reinforce your strong voice on this. That's why I wanted to be on this Subcommittee.

I want to pick up, if I could, on some of the line of inquiry from Mr. McDermott, because this is a millionaire's tax that has morphed into a lawyers and accountants and lobbyist tax, which is now being a tax on working two-income families with children.

Mr. Burman, I believe you mentioned that in 2001 the tax changes that were made doubled the cost of the fix, but in 2001, we had endless surpluses. We were concerned about paying off the Federal debt—those were the days, "What are we going to do when there are no taxable debt instruments in the United States?"

A conscious decision was made to ignore this, and instead, incrementally tinker with the tax system, making some very substantial benefits, transferring very substantial benefits, to a very relatively small group of people, concentrated, scatter some other things, making a hash out of our tax policy, and kicking the can down the road on the AMT.

It would have been a—and I would like, Mr. Chairman, for us to have provided to the Committee exactly what would have happened, in terms of the surplus that was projected in 2001, and instead of rounds of tax cuts for those who needed it the least, if we would have solved this problem that you have shown this searchlight on. I think that would be very interesting for the Committee to have.

My question and my concern is serving on the Budget Committee, I see that although this continues not to be a priority for the Administration. They have assumed the $50 million patch, but then they spend all this AMT on their budget, and they want to extend other tax cuts over the 5-year and 10-year horizon, instead of fixing this problem.

So, I would like to start, Mr. Solomon, to understand. It appears that this is not a priority of the Administration. They didn't deal with it when they could have, relatively easily in 2001, and they were concerned about the Federal Government having too much money, and they have watched as this has morphed into a tax on the middle class with families.

It doesn't hit the hedge fund manager. It hits the lobbyists, the accountants, and now it's hitting postal workers and fire fighters and teachers. I don't understand why this isn't a priority of the Administration, the same way of extending the tax cuts and spending all of this money in their budget plan.

Mr. SOLOMON. This is a priority for the Administration. This is a very important issue. In the budget, the Administration proposed a one-year patch to deal with this very difficult and important issue. We care, just like you do, about the effect that the AMT is having, and will have, on middle-income taxpayers.

Just to note, with respect to 2001, the issue of the AMT was raised during the 2001 considerations, and a patch was included as part of the tax relief. In addition, a patch was included in 2003.

Mr. BLUMENAUER. Yes. I understand the patch, the little—that's the Get Out of Jail Free card, that's the minimum that you can do to get away with it. If they didn't do the patch, the whole house of cards would have collapsed. If it is a priority, why does the Bush budget that we're dealing with in the Budget Committee right now—Mr. Doggett and I are sort of scratching our heads—why do you propose to spend all the money that the AMT is going to collect, if it is a priority to fix it?

Mr. SOLOMON. It is a priority to fix it, and we look forward to working with you to find solutions for the AMT problem.

Mr. BLUMENAUER. Let me try one last time. If it is a priority of the Bush Administration to fix it, having dodged the bullet and not done it earlier, why does the budget that you have given us assume that we are going to spend all the money it raises, except for a one-year patch? That doesn't sound like it is a priority, does it?

Mr. SOLOMON. It is a priority to deal with this very difficult and important issue. There are many facets of this, and many complexities to it, and we look forward to working with you to try to find a solution to it.

Mr. BLUMENAUER. Mr. Chairman, I would like, with the help of the Committee Chair and Ranking Member, to—and maybe it's—maybe this is all Mr. Solomon is authorized to say, that he wants to work with us, and it's a priority—but I would like to sort of see if we can get a response from the Administration as to whether or not it's a priority. If it is a priority, why are they proposing to spend all the money that it will raise, other than the one-year patch?

Mr. ENGLISH. Will the gentleman yield?

Mr. BLUMENAUER. I would be happy to.

Mr. ENGLISH. I am not sure I understand what the gentleman is now asking of the Administration. I think they have been very forthcoming and very direct. Certainly they have dealt with this as directly and as completely as any Administration recently has.

I really have to wonder what it is exactly you want Mr. Solomon to give you that he hasn't already given you.

Mr. BLUMENAUER. Reclaiming my time, Mr. English, I—what I am trying to say is we have had an orgy of tax cuts that has been produced by this Administration and the previous six years in Congress.

I guess I assume that the issue of a priority is what you spend money on. The only money that this Administration is willing to spend is the minimum, the one-year patch that they know has to happen, that will happen, whether they propose it or not, but they spend all the money that this tax would collect.

So, I am trying to find out if it is, in fact, a priority, if they are willing to put something on the line to deal with some of the other—either their spending or their tax proposals. If not, that is fine. If we are kind of on our own, and it's not a priority of theirs, and they are not going to help us, budgetarily, or in tax policy, that is okay. They will cooperate, but they won't put anything forward.

I think it is a legitimate question to ask. That's why I turn to you, Mr. English, and our Chair, to have some help in crafting the request, because I may not have artfully enough expressed it.

Chairman NEAL. I think that the gentleman's point is well taken, and I think there will be an opportunity, when the hearings are concluded in about 3 weeks, to have an opportunity to speak with the Secretary of the Treasury as well, at that moment, as we begin to proceed with what we believe to be a solution for this issue.

The gentleman from Texas, Mr. Doggett, will inquire.

Mr. DOGGETT. Well, I believe Mr. English is correct, at least in part, that the Administration has been very forthright and direct about this. You believe it's a priority to solve this problem for the next year, and you have a proposal to do that, right?

Mr. SOLOMON. That is correct.

Mr. DOGGETT. As far as a long-term proposal, you have had six years to propose something, and neither then nor today have you viewed it as a high enough priority to propose anything, and today you have no proposal whatsoever, other than to say you will work with us and listen if we can come up with a proposal, right?

Mr. SOLOMON. Our proposal is similar to what the Congress has done since 2001, with——

Mr. DOGGETT. Patch on top of patch, or Bondo on top of Bondo. You have no other proposal, right? Today? Other than your cooperation?

Mr. SOLOMON. We look forward to working with you——

Mr. DOGGETT. Cooperating. I heard that from Mr. Partman, earlier. Mr. Partman, who, when he testified to our Committee and the Budget Committee, did at least concede that without counting the AMT dollars, to which Mr. Blumenauer just referred, this Administration, President Bush, has not submitted a balanced budget. Of course he has never submitted a balanced budget to us, so that doesn't come as a great surprise, and there is no balance in the budget he has submitted, even in the future, because he includes this AMT revenue in order to achieve it.

Ms. Olson, first, I really appreciate the work you do as our taxpayer advocate. I read your reports each year, and have offered legislation on a few of the provisions, but I think they are extremely helpful to us.

You mentioned that there are a number of tax avoidance schemes that some of our wealthier neighbors utilize to avoid paying their fair share of taxes, but that these are not reached by the AMT.

It just seems to me—and I guess I would direct this question to Dr. Burman, too—that we may have the very flawed implementation of this policy, but the notion that all Americans should contribute something toward our National defense, if they have prospered in this country, is not unlike my feeling that all corporations should, and that we should not permit the amount of tax avoidance, which this Committee has traditionally been the number one protector of, by corporations who go offshore and dodge their taxes, but even want to do work at taxpayer expense.

Isn't there a way, as we look at the AMT, of preserving the concept that Americans all have a responsibility—once they reach a certain level of prosperity, at least—to share in the cost of our government?

