The Individual AMT: Problems and Potential Solutions

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Abstract

Originally targeted at high-income households, the individual alternative minimum tax (AMT) is now on the verge of switching from a "class tax" to a "mass tax." Under current law, the AMT will encroach dramatically on the middle-class over the next decade and will become the de facto tax system for upper-income households. These changes occur because of the non-indexation of the AMT for inflation and the tax cuts enacted in 2001. The trends are troubling because the AMT is notoriously complex, its effects on efficiency and equity are questionable, and its underlying purpose is controversial. This paper provides information on the AMT, its economic effects, and options for policy reform, and is intended to help inform the debate and the eventual reforms that will be required in the near future.

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I. INTRODUCTION

In January 1969, Treasury Secretary Joseph W. Barr reported to Congress that 155 individual taxpayers with incomes above $200,000 paid no federal income tax on their 1967 tax returns.[1] The news created a political firestorm. Members of Congress received more constituent letters in 1969 regarding the 155 taxpayers than concerning the Vietnam War (Graetz 1999). Later that year, the Tax Reform Act of 1969 created a minimum tax designed to ensure that individuals with high incomes did not take what was deemed undue advantage of tax laws to reduce or eliminate their federal income tax liability.

Although the original minimum tax and its successor, the individual alternative minimum tax (AMT), have historically had limited scope and applied only to a small minority of high-income households, the AMT is now on the verge of switching from a "class tax" to a "mass tax." In 2001, for example, fewer than 2 percent of taxpayers paid AMT. These taxpayers had substantial incomes, accounting for 7 percent of all adjusted gross income (AGI). Nevertheless, the tax accounted for just 1 percent of income tax revenue. Under current law, by 2010 the AMT will affect one-third of all taxpayers, who account for 55 percent of all AGI, and raise 10 percent of income tax revenues. The AMT will encroach significantly on the middle class, affecting a majority of taxpayers with AGI between $50,000 and $100,000. It will become the de facto tax system for taxpayers with AGI between $100,000 and $500,000, 95 percent of whom will pay AMT. Among married couples with two or more children and income between $75,000 and

[1] Barr (1969). Adjusted for inflation, $200,000 in 1966 is equivalent to about $1.1 million in 2001.

$500,000, the AMT participation rate will approach 100 percent. Indeed, by 2008, it would cost less in lost revenue to repeal the regular income tax than to repeal the AMT.

These projected increases raise a host of issues because the AMT is notoriously complex, its effects on efficiency and equity are questionable, and its underlying purpose is controversial. The purpose of this paper is to provide information on the AMT, its economic effects, and potential reform options.

Section II describes the calculation of AMT liability and the historical evolution of minimum taxes. The AMT tax base is essentially the sum of regular taxable income plus a variety of factors that are not included in the regular tax base, less the AMT exemption. The base is taxed at flatter rates than under the regular tax. AMT liability is the difference, if positive, between a taxpayer's overall liability under the AMT and a measure of tax liability based on the regular income tax.

The history of AMT reforms suggests that legislators intend for the tax to address broad issues of vertical and horizontal equity as well as the desire that every high-income person pay at least some income tax. Most major tax reforms since 1980 have involved AMT changes that broadly conform to the changes introduced in the regular tax. Two notable exceptions—the 1981 tax cuts, which indexed the regular income tax for inflation without indexing the AMT, and the 2001 tax cut, which slashed ordinary income taxes while leaving AMT rates and brackets unchanged (but for a temporary fix through 2004)—are the main culprits behind the predicted explosion of AMT coverage and liability. In section III, we use a new tax policy simulation model developed at the Urban-Brookings Tax Policy Center to document the projected AMT expansions noted above and relate the expansions to the lack of indexing for inflation and the 2001 tax cut.

Section IV analyzes economic issues related to the AMT. Although tax policy trade-offs and constraints imposed by budgets, political factors, and public opinion might rationalize the existence of some form of minimum tax, the existing AMT is difficult to justify formally. In equity terms, the AMT is more progressive than the regular tax, but AMT progressivity will decline markedly over the next decade, as more middle-class households fall prey to the AMT. The number of high-income people who pay no income tax has been roughly constant over time, but would have increased if not for the AMT.

The efficiency effects of the AMT are complicated. Observers typically characterize the AMT as having a broader base and lower marginal tax rates than the regular income tax. We show, however, that as of 2010, the opposite characterization will generally hold. For the vast majority of AMT taxpayers, the AMT will apply to less income and will be assessed at higher marginal tax rates than the regular tax. Interactions between the regular tax and the AMT have ambiguous effects on efficiency.

The AMT is complex. Rules regarding the timing of recognition of income and deductions require taxpayers to keep separate books for the regular tax and the AMT. The revenue gains of these rules are largely offset by another complicated set of rules that allow future tax credits for the tax benefits lost through the first set of rules. Thus, these two sets of rules are doubly complex and raise little revenue. The rules do, though, serve a recognizable policy goal: They reduce the number of high-income filers that pay no income tax in a given year. The potential value of other sources of AMT complexity is not readily apparent. Most people who are required to fill out the AMT forms end up owing no additional tax. The tax will impose increasing compliance burdens over time on middle-class taxpayers, who have never

been the main target of the AMT. Interactions between the AMT and the regular tax present taxpayers with complex planning problems.

Section V examines reform options. Indexing the AMT for inflation after 2002 would reduce the number of AMT taxpayers in 2010 by 70 percent, and the number with AGI between $15,000 and $100,000 by 90 percent. But it would cost $440 billion through 2012 under current law, and $100 billion more if last year's tax cut—which is currently slated to expire in 2010—is extended. With a few additional changes that would not increase tax sheltering, AMT participation would be cut by 99 percent by 2010 relative to current law. These changes include eliminating the phaseout of the AMT exemption, allowing exemptions for dependents and deductions for state and local taxes and miscellaneous expenses, and permitting the use of personal nonrefundable credits. This reform package, however, would cost $725 billion over the next decade, and $880 billion if EGTRRA is extended.

Repealing the AMT after 2002 would add $790 billion to the public debt by 2012 under current law, and $950 billion if EGTRRA is extended. Despite the growing share of middle-class taxpayers who are slated to pay at least some AMT, repeal would be regressive, and would raise the number of high-income taxpayers who pay no income taxes by a factor of four or more.

We also examine the financing of AMT reform. If the AMT were repealed and income tax rates changed to hold aggregate tax liability constant in each tax bracket, the resulting rate structure would require higher marginal tax rates for low- and middle-income taxpayers, much higher rates for most upper-income taxpayers, but lower rates for taxpayers in the top bracket.

Because projected AMT growth is due in large part to EGTRRA, freezing the tax cuts enacted in 2001 is a natural way to finance AMT reform. We show that freezing all of the cuts in upper income tax rates and in the estate tax in EGTRRA at their 2002 levels would be just

sufficient to finance indexing the AMT after 2002, but would fall about $300 billion short of financing AMT repeal. The AMT could, however, be retargeted at high-income households in a revenue-neutral fashion that spared most of the middle class, but significantly increased taxes on the very affluent.

Section VI provides concluding remarks. The Appendix describes our microsimulation model in more detail.

II. THE INDIVIDUAL AMT: AN OVERVIEW

Current Rules[2]

The individual AMT operates parallel to the regular income tax, with a different income definition, rate structure, and allowable deductions, exemptions, and credits.[3] Taxpayers who must calculate AMT follow a series of steps shown in table 1. The first several steps are analogous to those in the regular income tax: taxpayers determine the AMT tax base, apply the AMT tax rate and exemption phaseout schedules to determine pre-credit tentative AMT liability, and subtract applicable credits to obtain tentative AMT liability. Tentative AMT liability is the tax that would be owed by someone who paid taxes according to the AMT rules alone. AMT liability is the excess, if any, of tentative AMT above a measure of taxes due under the regular income tax.

AMT income: Alternative minimum taxable income (AMTI) is the sum of regular taxable income for AMT purposes, AMT preferences, and AMT adjustments. Each of these terms requires definition. Regular taxable income for AMT purposes is adjusted gross income

[2] See GAO (2000), JCT (2001b), and Rebelein and Tempalski (2000) for helpful summaries of AMT rules.

[3] A separate alternative minimum tax, which is similar in design to the individual AMT, applies to corporations. See Lyon (1997).

(AGI) less itemized or standard deductions less personal and dependent exemptions. It differs from regular taxable income--line 39 of form 1040--in that regular taxable income cannot be less than zero. Regular taxable income for AMT purposes can be negative.

An AMT preference is an item identified as a potential source of inordinate tax savings in the regular income tax that is not permitted in the AMT. An adjustment is simply any other exclusion, exemption, deduction, credit, or other treatment (such as a method for computing depreciation) in the regular income tax that is either restricted or disallowed in the AMT. There is no interesting economic distinction between preferences and adjustments in general; we will generally refer to both as preferences. But interesting distinctions do emerge among the various preferences and adjustments themselves.

Preferences and adjustments are of two types: exemptions or deferrals. Exemption preferences broaden the AMT tax base, and include the disallowance of personal exemptions, the standard deduction, and itemized deductions for miscellaneous expenses and taxes.[4] Deferral provisions change the timing of the recognition of income and deductions, typically to accelerate income and postpone deductions. Thus, they tend to raise the current-year tax base, but only at the expense of future tax bases. The most prominent among these relate to the treatment of incentive stock options (ISOs), depreciation of personal property, and passive activity losses.[5]

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[4] Other exemption items include disallowal of deductions for mortgage interest on debt not used to buy, build, or improve a home and for medical expenses between 7.5 and 10 percent of AGI. AMTI includes interest income from private activity bonds and adjusts the depletion allowances taxpayers can claim. The AMT also limits net operating loss deductions to 90 percent of AMTI (Harvey and Tempalski 1997).

