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The Alternative Minimum Tax for Individuals: Legislative Initiatives and Their Revenue Effects

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Summary

The alternative minimum tax (AMT) for individuals was originally enacted to ensure that all taxpayers, especially high-income taxpayers, paid at least a minimum amount of federal taxes. However, the AMT is not indexed for inflation, and this factor, combined with the recent reductions in the regular income tax, has greatly expanded the potential impact of the AMT.

Temporary provisions intended to mitigate the effects of the AMT expire at the end of 2005. If this occurs, then the number of taxpayers subject to the AMT will increase from 3 million in 2004 to 21 million in 2006. The Congressional Budget Office estimates that extending and indexing the 2006 AMT parameters would reduce federal revenue by $191 billion over the next five years.

The conference agreement on the 2006 budget resolution, H.Con.Res. 95, contained $106 billion in tax relief over the next five years, approximately $70 billion of which would be protected through the reconciliation process. Under reconciliation, $11 billion of tax relief is allocated for 2006. On November 16, 2005, the Senate Finance Committee approved a tax cut reconciliation plan — the Tax Relief Act of 2005 (S. 2020) — that would, among other things, extend AMT tax relief through 2006. The full Senate approved S. 2020 on November 18. On November 15, the Ways and Means Committee approved H.R. 4297 which, among other things, would provide partial AMT relief through a one-year extension of the treatment of nonrefundable personal tax credits under the AMT.

In addition, 15 stand-alone bills modifying the AMT have been introduced in the 109th Congress. The Administration did not include modifications to the AMT in its FY2006 budget proposal.

This report will be updated as legislative action warrants.

The alternative minimum tax (AMT) for individuals was originally enacted to ensure that all taxpayers, especially high-income taxpayers, paid at least a minimum amount of federal taxes.[1] However, absent legislative action, there will be a significant increase in the number of middle- to upper-middle-income taxpayers affected by the AMT in the near future. In 2004, about 3 million taxpayers were subject to the AMT, but by 2006, up to 21 million taxpayers could be subject to the AMT.

There are two main reasons for the increase in the number of taxpayers affected by the AMT. First, the regular income tax is indexed for inflation, but the AMT is not. Over time this has produced a reduction in the differences between regular income tax liabilities and AMT liabilities at any given nominal income level, differences that will continue to shrink in the absence of AMT indexation. The second reason is that the 2001 and 2003 reductions in the regular income tax have further narrowed the differences between regular and AMT tax liabilities. The combination of these two factors means that, absent legislative changes, there will be significant growth in the number of taxpayers affected by the AMT.[2]

The effects of the AMT have been temporarily mitigated through an increase in the basic exemption for the AMT. For 2005, the AMT exemption is $58,000 for joint returns and $40,250 for unmarried taxpayers. In 2006, the basic AMT exemption is scheduled to decrease to $45,000 for joint returns and $35,750 for unmarried taxpayers.[3]

Revenue Effects of Modifying the AMT

The fact that the AMT is poised to affect so many taxpayers in the near future has prompted calls to remedy the situation. Absent legislative action, the AMT will "take back" much of the recently enacted reductions in the regular income tax for millions of taxpayers. Because personal exemptions are not allowed against the AMT, large families will be particularly susceptible to the AMT. In addition, since deductions for state/local taxes are not allowed against the AMT, taxpayers who itemize and deduct these taxes on their regular income tax returns are also likely to be adversely affected by the AMT. However, modifications to the AMT will prove costly in terms of forgone revenue.

When discussing the long-run (beyond 2010) revenue implications of modifying the AMT, it is critical to specify whether it is assumed that the 2001/2003 tax cuts are allowed to expire after 2010 as scheduled or whether it is assumed that the tax cuts are extended beyond 2010. Allowing the 2001 tax cuts to expire as scheduled will reduce the costs of modifying the AMT. If the tax cuts are extended beyond 2010, then the costs of modifying the AMT will increase dramatically. Indeed, if the 2001/2003 tax cuts are extended, then, as a rough estimate, the cost of most options for modifying the AMT will almost double.

The revenue effects of several modifications to the AMT are shown in Table 1.

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[1] There is also a corporate minimum tax, but it is not addressed in this report.

[2] For more detailed information on the AMT see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Gregg Esenwein.

[3] For information on the income levels of taxpayers affected by the AMT in 2006, see CRS Report RS21817, *The Alternative Minimum Tax (AMT): Income Entry Points and "Take Back" Effects*, by Gregg Esenwein.