Ms. OLSON. I have tried to think about how you could leave a minimum tax, eliminate things like the State and local preferences and add-backs, or the dependents exemption, the standard deduction, or medical expenses that are itemized deductions, and replace them with items that are more targeted to the kind of abuse that we saw back in 1966 and 1969.

My concern is that you just wouldn't make—it still wouldn't be enough to make up the revenue impact, because so much of the AMT revenue is coming from these other items. I even personally witnessed that in 2001, when we first recommended repeal. We had some other alternative suggestions: index the exemption amount for inflation, which was more modest at that time; or simply say anybody with gross income under $250,000 wouldn't pay it.

Today, because of the passage of time, those solutions will not do it.

Mr. DOGGETT. Thank you. Dr. Burman?

Mr. BURMAN. I think you could maintain an AMT that did a better job of reigning in tax shelters than the current one, and still spare virtually the entire middle class. What you would do is what Ms. Olson suggested, get rid of those middle class tax preferences, no longer punish people for having kids or State and local taxes.

The other thing is to index it for inflation, so inflation doesn't push people on to the AMT. I would also restore something that was in the AMT prior to 1987, which is to tax capital gains and dividends as other income. That was the biggest preference item in the AMT before 1987.

Virtually any tax shelter you can imagine on the individual side eventually shows up as a capital gain. Basically, what tax shelters do is they convert ordinary income that is taxed at rates up to 35 percent into income that is taxed at the low capital gains rates or dividend rates of 15 percent.

Mr. DOGGETT. Thank you very much. I yield back.

Chairman NEAL. The gentleman from New York, Mr. Reynolds, will inquire.

Mr. REYNOLDS. I thank the Chairman for the opportunity to ask a few questions. I have learned a lot today about Bondo, a little bit about Bush tax cuts, and whether they're oppression, or whether Americans got an opportunity to all take advantage of it. I heard we have had an orgy of tax cuts.

What I haven't heard in all of the history that has come from the majority in both observations and questions is a reminder that while there are some opinions, both by possibly panelists as well as Members of this Committee that 2001 and 2003 Bush tax cuts caused some of the problem, I haven't heard anything come from the majority relative to reminding us that in 1969 it was a Democratic-controlled Congress that created AMT, or that in 1986, when one of my predecessors was in Congress, that we saw modification that didn't include changing AMT.

We have seen in 1993, the largest tax increase in the history of the country, and there have been some that have outlined that in

1993, that tax increase accelerated the amount of people that are in the AMT consideration. We can't forget that in my freshman year—many people have been much longer than I—we passed a repeal the AMT and sent it to the President, and it was vetoed. So, we have had both parties intricately involved in creating and looking at and touching and hoping to fix AMT.

There is a 1 trillion estimate to do a permanent fix. What I might ask the panelists is as you look at Senator Grassley, who is introducing a bill to repeal the AMT, he used in his words, "It's simply unfair to expect taxpayers to pay a tax they were never intended to pay. It's even more unfair to expect them to continue paying for that tax, once we get rid of it."

So, my question under pay-as-you-go rules, the House would have to find close to $1 trillion of offsetting tax increases to repeal the AMT. I wonder if anyone might say, "Are there folks who are not paying enough in taxes," that they're so low that you see a category where we should raise them, in order to fix the AMT? Or should Congress forgo and waive the Pay-go for the purpose of doing a permanent relief? My first question.

The second is Chairman Rangel is quoted as outlining the fact in a report to Bloomberg that they may rearrange tax rates so wealthy Americans pay more to prevent the AMT from hitting the middle-class income households, rearranging the rates. I just wonder what your thought might be of whether this Congress—and particularly this body—should look at using that approach for your consideration.

If the panels would, take the questions as they might.

Mr. BURMAN. The question of whether you need to offset the revenue lost from eliminating the AMT has come up before. The fact is that Congress was counting on the AMT when it enacted the tax cuts in the first place, and actually, it was a way of sort of enabling the tax cuts by reducing the measured cost by about a third.

If the country were swimming in tax revenues right now, if we were looking at surpluses, then of course it would make sense to look at tax cuts. The problem is that we are looking at some very serious budgetary problems in the long-term. In 2010, the Baby Boomers are going to start retiring. Even if you get the entitlements under control, it is going to put unprecedented demands on the government, and we are already running deficits.

In my view, we ought to be, at a minimum, thinking about how to get the budget under control in anticipation of the huge demands that are going to be put on the country in the future.

Saying that some people would have to pay higher taxes to offset the loss from the AMT, given that we were counting on that revenue all along, is not particularly unfair. I think it makes sense, as a matter of policy, to replace what is an irrational tax with a rational one. You can't do that without having some people pay higher taxes. You can't replace an irrational tax with a rational tax without changing things.

Mr. SOLOMON. One aspect of this question that one has to take into account is the amount of revenues that is the appropriate target for the government to take in. That is, what percentage of the economy should be taken for government purposes?

That is an important question. What is the level of revenues that should be collected through the tax system? The historical average has been around 18 percent of gross domestic product (GDP). Now it's about 18.4 percent. So, with respect to what you think the proper level of taxes is, and what you think the proper solution to AMT is, you need to take that into account.

As of now, it is projected that the share of taxes to GDP in this country is expected to rise to perhaps 19 or 20 percent in the next 5 to ten years. So, that needs to be considered in deciding how you want to deal with the AMT.

Ms. OLSON. I would just like to suggest that we don't have a lot of time to think about this. If we see that 26 percent of the taxpayers who are paying tax, who actually are the ones paying the revenue that are funding the government, are going to be pulled into this irrational tax, that you may actually see an erosion of participation in the tax system, that they will just become so disaffected, because they have to calculate their tax twice, or they have to pay someone to calculate their tax.

So, it's not just what's the proper amount of revenues that should come in, but whether your taxpayers are going to pay them.

Mr. VIARD. Mr. Congressman, I think that there are a number of ways that the cost of AMT relief, or AMT repeal, can be handled. I do think it would be preferable, in view of the fiscal imbalance we face, to try to address those costs today, rather than later.

I think the increases in marginal tax rates that some have talked about would not be the ideal way to finance it, that base broadening under the regular income tax would be a far preferable strategy.

Mr. REYNOLDS. Thank you, Chairman.

Chairman NEAL. I thank the gentleman. The gentleman from California, Mr. Thompson, will inquire.

Mr. THOMPSON. Thank you, Mr. Chairman.

Mr. BLUMENAUER. Mr. Thompson, would you yield for 20 seconds?

Mr. THOMPSON. For 20 seconds? Sure.

Mr. BLUMENAUER. Thank you. I was listening to my friend from New York talk about the history, and wonder why these things hadn't been raised. I would just note I didn't want to get too partisan in my line of inquiry. I was risking something, but this 1969 tax was birthed in the Nixon Administration. The 1986 changes in the tax code were under the watch of my fellow Oregonian, Bob Packwood, Republican from Oregon, who was probably the major architect in the Reagan Administration.

I do think that there are Republican fingerprints all over this. I didn't want to bring this up, because we don't want this to be partisan.

Mr. ENGLISH. Will the gentleman yield?

Chairman NEAL. It's Mr. Thompson's time.

Mr. THOMPSON. I'm going to be out of time before we get going.

