

Moving Beyond the Fight Over the Alternative Minimum Tax

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[1] The Alternative Minimum Tax albatross just keeps getting bigger and bigger. Neither political party yet wants to take responsibility. More to the point, neither wants to bear the revenue cost of dealing with it. And so the stalemate continues. Fixes are possible, but they require compromise over articles of faith for both parties. In particular, Democrats have to give up some of their fixation on progressivity and Republicans their fixation on lower statutory rates.

[2] The recent tax bill not only didn't address the AMT problem -- it made it worse. According to the Joint Committee on Taxation, the number of taxpayers paying the AMT will rise from about 1.5 million this year to more than 35 million by 2010 (of course, much growth was scheduled even under the old law). A temporary and very partial fix of the AMT through a higher exemption level expires at the end of 2004.

[3] Like a balloon into which air is constantly being forced, this one's eventually going to pop. The elasticity of the regular tax -- and the increasing ability of computer software to handle complex calculations -- allows the system to be stretched only so far.

[4] It's not just the increased number of AMT taxpayers that's going to be a nuisance. IRS compliance efforts on many items of the AMT are minimal. The Service essentially enforces items that are reported elsewhere on a normal tax return, such as state and local tax deductions and personal exemptions. Then it sends computer-generated letters to taxpayers who appear to owe AMT because these deductions and exemptions are not allowed in the AMT tax base calculation, and the alternative tax (with the smaller base and different rate) is higher than the regular tax.

[5] Now consider what happens as the number of taxpayers who owe the AMT keeps increasing. In effect, Congress has scheduled millions of taxpayers to get letters that they have underpaid their tax (especially if they fill out their returns themselves and don't use computer software). Many will be docked an extra penalty for late payment of taxes. At the same time, the IRS will almost automatically allow millions of taxpayers to get by with some noncompliance on harder-to-detect items.

[6] Some Democrats today complain that the Republicans failed to address the AMT problem in the new tax law -- favoring other changes over a fix. In addition, lowering the statutory rates without lowering the AMT rates makes it more likely that taxpayers will pay the AMT. But the Republicans can counterclaim that the Democrats have been ignoring the AMT for a long time themselves. Former President Clinton preferred to fight for HOPE scholarship tax credits and other special tax breaks rather than simplify the AMT. A bit of history also shows that the Democrats raised the AMT tax rate in 1993 when they raised the statutory rate. Despite an increase in the exemption level, they also allowed that level to decline over time relative to taxpayers' income. In effect, they, too, kept in the budget the expected revenues from a growing numbers of AMT taxpayers.

[7] The politics of blame, therefore, is not going to get us very far toward reaching a solution. The parties end up looking like two parents fighting over who has left the child alone while each one makes new engagements that prevent them from being with the child. While they blame each other, the child remains neglected.

[8] Republicans, of course, would be glad to get rid of the AMT or substantially reduce its reach. They simply don't want to pay for it. Given a choice between lower statutory rates and fixing the AMT, they will choose lower statutory rates. Democrats, of course, would be glad to have some AMT fix also. They simply don't want to give away any more money to those in the upper-income brackets or to give up other tax breaks that they

also favor. Given a choice between a bill with an AMT fix and a less progressive distribution of taxes and one without an AMT fix and more progressivity, so far they have chosen the latter.

[9] In a sense, both political parties get what they want: The Republicans get some of the statutory rate cuts they want and the Democrats maintain some of the progressivity they seek. The AMT provides the funding to do both. This is the way it's been for a long time now, with the recent tax bill being only the latest chapter in the drama. Sure, the current tax bill was deceptive in the way that it gave tax cuts with one hand (mainly statutory rate reduction) and then took them back with the other (the AMT). But this wasn't the first time, and both parties have been playing the game for some time now.

[10] What's going to end the game? Previously I have suggested that it might require folding the AMT into a larger package of simplification proposals. With or without a broader agenda on which to hang the AMT reform, it's also going to require the two political parties to move beyond their current positions. For the Democrats, it will require accepting a system that might even be less progressive than otherwise obtainable, while for the Republicans it will require accepting higher statutory rates than otherwise are obtainable.

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