Table 1. Revenue Costs of Modifying the AMT
(billions of dollars)

Policy Option	FY06-10	FY06-15 (2001 tax cuts expire)	FY06-15 (2001 tax cuts extended)
Maintain higher AMT exemption level, index exemption and bracket amounts	$191[a]	$385[c]	$642[d]
Allow AMT taxpayers to take personal exemptions and either the standard deduction or deductions for state/local taxes. (AMT basic exemption reverts to prior law levels)	$282[b]	$530[b]	N/A
Extended higher AMT level through 2006	$30[c]	—	—
Allow personal exemptions under AMT	$176[a]	$343[c]	N/A
Allow state/local tax deductions under AMT	$228[a]	$423[c]	N/A
Repeal the AMT	$337[a]	$611[c]	$1,160[e]

a. Joint Committee on Taxation, *Estimated Revenue Effects of Various AMT Options*, May 17, 2005, unpublished data that formed the basis for the ten-year estimates in the CBO testimony of May 23, 2005.

b. Congressional Budget Office, *Budget Option*s, February 2005, p. 275.

c. Congressional Budget Office, CBO Testimony, *The Individual Alternative Minimum Tax*, May 23, 2005, p. 8.

d. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2006 to 2015*, January 2005, p. 8.

e. U.S. Department of the Treasury, *Fact Sheet: The Toll of Two Taxes: The Regular Income Tax and the AMT*, March 2, 2005.

To keep the AMT from affecting more taxpayers in the out years than it will in 2005 would, at the least, require maintaining the higher exemption levels and indexing the AMT for inflation. According to the Congressional Budget Office (CBO), this option, which will almost hold the AMT "harmless," will cost $191 billion over the first five years. It will cost $385 billion over 10 years if the 2001/2003 reductions in the regular income tax are allowed to expire as scheduled. If the 2001/2003 tax cuts are extended beyond 2010, then this option would reduce revenues by $642 billion over 10 years.

CBO also estimates that allowing AMT taxpayers to take personal exemptions and either the regular standard deduction or their itemized deductions for state/local taxes would reduce revenues by $282 billion over the first five years and $530 billion over 10 years if the 2001/2003 tax cuts expire as scheduled. (A 10-year revenue estimate of this policy option that includes the interactive effects of extending the 2001/2003 tax cuts is not available.)

Repeal of the AMT would be the most expensive policy option. According to CBO, repeal of the AMT would reduce federal revenues by approximately $337 billion over five years and by $611 billion over 10 years if the tax cuts expire as scheduled. The Treasury Department estimates that if the 2001/2003 tax cuts are extended, then repealing the AMT would reduce federal revenues by over a trillion dollars between FY2006 and FY2015.[4] In fact, the Treasury Department has estimated that by 2013, it would be less expensive to repeal the regular income tax than it would be to repeal the AMT.

Legislative Initiatives in the 109th Congress

On March 17, 2005, the House approved its FY2006 budget resolution, H. Con. Res. 95. The House resolution assumed $106 billion in tax reductions over the next five fiscal years. Also on March 17, 2005, the Senate approved its budget resolution, S. Con. Res. 18. The Senate budget resolution assumed $134 billion in tax reductions over the FY2006 to FY2010 period.

The conference agreement on the 2006 budget resolution, H.Con.Res. 95, was approved by both chambers on April 28, 2005, and contained $106 billion in tax relief over the next five years, approximately $70 billion of which would be protected through the reconciliation process. Under reconciliation, $11 billion of tax relief is allocated for 2006. Although the budget resolution does not identify specific changes to the tax code, it does not provide enough tax relief to hold the AMT harmless over the five-year budget horizon . Holding the AMT harmless would require extension and indexation of the increased AMT exemption levels and extension of the provision allowing taxpayers to use personal tax credits against the AMT[5].

On November 8, 2005, Senator Charles Grassley unveiled a tax cut reconciliation plan that would, among other things, extend AMT tax relief through 2006. On November 16, 2005, the Senate Finance Committee approved the tax cut reconciliation plan — the Tax Relief Act of 2005 (S. 2020) — that extends AMT tax relief through 2006. The full Senate approved the Tax Relief Act of 2005 on November 18.

Specifically, this bill includes both an extension of the higher AMT exemption level and an extension of the treatment of nonrefundable credits against the AMT. In addition, the bill would also index the AMT exemption level for inflation. It is estimated that these changes would reduce federal revenues by $31 billion.

On November 15, 2005, the Committee on Ways and Means approved H.R. 4297 which, among other things, would provide partial AMT relief through a one-year extension of the treatment of nonrefundable personal tax credits under the AMT. This bill, however, does not include an extension of the higher AMT exemption amount. As a result, it would provide only minimal relief from the expected impact of the AMT in 2006. The provision extending the treatment of nonrefundable credits under the AMT is estimated to cost $2.8 billion.

