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Tax Reform: The Alternative Minimum Tax

The U.S. federal income tax has both a personal and a corporate alternative minimum tax (AMT). Both the corporate and individual AMTs operate alongside the regular income tax. They require taxpayers to calculate their liability twice—once under the rules for the regular income tax and once under the AMT rules—and then pay the higher amount. Minimum taxes increase tax payments from taxpayers who, under the rules of the regular tax system, pay too little tax relative to a standard measure of their income.

Corporate AMT

The corporate AMT originated with the Tax Reform Act of 1986 (P.L. 99-514), which eliminated an "add-on" minimum tax imposed on corporations previously. The corporate AMT is a flat 20% tax imposed on a corporation's alternative minimum taxable income less an exemption amount. A corporation's alternative minimum taxable income is the corporation's taxable income determined with certain adjustments (primarily related to depreciation) and increased by the disallowance of a number of preference items, primarily related to extraction activities (depletion and expensing of intangible drilling costs) and the special deduction for Blue Cross and Blue Shield companies. In 2013, the most recent year available, the adjustments reduced AMT taxable income relative to regular taxable income, while the preference items resulted in greater AMT taxable income. A corporation must pay the AMT if the computation of tax under the AMT is greater than the computation of its tax under the regular tax. The corporate AMT serves to limit the use of tax preferences to reduce tax on retained, as well as distributed, earnings. The corporate AMT allows a credit for prior year corporate AMT payments and also exempts small business corporations (with gross receipts averaging less than $7.5 million per year) entirely.

Corporate AMT Revenue

As shown in **Table 1**, the corporate AMT revenues were roughly 1% of corporate tax receipts in both 2003 and 2013. In these years, firms paying the corporate AMT were less than 2% of all corporations.

Table 1. Selected Corporate Income Tax Statistics

	2003	2013
Number of Returns	5,401,237	5,887,804
Number of AMT Returns	9,564	10,222
Total Tax Liability ('000s)	$241,275,165	$437,372,463
AMT Liability ('000s)	$2,298,776	$4,197,924

Source: Department of the Treasury, Internal Revenue Service, *Corporation Complete Book*, 2003 and 2013, Table 2 and Table 23.

Individual AMT

The modern individual AMT originated with the Revenue Act of 1978 (P.L. 95-600) and operated in tandem with an existing add-on minimum tax prior to its repeal in 1982. **Table 2** details selected key individual AMT parameters.

Table 2. Selected Individual AMT Parameters, 2017

	Single/ Head of Household	Married Filing Jointly	Married Filing Separately
Exemption	$54,300	$84,500	$42,250
28% bracket threshold	187,800	187,800	93,900

Source: Internal Revenue Code.

The individual AMT tax base is broader than the regular income tax base and starts with regular taxable income and adds back various deductions, including personal exemptions and the deduction for state and local taxes. In addition, the individual AMT restricts the use of selected tax preferences, such as tax-exempt interest from qualified private activity bonds and accelerated depreciation. Taxpayers deduct the AMT exemption amount to determine their AMT taxable income. To this measure of income taxpayers apply a two-tier rate structure with rates of 26% and 28% to determine their personal AMT liability; they pay the higher of their regular or AMT liability.

Individual AMT Revenue

As shown in **Table 3** the individual AMT revenues were between 1.5% and 2% of individual tax receipts in 2004 and 2014. In those years, tax filers paying the individual AMT were 2.3% (in 2004) and 2.9% (in 2014) of all tax filers.

Table 3. Selected Individual Income Tax Statistics

	2004	2014
Number of Returns	132,226,042	148,606,578
Number of AMT Returns	3,096,299	4,277,624
Total Tax Liability Before Credits	$884,342,703	$1,432,797,923
AMT Liability	$13,029,239	$28,645,905

Source: Department of the Treasury, Internal Revenue Service, *Individual Income Tax Complete Book*, 2004 and 2014, Table 1.4.

Due to its design, a taxpayer is more likely to face the individual AMT if they reside in a "high tax" state or if they have children. Also, since the graduated regular income tax rates extend higher than the top AMT tax rate, nearly 60% of taxpayers with incomes between $200,000 and $1 million face the individual AMT, making this group of taxpayers more than three times as likely to pay the individual AMT as taxpayers with income greater than $1 million.

Economic Analysis of the AMTs

Ideally, the regular tax system would fully address the trade-offs between equity, efficiency, and simplicity, along with the need to raise revenue. However, the existence of the AMT—a parallel tax system—suggests that the regular tax system does not achieve the desired balance under all circumstances.

Equity

The AMT was originally motivated by a rough idea of vertical equity: high-income taxpayers and profitable corporations should be required to pay at least some income taxes each year. The AMT attempts to achieve this by denying selected tax benefits to certain taxpayers, which may improve the overall equity of the tax system.

The design of the corporate and individual AMTs may raise concerns about horizontal equity, which requires that taxpayers with similar abilities to pay should pay similar taxes. The regular tax system, arguably, addresses this concern by allowing taxpayers with certain characteristics to pay less in taxes than otherwise equivalent taxpayers. The AMTs retain some of these preferences and disallow others. In cases where the AMT treatment differs from the regular income tax, ability-to-pay arguments may not be taken into account and horizontal equity may be reduced as a result. This may reduce the overall equity of the tax system.

Efficiency

A tax system is considered economically efficient if it does not distort the choices that would be made in its absence. No feasible tax system is fully efficient. This is because the structural components of a feasible tax system—such as tax rates, deductions, and credits—influence decisions that taxpayers make.

Given that the corporate and individual AMTs both disallow selected tax preferences (removing their ability to influence choices), they could improve the economic efficiency of the federal tax system. However, affected corporations and individuals face higher marginal tax rates as a result of the AMT, which is likely to influence economic decisions. Overall, it is not clear which effect is larger. The overall effect depends upon taxpayers' awareness of how the AMT applies to them, taxpayers' responsiveness to these incentives, and other factors.

Simplicity and Transparency

The AMT reduces both the simplicity and transparency of the tax system. The need to calculate taxes twice for many corporate and individual taxpayers decreases the simplicity of the overall tax system. The AMT is also likely to reduce the transparency of the federal tax system, as corporations and individuals may have greater difficulty in determining the tax consequences of certain choices.

Recent Proposals

The House-passed version of the "Tax Cuts and Jobs Act" would eliminate both the corporate and individual AMT beginning in 2018. The Senate-passed version, however, would retain the corporate AMT and modify the individual AMT (by raising the AMT exemption levels). The modification of the individual AMT would sunset at the end of 2025.

The House "Better Way" tax reform blueprint proposed to eliminate both the corporate and individual AMTs. The Urban-Brookings Tax Policy Center (TPC) estimated that repealing the individual AMT would reduce federal revenue by $427.3 billion over 10 years. The TPC did not separately estimate the revenue effects of repealing the corporate AMT.

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