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What is Responsible for the Growth of the AMT?

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Under current law, the number of taxpayers affected by the alternative minimum tax (AMT) is projected to rise from about 4 million in 2006 to more than 23 million in 2007 and more than 32 million in 2010. On average, taxpayers affected by the AMT in 2010 will owe an additional \$3,600 in taxes. Two primary culprits are responsible for this impending explosion: the failure to index the AMT for inflation and the 2001–2006 tax cuts.

The Tax Reform Act of 1986 established the AMT in its current form. Subsequent changes to the AMT have altered the rates, the exemption amounts, and the credits allowed against the tax, but the basic structure has remained unchanged. The Omnibus Budget Reconciliation Act of 1990 (OBRA90) increased the single AMT rate from 21 to 24 percent. The 1993 budget reconciliation act (OBRA93) increased the AMT rate to 26 percent, added a second rate of 28 percent, and increased the exemption amounts from \$40,000 to \$45,000 for a joint return and from \$30,000 to \$33,750 for single and head of household filers.² The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) allowed the child credit against the AMT through 2010 and increased the AMT exemption amounts for 2001–2004. Legislation first enacted in 1998 and later extended through 2006 allowed personal nonrefundable credits against the AMT. Since 2003, the exemption has been periodically increased above EGTRRA levels in a series of short-term patches affecting tax years through 2006.

Taxpayers owe AMT when their tax calculated under the alternative rules, referred to as “tentative AMT,” exceeds their tax calculated under the regular system. The amount by which their tentative AMT exceeds their regular tax is then payable as AMT liability. Because of this comparison, the number of taxpayers affected by the AMT depends on the spread between the regular tax rates and the AMT rates. Changes that increase the spread will reduce the number of AMT taxpayers and changes that decrease it will tend to increase the number of AMT taxpayers.³ This interdependence means that the impact of changes to the AMT on the number of AMT taxpayers cannot be meaningfully assessed without also considering changes to the regular tax rates. OBRA90 increased the top regular income tax rate from 28 to 31 percent; OBRA93 added two additional tax rates of 36 and 39.6 percent; and EGTRRA reduced the top rates from 31, 36, and 39.6 percent to 28, 33, and 35 percent.

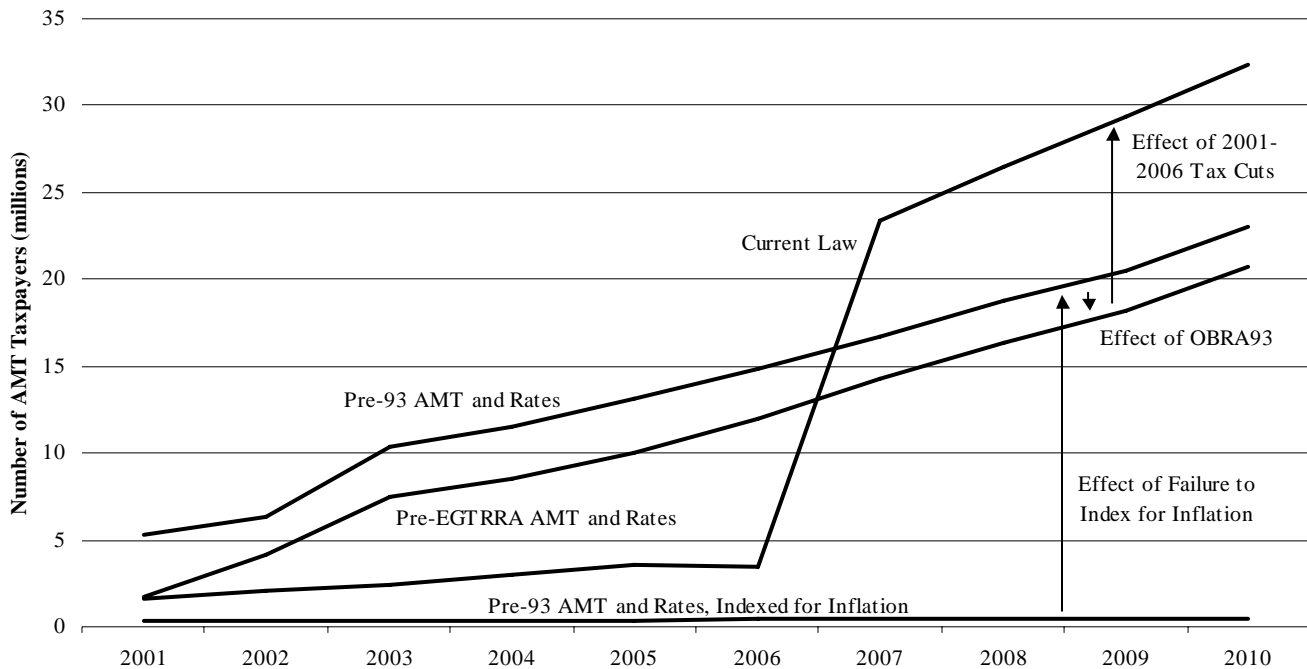
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² Married couples filing separately may claim an exemption equal to half that for those filing jointly.

³ Increasing the AMT exemption—since it lowers tentative AMT without affecting regular tax—and allowing additional credits against the AMT both reduce the number of taxpayers affected by the AMT.