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[4] These estimates do not include the additional cost that would arise through debt financing of these policy options. These additional costs would be substantial. For instance, CBO estimates that the cost of the debt service associated with maintaining the higher AMT exemption levels and indexation of the AMT would be $132 billion over a 10-year period.

[5] Effective in 2006, certain personal tax credits (for example, the dependent care credit, the HOPE Scholarship and Lifetime Learning credit, and the D.C. homebuyer’s credit) cannot be used to reduce a taxpayer’s regular income tax below their AMT liability.

In addition to the budget reconciliation tax bills, 15 stand-alone bills affecting the AMT have been introduced in the 109th Congress.

S. 1099. Tax Simplification Act of 2005. Introduced on May 5, 2005, by Senator Richard Shelby. This bill would repeal the AMT.

S. 1103. Introduced on May 23, 2005, by Senators Baucus, Grassley, Wyden, Kyl, Schumer, and Crapo. This bill would repeal the AMT for individuals effective for tax years beginning after December 31, 2005.

S. 1229. Renewable Energy Incentives Act. Introduced on June 13, 2005, by Senator Harry Reid. This bill would allow the credit for electricity produced from renewable resources against the AMT.

S. 1240. Introduced on June 14, 2005, by Senator Gordon Smith. This bill would allow a new investment credit for the purchase of trucks with new diesel engine technologies to be take against the AMT.

H.R. 206. Introduced on January 4, 2005, by Representative José Serrano. This bill would provide a business credit for the use of clean-fuel vehicles by businesses located within designated areas. The credit would be allowed against both the regular income tax and the AMT for both individuals and corporations.

H.R. 703. The Middle Class Fairness Act of 2005. Introduced February 9, 2005, by Representative Scott Garrett. This bill would repeal the AMT limitation on the use of state and local tax deductions. It would also index, beginning in 2005, the AMT exemption amount for inflation.

H.R. 1091. Introduced on March 3, 2005, by Representative Phil English. This bill would allow the work opportunity, welfare-to-work, and the research credit against the AMT.

H.R. 1186. Alternative Minimum Tax Repeal Act of 2005. Introduced on March 9, 2005, by Representative Phil English. This bill would repeal the AMT starting in 2006.

H.R. 1538. Introduced April 8, 2005, by Representative Steve Israel. Increases the AMT exemption to $100,000 for joint returns and $75,000 for all other returns. Increases the AMT exemption phase-out threshold. Indexes the AMT exemptions and phase-out thresholds.

H.R. 1599. Introduced April 13, 2005, by Representative Jeb Bradley. Extends and indexes the increased AMT exemption amounts through 2007.

H.R. 2950. The Individual Tax Simplification Act of 2005. Introduced on June 16, 2005, by Representative Richard Neal. Among other things, this bill would repeal the AMT.

H.R. 2987. Introduced June 20, 2005, by Representative Robert Andrews. Allows a deduction for state and local income and property taxes under the AMT.

H.R. 3180. Introduced on June 30, 2005, by Representative Ron Paul. This bill would allow a deduction against the AMT for qualified attorney fees and court costs associated with settlements of civil actions.

H.R. 3301. Introduced July 14, 2005, by Representative J.D. Hayworth. This bill would allow a new investment credit for the purchase of trucks with new diesel engine technologies to be take against the AMT.

H.R. 3385. AMT Credit Fairness Act of 2005. Introduced on July 21, 2005, by Representative Sam Johnson. This bill would increase the allowable credit for prior year AMT liability and make it refundable.

Revenue estimates for these specific legislative initiatives in the 109th Congress are not available.

Administration's Proposal

In its 2005 budget proposal, the Administration proposed a one-year extension for both the increased AMT exemption levels and the provision allowing personal credits to offset AMT tax liability. Both of these proposals were ultimately enacted as part of the Working Families Tax Relief Act of 2004. The Administration also directed the Treasury Department to study and to report back within a year, on long-term solutions to the AMT problem.

In its 2006 budget proposal, the Administration did not address the AMT issue. Subsequent statements by Secretary of the Treasury John Snow indicate that the AMT issue is to be addressed by the tax reform panel appointed by the Administration. Although the tax reform panel has not released its recommendations, it is expected that any tax reform proposals will be revenue neutral. If the reform proposal is revenue neutral, and if a long-term AMT solution is to be incorporated into the panel's reform proposal, then other taxes will have to increase by an amount at least equal to the revenue cost of holding the AMT harmless under the current system. Hence, the reform proposal will need to raise $198 to $642 billion over the next five to 10 years to cover the minimum cost of fixing the AMT.