

AMT Relief in the FY2005 Budget: A Bandaid for a Hemorrhage

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By now, the problems with the individual Alternative Minimum Tax (AMT) are well known. Originally intended to ensure that high-income people pay at least some tax, the tax is now on track to ensnare 33 million households by 2010—or about one-third of households—in a web of pointless complexity and higher taxes by the end of the decade¹. The AMT increasingly afflicts middle-income taxpayers, especially those with children or who live in high-tax states. Under current law, 97 percent of married taxpayers with two or more children and incomes of \$75,000 to \$100,000 will be affected by the AMT by 2010.

The President's Budget, released on February 2, 2004, admits that there is a problem with the AMT, but proposes only a small and temporary fix—extending through 2005 an existing temporary fix that currently expires at the end of 2004. This not only fails to resolve the problem, it also substantially reduces the apparent budgetary cost of the President's main proposals to make the 2001 and 2003 tax cuts permanent (because taxpayers on the AMT will get less benefits from the rate reductions).

Taxpayers owe AMT only if their taxable income—augmented to include certain “preference items” such as personal exemptions and state and local taxes—exceeds the AMT exemption, which is currently \$58,000 for married couples and \$40,250 for singles and heads of households. Under current law, those thresholds are scheduled to fall to \$45,000 and \$33,750 respectively at the end of 2004, which would cause the number of AMT taxpayers to skyrocket. The new budget would delay that day of reckoning by one year—the temporarily higher exemptions would be extended through 2005. In addition, taxpayers will be able to use their personal credits, such as the education and child and dependent care tax credits, to reduce their AMT liability as well as their regular income tax liability.

The consequence of these provisions is that the projected number of AMT taxpayers in 2005 will decline from the current estimate of about 13 million to under 4 million. But, in 2006, after the temporary fix expires, the number jumps back up to almost 21 million. Moreover, because the budget proposes to make permanent the income tax cuts enacted in 2001 and 2003, the number of AMT taxpayers will continue to grow after 2010. We project that, by 2014, over 44 million taxpayers will be affected by the AMT. (See Figure 1.)

Table 1 shows that, without the temporary fix, the AMT would be seriously encroaching on the middle class in 2005. About 27 percent of tax filers with incomes between \$75,000 and \$100,000 (in \$2002) would be on the AMT in 2005 without a fix. More than half of those with incomes between \$100,000 and \$200,000, and more than 80 percent of those with incomes between \$200,000 and \$500,000, would be affected by the tax. (The participation rate falls at

¹ For a detailed discussion of the AMT problem and options for reform see Leonard E. Burman, William G. Gale, and Jeffrey Rohaly, “The AMT: Projections and Problems,” *Tax Notes*, July 7, 2003. <http://www.taxpolicycenter.org/publications/template.cfm?PubID=1000505>

higher income levels, suggesting how far the AMT has strayed from its original purpose.) But, if the higher exemptions are retained, less than 10 percent of tax filers with incomes between \$100,000 and \$200,000, and only about 1 percent of those with income between \$75,000 and \$100,000, will be subject to the tax in 2005. The table also shows that the temporary fix will also reduce the onerous marriage and child penalties inherent in the AMT—married families and those with kids will still be disproportionately affected by the tax, but the number of such families would be sharply curtailed.

Table 2 shows who would benefit from the AMT provisions in the budget. More than three-quarters of the benefits would accrue to those with incomes over \$100,000, although only a tiny fraction of the cut goes to those with incomes over \$1 million. Similarly, the average tax cut for people with incomes between \$200,000 and \$500,000 is almost \$2,100, because so many of those families are slated to owe AMT in 2005 under current law. Tax filers with incomes between \$100,000 and \$200,000 would get an average tax cut of \$869. The tax cut amounts to almost 1 percent of income for those with incomes between \$200,000 and \$500,000, and about 0.7 percent for those with incomes between \$100,000 and \$200,000. The tax cut is smaller, but still significant for those with incomes between \$50,000 and \$100,000. For most other taxpayers, the tax cut is negligible.