[5] Other deferral items include some of the excluded capital gain on small business stock, farm shelter activity losses, and retiming of income from long-term contracts and costs associated with intangible drilling, research and experimentation, mining exploration, circulation expenses, and amortization of pollution control facilities (Harvey and Tempalski 1997).

Deferral and exemption provisions differ with respect to usage, distributional effects, revenue effects, complexity, and policy implications. A small number of exemption provisions involve widely used features of the tax code and account for the overwhelming share of the difference between regular taxable income and AMTI. In 2000, for example, state and local taxes accounted for 54 percent of the difference, personal exemptions for 23 percent, and miscellaneous expenses above the 2 percent of AGI floor for 20 percent (Rebelein and Tempalski 2000). Exemption provisions are used heavily by middle-income AMT taxpayers, but are relatively simple to comply with, since they just involve adding figures to taxable income. The exemption measures might be interpreted as an effort to reduce tax incentives generally and move toward an alternative tax that is simpler than the regular system.

Deferral preferences differ considerably from exemption items. Relative to exemption preferences, there are more deferral items in the code, but they are used much less frequently, tend to be used by high-income taxpayers, and generate much less revenue. Deferral items tend to be complex, as taxpayers generally need to recalculate income and costs using different schedules and keep separate sets of books for regular tax and AMT. Also, taxpayers may use AMT liability created by deferral provisions, but not by the exemption provisions, as a credit against future years' regular tax liability in excess of the tentative AMT. The deferral provisions, coupled with the credit they create, are consistent with a policy goal of having every high-income filer pay some positive tax in each year, even if his or her overall multiyear tax liability does not change.

Another AMT tax base issue involves capital gains. Tax preferences for capital gains under the regular tax were one of the key reasons for creating minimum taxes, and capital gains comprised the bulk of minimum tax and AMT preferences between 1970 and 1986. The Tax

Reform Act of 1986, however, taxed all capital gains at ordinary income tax rates and thus eliminated capital gains as an AMT preference item. Since then, tax rates on capital gains have been cut while tax rates on other income have increased, but the untaxed portion of capital gains has not reappeared as an AMT preference item. In some cases, however, capital gains are still treated differently under the AMT. When depreciation deductions are recalculated, for example, the adjusted basis of the asset—and thus the size and possibly the sign of any capital gain—will differ for regular tax and AMT purposes. Also, under the regular income tax, exercising an ISO generates no tax liability, but selling the stock generates capital gains tax on the difference between the sale price and the option price. Under the AMT, exercising a qualified stock option generates taxable income equal to the difference between the exercise price and the option price if the stock is not sold in the same year. Selling the stock generates capital gains taxes, but only on the difference between the sale price and the exercise price.[6]

Finally, we note a matter that may appear purely definitional but will prove substantively important. Alternative minimum *taxable* income is most comparable to adjusted *gross* income in the regular income tax, because neither measure subtracts exemptions. The AMT concept most analogous to taxable income in the regular income tax is the *difference* between AMTI and the AMT exemption. We will refer to that difference as the AMT tax base. The difference is given in line 23 of form 6251, but has no name in the tax code.

AMT exemption: Exemptions in the AMT are neither indexed for inflation nor adjusted for family size. For tax years before 2001 and after 2004, the AMT exemption is $45,000 for

[6] Recently, the AMT treatment of ISOs has generated attention in the popular press. Many taxpayers who exercised options on tech stocks and continued to hold the shares saw the stock value fall precipitously. The exercise triggered AMT liability even though the subsequent drop in share value led to massive capital losses (Johnson 2001, Richtel 2001). Although the AMT generates a credit that can be used in future years to the extent that ordinary income tax liability exceeds tentative AMT, taxpayers with modest incomes who exercised stock options worth many times their annual income may never be able to use the resulting AMT credits against their tax liability, especially if the stock never generates a capital gain.

married couples filing jointly and for surviving spouses, $33,750 for unmarried individuals other than surviving spouses, and $22,500 for married individuals filing separately. Last year's tax cut raised the exemptions to $49,000, $35,750, and $24,500, respectively, for years 2001 to 2004. AMT exemptions phase out for high-income taxpayers at a rate of 25 cents per dollar of AMTI over thresholds of $150,000 for joint returns, $112,500 for singles, and $75,000 for married individuals filing separately. The thresholds are not indexed for inflation.[7]

AMT tax rates: Pre-credit tentative AMT liability is determined by imposing the AMT tax rate schedule and the exemption phaseout schedule on the AMT tax base. The statutory AMT tax rate is 26 percent on the first $175,000 in AMT tax base for married couples or singles ($87,500 for married taxpayers filing separately) and 28 percent on additional amounts. The phaseout of the exemption, noted above, makes the effective marginal tax rate one-fourth larger than the statutory rate through the phaseout range. AMT tax brackets are not indexed for inflation. The AMT generally preserves the lower tax rates on capital gains in the regular tax.

Allowable credits: After determining pre-credit tentative AMT liability above, taxpayers subtract foreign tax credits (FTC). The FTC is the only credit that can reduce pre-credit tentative AMT liability, but it cannot reduce that liability by more than 90 percent. Tentative AMT liability is pre-credit tentative AMT liability less the applicable AMT foreign tax credit.

AMT liability: AMT liability is the excess, if any, of the tentative AMT liability over a tax liability measure based on the regular income tax. The latter measure is regular income tax liability before credits (that is, the tax due on adjusted gross income minus allowable exemptions

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[7] Besides the rules noted above, married taxpayers who file separately face an additional provision that increases their AMTI by an amount equal to the phaseout rate of the AMT exemption, currently 25 percent, times the amount that their AMTI exceeds the income level at which the exemption is completely phased out, up to a maximum equal to the married filing separately exemption amount. The purpose of this provision is to eliminate any AMT advantage of filing separately.

and deductions) less any taxes due because of lump-sum distributions and less any applicable FTC in the regular tax. For simplicity, we refer to this measure as "regular tax liability for AMT purposes."

AMT and the use of regular tax credits: After regular tax liability for AMT purposes and AMT liability, taxpayers return to the 1040 to calculate applicable credits. As of 2002, the AMT does not restrict the use of personal refundable credits--the earned income credit and the child credit. Under current law and through 2003, all personal nonrefundable credits can be used to reduce personal income tax liabilities to zero regardless of the AMT.[8] After 2003, all of these credits other than the adoption, child, and IRA credits are allowed only to the extent that the individual's regular tax liability exceeds the tentative AMT liability. The general business credit can reduce tax only to the level of tentative AMT liability, but unused portions may be carried backward or forward. Taxpayers whose ability to use credits is limited by their tentative AMT liability are said to have "lost credits." Finally, as noted above, payment of AMT creates a regular income tax credit for future years to the extent that the AMT liability is the result of timing-related preferences or adjustments.

Evolution of Minimum Tax Rules

Minimum taxes have changed frequently and significantly since they were introduced in 1969, as various Congresses and Presidents have aimed to balance a variety of policy goals. Table 2 summarizes significant minimum tax legislation. Figures 1 and 2 summarize historical trends in minimum tax participation and revenue.[9]

[8] The credits include those for dependent care, the elderly and disabled, adoption, child, interest on certain home mortgages, HOPE, Lifetime learning, IRA, and D.C. homebuyers (JCT 2002).

[9] Tempalski (1996) provides a comprehensive summary of the evolution of minimum tax rules. See also Graetz and Sunley (1988), Harvey and Tempalski (1997), JCT (2001b), and Karlinsky (1995). JEC (2001) summarizes all enacted legislation affecting minimum taxes since 1970.

Although the AMT is now a parallel tax, the original 1969 legislation created a minimum "add-on" tax, a tax on certain preference items that was paid in addition to regular income tax. The add-on tax rate was 10 percent, levied on tax preferences less an exemption of $30,000 and a deduction for regular tax payments. The major preference item was the excluded portion of capital gains. Other preferences included accelerated depreciation, stock options, and depletion allowances, all of which have remained preferences since then.

After a Treasury study showing that, even with the minimum tax, 244 high-income taxpayers had no income tax liability in 1974, the Tax Reform Act of 1976 reduced the exemption to the greater of $10,000 or half of regular tax liabilities, raised the tax rate to 15 percent, and added certain itemized deductions to the list of preferences.[10] These actions significantly increased AMT participation and revenues.

The Revenue Act of 1978 responded to concerns that the minimum tax was reducing capital formation by creating the modern AMT and transferring the taxation of excluded capital gains and excess itemized deductions there. The existing add-on tax was maintained for all other preferences. Unlike the add-on tax, the AMT operated as a parallel tax, with a $20,000 exemption, and graduated rates of 10, 20, and 25 percent. It allowed refundable credits and the foreign tax credit. Taxpayers paid AMT if their AMT liability exceeded regular tax plus add-on tax. The 1978 act substantially reduced add-on tax participation and revenues. Upon its inception, the AMT had more than twice as many taxpayers and raised twice as much revenue as the add-on tax.

From 1978 through 1982, taxpayers could potentially be subject to the add-on tax, the AMT, and the regular tax. The Economic Recovery Tax Act (ERTA) of 1981 reduced the top

[10] The legislation also required Treasury to report annually on the number of high-income taxpayers with no federal income tax (Harvey and Tempalski 1997).

AMT rate from 25 to 20 percent to conform with the reduction in regular tax rates in general, and the reduction in the top capital gains rate from 28 to 20 percent in particular. ERTA also indexed the exemptions, standard deductions, and brackets in the regular tax for inflation, but did not index the AMT.