Mr. Solomon, it has been brought up by a number of my colleagues on the dais today that the current budget proposes to make just about every tax cut known to mankind permanent, but only provides for a one-year fix in the AMT.

I just want to draw on one particular part of your testimony, where you say, “A permanent solution to the AMT is essential for the continued functioning of our individual income tax system.” If you believe that, don’t we need a permanent fix?

Mr. SOLOMON. We do need a permanent fix to the AMT.

Mr. THOMPSON. Then why is it part of the budget?

Mr. SOLOMON. It’s not part of the budget. We have an immediate problem, which is for 2007, which has already begun. The immediate problem is to deal with 2007.

So, to deal with the immediate problem, the budget includes a one-year patch.

Mr. THOMPSON, but we have been doing the one-year patch.

Mr. SOLOMON. I understand. The President’s budget proposal is consistent with that, but it also important that we take the time to examine permanent solutions to the AMT.

There are a number of possibilities that we can consider: for example, dealing with the exemption on a long-term basis, dealing with the rates——

Mr. THOMPSON. It just seems to me—and other people have already said it—but the budget is the priority of our Administration, it’s a priority of our country. If it’s not in the budget, it is just—you can spin it any way you want, it’s just not a priority.

I tend to agree with you that this does need to be fixed, and needs to be fixed on a permanent basis. Any one-year patches, we’re just obfuscating the potential problems, and the real need to do our work.

Ms. Olson, if taxpayers—you have noted that this is a particularly difficult system to navigate, and a lot of people just don’t even know about it. If a taxpayer does his or her own tax work, and they fail to do it under the AMT, and they later found that they should have, what happens?

Ms. OLSON. Well, the IRS has systems that will check whether you have—based on how we plug in the information from the return that we get—and it will just tell us that you should have calculated the AMT.

Mr. THOMPSON. So, do you get a penalty?

Ms. OLSON. You will get a letter from the IRS, and then you will get a penalty for—certainly you will have interest, and then you will get a penalty for failing to pay, unless you can show reasonable cause. Ignorance of the law is not an excuse.

Mr. THOMPSON. So, if you just say, “This is really confusing, I didn’t know about it”——

Ms. OLSON. That’s not good enough.

Mr. THOMPSON. You still get your—so there is a bunch of taxpayers out there who are apt to get hit with this penalty?

Ms. OLSON. Yes. One of the things that we point out is that because it is so hard to know until all of your information is at the end of the year, you can’t predict when you will be hit by the AMT.

So, even if you calculate it correctly, you may have to get—you may be charged an estimated tax penalty, because you didn’t pay in enough money during the year to pay the alternative——

Mr. THOMPSON. Right. Does the IRS do an outreach to let people know that this is a problem they ought to be watching out for?

Ms. OLSON. The IRS has been working on a publication. It is one of the few issues that we don't have a publication on, which——

Mr. THOMPSON. What do you think happens? You get your publication done first, or we fix this permanently first?

Ms. OLSON. That would be a hard one to predict.

Mr. THOMPSON. That's what I was afraid of. Dr. Burman, you have given us several options as to how to deal with this. Do you have a favorite? If you were the benevolent tax czar, what would—how would you do it?

Mr. BURMAN. I think there is actually a lot of merit to the tax reform panel's proposal to eliminate State and local tax deduction. I know that's not politically very popular, but it's going away on its own, and it does make things more complicated. If you didn't have a State and local tax deduction, fewer people would have to itemize, and it would raise more than enough revenue to eliminate the AMT.

Mr. THOMPSON. It just goes to show you should not ask a question you do not already know the answer to. Thank you.

Chairman NEAL. I thank the gentleman. The gentleman from Virginia, Mr. Cantor, will inquire.

Mr. CANTOR. Thank you, Mr. Chairman. You know, I appreciate the panel being here. It has been a very interesting discussion, educating one for me.

It seems to me, though, as we are looking to try and find not an easy, but a sensible way to address this growing problem, that perhaps we ought to look at the 1993 tax hike that essentially raised the AMT from a 24 percent flat rate to a dual tax rate of 26 percent on AMT income up to $175,000, and 28 percent on AMT income above that amount.

You know, I know that joint tax has done an analysis which has shown that about 11 million more Americans will have to pay the AMT next year, thanks to the higher post-1993 AMT rates.

So, if it is in our interest to really shield, or spare, the average American—and as my friend from Oregon—I think he's no longer—wants to make sure the social worker, the fire fighter, and the teacher is protected from the AMT, then the cleanest solution would be to repeal the Clinton AMT tax rate hikes, and basically move back to a pre-Clinton 24 percent, and then index the exemption for inflation at the 2005 level of $40,250, which would now mean $58,000 for a joint return.

What I have read, that—going back to this—would mean that only about 2.6 million taxpayers would be—filers—would be subject to an AMT penalty next year, instead of the 23 million that we are anticipating under current law. So, I would like to put that out to the panel for comment, number one.

Number two, also, maybe Dr. Viard or Mr. Solomon could answer the question about when we are operating under the majority's PAY–GO rules, and they are looking to try and "pay for the AMT fix," and if the proposal is to do so by repealing the death tax, perhaps, or ending the repeal to death tax, or repealing the rate cuts on cap gains—dividends, especially—will not that have a global effect, in terms of economic activity generation, and in essence, we will then be suffering from a decline in economic activity, a decline in revenues, that will then not serve the purpose that we were trying to do anyway, under the PAY–GO rules that they put in place, which is to, again, "pay for the AMT fix?"

Mr. SOLOMON. You've asked at least two questions, and I will try to address each one of them.

First, you mentioned the 1993 rate adjustments. The 1993 rate adjustments are just one change among many changes to the AMT that have caused it to become a large issue. One of the possibilities that one might consider is to change the rates, as I mentioned just a few minutes before.

I think also, as perhaps you mentioned, it would be important to index the AMT and all the parameters of the AMT, as well. So, changing the rates and indexing various parameters would help reduce the impact of the AMT.

With respect to other proposals, you would have to take into account the repercussions, the consequences of those proposed changes.

For example, the lower rate on capital gains and dividends, which was part of the 2003 tax relief, we believe was very important for economic growth, and we have had sustained economic growth since that time. There has been a very positive economic recovery. Therefore, there would be, we believe, very important ramifications that you would have to take into account with respect to any of the changes that you have suggested.

Mr. BURMAN. I would like to make a quick comment about the effect of the 1993 Act. All of the measured effect that you were talking about actually would have come from indexing the exemptions, starting from 1993. If you did that, it would reduce the number of people on the AMT.

Basically, if we had indexed the AMT exemption at any point in history, the problem would be a lot smaller. The AMT Act did raise the rate on the AMT, but it also raised the exemption. If all you did was replace the current exemption and rates with the 1993 exemption and rates, you would actually have more people on the AMT, although they would be paying less tax.

So, indexing is the story, but the change in 1993 was not.

Mr. VIARD. I want to agree with you, Mr. Congressman, that reinstating the estate tax, or raising tax rates back up again on capital gains and dividends would be undesirable ways of trying to finance AMT relief, because that would increase the tax burden on savings and investment, which is the most harmful economic distortion that the tax system imposes.

It would be far preferable, as I said earlier, to pursue base broadening within the regular income tax that does not involve increasing the tax burden on savings and investment.

I think that Len actually mentioned one very interesting option just a few minutes ago, which is to repeal the State and local tax deduction. There are others that also could be pursued.