The tables show that the proposal would provide meaningful relief to taxpayers in 2005, but it does nothing to address the problem when it becomes most acute. Indeed, extending the 2001 and 2003 tax cuts makes the AMT problem much larger and more expensive to correct. The President has asked the Treasury Department to study ways to solve the AMT problem. Unfortunately, the large tax cuts enacted by this Administration will make coming up with the resources needed to address the AMT problem an even more difficult challenge than it would otherwise be.

Figure 1
AMT Taxpayers under Bush Budget Proposal,
2005-2014

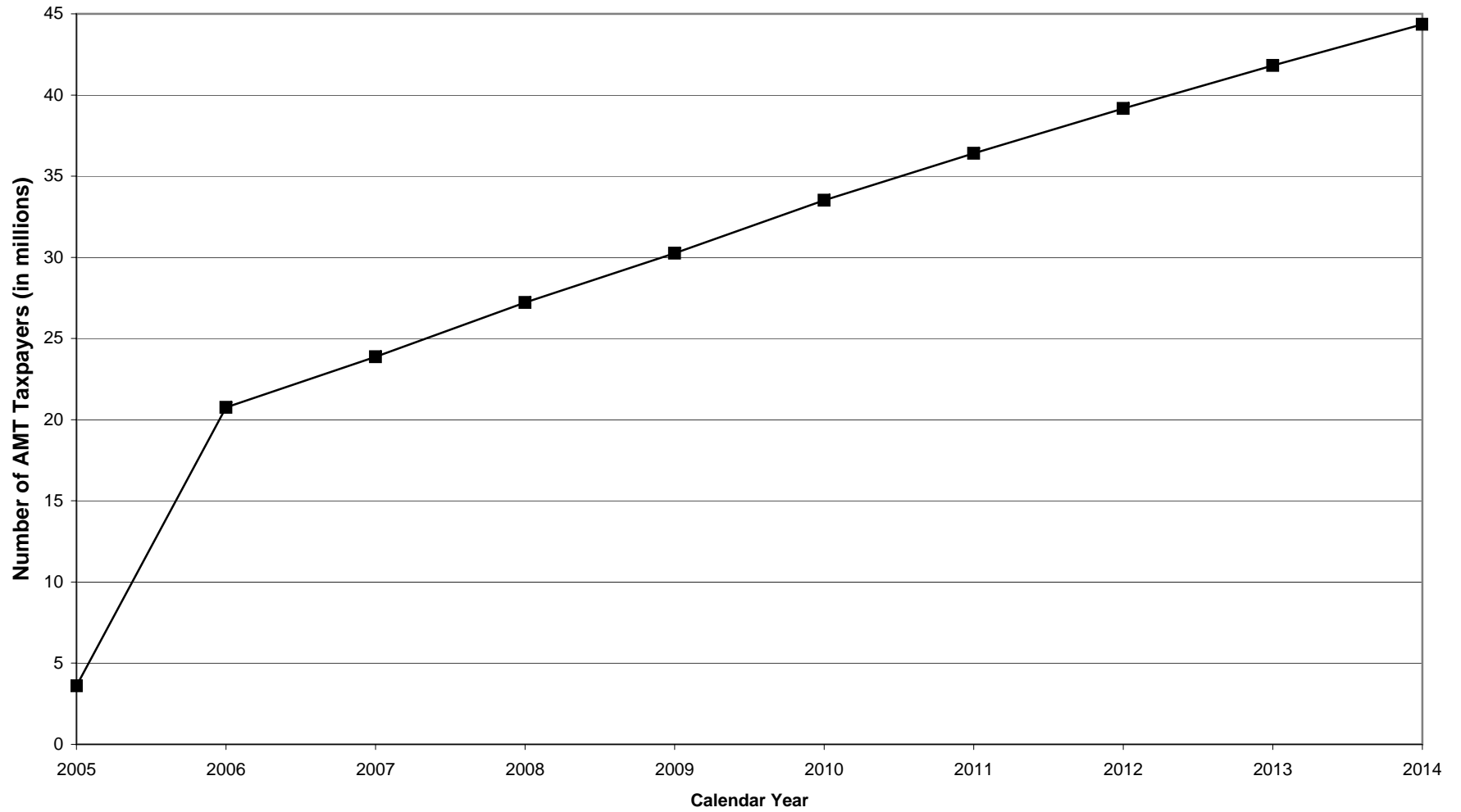


Table 1
AMT Participation Rate (percent) by Individual Characteristics¹

Group	Current Law²		Budget Proposal
	2003	2005	2005³
All Taxpayers⁴	2.6	12.8	3.2
All Tax Filers	1.8	9.3	2.4
Tax Filers by AGI (thousands of 2002\$)			
Less than 30	*	*	0.0
30-50	0.1	1.5	0.1
50-75	0.5	9.5	0.7
75-100	1.1	27.4	1.4
100-200	9.3	54.3	9.7
200-500	55.3	83.5	60.4
500-1,000	28.9	27.4	27.2
1,000 and more	19.3	18.7	18.7
Tax Filers by Number of Children⁵			
0	1.2	3.7	1.6
1	1.8	11.3	2.2
2	3.5	26.4	4.1
3 or more	6.0	35.4	7.0
Tax Filers by Filing Status			
Single	0.5	1.1	0.8
Married Filing Joint	3.7	20.9	4.4
Head of Household	0.8	4.0	0.9
Married Filing Separate	4.4	18.4	4.8
Married Couple, 2+ kids, 75K<AGI<100K⁶	1.0	65.3	1.3

* Less than 0.05 percent.

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0503-1).

(1) Includes returns with AMT liability on Form 6251 and those with lost credits.

(2) Includes the Job Creation and Worker Assistance Act of 2002 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

(3) Higher AMT exemption thresholds and the allowance of personal credits regardless of AMT liability are extended through 2005.

(4) Taxpayers are defined as nondependent returns with positive income tax liability net of refundable credits.