The Tax Equity and Fiscal Responsibility Act of 1982 repealed the add-on tax and moved almost all of the preferences taxed there to the AMT. The AMT exemption rose to $40,000 for joint returns ($30,000 for singles) and tax rates were set at a flat 20 percent. From 1982 to 1986, AMT participation and revenue quadrupled.

The Tax Reform Act (TRA) of 1986 was a watershed event in the history of the regular income tax and the AMT. TRA reduced the top rate in the regular tax to 28 percent, taxed all realized capital gains as ordinary income, imposed restrictions on passive losses, and repealed the investment tax credit. These changes had profound effects on the AMT, primarily because they reduced sheltering activity (Samwick 1995) and because excluded capital gains had been 85 percent of AMT preferences before 1986 (Harvey and Tempalski 1997).

The 1986 reforms also fundamentally altered the AMT. The Act added numerous AMT preferences, expanding the difference between rules and definitions in the AMT and the regular tax, and significantly increasing the role of deferral preferences. It raised the AMT rate to 21 percent, created the exemption phaseout, introduced the notion of the AMT as a floor on taxes by limiting the extent to which net operating losses and foreign tax credits could reduce AMT, and created a minimum tax credit in the regular tax for AMT liability caused by deferral items. After 1986, AMT participation and revenues fell to pre-1982 levels.

Over time, policy changes and the effect of inflation on the unindexed AMT steadily raised AMT participation and revenues. Legislation in 1990 increased the AMT tax rate to 24

percent and raised the top regular income tax rate. In 1993, top income tax rates were increased again, AMT rates and tax brackets rose to their current levels, and the AMT exemptions rose to $33,750 for individuals and $45,000 for joint filers. The Taxpayer Relief Act of 1997 reduced capital gains rates in the regular tax and the AMT. Legislation in 1998 changed AMT rules so that in 1998 taxpayers could apply nonrefundable personal credits against regular tax liability regardless of AMT. This provision was extended for 1999 and expanded for 2000 and 2001 so that in the latter years, taxpayers could apply personal nonrefundable credits against both the regular tax and AMT.[11] In 2002, the expanded provision was extended through 2003.

By 1999, although it accounted for only 1 percent of returns and revenues, the AMT was growing rapidly. The number of AMT returns had doubled in the previous four years. AMT revenues had doubled as a share of income tax revenue and quadrupled in nominal terms in the previous seven years.

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 temporarily increased the AMT exemptions, as noted above, and allowed the adoption, child, earned income, and IRA credits to be used regardless of AMT liability until the entire bill sunsets at the end of 2010. Unlike the last major tax cut in 1981, though, EGTRRA provided no sustained and significant cuts in the AMT.

III. PROJECTIONS OF AMT PARTICIPATION AND REVENUES

[11] For example, consider a taxpayer with regular tax liability before credits of $1,000, tentative AMT of $1,250, and thus AMT liability of $250. The taxpayer also has $2,000 of personal nonrefundable credits. Before 1998, the taxpayer could not use any of the credits since tentative AMT exceeded regular tax liability. For 1998 and 1999, the taxpayer could use $1,000 of credits to reduce regular tax liability to zero, leaving the taxpayer owing $250 in AMT. After 1999, the taxpayer could use $1,250 of credits to reduce both regular tax liability and AMT to zero.

To project future AMT participation and revenue, we use the Urban-Brookings Tax Policy Center Microsimulation model, a large-scale microsimulation of the federal individual income tax system.[12] The data are taken from the stratified, random sample of tax returns contained in the 1996 public-use file produced by the Statistics of Income Division of the Internal Revenue Service. The appendix describes the model in more detail and compares our results with projections from the JCT (2001a) and Tempalski (2001).

Table 3 provides aggregate projections of AMT participation and revenues under current law. As of 2001, 1.8 million taxpayers, comprising less than 2 percent of all those with positive tax liability and less than 1.5 percent of all returns, were affected by the AMT as evidenced either by form 6251 liability or lost credits in the regular tax. Despite EGTRRA's increase in the AMT exemption, AMT participation is projected to triple between 2001 and 2004, to 5.5 million. When the higher exemption expires in 2004, AMT participation skyrockets, rising to 20 million by 2006, and more than 35 million by 2010 (see figure 3). The latter figure represents 33 percent of all taxpayers and 24 percent of all tax filers. In comparison, in 2000, 36 percent of taxpayers and 26 percent of tax filers claimed the mortgage interest deduction (SOI 2002).

AMT revenue follows a similar pattern.[13] In 2001, the AMT raised $11 billion, or 1.2 percent of all income tax receipts. AMT revenue rises to $21 billion by 2004, $61 billion in 2006, and $141 billion in 2010, at which point the AMT accounts for 10 percent of all income tax revenue. These figures provide a gauge of how difficult it will be to repair the AMT. The revenue gain shown is also a static estimate of the revenue loss from AMT repeal. The actual

[12] We use the term participation as convenient shorthand to refer to individuals who either owe AMT or lose personal credits because of the AMT.

[13] Technically, the figures reported in the table and discussed in the text refer to calendar-year AMT liabilities, not revenue. A portion of calendar-year tax liabilities is not collected as revenue until final tax returns are filed and final-quarter estimated taxes are paid in the following calendar year.

cost would be greater to the extent that repeal induces additional tax sheltering. Because of the rapidly rising number of AMT taxpayers over time, the revenue loss from repealing or significantly reducing the tax will grow rapidly over time as well. The table provides two other ways of gauging the quantitative significance of the AMT over time. By 2010, AMT returns will account for 55 percent of all AGI. More strikingly, by 2008, it will cost *less* to repeal the regular income tax—by setting the rates equal to zero and abolishing all credits—than it will to repeal the AMT.

Because AMT parameters are set in nominal terms, the projections are sensitive to variations in the rate of inflation. We estimate (not shown) that if inflation averaged 3.5 percent rather than the 2.5 percent rate built into the projections, AMT participation in 2010 would increase by 20 percent to 42 million, with revenues rising by over 40 percent to $199 billion. Lower inflation would reduce the figures by commensurate amounts, but with inflation running low by historical standards, the risks may not be symmetric.

We distinguish two sets of factors driving AMT trends: the design of the AMT and the 2001 tax cut.[14] A significant part of the projected increase in AMT participation and revenues arises because AMT parameters are not indexed for inflation, but regular tax parameters are. As a result, at a fixed real income level, inflation tends to raise tentative AMT liability more than regular tax liability and thereby places more taxpayers on the AMT. Even with moderate inflation, these effects cumulate into large changes over time. EGTRRA directly changed AMT rules in ways described above, but its biggest impact on the AMT will occur through its

[14] In principle, one could attribute the trends to an infinite variety of causes, depending on the counterfactual assumed. For example, the trends would look quite different if in some previous year the AMT exemption had been set at a very high income level, or had been indexed, or the AMT had been repealed. Likewise, if price inflation or real income growth were negative over the next decade, the trends would be different. Lindsey (2001) attributes a substantial effect to the AMT changes made in 1993, but their net effects are small compared to EGTRRA. In light of these issues, we focus on existing AMT design features and recent large policy changes as the two most salient causes of the current projections.

substantial reduction in regular tax liabilities. Large cuts in regular taxes, coupled with small and temporary cuts in AMT liability, imply that EGTRRA will exacerbate pre-existing AMT trends.[15]

Figure 3 shows the effects of non-indexing and EGTRRA on AMT coverage rates. If the AMT had been indexed for inflation when the regular tax was, only 300,000 people would have faced the AMT in 2002, and about the same number would face the AMT in 2010 under pre-EGTRRA law. Had EGTRRA not been enacted, 18 million taxpayers would have faced the AMT by 2010. Under current law—that is, adding in the effect of EGTRRA—the projected number of AMT taxpayers in 2010 nearly doubles, rising from 17.9 million to 35.6 million. Table 3 shows that EGTRRA also triples AMT revenue from $47 billion to $141 billion.[16]

AMT trends after 2010 depend critically on whether EGTRRA “sunsets" at that point, as current law requires, or is extended, as the President advocates and the House of Representatives recently voted. If EGTRRA is extended, the AMT will affect 37 percent of all taxpayers in 2012 and the revenue loss for 2003 to 2012 from AMT repeal will be $560 billion larger than under pre-EGTRRA law. The difference between AMT revenues under an extended EGTRRA and pre-EGTRRA law rises over time (figure 4), suggesting that the 10-year horizon significantly understates the longer-term cost of repeal.

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[15] EGTRRA features cuts in the highest income tax rates; a new 10 percent bracket; tax cuts for retirement saving, higher education, taxpayers with children, and married taxpayers; repeal of the phaseouts of personal exemptions and limitations on itemized deductions; and repeal of the estate tax (Burman, Maag, and Rohaly 2002, Gale and Potter 2002).

[16] The difference between the upper two panels and the lower two panels in table 3 includes the effects of EGTRRA and the Job Creation and Worker Assistance Act of 2002. The effects of the 2002 Act, however, are small and extend only through 2003. Appendix Table 1 shows that our aggregate AMT participation and revenue figures under pre- and post-EGTRRA law are close to those projected by JCT (2001a) and Tempalski (2001).

Table 4 reports AMT projections based on taxpayer characteristics. The most notable trend is the sharp rise in AMT participation in the middle class. In 2002, 1.4 percent of filers with income between $50,000 and $75,000 and 3 percent with income between $75,000 and $100,000 face the AMT. By 2010 these figures skyrocket to 43 and 79 percent, respectively.