Chairman NEAL. I thank the gentleman. Ms. Schwartz.

Ms. SCHWARTZ. Thank you, Mr. Chairman, and first I want to say I think my colleagues did a really good job of presenting the concerns we have from the budget Committee point of view. I thought they made it very clear that if we don't do something about it—and the Administration has not proposed anything but a one-year fix, and we're even hearing from the other side of the aisle that a trillion dollars in additional—we don't really worry about it. The Administration is not worried about it. The other side of the aisle is not worried about another trillion dollars of debt, though I guess we're going to have to borrow from another foreign country to make ends meet.

I think on the budget Committee we do care about it. So, what I wanted to do though is to take that to the—a little bit more to some of my constituents who are going to see the effect of the Administration's proposal, which is a one-year fix and then no other change, the AMT stays in place.

As I understand it that really means that people—families who are within $100,000, $150,0000 will be paying more. They'll be paying the AMT. That's what the budget looks like, that's what the proposal is because we only fix it for one year, and that in fact that means that they will be paying for this benefit for someone else, that we're really taking, really at this point at least in my district—really perceive themselves as middle class taxpayers who are going to be paying for the tax cuts that the Bush Administration has put in, since there's no changes in that.

In fact, in my district we're looking about half of the taxpayers who are affected. On this panel actually more of my constituents are affected by the AMT than anyone else, which is kind of interesting. I didn't realize that until we got some of these numbers, but the group, the adjusted gross income group are those people at $100,000 to $200,000 family income, not the people making over $500,000, a million, two million, three million dollars.

Given the intention of the AMT, isn't it true that those people who are making $100,000 will be paying, both for the Bush tax cuts and really helping out much wealthier Americans because they're going to be paying it and other people won't? I guess I would ask Mr. Solomon, since it's the Administration's proposal that's suggesting this.

Mr. SOLOMON. We very much share your concern about the effect of the AMT on the middle class and the effect it will have if it's not fixed in the future, given that it will affect an increasing number of taxpayers. The Administration's proposal for a one-year patch is a first step to deal with this issue.

We agree with you that there should be a long-term solution.

Ms. SCHWARTZ. You've said that several times, and I think the Administration has been suggesting a one-year patch for six years.

Mr. SOLOMON. Which is consistent with what the Congress has done for the last six years. I would agree with you. I'm in agreement with you with respect to the importance of this issue and that we do not want the AMT to affect the middle class.

Ms. SCHWARTZ. So, you agree that it is the middle class, the $100,000 family income that's going to be hit the hardest if we don't do anything about it?

Mr. SOLOMON. I do not have the numbers before me, but it is true that the group between $100,000 and $200,000 will be affected significantly if the AMT is not fixed after 2007.

Ms. SCHWARTZ. I can't speak for all Americans but I can tell you the numbers we got on this panel, every member, the constituents we represent, the group hit the hardest is $100,000 to $200,000. So, you're confirming that that's who is going to get hit.

Mr. SOLOMON. If the AMT is not fixed they will be significantly impacted by the AMT, I do agree with that.

Ms. SCHWARTZ. The Administration, the President's proposal is to—really is hollow. It is to postpone it for one year, patch it for one year and then no suggestions about how to fix it for the future.

Mr. SOLOMON. It is the first step in dealing—the President's proposal, the Administration's proposal is the first step toward finding a long-term solution to this issue.

Ms. SCHWARTZ. So, how much—I've only been for one term, so how much progress had you made when you made the same proposal four years ago, five years ago? This has been six years of—we're going to do it one year and then we're going to make some progress, we're going to have some discussion.

So, since—from what—year, you've not made any progress. So, what makes you think you'll make more progress this year?

Mr. SOLOMON. There has been progress. That is, the number of AMT taxpayers has been kept at a minimum over the last six years.

Ms. SCHWARTZ. By doing a one-year-at-a-time patch?

Mr. SOLOMON. It has been through short-term, temporary patches. That's correct.

Ms. SCHWARTZ. So, is the intention to do a patch for next year and then the year after and then leave it to the next President?

Mr. SOLOMON. We hope to work with you to find a long-term solution for this problem. We share your concerns. The question is how will we deal with it moving forward.

Ms. SCHWARTZ. I think 'share your pain' is probably not going to be enough. I would think we need some—and I would say some really specific proposals.

Again, our Chairman is really working hard on this, and I think is interested as we all are in creating that fix, but come on, you're the Administration, you have lots of specific proposals. I'd like to see some very specific proposals for the changes to the President's tax cut that you think have to be made in order to fix this or something new.

I think it's not good enough to just say, "we're open for suggestions." Thank you.

Chairman NEAL. I thank the gentlelady.

Mr. Solomon, let me do some followup based on what the gentlelady from Pennsylvania has said. I think it might highlight some of the frustration that we do feel. Let me just read some quotes to you.

"We estimate that the number of individuals affected by the AMT would almost double under the Bush proposals." That comes from Joint Tax. That's not a partisan organization.

"It is true that the AMT would eat away at some of the benefits flowing from the President's tax proposals as compared to the absence of an AMT interaction with the rest of the tax code." That's the Secretary of the Treasury, Mr. O'Neill. "Otherwise, we are giving people a tax decrease on one side and a tax increase on the other side, and they aren't really getting what we said they were going to get." That's Senator Charles Grassley.

The 2001 tax cut bill "will roughly double the number of AMT taxpayers in most of the last years of the budget window so that in 2010 an estimated one-third of all taxpayers will be subject to the AMT." That's the Treasury economist Jerry Tempalski.

These are all quotes, as the gentlelady said, from 2001. As I've indicated, they're not partisan positions. I accept your word that you'd like to work with Members of the Subcommittee and the full Committee and the Members of the house but there has to be something that moves beyond the level of testimony to really tackle this issue because I want to tell you—it's the intention of the Chairman of the full Committee to tackle this issue in the next couple of months.——

So, I assure you that we appreciate your desire to work with us but this is not going to go away. We intend to do the followup based on what I proposed.

If you'd like to comment, please.

Mr. SOLOMON. Yes, just a few comments. First, there have been a couple of references that the President's tax relief is the cause of the problem. I just want to reiterate that in my view the source of the problem is the AMT itself, and we need to recognize that.

The AMT causes a penalty for being married. It causes negative effects on families because the personal exemptions are denied. It denies the standard deduction. It denies personal exemptions. It denies the itemized deduction for State and local taxes. All of these things are part of the AMT and they need to be—and they need to be addressed.

In terms of particular kinds of proposals, some of the things that might be considered, for example, are increasing the exemption or reducing the rate. Those are some of the things that one might consider.

Chairman NEAL. Dr. Burman, would you like to comment?

Mr. BURMAN. Well, I disagree with Mr. Solomon that the 2001 tax cuts are not a factor. I think we were counting on the AMT revenue when the 2001 tax cuts were enacted. It made them appear to be much less costly in terms of revenue than they actually turned out to be.

I think we need a permanent solution. I'm glad that the Administration says they want to work toward a permanent solution. I think the response from Mr. Thomas to my response to what my favorite solution is suggests that it's harder for politicians to fix this than for economists to do it, so it's a difficult problem.

We could have come up with 20 different solutions and none of them would be ones that you could just go back to your constituents and say, "hey, I've got the solution and everybody is better off." The fact is that this tax is a capricious tax. It's not hitting the people that you think it should be hitting. If you're going to make up the revenue with something that makes sense, some other people are going to be paying more tax.

