

The Crazy Politics of the Alternative Minimum Tax

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One item likely to be part of any tax bill this year will be some modest relief from the individual alternative minimum tax (AMT). For example, proposals by Rep. Jerry Weller, R-Ill., and Rep. Jennifer Dunn, R-Wash., and by Nancy Johnson, R-Conn., and Charles Grassley, R-Iowa (see Tax Notes, Mar. 8, 1999, pp. 1395-1398), would attempt to prevent the value of various tax credits—mainly low- and middle-class credits, such as the child credit—from being reduced by the AMT. The Clinton administration generally has come to support these types of adjustments, especially for credits established or increased during its tenure. Almost none of the relief proposals, however, go to the heart of the AMT. Despite fairly widespread agreement that the AMT is not a very good tax, significant reform remains off the table.

Why? If the vast majority of elected officials think it is a bad tax, why don't they either eliminate it or drastically pare it? The logic, I believe, goes something like this: The AMT is scheduled to raise increasing amounts of revenue over time, mainly from those in the higher-income classes. Reforming it means dealing with effects on both revenues and progressivity. If tax cuts are going to be enacted, Republicans have their own preferred revenue losers—so do the Democrats. As far as reducing progressivity, the Democrats don't want it and the Republicans don't want to be blamed for it.

Much of the revenue growth over time comes from the failure to index the AMT so as to prevent more and more taxpayers from coming under its provisions. As state and local taxes rise over time with rising incomes, for instance, the itemized deduction of those taxes adds to the amount of measured "preferences" and tends to push taxpayers into paying the AMT. Almost no one argues that this is a good thing; yet it remains scheduled under current law. The primary "preferences" that will suck taxpayers into the AMT, moreover, aren't really traditional shelters or preferences in the usual sense. Rather they are itemized deductions for state and local taxes and miscellaneous expenses.

Despite millions of additional unintended victims over time, reducing the AMT does not have populist appeal for either party. Something else always takes priority. Most of the public worries about long-term health care, for instance, so a long-term care credit seems to have more universal appeal. Tens of millions of taxpayers face marriage penalties and would be glad to see some gesture to reduce them. Even an across-the-board tax cut spreads the benefits of a cut more evenly across the population of taxpayers. Thus, it's alright to fix the AMT, but only if the other party spends its chits in doing so.

If Congress is dealing with a 3-year, 5-year, or 10-year budget window, moreover, it is likely to enact small "fixes" only for a year or two. This Congress might prevent certain family credits from raising AMT liability only until the end of 2000. After 2000, future Congresses would be required to "spend" revenues not merely to enact a more elaborate reform, but simply to maintain whatever reform was enacted temporarily in 1999. Partly because of its illusionary effect, this type of short-term fix can add to the difficulty of achieving a more permanent fix.

Simply cutting back the AMT raises distributional, as well as revenue, issues. The "benefits" of reform would appear to favor mainly the upper-middle- and upper-income classes (many of whom avoid tax increases rather than receive tax cuts relative to prior years' liabilities). It may be bad enough that AMT relief would benefit only a few million taxpayers, but when few of those are poor or lower- middle class, public support is even harder to engender.

Of course, it is always possible that a tax bill will contain other provisions that would spread benefits more evenly across income classes. Still, with the budget constraining the overall size of any tax cut—eventually Congress will set a specific target—the more that is spent on AMT relief, the less there is for anything else. So almost any bill that uses revenues to reform the AMT could be made to look less progressive than a bill that is identical except that it dodges AMT reform. And if taxes are to be reduced for the rich, many would favor

lowering rates to reforming the AMT.

Some liberal advocates seem to be saying that any tax on the rich and upper-middle class, no matter how badly designed, is a good tax. Some conservative advocates seem to be saying that any tax on the rich is bad, but an explicit tax is worse than a badly designed, implicit, one. The compromise: keep the AMT more or less as it is.

Students of tax reform will recognize the problem as one of politics, not of logic. But there is a simple solution, one that would both maintain revenues and progressivity. Simply eliminate or cut the AMT and then replace it with more direct taxes on the income classes that benefit from the AMT tax cut. Suppose, for instance, that the rich would pay the same amount of tax if the AMT were eliminated because either their direct preferences were reduced or the top marginal rate was increased by 1 percentage point.

Neither political party, it seems, is ready for a more sweeping type of reform. The net result is that both parties are put in the position of favoring stealth taxes over explicit taxes. Meanwhile, the AMT remains and grows in size every year.

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