If neither the OBRA93 nor the EGTRRA changes to tax rates and the AMT had occurred and if the AMT had been indexed for inflation along with the regular income tax in 1985, the number of taxpayers affected by the AMT would have remained under 500,000 through 2010, less than half of 1 percent of all tax units (see the “pre-93 AMT and rates, indexed for inflation” line in the chart).⁴ But in fact, the AMT was never indexed for inflation. How did the lack of indexation affect the growth in the number of AMT taxpayers? Assuming again that neither the OBRA93 nor the EGTRRA changes had occurred (i.e., that the regular income tax rates and all AMT parameters had remained at their pre-1993 levels), the number of taxpayers affected by the AMT would have been 5 million in 2001 rising to 23 million in 2010 (see the “pre-93 AMT and rates” line in the chart).⁵

Impact of Changes in the Regular Tax Rates and the Alternative Minimum Tax on the Number of AMT Taxpayers within a Current Law Tax Code, 2001-2010



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).

⁴ Excluding changes to the statutory regular income tax rates and the AMT, the tax law used in every simulation in this article consists of current law. This convention allows for a clearer comparison of the various incarnations of the AMT over the last two decades by abstracting away from the many other tax changes made in the intervening years. However, particularly in the case of the 2001–2006 tax cuts, the ignored changes will also affect the number of AMT taxpayers. As a result, care must be exercised in appropriately interpreting the results. For example, the entirety of the 2001–2006 tax cuts increased the projected number of AMT taxpayers in 2007 from 10 million to 23 million. However, the increase shown here is from 14 million to 23 million because the pre-EGTRRA number has already been inflated by several provisions of the tax cuts that reduced regular tax liability unrelated to the marginal rates or AMT, such as the expanded child credit and the phase-out of the phase-out of itemized deductions.

⁵ This increase is one of many possible measures of the number of taxpayers affected by the AMT because it was never indexed for inflation. Other options include going back further and making the same comparison eliminating the regular tax rate and AMT changes in OBRA90 or making the same comparison with the AMT indexed in 1987 rather than 1985. If we were to include OBRA90, the effect of the failure to index for inflation would be smaller and the effect of OBRA90 would be to increase the number of taxpayers affected by the AMT. Since recent discussion of this issue has focused on OBRA93 and the 2001–2006 tax cuts, we limit our discussion to those acts.

Next, we examine what OBRA93 did to the number of AMT taxpayers. The 1993 legislation increased rates under both the regular tax and the AMT but maintained a similar spread in the rates for all except the very small number of high-income taxpayers subject to the new 39.6 percent rate. The rate changes alone would be expected to have a small effect on the number of AMT taxpayers but the change could be in either direction. However, the legislation also increased the AMT exemption. In combination, these changes reduced the number of AMT taxpayers below the number that would have existed under current law with the pre-1993 AMT and regular tax rates. More specifically, including the OBRA93 changes to the AMT and the regular tax rates—and assuming that the EGTRRA rate changes had never occurred—the number of taxpayers affected by the AMT would have been 3.5 million in 2001, rising to 21 million in 2010 (see the “pre-EGTRRA AMT and rates” line in the chart).⁶ Thus, the OBRA93 changes to the AMT and to regular tax rates alone—ignoring the EGTRRA rate cuts—would have reduced the number of AMT taxpayers in 2010 by about 2 million.

EGTRRA and subsequent legislation reduced regular tax rates without changing the AMT rates, resulting in a dramatic increase in the projected future number of AMT taxpayers. However, the legislation has also applied a series of short-term patches to the AMT to increase the exemption amounts and to allow personal credits. Between 2003 and 2006, the patches have held down the number of AMT taxpayers to less than one-third of the pre-EGTRRA levels. If the patches expire as scheduled under current law, the number of taxpayers affected by the AMT will rise dramatically above the pre-EGTRRA level: 23 million in 2007 and 32 million in 2010 (see the “current law” line in the chart).

Why then is the number of AMT taxpayers projected to rise so dramatically in 2007? The proximate cause is the expiration of the last of the series of temporary patches put in place since 2001. However, the patches have only served to mask the underlying problems. Over the long term, the AMT is growing due to the combination of two factors. First, it is the failure to index the AMT for inflation. On top of that, the 2001–2006 tax cuts have reduced regular taxes without a corresponding, permanent reduction in the AMT. As a result, the number of taxpayers affected by the AMT will rise even more.

Would the number of AMT taxpayers be lower if the AMT rates were at their pre-90 or pre-93 levels? Yes, if those were the only changes made. However, such a comparison misses the point. The AMT does not exist in a vacuum separate from the rest of the tax code; it acts only in conjunction with the regular tax. The 1993 act increased rates for both the regular tax and the AMT, not just for the AMT. It also raised the AMT exemption. In fact, had the changes to the regular income tax rates and AMT in the 2001–2006 tax cuts and 1993 act never happened, implementing the changes in the 1993 act today would reduce the number of AMT taxpayers.

Are the taxpayers newly affected by the AMT as a result of the 2001–2006 tax cuts paying more than they would have without the tax cuts? No, the AMT sets a floor on tax liability and it simply reduced the size of the tax cuts that people actually received. If the only reason to be concerned about the AMT is its impact on tax liability, then there is not much cause for concern about the

⁶ Additional changes to the AMT enacted after OBRA93 but prior to EGTRRA would have further reduced the number of AMT taxpayers in 2001 from 3.5 million to less than 2 million. This reduction appears in the “pre-EGTRRA AMT and rates” line in the chart but is not due to OBRA93. As these changes were due to expire after 2001 under pre-EGTRRA law, a comparison between the pre-93 and pre-EGTRRA lines for the years 2002–2010 can be viewed as a measure of the impact of OBRA93.

impact of the tax cuts on the number of AMT taxpayers. However, if the share of taxpayers subjected to the needless complexity and lack of transparency of a backup tax system meant to deter sheltering is viewed as an indicator of the quality of the tax code, then there is.