My preference would be to shift the tax burden onto people who are most able to pay, the ones who benefited the most from the economic expansion of the last two decades, but that's obviously not uncontroversial.

Chairman NEAL. I thank you. Mr. Blumenauer, would you like to further inquire?

Mr. BLUMENAUER. I would like to just follow up with Dr. Burman.

I must note, in your testimony you've got the couple in box one that is just $75,000 of income, a teacher and a firefighter, actually not a well paid teacher and a junior firefighter, frankly, with four children, who pay a $2,000 surcharge to the AMT in 2007.

As you point out further in your testimony, by 2010 we're going to be in a situation where less than 40 percent of the millionaires—not millionaires, people who make a million dollars a year or more will be subject to the AMT, but 94 percent of the $200,000 to $500,000—it just—I want to commend you for examples that show how starkly this is perverting what we are attempting to do with the tax code.

I would like, if you would, to just elaborate where you were a moment ago. You were taking modest exception to the Secretary about whether or not the 2001 tax cuts figured into this. You've already pointed out that it doubled the number of people who were impacted when there was a chance, when there were trillions of dollars theoretically available, and they weren't spent to ameliorate it. In fact, it made it worse.

As you pointed out this money was used—in the AMT was used to justify larger tax cuts if they were "affordable" by assuming this revenue. Now, as I pointed out in the earlier round, this money is assumed in the next round of budgets that are being proposed other than the one year.

I wonder if you could comment on this—on how much more difficult resolution is going to be if we were to take the approach recommended by the Administration, which is spend it all except the one-year patch as opposed to making some adjustments in the tax code, not making it worse, not extending it, not complicating it further, but redirecting to be able to have some of the simpler approaches that you've suggested.

If you wanted to sort of elaborate on the difference between these two in terms of ultimately being able to solve the problem—spend it all versus making some adjustment and try and get on it sooner rather than later.

Mr. BURMAN. Well, I certainly agree that the sooner you deal with the AMT—and Ms. Olsen made this point in her testimony. The sooner you deal with it, the easier it's going to be. Every year the cost goes up by a lot because you're adding another year with $200 billion of revenue costs.

I don't want to get into assigning blame, into a discussion of that.

Mr. BLUMENAUER. If the tenor of my question suggests that I was suggesting you assign blame, please don't. I just want you to assess the difficulty of the two approaches.

Mr. BURMAN. I think it's better to deal with it now than to put it off. I you do, this Congress will be remembered as the one that dealt with the really hard issue that had escaped the grasp of Congresses of both parties for the last 25 years. I think it would be great.

Ms. OLSON. If I might make an observation, the AMT, just to remind folks, is not just about cost or at least the dollar cost. It's about the cost on taxpayers themselves. So, as more taxpayers are pulled into this system more taxpayers are having to go through the process of calculating their income tax returns twice, and that is an enormous compliance cost for taxpayers alone, and it does have an effect on the tax system overall.

Mr. BLUMENAUER. Ms. Olsen, I really appreciate your elaboration.

Mr. Chairman, one of the things that I hope we might be able to do if maybe some of our expert witnesses can help guide us in this point. Dealing with these lower income families that are being caught in the net—you know, the reference that Dr. Burman had to the $75,000—getting—if we can have some sense of what the costs of tax compliance will be as a percentage of what they're paying—and I—maybe, Mr. Secretary, you've got something in Treasury, maybe our tax advocate has it, but it just seems to me that we're going to be looking at a lot of people who are going to be paying maybe an extra $500, $1,000, $2,000, $2,500, but they're going to be paying an accountant an extra thousand dollars for this $1,500 bill.

Chairman NEAL. I think that the next panel that we've scheduled—we're going to hear from the practitioners and then we're going to hear from those who have born the burden of AMT, and we'll have an opportunity to hear not just anecdotes, but attach them to real stories.

I thank the gentleman from Oregon.

Mr. English.

Mr. ENGLISH. This has been an excellent panel, Mr. Chairman. I would say the one comment I would make is that there certainly has been, through this line of questioning, a focus on the way—on the AMT that I find surprising, one, blaming the Administration or the Administration's tax policies for the problem when of course we go back to the last Administration and they threw away an opportunity to actually repeal flat out the AMT at a time when it would have been a much more affordable solution.

I don't want to join my colleagues in making partisan political statements but I do think that it is fair to say that pro-growth tax policies are not the reason why the AMT has been a growing problem, and the attempts to somehow link recent tax relief programs to the growth of the AMT instead of tying it to mere inflation and the growth of the economy reminds me of some of the Presocratic philosophers; concepts like Xeno's paradox where somehow Achilles is never going to quite capture the tortoise because he's moving along a straight line.

The idea that somehow tax relief has exacerbated the AMT is a strange, abstract argument, but I am delighted that some of my colleagues have put on the Administration a challenge that reasonably can be moved back to them if in fact they feel this is something that needs to be addressed in the short term. They certainly have the opportunity to do it and I am certainly prepared to work with them.

As co-Chairman of the zero AMT caucus, I have been looking for that kind of a partnership for years. I thank the Chairman for having provided this opportunity to explore some of the problems with the AMT, and I would simply want to ask the panel as a closing question, is not the elimination or reform of the AMT something best done in the context of something that in the last Bush Administration was a—or I should say the first Bush Administration—was considered to be one of the priorities to drive their tax discussion, and that is fundamental tax reform.

As you noted, Dr. Burman, the AMT was one of the things that the President's tax panel did focus on and in fact explored one possible solution, you know, one that doesn't necessarily appeal to me as a former city finance officer, but the eliminating the deductibility of State and local taxes, which at least would have some reasonable distributional effect and would also be an approach that would end the obvious inequity that Federal taxes are paid less by those from high tax jurisdictions.

Is not this issue, very quickly, for each of you, best dealt in the context of a fundamental overhaul of the Code given the dimensions of the AMT problem? Dr. Viard.

Mr. VIARD. Yes, Mr. Ranking Member. I agree that the fundament tax reform would be the best context in which to address this. It is such a big problem that a permanent solution to the AMT, particularly if there is offsetting financing through something like the repeal of the State and local tax deduction would itself almost qualify as a fundamental tax reform by itself.

So, I think it would be best to address it in the context of something very broad based, whether that be a move to a consumption tax, as I would prefer, or whether it be a restructuring of the income tax.

Mr. ENGLISH. Dr. Burman.

Mr. BURMAN. I agree with you. I actually came to Washington to work on what became the Tax Reform Act 1986. It used to be that people perceived the income tax as the fairest tax. Now they perceive it as the least fair tax.

The income tax actually is at its heart a very fair tax system. It's progressive. It raises a much larger share of revenue from those who are most able to pay, but it's too complicated. I think that before too long we need to fix the income tax so that people will support it as we're demanding more from it to finance the growing demands of the government as the Baby Boomers retire.

Mr. ENGLISH. Ms. Olson.

Ms. OLSON. Well, I've often noted the need to repeal or deal with the AMT is going to drive fundamental tax reform because it will eventually cost more to repeal the AMT than it is to repeal the income tax, the regular tax and leave the AMT.