Another noteworthy trend is the dominance of the AMT at somewhat higher income levels. About 95 percent of filers with income between $100,000 and $500,000 will face the AMT. The share of taxpayers on the AMT is lower for the very highest income groups, because the top tax rate in the AMT is below that in the regular tax. Nevertheless, more than half of tax filers with incomes between $500,000 and $1 million and more than one quarter of tax filers with incomes above $1 million will face the AMT in 2010.[17]

Because it does not provide dependent exemptions, the AMT raises tax burdens on large families relative to small ones (Johnston 1999). More than half of tax filers with 3 or more children will face the AMT in 2010, compared with 46 percent of those with 2 children and 16 percent of filers with no children. Many filers with children, however, pay no income tax. Among tax *payers* with 3 or more children, the likelihood of being on the AMT is 94 percent in 2010; among tax payers with 2 children, the analogous figure is 80 percent (not shown).[18]

To examine the impact of state taxes on AMT participation, we divide taxpayers into high-, middle- and low-tax states following Rebelein and Tempalski (2000).[19] For confidentiality reasons, the SOI public-use file does not provide a state code for filing units with

[17] Our estimates of AMT participation by income level are somewhat different from Tempalski (2001) because we report income classes in 2001 dollars, whereas Tempalski uses 2010 dollars. Our aggregate participation rates, however, are virtually identical (see appendix table 1).

[18] Kiefer et al. (2002) project that in 2010 a family of four with average itemized deductions and all income from wages would be on the AMT if its AGI were anywhere between $80,000 and $860,000.

[19] Rebelein and Tempalski rank states by state and local tax deductions as a share of income among itemizers and create three groups, each with about one-third of the number of taxpayers and tax liability.

1996 AGI above $200,000. Thus, we use only the records with state information. Because the AMT does not provide a deduction for state and local income and property taxes, filers in states with high taxes are more likely to face the AMT than those in states with low taxes. The relative importance of this provision declines over time as lack of indexation and EGTRRA cause more and more filers to face the AMT regardless of their state of residence.

Because the AMT exemption and tax bracket for married couples filing jointly are less than twice as large as the similar parameters for singles, the AMT creates marriage penalties. In addition, married filers tend to have higher income and more children than singles. All of these factors raise the likelihood of facing the AMT. Table 4 shows that by 2010 more than half of married couples will be on the AMT.

The AMT also imposes heavier burdens on heads of households compared with singles, relative to the regular income tax. Heads of households do not benefit in the AMT from the higher standard deduction and more generous tax brackets they enjoy, relative to singles, in the regular tax. In addition, heads of households typically have dependent exemptions, which are disallowed under the AMT. Partially as a result, AMT participation rates for heads of households are projected to rise to 10 percent by 2010, compared with 3 percent for singles.

The figures in table 4 thus project dramatic and widespread increases in AMT participation under current law. Combining some of the criteria noted above can present the "AMT problem" in an even starker fashion. For example, in 2010, among couples who file jointly and have two children, 71 percent of those with AGI between $50,000 and $75,000 and fully 97 percent of those with AGI between $75,000 and $100,000 will be on the AMT (not shown). About 99 percent of couples with two children and with income between $100,000 and $500,000 will face the AMT.

Table 4 also provides information on the extent to which the AMT problem predated EGTRRA. Under pre-EGTRRA law, AMT participation would have risen substantially in all income classes above $30,000. Even so, EGTRRA raised the likelihood of facing the AMT in 2010 by 18 percentage points for filers with incomes between $50,000 and $75,000 and by between 40 and 54 percentage points for filers with incomes between $75,000 and $1 million. It also more than doubled the share of AGI that is affected by the AMT, from 26 percent to 55 percent.

IV. ECONOMIC ISSUES

The projected rise in AMT participation and revenues highlights the need to understand the role of the AMT in the overall tax system. In this section, we examine potential justifications for an AMT, and the impact of the AMT on equity, efficiency, and complexity.

Potential Justifications

As the 1969 episode suggests, one possible rationale for an AMT is to ensure that all high-income households pay at least some federal income tax every year. On strictly economic grounds, it is easy to eviscerate the logic of a such a goal: the goal confuses tax payments with tax incidence; it focuses on an arbitrary measure of time; it focuses on one tax, rather than the tax system as a whole; and it seems to suggest that legally reducing tax burdens by $1 starting from a large positive number is acceptable, but reducing it from $1 to zero is not (Shaviro 1988, 2001).

Although the critique is valid as far as it goes, it does not rule out a minimum tax, for two reasons. First, the letter-writing campaign in 1969 and more recent events suggest that the public is sensitive to *perceived* inequities in the tax system, even if the supposed inequities can be explained away in economic terms. The notion, for example, that a company's chief executives

should pay less tax in particular years than members of their support staffs often meets with understandable public opposition. Public opinion creates important constraints on legislative outcomes, regardless of the economic merits of such views. To the extent that it improves perceived equity, the AMT could have value.

Second, the AMT has multiple goals. The JCT (1970) describes congressional views of the purpose of the original minimum tax:

> The prior treatment imposed no limits on the amount of income which an individual ...could exclude from tax as a result of various tax preferences. As a result, there were large variations in the tax burdens placed on individuals...with similar economic incomes...[I]ndividuals...[who] received the bulk of their income from such sources as capital gains or were in a position to benefit from....tax-preferred activities tended to pay relatively low rates of tax. In fact, many individuals with high incomes who could benefit from these provisions paid lower effective rates of tax than many individuals with modest incomes. In extreme cases, individuals enjoyed large economic incomes without paying any tax at all.[20]

Similar statements can be found regarding the purposes of subsequent reforms to minimum taxes (JCT 2001b). These statements clarify that the minimum tax has always been intended to address broad issues of horizontal and vertical equity, and other issues relating to what might be called the "excessive" use of tax shelters, not merely to ensure that every high-income person pays a positive level of federal income tax.

In a perfect world, the regular tax system could adequately address trade-offs between efficiency, equity, complexity, and perception issues. Thus, a justification for an AMT is most likely to arise from some sort of second-best consideration. Graetz and Sunley (1988), for example, support the AMT as a rational response in light of policy constraints. They argue that

[20] The quoted passage is taken from JCT (2001b), which cites the original 1970 document.

Congress would like to use tax provisions to achieve various economic goals, but also to ensure that taxes are distributed fairly. A minimum tax ensures that everyone with substantial income pays at least some tax, and that the actual and perceived distributions of taxes are more equitable than would occur under the regular tax alone. Although the AMT may add complexity and reduce efficiency, they believe the benefits are worth the costs.

Shaviro (2001) is more circumspect, but defends the existence of an AMT in principle—as opposed to the current formulation of the AMT in practice—as a second-best response to political economy constraints. The regular tax may contain features that are inefficient or inequitable but that are difficult, for political reasons, to shut down or directly modify. If so, it may be more politically feasible to make changes indirectly via a minimum tax than dire4ctly in the regular tax.

These lines of argument suggest that it could be possible to justify an alternative minimum tax of some kind, but clearly the theoretical claim has not been established in the real world. First, even given the reasons above, it is not obvious that the *current* AMT improves the present system, and we are aware of no empirical studies weighing the relevant costs and benefits to make that determination. In addition, the second-best claims for the AMT depend on the implicit assumption that policy in the regular tax contains flaws, but that policies in the AMT, made by the same political agents who are subject to the same budget and political constraints as when they make changes in the regular tax, effectively counteract those flaws. It is unclear why this assumption should be accepted. Moreover, the view that it is easy to alter flawed policies in the regular income tax by hiding corrections in the AMT will be less plausible as more people are exposed to the AMT.

Equity

The basic rationale behind the AMT is to reduce vertical inequity. Table 5 shows that the AMT currently imposes burdens more progressively than the regular tax. In 2002, the AMT and regular tax will collect about the same share of their revenues from taxpayers with incomes above $1 million, and from taxpayers with income between $100,000 and $200,000. The significant differences occur for taxpayers with AGI between $200,000 and $1 million—where the AMT collects 51 percent of its revenues and the regular tax collects 25 percent—and taxpayers with AGI between $15,000 and $100,000—where the AMT collects 6 percent of its revenue compared with 33 percent for the regular tax.

The progressivity of each tax, however, is slated to decline over time. The income tax share paid by taxpayers with income over $1 million falls from 22 percent in 2002 to 18 percent in 2010. The share paid by those with income above $500,000 falls from 30 percent to 26 percent, even though the share of all taxpayers in that category rises. These declines occur because the tax cuts in EGTRRA are regressive, especially among the top 1 percent of all taxpayers (Burman, Maag, and Rohaly 2002, Gale and Potter 2002).

Changes in the distribution of AMT payments are even more dramatic. By 2010, the AMT will collect only 5 percent of its revenue from taxpayers with income over $1 million and 9 percent from taxpayers with income above $500,000. The analogous figures for 2002 are 20 percent and 33 percent. The decline in AMT share for high-income taxpayers is due to the explosive growth in the number of AMT taxpayers with lower incomes. The share of AMT paid by taxpayers with AGI between $15,000 and $100,000 rises from 6 percent in 2002 to 24 percent in 2010, and the share paid by taxpayers with AGI between $100,000 and $200,000 rises from 21 percent in 2002 to 38 percent in 2010.

Thus, table 5 suggests that the AMT will continue to collect more of its revenues from taxpayers with AGI above $100,000 than the regular tax does. But the progressivity of the AMT is declining in important ways. The AMT will collect a much smaller portion of its revenue from taxpayers with income above $500,000 than will the regular tax. The AMT will also become more of a middle-class tax, with more than half of AMT taxpayers and a quarter of AMT revenues coming from taxpayers with AGI below $100,000. These new AMT taxpayers will be subject to the AMT for reasons relating to marital status, number of children, or state of residence. By 2010 personal exemptions will account for 46 percent of all preferences, the standard deduction for 5 percent, and state and local taxes for another 44 percent (Rebelein and Tempalski 2000). The last item may or may not be appropriate as a preference, since taxes may be considered the purchase of public services. Even so, the AMT tax base is moving over time toward a measure that has very little to do with aggressive tax sheltering.

