A Progressive Solution to the AMT Problem

Keeping the individual Alternative Minimum Tax from affecting tens of millions of innocent taxpayers is a problem that has bedeviled Congress ever since it passed President Bush's big cuts in the regular income tax back in 2001 without simultaneously adjusting the AMT.[1]

Over the past several years, Congress has repeatedly enacted temporary increases in the AMT exemption to protect most otherwise-affected families from having to deal with the AMT. But the cost of continuing these temporary patches has become prohibitive — exceeding $250 billion in lost revenues over the next four years.

Yet there is a straightforward way to pay for extending the temporary AMT relief through the end of this decade without busting the budget. This solution has the added advantage of returning the AMT to its original purpose: to assure that people with very high incomes pay a reasonable amount in federal income taxes.

A four-year, revenue-neutral AMT reform would have two key elements:

1. Extend the 2006 AMT exemptions through 2010, indexed for inflation.

2. Remove the special low 15 percent tax rate on capital gains and dividends from the AMT. That would mean treating capital gains and dividends the same as other income for AMT purposes.

What would be the effects of this reform plan?

- **Keeping the AMT exemptions at their inflation-adjusted 2006 level would prevent tens of millions of families in the upper-middle and near-rich ranges from falling into the AMT.** Overall, the proposal would reduce the percentage of taxpayers paying the AMT from an expected 17 percent in 2007, rising to 23 percent in 2010, down to only 4-5 percent.
- **Restoration of the AMT's intended purpose:** Eliminating the capital gains and dividends loophole in the AMT would pay for this change by shifting the AMT back to its original purpose: ensuring that the very rich pay a reasonable amount in taxes, however many loopholes they may enjoy under the regular income tax.
- **Little or no cost:** Taken together, these two proposed AMT reforms would cost a relatively modest $33 billion over the next four years — far less than the $250 billion cost of simply extending the 2006 AMT relief. Adding one additional change, an increase in the top AMT rate from 28 percent to 29 percent in 2009 and 2010, makes the plan virtually revenue-neutral for the rest of the decade.[2]