I would also add that we don't have time. I've characterized the AMT at times as a time bomb with a short fuse, which almost sounds impossible because you can't have a time bomb with a fuse, but it is ticking away, and it is also exploding every single year as we either have to have a revenue hit to do the one-year patches in order to keep people off of it. We have to address both.

Mr. ENGLISH. Mr. Solomon.

Mr. SOLOMON. Yes, the long-term solution to the AMT could be considered as part of tax reform. The only comment I want to add is that we also have a short-term problem. We have to deal with AMT for 2007.

Tax reform is going to take longer than that, and so it is important that we deal with the issue for 2007, a year that has already begun, which is consistent with the Administration's proposal.

Mr. ENGLISH. Thank you.

Chairman NEAL. The gentleman from Texas.

Mr. DOGGETT. I will just agree particularly with what Ms. Olson just said. Fundamental tax reform is fine, but I've been through 12 years of Republican rule. In fact, I've never known anything else in the House until this year, and they never once brought fundamental tax reform proposals to a vote in this Committee or anywhere else.

President Bush has had six years to propose fundamental tax reform. He has yet to offer a specific proposal to do that.

I think you're right. This is a time bomb. While we do need more comprehensive reform we ought not to wait for the perfect reform if one exists in order to try to provide some redress to middle class taxpayers.

Mr. ENGLISH. Will the gentleman yield?

Mr. DOGGETT. I'll yield.

Mr. ENGLISH. Will the gentleman then be in favor of perhaps considering in this Congress' fundamental tax reform?

Mr. DOGGETT. Well, the gentleman has had a majority for the last 12 years and was unable to——

Mr. ENGLISH. Now you do. Are you willing to do it?

Mr. DOGGETT [continuing]. And controlled this Committee and never once did it. I'd be willing to——

Mr. ENGLISH. Are you willing to do it?

Mr. DOGGETT. I'd be willing to consider any proposal you want to advance, but the only ones that we've talked about in the Committee rather than voted on have been ones that simply shift more of the burden to working people and less of the burden to the people that are already trying to dodge and avoid their taxes, and that kind of fundamental tax reform is fundamental tax deform, not reform.

Mr. ENGLISH. Then I encourage the gentleman, look at my fundamental tax reform proposal, the simplified USA tax, and I don't think that he can make the same claim about that. I yield back.

Mr. DOGGETT. I will do so.

Chairman NEAL. I would note today that for the panelists and the members of the audience that you could see what new leadership has brought. There are more esoteric arguments.

We began with St. Augustine, we moved to Achilles, but I must tell you after all these years of being on this Committee and dealing with tax policy, the real test is Sisyphus, to continue to roll this boulder back up the hill.

I thank the panelists. This was most informative, and I look forward to the next round of hearings, but most importantly a solution. This meeting stands adjourned.

[Whereupon, at 3:42 p.m., the hearing was concluded.]

[Questions submitted by the Members to the Witnesses follow:]

Question submitted by Mr. Johnson to Eric Solomon

Question: Section 402 of Public Law 109–432 addresses the problem of stranded AMT tax credits. When I introduced the bill on this topic (H.R. 3385) and when it was reviewed by Legislative Counsel and the Joint Committee on Taxation, the intent of the law was to make sure that individuals were able to use their stranded credits in no more than five years. We fully intended that individuals could get credits back in 20 percent increments over five years. Is that your understanding of how the new law works?

Unfortunately the law did not have any report language associated with it. However, it is clear to me that Congress was attempting to put this mess behind our constituents who voluntarily came forward to report this tax situation. Those taxpayers who *never* reported these Incentive Stock Option transactions are likely to have evaded this tax burden due to the fact that there was no reporting to the IRS of these transactions. For taxpayers who are known to the IRS, I would strongly encourage you to settle out these cases in a fair manner and to stop accruing additional interest and penalties. Mr. Assistant Secretary, I would encourage you and the IRS to simply settle out these cases as expeditiously as possible.

Answer: Section 53(e) of the Code, as added by Pub. L. No. 109–432, § 402, provides special rules that make so-called stranded AMT tax credits refundable through 2012. The provision allows an annual AMT credit equal to the greater of 20 percent of the taxpayer's long-term unused minimum tax credits (stranded credits) or 5,000 (or the remaining amount of long-term unused minimum tax credits, if smaller than 5,000). Under the statute, it is clear that taxpayers with stranded credits over $25,000 will not fully recover the entire amount of these credits within five years. This is because for 2008 through 2012, the amount of the stranded credits will be reduced by the amount refunded in the prior year, and thus, the 20 percent will be multiplied by a smaller amount, not the original amount of stranded credits. For example, assuming that in each year a taxpayer could not otherwise use AMT credits to offset regular liability, if the total amount of the taxpayer's stranded credits in 2007 is $100,000, the refundable credit is $100,000 × 20% = $20,000. In 2008, the total amount of stranded credits is now $80,000; therefore, the refundable credit is $80,000 × 20% = $16,000. In this example, the taxpayer would still have more than $26,000 of stranded credits left over in 2012.

With respect to the issue of settling cases, although the Office of Tax Policy is not involved in the resolution of specific taxpayer cases, I can assure you that the IRS will ensure that section 53(e) is fairly applied as enacted.

Question submitted by Mr. Johnson to Nina Olsen

Question: Unfortunately the Public Law 109–432 did not have any report language associated with it. However, it is clear to me that Congress was attempting to put this mess behind our constituents who voluntarily came forward to report this tax situation regarding AMT and Incentive Stock Options. Those taxpayers who *never* reported these ISO transactions are likely to have evaded this tax burden due to the fact that there was no reporting to the IRS of these transactions. For taxpayers who are known to the IRS, I would strongly encourage you to settle out these cases in a fair manner and to stop accruing additional interest and penalties.

Do you consider the taxpayers who have been caught in this nightmare of paying income taxes on phantom gains they never received to be in a more sympathetic position than those taxpayers who never reported these transactions at all and have never paid a penny toward similar tax bills?

Isn't it time to simply settle these cases?

[Response pending.]

[Submissions for the Record follow:]

Statement of Grover Norquist, Americans for Tax Reform

Chairman Neal, Ranking Member English and other Members of this subcommittee, I thank you for the opportunity to submit testimony on the Alternative Minimum Tax.

My name is Grover Norquist, and I am president of Americans for Tax Reform. I submit my comments to you today with serious concerns about the effectiveness of the Alternative Minimum Tax and the possible remedies being proposed by Congress.

More specifically, the AMT is worst case example of everything wrong with tax policy in this country. As we all know this tax was established to prevent certain Americans and corporations from using otherwise available deductions to reduce (and in some cases eliminate) their income tax liability. The individual AMT was thus intended to act as a failsafe mechanism to ensure that a small number of upper income individuals had to pay income tax.

But as with just about every other tax, the AMT has gone way beyond hitting only a wealthy few and now we are faced with the possibility of 30 million taxpayers facing this onerous burden. And as our members remind us every year around tax filing season, the burden is not just the additional taxes being paid but also the time to comply with the additional paperwork. The important point from the AMT lesson is that over time taxes do not hit just the wealthy as the middle-class always creep into these higher taxes.

Just ask any household with a telephone which has been forced to pay an excise tax for over 100 years when Congress intended the tax to be a tax on the "rich" to pay for the Spanish-American War. The last time I checked America won that war but American taxpayers of all incomes continued to pay the tax. This is also the direction we are headed with the AMT and to a lesser extent the estate tax.