Despite all of the changes to minimum tax policy documented above, the percentage of high-income returns (returns with income above $200,000 in 1966 dollars) that pay zero federal income tax has not changed very much over the past 25 years (figure 1). This does not mean the AMT has had no effect on the number of zero returns though. In 2001, an estimated 100 taxpayers with income above $1 million paid no federal income tax, even with the AMT. Had the AMT not existed, more than 700 high-income taxpayers would have paid no federal income taxes. Thus, the AMT reduced the number of high-income taxpayers who do not pay any federal income tax by a substantial percentage, but both numbers are tiny relative to the pool of high-income taxpayers. Of course, the number that would pay no income tax in the absence of the

AMT would rise to the extent that the AMT has actually discouraged some high-income filers from using tax preference items more aggressively.[21]

Interactions between the regular tax and the AMT also raise equity concerns. The AMT distorts the workings of, and the effects of changes in, the regular tax. For example, table 6 shows that about 5 percent of all tax filers, including 50 percent of those with income between $200,000 and $500,000, will receive no income tax cut from EGTRRA solely because of the AMT. In 2010 the AMT will "take back" over one-third of the regular income tax cuts that would have occurred had the AMT not existed. This includes more than 70 percent of the average income tax cut for filers with income between $100,000 and $500,000 and 42 percent for filers with income between $75,000 and $100,000, but only 8 percent for those with income above $1 million. The take-back pattern also varies with respect to taxpayer characteristics such as filing status and number of dependents (see Davis 2001, Gravelle 2001).

Efficiency

The individual AMT affects economic efficiency in numerous ways. We first examine efficiency issues as if the AMT were a stand-alone tax, and then examine issues that arise from interactions between the regular tax and AMT.

Stand-alone tax: Virtually every discussion of the AMT characterizes the tax as having a broader base and lower marginal rates than the regular tax. This characterization is misleading.

The confusion over the tax base arises in part because, for most taxpayers, AMTI is the sum of taxable income in the regular tax plus AMT preferences and adjustments. Because the

[21] IRS (2000) reports that 303 taxpayers with AGI above $500,000 paid no federal income tax in 1997. Our simulations indicate that in 2001, more than 200 taxpayers with AGI above $500,000 paid no federal income tax, and that if the AMT had not existed almost 1,800 would not have paid any income tax, even abstracting from any changes in tax sheltering or other behavior that would be induced by AMT repeal.

last two items are virtually always positive, AMTI virtually always exceeds taxable income.[22] However, while taxable income is the base in the regular tax, AMTI is *not* the base in the AMT. The AMT base is the difference between AMTI and AMT exemptions. Thus, any AMT taxpayer with preferences and adjustments that are smaller than the allowable AMT exemption will have more income subject to tax in the regular tax than in the AMT (where income subject to tax under AMT is AMTI minus exemptions).

Table 7 shows that in 2002 only 34 percent of AMT taxpayers have more income subject to AMT than subject to the regular income tax. The vast majority of AMT taxpayers with income between $50,000 and $200,000 simply do not have enough preferences and adjustments to make their AMT base exceed their regular tax base. Among filers with AGI above $500,000, though, the exemption is phased out and preferences rise, and the AMT base tends to be larger.

Between 2002 and 2010, the AMT exemption drops in nominal terms, and the share of middle-class taxpayers on the AMT rises dramatically. As a result, in 2010, 87 percent of AMT taxpayers will have more income subject to tax in the regular tax than in the AMT. As in 2002, the share varies dramatically by income class, with more than 90 percent of AMT taxpayers with AGI between $15,000 and $200,000 having more income subject to the regular tax and over 93 percent of AMT taxpayers with higher AGI having more income subject to AMT.[23]

Because most AMT taxpayers will have less income subject to AMT in 2010 than to the regular tax it must be true that the average tax rate will be higher under the AMT. For the vast majority, their marginal tax rates will be higher too. Our measure of effective marginal tax rates

[22] For taxpayers with negative regular taxable income for AMT purposes (defined above), regular taxable income in the regular tax is set at zero, so that AMTI may be less than regular taxable income even if adjustments and preferences are positive.

[23] Taxpayers with negative AGI have AMT preferences more in line with the highest income groups than other groups. Burman and Ricoy (1997) obtain a similar result, noting that groups with negative AGI and very high AGI are more likely to have large capital gains or losses than the population at large.

includes the effects of statutory tax rates, phaseouts of exemptions, limitations on itemized deductions, and phase-ins and phaseouts of the various refundable and nonrefundable credits for which taxpayers are eligible under each tax. Currently, 64 percent of AMT taxpayers has a lower effective marginal tax rate in the AMT (table 7), consistent with the common characterization of the AMT noted above. By 2010, however, this figure will shift dramatically under current law: 93 percent of AMT taxpayers will face a higher marginal rate in the AMT. As with the tax base comparisons, the results depend on income. For AMT taxpayers with AGI below $200,000, 95 percent will face higher marginal rates in the AMT. Among AMT taxpayers with AGI above $500,000, 76 to 90 percent face lower marginal rates in the AMT.

Thus, by 2010 almost all AMT taxpayers will face a smaller tax base and higher marginal tax rates in the AMT than they would in the regular tax, completely contrary to the common characterization of the AMT. Only for the 1 percent of AMT taxpayers with AGI above $500,000 will the AMT base be broader and AMT rates be lower than in the regular tax.

Even for these high-income taxpayers, though, the efficiency effects of the AMT as a stand-alone tax are unclear. High-income AMT taxpayers are more likely to use the deferral preferences, which typically reduce the generosity of investment write-offs. The net impact of the AMT on the cost of capital for these taxpayers is ambiguous, since the marginal rate is lower than the regular tax, but investment write-offs are less generous. Graetz and Sunley (1988) and Gravelle (1988) show that the AMT generally reduces the cost of equity-financed investments and raises the cost of debt-financed investments. How these changes in the cost-of-capital affect efficiency depends in part on whether the underlying investment is a tax shelter or a sound project based on solid economic fundamentals.

Interactions between AMT and regular tax: Interactions between the two taxes are the basis for the standard "second-best" claim for the AMT (as in Shaviro 2001). The notion is that even if the AMT per se is flawed, it may be a useful second-best adjustment to a flawed regular tax. For example, the AMT's taxation of private activity bond interest income will reduce the subsidy afforded such investments in the regular tax and might improve efficiency. This claim, however, depends on two points: that the subsidies in the regular tax are flawed, and that the AMT actually offsets the flawed subsidies in an efficient way. For example, many AMT taxpayers receive tax subsidies from a preference item in the regular tax up to the point where their use of the item puts them on the AMT. As a result, they receive no benefit at the margin from the preference item, but they do obtain inframarginal subsidies. If the underlying subsidy in the regular income tax is not justified, the AMT enhances efficiency by rendering the subsidy ineffective at the margin. If the underlying subsidy in the regular tax is justified (say, for externality reasons), then by making the subsidy inframarginal, the AMT creates the worst of both worlds. The subsidy continues to cost the government revenues, but the AMT nullifies the effect of the subsidy at the margin.

The simultaneous existence of two tax systems can create other efficiency problems, too. First, with some investors facing regular tax rules and others facing the AMT, the effective tax rate on a given investment will vary across individuals, which in general will prove inefficient. Second, as a taxpayer's income or deductions grow and the taxpayer moves from the regular tax to the AMT or vice versa, the applicable marginal tax rate will generally change. This will give taxpayers inefficient incentives to arrange their financial affairs to avoid the change in marginal tax rates. Third, taxpayers may have more difficulty assessing their expected future marginal tax rates if they are uncertain whether they will be on the AMT. This may cause taxpayers to over-

or under-estimate the value of various provisions in the regular tax and the AMT. In either case, taxpayers would be making less efficient choices than if they knew more about their likely marginal tax rate.

Complexity[24]

Although meaningful quantitative indicators of tax complexity are difficult to obtain, the prima facie case that the AMT is complex is overwhelming, and both the National Taxpayer Advocate (2001) and the IRS (2000) highlight the AMT as one of the most difficult areas of the tax law to comply with and administer.[25] The key issue, though, is not the overall level of complexity, but rather what complexity allows policymakers to achieve in terms of equity, efficiency, or other goals (Gale and Holtzblatt 2002). We focus on three areas of AMT complexity and the potential for policy gains.

Deferral preferences and AMT credit: The two major sources of complexity in the AMT are the determination of deferral preferences and the calculation of the AMT credit used in the regular tax. The deferral preferences typically involve recalculating depreciation or amortization using different schedules than the regular tax. This requires keeping separate sets of books for each tax system, because different depreciation rules lead to differing asset bases, passive losses, net operating losses, foreign tax credits, etc. The recalculations also require new concepts, definitions, and rules, and extensive linkages among forms and schedules. It is also worth noting

[24] For summaries of the effects of the AMT on complexity, see Harvey and Tempalski (1997), GAO (2000), Graetz and Sunley (1988), IRS (2000), JCT (2001b), National Taxpayer Advocate (2001), Rebelein and Tempalski (2000), and Tempalski (2001).

[25] Some quantitative measures of AMT complexity include the following: The AMT form (6251) contains 50 lines. The AMT credit form (8801) has another 48 lines. The IRS (2000) estimates that it takes about six hours to fill out a form 6251 and that taxpayers spent 29 million hours doing so in 1997. The hours estimates are based on the number of lines and other factors in the Arthur D. Little model of compliance costs, which is under review at IRS and which is summarized and critiqued in Gale and Holtzblatt (2002). IRS (2000) also notes that in 1997, 52 percent of tax filers used paid preparers, compared to 84 percent of those who filed an AMT form. The role of the AMT in these statistics is not clear, though, because AMT taxpayers have higher income and more complex financial arrangements than others.

that the adjustments have to be done on an asset-by-asset basis. Despite all of these adjustments, deferral items accounted for less than 20 percent of AMT adjustments and preferences in 2000 and are expected to account for far less in the future, as personal exemptions and state and local taxes rise in importance (Rebelein and Tempalski 2000).