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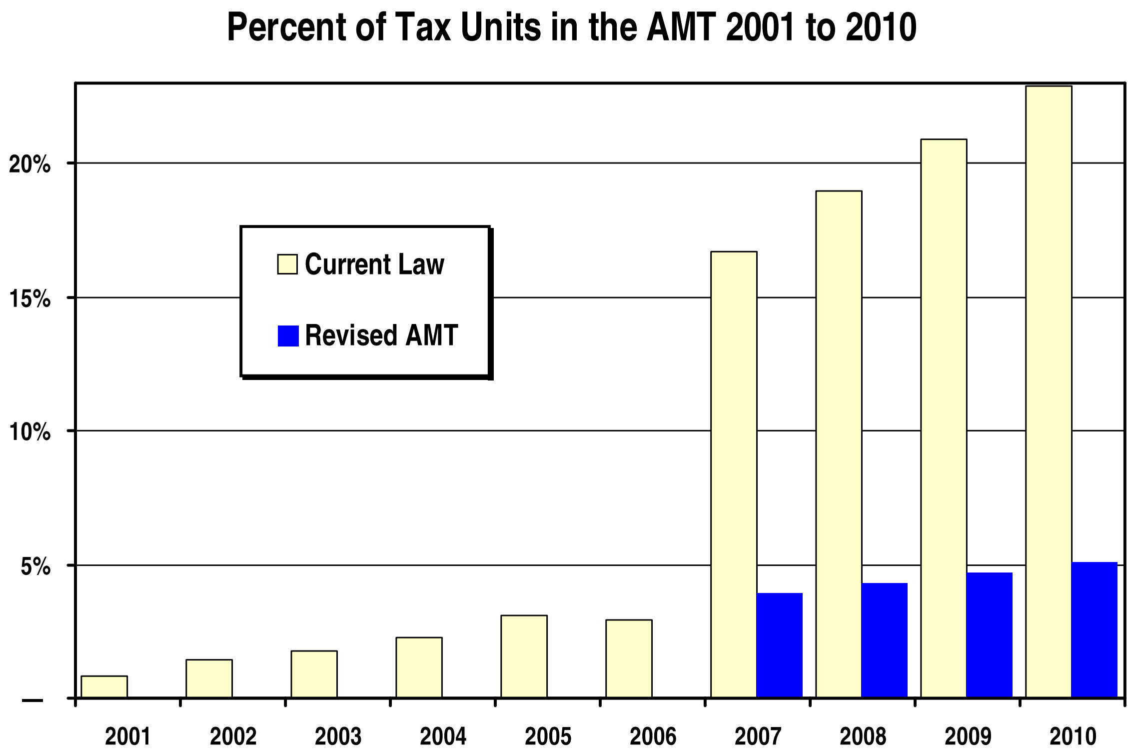
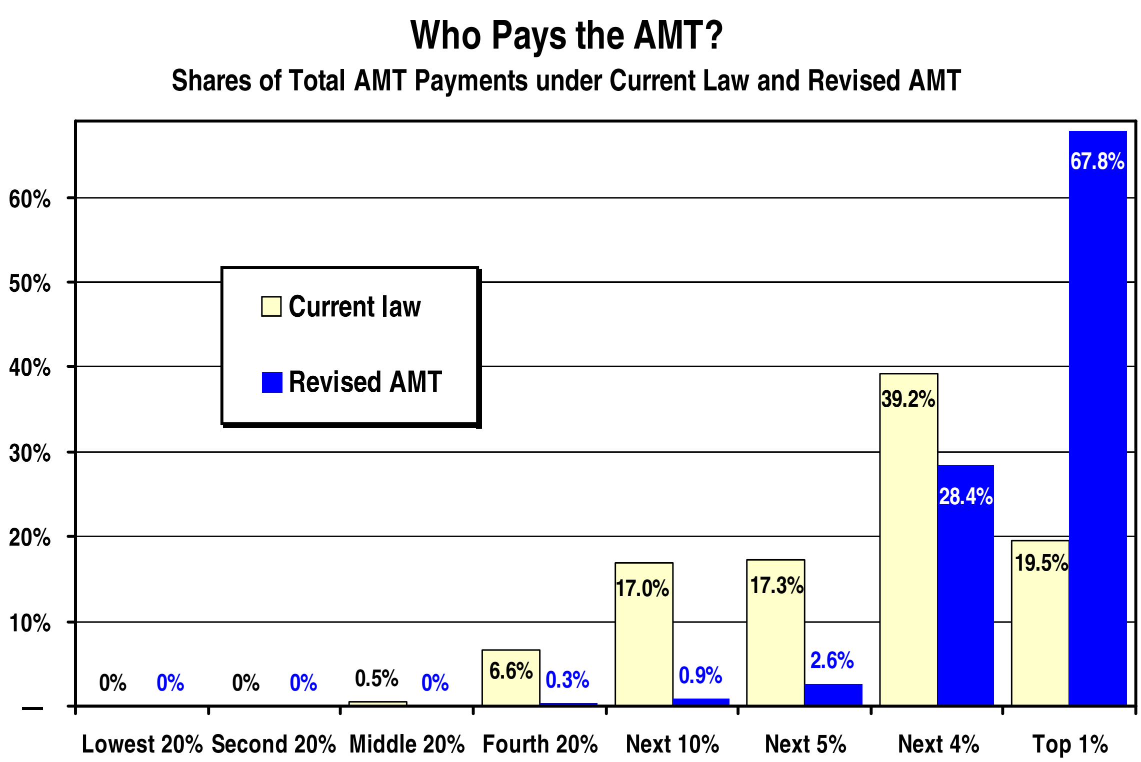
[1]As an alternative tax, the AMT is paid only if it exceeds the regular income tax. So if the regular income tax is cut, then the (unchanged) AMT is more likely to exceed the regular tax. (Note: the AMT is measured as the excess of the AMT over the regular income tax. If the regular tax is $1,000 and the tentative AMT is $1,050, then the AMT is $50.)