Identifying the Problem

For policymakers to identify the correct remedy of the AMT explosion it is important to understand the true reason this occurred. As we show below, the surge is not the result of the 2001 and 2003 tax cuts but the AMT tax increases of 1990 and 1993 and the failure to index income exemptions to inflation. By our count, 97 percent of AMT payers expected to be paying the AMT in 2016, 30 of the 31 million taxpayers, are paying because of the higher rates enacted in 1993 and the failure to index to inflation at the same time.

In talking about the Alternative Minimum Tax (AMT) a lot of blame has recently been targeted at the tax cuts enacted in 2001 and 2003. The idea behind this is that reducing taxpayers' regular income tax liability pushed their Alternative Minimum Tax liability higher, thus creating this rapid growth of AMT payers. As such, some Members of Congress are proposing to eliminate the tax cuts of 2001 and 2003 to fix the AMT problem.

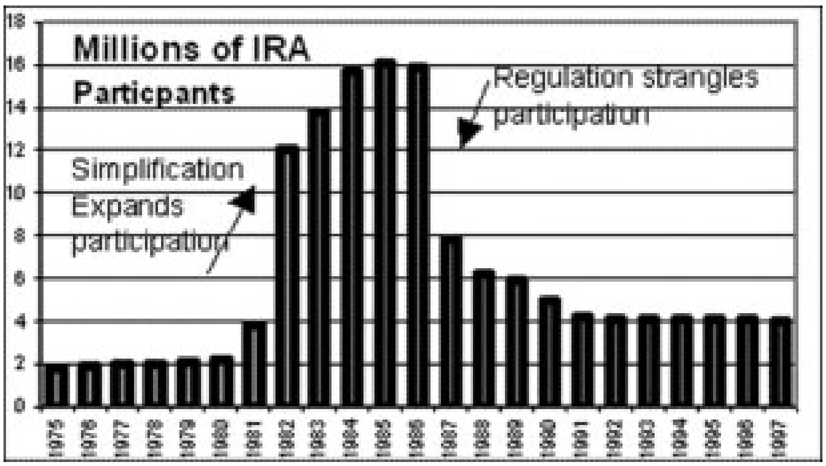
This is simply a race to the bottom whereby Congress is raising taxes on American middle class families to eliminate a different tax. A more common sense approach would be to just get rid of the AMT in the first place because the tax is not achieving its objectives.

Moreover, the idea that the recent tax cuts have something to do with the recent surge is suspect. On October 29, 1999, the Senate hurriedly inserted a provision in an $8.5 billion tax package to allow families to use certain tax breaks so that they could avoid paying the dreaded—but surprisingly little-known at the time—AMT. Senate Finance Committee Chairman William Roth (R–DE) and ranking Member Sen. Daniel Patrick Moynihan (D–NY) issued a joint statement earlier in the week, declaring "If we fail to extend the AMT relief, millions of middle-income taxpayers will face an unintended and unexpected tax increase." [1]

So this surge of AMT payers was already occurring before the 2001 and 2003 tax cuts. In fact, the surge in the 1990's was dramatic. According to data compiled by the Tax Foundation and analyzed by Americans for Tax Reform, 117,500 taxpayers paid the AMT in 1989 with an average tax burden of $11,500 per taxpayer (in 2006 dollars). By the time the Sens. Roth and Moynihan issued their press release in 1999 that number had increased more than ten-fold to over 1 million taxpayers. The average AMT liability was $7,700 (again in 2006 dollars) in 1999 which demonstrates the AMT was slowly creeping into the middle-class. More people were paying but as the incomes of the taxpayers affected were smaller these taxpayers were also paying smaller amounts.

[1] Godfrey, John. "Senate votes to keep tax breaks." *The Washington Times.* October 30, 1999.

AMT Bracket Creep Was Already Occurring Before 2001 & 2003 Tax Cuts



Sensing this growing problem both the House of Representatives and the Senate voted on August 5, 1999 to repeal the Alternative Minimum Tax as part of the Taxpayer Relief Act of 1999. At the time the "cost" of repeal was just $105 billion. Most of the Members today complaining about the AMT problem voted against this legislation. Despite their opposition the legislation passed both Houses of Congress only to be vetoed by President Clinton with the common mantra that the legislation was a "tax cut for the rich." We would not have this "problem" today if that legislation was signed into law by President Clinton.

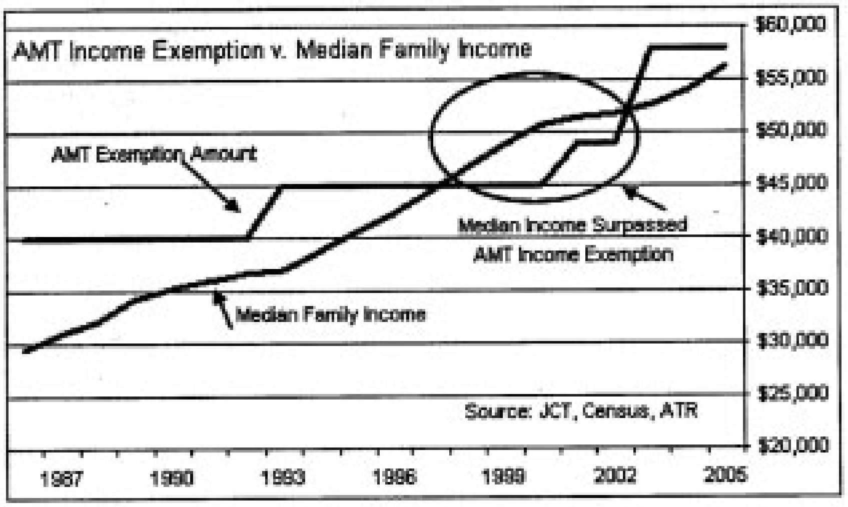
So what caused this dramatic surge? In 1990 and again in 1993 Congress raised the individual income tax. Knowing this would knock taxpayers off the higher revenue raising AMT and into the regular income tax, Congress also raised the Alternative Minimum Tax rates. This ensured all the people already paying the AMT stayed in the AMT system but also pushed more taxpayers into the AMT.

Following the 1990 AMT tax increase the number of people paying the AMT nearly doubled from 132,000 to 244,000 taxpayers in just one year. In 1993 Congress created a two rate AMT tax system raising the rates from 24 to 26 percent for taxpayers with incomes under $175,000 and a 28 percent tax rate for taxpayers with incomes over $175,000. Following the 1993 tax rate the number of taxpayers paying the AMT increased an astonishing 354 percent by the end of 2000.

At the same time Congress failed to index the AMT income exemption for inflation so as taxpayers incomes increased over time more and more taxpayers were hit with the AMT. Even with an inflation index, incomes grow faster than inflation so this would not have solved all the problems but indexing for inflation would have at least mitigated some of the problem.

For example, in 1986 the median family income was just $29,458 while the AMT exemption was $40,000. The AMT exemption was lifted to $45,000 with the 1993 tax increase but by 1997 the median family income was exactly at the AMT income amount. Following 1997, the median income was higher than AMT rate which was a key component to driving the rapid increases in AMT payers.