Taxpayers, of course, can reclaim benefits lost through deferral exemptions via the AMT credit against regular tax liability. But that credit adds to complexity. Taxpayers who claim the credit for previous AMT payments on their regular tax in the current year not only have already calculated regular tax, AMT, and AMT with just deferral items in some previous year, they must also calculate the AMT in the current year to see how much of the credit they can actually use.

The deferral and credit provisions are not only complex, they also have small effects on revenue taken by themselves, and they work to offset each other over time. The deferral adjustments limit the value of preference items in the current year. The credit gives the value back in the future. Over time, the net effects on tax liability largely offset each other, although the government gains from the time value of money, but both sources add significantly to complexity.

The complicated and offsetting rules regarding deferral preferences and the AMT credit do, however, serve two policy goals. First, without a credit, deferral provisions may result in lost deductions over time for taxpayers that move between the AMT and the regular tax (Graetz and Sunley 1988). Second, and perhaps more important, the rules aim to ensure that all high-income people pay some positive tax in a given year. As noted above, the AMT reduced the share of high-income filers paying no income tax by a large percentage in 2001. We present evidence below that the AMT will continue to play an important role in this regard in the future. Both of

these policy goals, however, could be served equally well with no additional complexity by adjusting the rules under the regular tax to limit deferral preferences.

Middle-class complexity: Because most middle-class AMT filers have only exemption preferences, rather than deferrals, the complexity that the AMT imposes on middle-class taxpayers might be considered unimportant. In fact, however, AMT complexity is a significant and increasing problem for middle-class taxpayers for several reasons. First, the share of AMT taxpayers—and hence required AMT returns—with income between $30,000 and $100,000 will rise from 23 percent in 2002 to 53 percent in 2010. Hence other things equal, a greater share of compliance costs will be imposed on the middle class. Second, AMT taxpayers with income below $100,000 have estimated average AMT liability in 2010 of less than $2,000, so the ratio of compliance costs to revenue raised is likely to be high. Third, calculating capital gains under the AMT is complex and is required for any AMT taxpayer with capital gains in the regular tax. Fourth, to the extent that personal nonrefundable credits are disallowed against the AMT, taxpayers who wish to claim such credits may be forced to fill out complicated worksheets, even if they do not owe AMT. Finally, a large share of those who fill out the AMT forms end up not owing any AMT. The National Taxpayer Advocate (2001) reports that in 1998 more than 6.4 million returns required AMT computation, and more than 4 million filers submitted the form, of which 3.4 million did not owe any AMT. IRS (2000) shows that most of the completed forms that did not have AMT liability are submitted by filers with AGI below $100,000. It is hard to see any policy goal achieved by having so many superfluous forms completed. All of these factors suggest that the burdens of AMT compliance are imposed increasingly on taxpayers who have little to do with the AMT's ultimate goals.

Interactions with regular tax: For taxpayers who expect to move back and forth between the AMT and regular tax, the deferral preferences and the associated credits can complicate tax planning (see Graetz and Sunley 1988; Shaviro 2001). Moreover, for any taxpayer facing the AMT, the list of tax choices is huge. For example, taxpayers always have the right to forgo use of any preference item *in the regular tax*, and in some cases choosing the less generous treatment in the regular tax can ultimately reduce the taxpayer's liability. Rebelein and Tempalski (2000) present a simple intuitive example: some taxpayers whose itemized deductions are smaller than the standard deduction may be better off itemizing if most of the deductions are not AMT preferences (for example, charitable contributions or mortgage interest on a home).[26] Graetz and Sunley (1988) discuss this issue in the context of depreciation and timing rules. It is hard to see any policy value from such complexity.

There are also two potential bright spots for the AMT as it relates to tax complexity. First, the advent of tax software might make such complexity concerns less important in the future. We are skeptical of this claim, however, because many features of the AMT—in particular the provisions that link liability across years and require multiple accounting systems on an asset-by-asset basis—may prove difficult even for advanced software programs (Shaviro 2001). Second, if the AMT were repealed it may turn out that tax shelters proliferate, raising private compliance costs and IRS administrative costs and difficulties (as well as draining revenue and reducing tax equity). Some observers (including JCT 2001b) believe this would not be a problem on the grounds that the regular tax system already effectively shuts down the major

[26] The AMT could increase ordinary income tax liability for another group of taxpayers in 2004 and 2005 under current law. EGTRRA allows taxpayers the choice of taking a deduction or credit for certain education expenses until 2005. If the provision allowing the use of personal credits against the AMT expires as scheduled after 2003, some taxpayers in 2004 and 2005 could minimize their tax liability by limiting their education tax credits and claiming the tax deduction for the remaining portion of their education expenses so as to set their regular income tax liability equal to their tentative AMT. They will not technically be AMT taxpayers nor will they appear to lose credits due to the AMT, but they will pay more tax than they would have without the AMT.

sheltering opportunities that are captured by the AMT. Moreover, options short of repeal could remove virtually all middle-income taxpayers with AMT while still deterring tax shelter activity as discussed below.

V. POLICY OPTIONS

Numerous proposals have been put forth for AMT reform or repeal. This section considers the revenue and distributional effects of a range of AMT reforms and financing offsets. We focus on policies that can be usefully examined using the TPC simulation model.[27]

Reform Options

The first change we consider is indexing the AMT—including the exemption, the tax bracket, and the threshold for phasing out the exemption—for inflation beginning after 2002.[28] This mirrors the inflation indexing that occurs in the regular income tax. Indexing the AMT for inflation after 2002 has substantial effects, reducing the number of AMT taxpayers in 2010 by over 70 percent relative to current law (tables 8 and 9). The changes especially benefit the middle class. The number of AMT taxpayers would fall by over 90 percent among filers with AGI between $15,000 and $75,000, and by 84 percent for filers with income between $75,000 and $100,000, but by less than 3 percent for filers with AGI above $500,000. Taxpayers with income below $200,000 would obtain 83 percent of the tax cut (table 9), but would pay 63 percent of the AMT in 2010 under current law (table 5). Indexing would raise after-tax income by about 2 percent for AMT taxpayers with income between $30,000 and $500,000 and would

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[27] For other proposals, see AICPA, American Bar Association and Tax Executives Institute (2000), JEC (2001), JCT (1998, 2001b), IRS (2000), and National Taxpayer Advocate (2001). The Clinton administration's fiscal year 2001 budget proposed that personal exemptions and standard deductions be allowed in the AMT.

[28] This option and the option to index the AMT after 2004 (discussed below) would eliminate the scheduled reduction of the AMT exemption in 2005.

raise after-tax income by about 2 percent for *all* taxpayers with income between $75,000 and $500,000. After-tax income would remain constant for those with higher incomes, because of the exemption phaseout. Indexing would be costly, however. Revenues would fall by $89 billion in 2010 alone. The budget costs over the decade, including interest payments on added federal debt, would be about $440 billion if EGTRRA expires in 2010 and $540 billion if EGTRRA is extended through 2012.

For comparison purposes, tables 8 and 9 also show the effect of delaying indexing until after 2004. Delay would reduce the costs somewhat, but the revenue loss in 2010 would still be $80 billion and the 10-year cost would be on the order of $380 billion if EGTRRA expires and $470 billion if EGTRRA is extended. Delay would also raise the number of AMT taxpayers in 2010 by 30 percent relative to indexing after 2002.

Our second reform plan supplements indexing after 2002 with AMT dependent exemptions (equal to regular tax exemptions and not subject to phaseout) and allowances for all personal nonrefundable credits to be used regardless of AMT. These changes address items that focus on middle-class taxpayers and that, in our view, are unrelated to egregious tax sheltering.

Plan 2 would reduce the number of AMT taxpayers in 2010 by 83 percent relative to current law and by more than 40 percent relative to indexing alone. The plan would remove almost all middle-class filers from the AMT: among filers with AGI between $15,000 and $100,000, AMT participation would decline by 97 percent. The distribution of changes in tax burdens and after-tax income are similar to those under indexing. The costs are slightly larger, though, including a revenue loss of $99 billion in 2010 and a 10-year budget cost exceeding $500 billion if EGTRRA sunsets and about $625 billion if EGTRRA is extended. Plan 3 starts with plan 2, but repeals the AMT exemption phaseout (to match the repeal of the personal

exemption phaseout in the regular income tax, slated for 2010) and allows deductions for state and local taxes and for miscellaneous expenses above the 2 percent of AGI floor. Like the changes in plan 2, these reforms address items that in our view do not constitute aggressive sheltering opportunities. Unlike the changes in plan 2, however, the additions in plan 3 mainly target high-income filers.[29] Plan 3 results in the virtual abolition of the AMT for all but the highest- and lowest-income taxpayers. The aggregate number of AMT taxpayers in 2010 falls by more than 99 percent relative to current law, from 35.6 million to 0.3 million. Participation falls by at least 97 percent for all AGI groups between $15,000 and $500,000, and by 90 percent for those with income between $500,000 and $1 million.[30] The distributional effects of plan 3 differ significantly from those of plan 2. Plan 3 provides much larger tax cuts to households with income above $200,000. AMT taxpayers with income above $1 million would receive an average tax cut of more than $60,000 from plan 3 compared with $1,323 from plan 2. Filers with income above $500,000 receive 6.5 percent of the tax cuts in plan 3, compared to only 0.6 percent in plan 2. Plan 3 is also substantially more expensive than plan 2. Plan 3 would cost $134 billion in revenue in 2010. Including interest costs, the plan would add $725 billion to the debt over the decade if EGTRRA sunsets, and about $880 billion if EGTRRA is extended through 2012. Finally, under plan 3, the number of taxpayers with income above $1.1 million in 2001 dollars that pay no federal income tax would rise to about 500 in 2010, compared to about 300 under current law or plans 1 or 2.