[2]The charts and tables that follow include this one-point AMT rate increase. The revenue estimates here assume no change in capital gains realizations as a result of the proposal. If realizations are assumed to be reduced, then the plan would need further tweaking to be revenue-neutral.

Percent of taxpayers in the AMT: The following chart shows the percentage of all couples and individuals paying the AMT, under current law and the proposal outlined here. (The years 2001-06 are not affected by the proposal.)



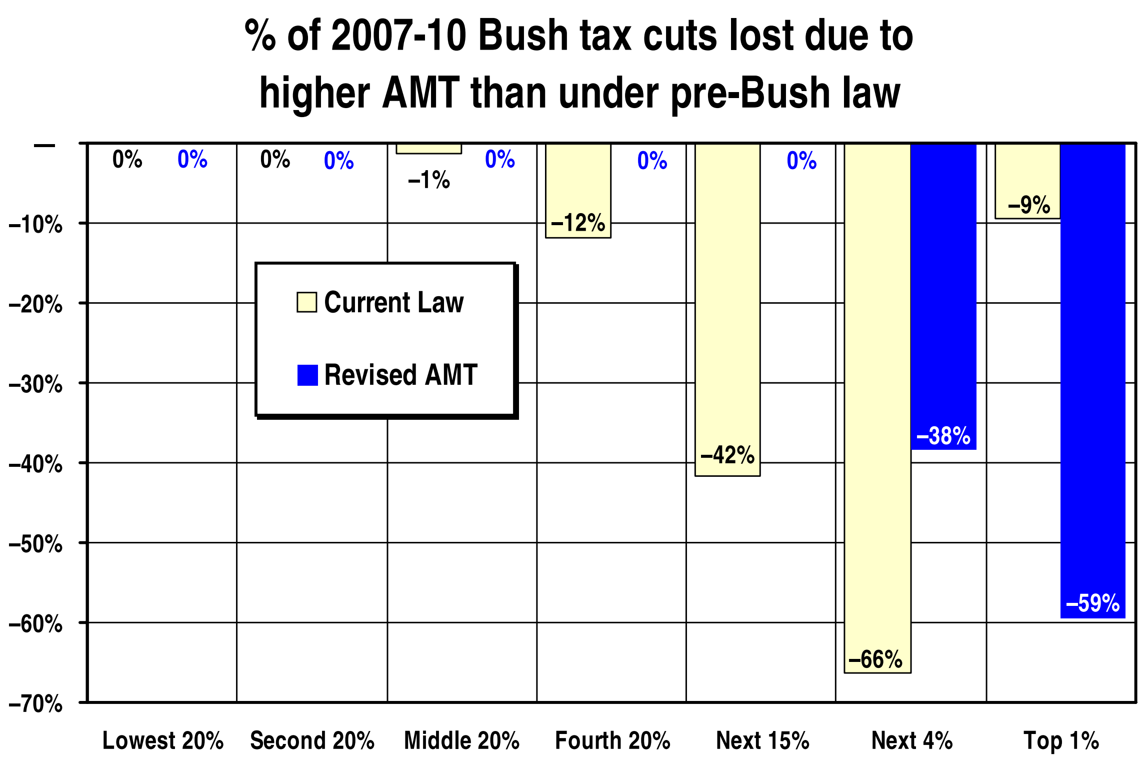
Who pays the AMT? The next chart shows how the proposal shifts the distribution of total AMT payments away from the upper-middle and near-rich income ranges and onto those at the very top of the income scale.



Winners & losers: As the table on page four details, in every income group affected by the plan except the best-off one percent, the winners would far outnumber the losers. Most taxpayers making between $160,000 and $500,000 would get significant tax cuts. Of course, taxpayers in the highest-income group — the best-off one percent — would pay considerably more in AMT than they do now. But they would still retain almost half of the huge Bush tax cuts they are scheduled to receive over the 2007-10 period.