(5) Number of children is defined as number of exemptions taken for children living at home.

(6) AGI is measured in 2002 dollars.

Table 2
Effects of the AMT Provisions of the U.S. Budget for the Fiscal Year 2005¹
Distribution of Income Tax Change by AGI Class, 2005²

AGI Class (thousands of 2002 dollars) ³	Tax Units ⁴		Percent with Tax Cut	Percent Change in After-Tax Income ⁵	Percent of Total Income Tax Change	Average Tax Change (\$)	Average Income Tax Rate ⁶	
	Number (thousands)	Percent of Total					Current Law	Proposal
Less than 10	33,996	23.7	*	*	*	**	-10.0	-10.0
10-20	23,559	16.4	*	*	*	**	-4.4	-4.4
20-30	18,596	13.0	0.1	*	0.1	-1	3.3	3.3
30-40	13,801	9.6	0.9	*	0.4	-5	6.9	6.9
40-50	10,591	7.4	2.1	*	0.8	-14	8.6	8.6
50-75	18,383	12.8	9.3	0.1	7.5	-76	9.8	9.7
75-100	10,218	7.1	26.9	0.3	15.3	-278	11.8	11.5
100-200	10,288	7.2	54.3	0.7	48.2	-869	15.5	14.9
200-500	2,447	1.7	74.3	0.9	27.7	-2,099	22.3	21.6
500-1,000	404	0.3	1.8	*	0.1	-22	25.6	25.6
More than 1,000	210	0.1	0.4	*	*	4	25.8	25.8
All	143,413	100.0	8.5	0.3	100.0	-130	13.0	12.7

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0503-1).

* Less than 0.05 percent. ** Less than \$1 in absolute value.

(1) The provisions allow a \$58,000 AMT exemption for married filing joint returns (\$40,250 for heads of household and singles and \$29,000 for married individuals filing a separate return) and also allow personal credits to be taken regardless of AMT liability.

(2) Calendar year. Baseline is current law.

(3) Tax units with negative AGI are excluded from the lowest income class but are included in the totals.

(4) Includes both filing and non-filing units. Tax units that are dependents of other taxpayers are excluded from the analysis.

(5) After-tax income is AGI less individual income tax net of refundable credits.

(6) Average income tax, net of refundable credits, as a percentage of average AGI.