None of the changes above relate to deferral preferences. However, because changing the basic exemption preferences in plans 1, 2, and 3 eliminates so much of the AMT, repeal

[29] Appendix Tables 2 and 3 contain estimates of the effects of each change as a stand-alone option.

represents the logical next option to consider. The main difference between plan 3 and repeal is the deferral provisions. Repealing the AMT at the end of 2002 would be expensive. The revenue loss in 2010 alone would exceed $140 billion. Over the next 10 years, repeal would add about $790 billion to the debt under current law, and $950 billion if EGTRRA is extended.[31]

Repeal would dramatically raise the number of high-income filers who pay no federal income tax. Approximately 1,300 filers with income above $1.1 million (2001 dollars) and more than 17,000 with income above $200,000 would owe no federal income tax. These figures are several times larger than the analogous figures for plan 3 and thus show the power of the deferral provisions to reduce the number of high-income tax filers that pay no tax.

Repeal would provide very substantial tax cuts for the highest-income households. AMT taxpayers with income above $1 million would receive a $97,000 average tax cut relative to current law, and those with income between $200,000 and $500,000 would receive an average tax cut of $13,000. The tax cut is especially regressive compared with the tax cuts involved in plan 3. Tax filers with incomes below $100,000 would save an average of less than $12 going from plan 3 to repeal, but tax filers with AGI above $1 million would gain $10,000 from that step.

The tax changes under AMT repeal approach the size of those in EGTRRA. When fully phased in, EGTRRA will raise after-tax income for households in the 60th to 99th percentile by between 2.2 percent and 2.8 percent (Gale and Potter 2002). Under AMT repeal, average after-

[30] The AMT participation rate drops by only 55 percent for taxpayers with AGI below $15,000, but the participation rate for such taxpayers is trivial to begin with (table 3). Table 7 shows that taxpayers in this income group have large amounts of preference items relative to other income groups.

[31] These estimates are very close to results in Tempalski (2001), who estimates that AMT repeal at the beginning of calendar year 2002 would cost $603 billion in revenues over fiscal years 2002-2011 if EGTRRA sunsets. We repeal the AMT at the beginning of calendar year 2003, so comparable estimates would cover fiscal years 2004 to 2011. Over that period, we project a revenue loss of $582 billion, while Tempalski estimates $584 billion.

tax income would rise by 4.7 percent for households with income between $200,000 and $500,000, and between 1.6 percent and 2.9 percent for all other filers with incomes between $75,000 and $1 million. Likewise, in 2010, the tax cuts in EGTRRA will reduce revenue by about $187 billion (JCT 2001a), compared with $140 billion under repeal of the AMT.

We also explored the effects of changes in AMT tax rates. Relative to the tax base changes noted above, and for a given amount of revenue loss, AMT tax rate cuts were substantially less effective in reducing the number of AMT taxpayers and substantially more regressive. For example, cutting the AMT rate to a flat 20 percent and eliminating the phaseout of the AMT exemption cost almost as much as plan 3, but only reduced the number of AMT taxpayers as much as plan 2.[32] Tax cuts among filers with more than $1 million in income roughly equaled those in plan 3, whereas tax cuts for filers with income between $15,000 and $100,000 were smaller than those under indexing (plan 1). In stark contrast to patterns in plans 1, 2, and 3, projected AMT participation rates fell by more for those with income above $500,000 than for those with income between $15,000 and $100,000.

A Constant-Revenue, Distributionally Neutral AMT and Income Tax Change

The plans described above introduce substantial changes in the revenue and distributional effects of the overall tax system. However, given the dramatic deterioration in the budget outlook since January 2001 (Auerbach, Gale, and Orszag 2002), it is unlikely and undesirable that substantial new tax cuts be enacted. In addition, because AMT liability is generally more progressive than regular tax liability, distributional considerations are likely to be important for AMT reform. In the next three subsections, we examine the revenue and distributional effects of AMT reforms coupled with other tax changes.

[32] Appendix Tables 4 and 5 report details of these estimates.

A natural first policy to consider is a combination that repeals the AMT and adjusts the regular income tax so that taxpayers in each bracket have the same overall tax liability as they do under current law (Steuerle 2001, Shaviro 2001). We examine the effects of leaving the regular tax base unchanged, but altering the regular tax rates to achieve revenue and distributional neutrality. Using data for 2010, we find that the requisite rates would be 10.7 percent, 16.3 percent, 29.2 percent, 33.8 percent, 43 percent, and 33.2 percent (figure 7). That is, the statutory regular income tax rate would have to rise for those in the bottom five brackets and fall in the highest income group.

This pattern of marginal rate changes reflects the large burden of the AMT on filers with income between $100,000 and $500,000 under current law, and the large number of AMT taxpayers who pay smaller AMT amounts in the middle class. The resulting tax structure bears a vague resemblance to tax rates derived in the optimal tax literature (Gruber and Saez 2000; Mirrlees 1971). Although the rates in figure 7 would hold constant the amount of tax liability owed by taxpayers in each tax bracket, the reform would generate a fourfold increase in the number of high-income individuals that pay no income tax (table 10), and huge changes in the distribution of liabilities within tax brackets or AGI classes (table 11). The reform would raise tax liabilities for 62 percent of all taxpayers, including more than 80 percent of those with AGI between $15,000 and $75,000. Even though such taxes are unlikely to be adopted, the estimates are informative in that they describe the rate structure that would generate the same pattern of average tax rates as the tax system will in 2010 under current law.

Changes in the AMT and EGTRRA: Revenue Effects

Last year's tax cut is a natural source of financing for AMT reform. Unlike previous reforms in general and the previous major tax cut (in 1981) in particular, EGTRRA did not make

sustained, substantial conforming adjustments to the AMT. Instead, its tax cuts made the AMT problem far worse by raising the cost of repeal or reform and allocating available government resources to other uses. We examine the effects of freezing the income tax rate cuts and estate tax cuts in EGTRRA at their 2002 levels.[33]

When coupled with the AMT reforms described in table 8, freezing the upper-income tax rate cuts would raise revenue by between $254 billion and $345 billion through 2012 under current law, and by between $325 billion and $448 billion relative to an extension of EGTRRA. As a result, Table 10 shows that freezing the upper-income tax rate cuts alone is not sufficient to pay for any of the AMT alternatives noted above. Roughly speaking, it falls $100 billion short of financing indexing after 2002, $300 billion or more short of financing plan 3, and more than $350 billion short of financing repeal.

Freezing the estate tax at 2002 levels would raise $62 billion through 2012 under current law, and $110 billion relative to an extension of EGTRRA.[34] As a result, freezing both the upper income tax cuts and the estate tax cuts would pay for indexing the AMT, but would still fall short of financing plan 3 or repeal by $200 billion to $300 billion.

Changes in the AMT and EGTRRA: Distributional Effects in 2010

We examine the distributional effects of changes in the AMT and the income tax in the year 2010 (when EGTRRA is fully phased in). None of the distributional analysis incorporates

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[33] Amending the rate cuts only affects the top four tax brackets, which are slated to decline from between 28 and 39.6 percent under pre-EGTRRA law to between 25 and 35 percent by 2010. We do not change the other income tax provisions of EGTRRA, and thus leave intact the 10 percent bracket, the repeal of personal exemption phaseouts, the repeal of itemized deductions limitations, marriage penalty relief, and so on.

[34] We assume that the revenue loss from the estate tax changes enacted in 2001 would grow at roughly 5 percent per year, consistent with CBO (2001) projections of overall estate tax revenue growth for 2002 to 2011 under pre-EGTRRA law. The difference between the imputed revenue loss and JCT (2001b) estimates of projected revenue losses from the estate tax changes under EGTRRA equals the estimated revenue savings from the estate tax freeze.

changes in the estate tax. As noted, AMT repeal coupled with a tax rate freeze would reduce revenues by $74 billion in 2010. About 110 percent of the net tax cut would accrue to taxpayers with income between $75,000 and $500,000 (see table 11). Taxpayers with income over $1 million would face a tax increase equal in size to 19 percent of the overall tax cut. Filers with income below $50,000 would see little change, but tax payments would decline significantly for income groups between $50,000 and $500,000, and rise for higher income groups.

Indexing the AMT after 2002 coupled with a 2002 freeze of the EGTRRA income tax rate cuts reduces revenue by $30 billion in 2010 and has broadly similar qualitative patterns to the policy described above, as shown in table 11. Taxpayers with income between $75,000 and $500,000 would receive 144 percent of the net tax cut. Those with higher income would face tax increases equal in size to 65 percent of the net tax cut. For both policies, after-tax income rises for those with income between $50,000 and $500,000 and falls for higher-income filers.

Notably, all of the results above compare the distributional effects of proposed changes to the distributional outcomes under current law. Other estimates (not shown) find that even households in the high-income groups where tax burdens rise in the policies considered in Table 11 would still be paying significantly less in income tax (including the AMT) under those policies than they would have had EGTRRA not been enacted.[35]

Revenue-Neutral AMT Reform

The final option in tables 10 and 11 adjusts AMT parameters alone to retarget the tax to upper-income households without sacrificing tax revenues. As one example, we examine the effects of indexing the AMT exemption for inflation starting in 2005, allowing use of all

[35] This comparison to pre-EGTRRA law does not incorporate the estate tax changes considered above. Including estate taxes, higher income groups would gain even more relative to pre-EGTRRA law, but would see larger tax increases compared with post-EGTRRA law.

personal credits against the AMT, eliminating the phaseout of the AMT exemption, raising the top AMT tax rate to 35 percent, reducing the threshold at which the higher tax rate takes effect to $65,000 from $175,000 for married couples, and indexing that threshold for inflation starting in 2010.