Would President Bush sign this kind of AMT reform? Or would he say it's an intolerable rollback of his signature program, his tax cuts? Well, he might jump to that conclusion at first, but if so, he should reconsider. After all, what the reform plan does is give a lot of people *more* of the tax cuts that Bush promised them, but that are scheduled to be whittled away by the AMT. At the same time, it reduces the Bush tax cuts for a small number of people. Since the plan is revenue-neutral, it does not lower the total size of the Bush tax cuts at all. So the real question is who Bush wants to get the tax cuts he promised: a lot of rather well-off people or a few very rich people?

The next chart shows how the AMT reduces the promised Bush tax cuts over the 2007-2010 period, under current law and the proposed AMT reform.



Who has a dog in this fight? At first glance, the AMT battle might look like a relatively narrow fight that pits people making hundreds of thousands of dollars a year against people making millions. But it's much more than that — especially since Congress's new leaders have promised to pay for any new initiatives with higher taxes or reduced public services. So even the majority who are not directly affected by the AMT have a big stake in keeping AMT reform from costing large sums of money.

Tables detailing the effects of this AMT reform plan are on the next page.

Effects of Extending the 2006 AMT Exemptions (indexed) through 2010 With No Special AMT Rates for Capital Gains & Dividends and a 1 point increase in the top AMT rate starting in 2009

Revenue Effects ($-billion, calendar tax years):

2007	$ +3.0
2008	–5.4
2009	–0.6
2010	–0.4
4 yr total	**$ –3.4**

Note: fluctuations in the revenue effects reflect more usage of the increased AMT exemption each year, offset after 2008 by the 1 point increase in the top AMT rate.

Average tax changes for all taxpayers (calendar years)					Winners & losers (in 2010)			Ave AMT (all, 2010)	
	2007	2008	2009	2010	% win	% lose	% no ch	cur law	proposal
Lowest 20%	$ —	$ —	$ —	$ —	—	—	100%	$ —	$ —
Second 20%	—	—	—	—	—	—	100%	—	—
Middle 20%	–9	–13	–18	–26	4%	—	96%	26	—
Fourth 20%	–113	–176	–252	–353	30%	—	70%	368	15
Next 10%	–785	–1,019	–1,258	–1,523	74%	1%	25%	1,606	83
Next 5%	–1,621	–1,928	–2,237	–2,590	88%	4%	9%	3,066	476
Next 4%	–1,929	–2,308	–1,819	–1,808	76%	21%	3%	8,562	6,754
Top 1%	+28,322	+28,977	+36,031	+42,727	3%	79%	18%	16,929	59,656
ALL	**$ +22**	**$ –38**	**$ –4**	**$ –3**	**21%**	**2%**	**77%**	**$ 892**	**$ 889**

% in AMT	Current law				Proposal				% ch in
	2007	2008	2009	2010	2007	2008	2009	2010	2010
Lowest 20%	—	—	—	—	—	—	—	—	na
Second 20%	—	—	—	—	—	—	—	—	na
Middle 20%	1.4%	1.9%	2.6%	3.7%	—	—	—	—	–100%
Fourth 20%	13.9%	18.8%	24.0%	29.7%	0.5%	0.6%	0.8%	0.8%	–97%
Next 10%	55.8%	63.8%	69.9%	74.4%	2.4%	3.3%	3.8%	4.7%	–94%
Next 5%	80.0%	84.9%	88.0%	90.2%	11.5%	13.0%	13.8%	15.8%	–82%
Next 4%	92.5%	95.1%	96.0%	96.8%	59.1%	63.8%	68.9%	73.9%	–24%
Top 1%	59.2%	63.9%	63.1%	67.7%	66.1%	70.3%	78.5%	81.9%	+21%
ALL	**16.7%**	**19.0%**	**20.9%**	**22.9%**	**3.9%**	**4.3%**	**4.7%**	**5.1%**	**–78%**
Millions:	**23.5**	**23.5**	**30.1**	**33.3**	**5.5**	**6.1**	**6.8**	**7.5**	**–78%**

Source: ITEP Tax Model, December 2006

Citizens for Tax Justice, Dec. 2006