Failure to Index AMT to Inflation Led To Rapid Rise in AMT Payers



97 Percent of AMT Payers Are Paying Because of the 1993 AMT Tax Increase

According to estimates by the Joint Committee on Taxation (JCT), in 2016 the number of taxpayers paying the AMT will reach 30.8 million. Repealing the 1993 tax increase will remove 12.2 million taxpayers from the AMT rolls. As such 40 percent of all AMT payers are paying because of the higher AMT tax rates enacted in 1993. These higher AMT rates from 1993 will force American taxpayers to pay an additional $375 billion of taxes from 2006–2016.

The next step in our analysis was to determine the second part of the AMT problem—the fact that rates and income are not subject to inflation protections as is the regular income tax. If the AMT was indexed for inflation in 1993 most of the people paying would be off the rolls.

Recent inflation protections enacted in 2001, 2003, 2004, and 2006 has kept 17.6 million people from paying the AMT. This runs contrary to the opinion that the recent tax cuts have increased the number of people paying the AMT.

So when adding the two numbers from the higher rates coupled with the inflation protections, 29.8 million of the 30.8 million that will be forced to pay the AMT are only paying because of the Clinton tax increase and the failure to index to inflation. That would leave only 1 million people are actually paying because of high incomes and lots of deductions.

The Impact of the Tax Cuts on AMT

Recently a number of policymakers have suggested that the tax cuts enacted since 2001 has increased the number of AMT payers. This could be the case but not for the reasons suggested. As I discussed above the AMT tax rates were increased correspondingly with increases in the income tax rates. Conversely, when income tax rates were cut in 2001, and again in 2003, AMT rates were not reduced correspondingly. This created an AMT tax liability higher than the regular income tax liability for some taxpayers. As such, the solution to this is not to raise the rates, either income or AMT, but to lower the AMT rates to match the lower income tax rates.

A second reason for the rise in AMT is that the tax cuts created a number of new deductions for the regular income not available in the AMT. Most of these deductions enjoy bi-partisan support such as college tuition tax deduction. Therefore, to fix the AMT problem from the recent tax cuts is to get rid of the deductions that most members support.

The combination of these two factors coupled with the policy failure of the 1993 tax increase is not the reason currently being given as the rise of the AMT. Accordingly, the proposed policy solutions such as increasing higher income tax bracket rates or AMT rates will do nothing to fix the problem. Furthermore, as we have witnessed in the past, lifting income exemption amounts only delays the problem. As incomes grow more and more people will be hit with the tax in the future. This is a situation of a dog chasing its own tail.

Recommendations

- **AMT Repeal. We believe given these factors the Alternative Minimum Tax should be repealed with no offsets**. It is unconscionable that Members of Congress who created this problem by raising tax rates and failing to index for inflation and then subsequently voting against repealing this tax six years later are now seeking to rearrange the chairs on the Titanic by forcing nearly 1 trillion of tax increases to "pay" for AMT repeal/reform. Raising taxes on small businesses to pay for an income exemption that will only sock taxpayers at a later date is a ridiculous proposal. Taxpayers should not be paying this tax today and therefore should not be forced to pay higher taxes from one pocket to reduce their burden on the other pocket.
- **Repeal The Clinton AMT Tax Increase**. Absent repeal without offsets, Congress should repeal the 1993 AMT tax increase to bring the AMT tax rates in line with the regular income tax. We know 40 percent of the AMT taxpayers are paying this tax solely because of the higher rates and these higher rates are generating nearly 50 percent of the revenue. This will not only remove 40 percent of the taxpayers from AMT it will also substantially reduce the amount of AMT taxes for existing taxpayers. Sen. Arlen Specter of Pennsylvania just last week introduced this legislation and I would urge a similar bill in the House and encourage all members to reverse this damaging tax increase.
- **Do Not Raise Taxes Under The Guise of AMT Reform**. Raising taxes to offset the "cost" will result in fewer jobs, a slower stock market, less growth, and ultimately a lower standard of living for all Americans. Any proposal to raise one set of taxes to offset the AMT is unnecessary and growth inhibiting. I urge all members to avoid this avenue.

Thank you for the opportunity to submit my written testimony and I look forward to working with you on ending the Alternative Minimum Tax.

Statement of Betty & Carmelo Rivero

We have, for some time now, been paying $1,750 per month to pay off our taxes for the year 2000. This is addition to the initial payments we made plus the bankruptcy filing we had to make in order to provide enough cash flow to make the $1,750 payments we are presently making.

These issues began when I was working for i2 Technologies an up and coming supply chain management software company, as an Administrative Assistant. I was hired in 1995 at a starting salary of $27,000 per year. In 1998 i2 Technologies went public and I was given stock options along with other people in our company. This was the first time in our lives that either of us had ever been offered stock options and all we thought about was that this would give us the ability to do things for our daughters, Carmen and Amy and possibly buy a new home.

In 1999 the stock started to rise pretty rapidly and in February 2000 I started to exercise my options. Later that year we put a down payment on a new home in Carrollton. It was over 15 miles closer to both our jobs. We thought we were at the perfect point in our lives.

At the end of 2000, i2 Technologies along with many other technology companies' stock started to drop drastically. Earlier that year I was told that I would be put on the black list, because of software on my computer that allowed me to support the company Controller, Nancy Brigham. Being put on the black list meant that I could not sell my stock during specific times of the year. Years later I was told that I was never added to this list but that I should not have sold my stock during that time because of the potential knowledge I had, given my position in the company.

The black out period for that quarter began December 1st and it was lifted January 19th after we released our earnings for that quarter. Not selling my stock during this time caused me to acquire AMT taxes on stock I exercised early in 2001. But what I did not know at the time, was that the stock that was valued anywhere from $50 to $105 at the time I exercised it would only be worth $3 a share when I sold it. And I would be required to pay taxes not at the price it was sold for, but at the exercised amount.

When I realized I owed these taxes I thought this was going to be an easy task to handle with the IRS. I could prove I never received the income at the exercise value for which the AMT taxes were being accessed. Well, we found that this tax, no matter how unfair, is legally owed to the IRS and they were not willing to consider dismissing it. They said that we needed to pay our taxes in full. Their job was to collect taxes not to consider whether the taxes were fair or not. Added to this when we were able to sell the stock at the $3 a share in 2001 we were unable to take a loss against the exercised AMT taxed value but were required to use as basis the amount paid which reduced our taxable loss greatly and was further limited by the allowable capital loss deduction of $3,000 per year. We are required to pay tax on income we never received on stock purchased in 2000 not sold until 2001 and the losses actually sustained for the same stock when sold was limited to $3,000 per year Capital Loss deduction (deduction against income not tax).

As we have already stated, we have now settled with the IRS and are paying $1,750 per month. This payment will continue until we pay all of the taxes, penalties and interest that are owed. At the present time we have accrued about $40,000 in penalties and interest. We feel that this is the most bizarre portion of this affair: "We are being *penalized* on taxes we owe for *income we never received*."

We are not saying we do not owe the IRS money because we do. However, we would have been able to settle with them years before we finally reached an agreement, if we did not have the AMT taxes to pay. We could understand owing taxes if we would have received the level of income for which the taxes are owed, but to be taxed for what we consider to be phantom income is difficult to understand, even though it is legal. We do not see an end to our paying the IRS. With the mounting penalties and interest it looks like we will be paying indefinitely.

My husband and I are requesting your help, in any way possible, in eliminating alternative minimum tax (AMT).

Respectfully,

BETTY RIVERO
CARMELO RIVERO