These adjustments would reduce the number of AMT taxpayers by more than 50 percent in 2010 relative to current law and redirect the tax toward high-income households. The number of AMT taxpayers would fall by more than 90 percent for filers with income between $15,000 and $75,000, but would rise by 80 percent for those with income between $500,000 and $1 million and by 260 percent for those with higher income. Only 4 percent of filers would face tax increases. They include virtually no one with income below $75,000, but 92.5 percent of filers with income above $500,000 and 82 percent of filers with income between $200,000 and $500,000. About 20 percent of filers would pay lower taxes, including 75 percent of filers with income between $75,000 and $200,000 and 43 percent of those with income between $50,000 and $75,000.

VI. CONCLUSION

Under current law, the AMT is destined to become a vice grip on American taxpayers. On one side, the lack of indexation for inflation creates automatic annual AMT tax increases. On the other side, the phase-in of last year's tax cuts will steadily reduce regular income tax burdens over time. Caught in the middle, taxpayers will be squeezed by a tax that most of them were never intended to pay and that is replete with problems. The AMT can be exceedingly and pointlessly complex. Although the AMT may help reduce the use of inefficient shelters in the regular tax, the efficiency effects of the AMT are marred by the fact that by 2010 the vast majority of AMT taxpayers will face a smaller tax base and higher tax rates in the AMT than in the regular tax. The AMT is progressive, but will become much less so over time, as the factors noted above raise middle-class participation. These trends and problems make AMT reform an urgent policy goal. Nevertheless, how the AMT should be restructured and how such changes should be financed remain open questions.

AMT repeal would be regressive and would cost upwards of $1 trillion over the next decade if enacted in 2003. The nation may have neither the resources nor the predisposition to make such changes under current circumstances. Repeal would also raise the number of high-income individuals that pay no federal income tax by a factor of four or more and may lead to more use of aggressive tax shelters, which might spark the type of public outrage that led to the creation of the AMT in the first place. AMT repeal could be partially financed by a combination of freezing the income tax rate cuts and the estate tax rate cuts enacted in EGTRRA at their 2002 levels, but that would still leave a several hundred billion dollar fiscal hole over the next decade.

An alternative approach would change the AMT in a revenue-neutral manner, as outlined earlier. This would impose significant new burdens on high-income households, but would reduce substantially the number of AMT taxpayers among the middle class.

A less sweeping reform would index the AMT for inflation in the same way as the regular tax, but leave intact all of the other AMT rules. This would significantly reduce the number of AMT taxpayers—by 70 percent overall and by 90 percent for the middle class. But even this simple option would cost upwards of $400 billion by itself and would require essentially all of the revenue that freezing the upper-income tax rate cuts and estate tax cuts at 2002 levels would generate. Adding dependent exemptions and personal credits in the AMT would further conform the AMT to the regular tax without raising tax sheltering and would significantly lighten burdens on middle-class AMT taxpayers, but would be more expensive.

Many other options could be examined, but it may prove more productive to focus on different guiding notions for AMT reform. One view is that the AMT is most useful in serving to reduce the number of filers that pay no federal income tax in a given year. A reform that focuses on this issue would eliminate the commonplace exemption preferences but maintain the deferral preferences and the tax credit based on the preferences. Our plan 3 is in the spirit of this view—although one could go much farther in removing minor preferences. Plan 3 would reduce AMT participation by over 99 percent relative to current law, but would cost between $725 billion and $880 billion over the next decade, depending on whether the 2001 tax cut is extended.

A better approach would be to assess which elements of AMTI are actually necessary to properly measure income or address political concerns about high-income nontaxpayers, and incorporate them directly into the regular income tax. For example, the regular income tax could

feature less generous depreciation deductions and limits on percentage depletion allowances.[36] Tighter limits on private-activity tax-exempt bonds could be legislated directly. This option would reduce the revenue cost of AMT repeal, and potentially improve horizontal equity and economic efficiency. It would simplify tax compliance without spurring the proliferation of tax shelters or necessarily making the tax system less progressive. A full analysis of such proposals is beyond the scope of this paper, though.

Notably, fundamental tax reform is unlikely to resolve the issues that generated the AMT in the first place. Under the flat tax, for example, individuals would pay no tax on their capital income at the individual level and the appearance of tax inequities could grow dramatically.

Ultimately, reforming the AMT may prove difficult for political reasons (Steuerle 1999, 2001) and the findings above certainly leave policymakers with a difficult set of trade-offs. The most durable and equitable policy changes are likely to come from reforms that incorporate well-defined notions of the AMT's purpose and that consider the impact of AMT changes and related financing options on the overall tax system and economy, rather than just the AMT.

[36] Treasury (2000) concludes that the depreciation rules in the regular income tax are roughly appropriate to properly measure income. Thus, the AMT rules might be too draconian and moving the regular income tax rules closer to the AMT rules could impair economic efficiency.

VII. APPENDIX: MODEL AND METHODOLOGY

We use a large-scale microsimulation model of the U.S. federal individual income tax system, developed at the Urban-Brookings Tax Policy Center (TPC). The model is similar to those used by the Congressional Budget Office (CBO), the Joint Committee on Taxation (JCT), the Treasury's Office of Tax Analysis (OTA), and private-sector tax analysts.

The model uses data from the 1996 public-use file produced by the Statistics of Income (SOI) Division of the Internal Revenue Service. The file contains about 112,000 records with detailed information on federal individual income tax returns filed in the 1996 calendar year.[37] In some cases, imputations from other sources such as the Current Population Survey of the U.S. Census Bureau supplement the SOI tax data. For example, imputations for education expenses are necessary to estimate the HOPE and lifetime learning credits.

The model incorporates EGTRRA provisions for changes in marginal tax rates, the 10 percent tax bracket, credits for children and dependent care, itemized deduction limitations, personal exemption phaseouts, the AMT, and the standard deduction, 15 percent bracket, and earned income tax credit provisions for married couples. It does not currently incorporate EGTRRA's education and retirement saving provisions. The model also incorporates features of the Job Creation and Worker Assistance Act of 2002 that affect the AMT.

To produce a representative sample of filers in years beyond 1996, the input data are first extrapolated to 1999 based on published SOI data and then "aged" to future years based on CBO aggregate forecasts and projections. The extrapolation to 1999 occurs in two steps. First, the dollar amounts for income, adjustments, deductions and credits on each record are grown by their actual per capita 1996-1999 growth rate. To capture the large growth in income at the top

[37] Weber (2001) describes the SOI public-use data file, including the sampling methodology and disclosure avoidance procedures used to maintain taxpayer confidentiality.

end of the distribution that occurred between 1996 and 1999, we employ a separate wage-skewing factor for high-income returns. For items where SOI provides the necessary information, separate per capita growth rates are used for each filing status. Record weights are grown by the actual growth rate in the number of returns by filing status over the 1996-1999 period. Second, the weights on each record are adjusted via a large linear programming problem to ensure that for the major income items, adjustments, and deductions the model hits aggregate targets, and for some items—including wages and AGI—it hits distributional targets, too. The extrapolated outcomes closely resemble published aggregate and distributional results for 1999.

For years 2000 to 2012, we "age" the data based on forecasts and projections from CBO (2001) for variables such as wages, personal income, capital gains, and inflation. Where possible, we use actual 2000 and 2001 data instead of projections. Again, we use a two-stage routine, this time for each future year. In the first stage, dollar amounts for the items on each record are grown by the appropriate forecasted per capita growth rate, with per capita personal income serving as the default growth factor for many items. Record weights are increased each year by the average annual growth rate for each filing status over the last decade. In the second stage, the record weights are further adjusted to ensure that the model hits a very limited number of aggregate targets. For years beyond 1999 we do not target distributions for any item; wages and salaries, for example, are grown by the same per capita growth factor for all records.

The data file provides information on AMT adjustment and preference items for taxpayers who filed Form 6251 in 1996. However, when we simulate tax law and income levels for future years, individuals who were not subject to the AMT in 1996 could potentially be affected by the tax. This requires calculating AMT adjustments and preferences for all individuals in future years. Using the public-use file, we calculate the major AMT items: state

and local tax deductions, personal exemptions, miscellaneous deductions above the 2-percent floor, the standard deduction, the additional disallowance of medical deductions, and state and local tax refunds. Together, these provisions account for over 95 percent of the projected reconciliation between AMTI and regular taxable income by 2010 in Tempalski (2001). Our measure of lost credits includes disallowed amounts for the following credits, where appropriate: child, child and dependent care, elderly, HOPE, lifetime learning, general business, and prior year minimum tax.

The TPC model estimates for AMT taxpayers and revenue are very similar to those in the Treasury's Office of Tax Analysis model (Tempalski 2001), and the JCT (2001a). Appendix table 1 shows that the TPC projections differ from those of JCT and Treasury for the number of AMT taxpayers in 2010 under current law by less than 0.5 million. TPC estimates of AMT revenue are within $1.5 billion of Tempalski's (2001) estimates under current law in each year through 2007, and 6 percent higher in 2010.

Our somewhat higher revenue estimates may be due to differing baselines. The TPC model generates direct AMT liability of $6.2 billion in 1999. Tempalski (2001) does not estimate 1999 figures, but estimates AMT liability of $6.3 billion for 2000. Since AMT revenue was growing quickly over this period, it is likely that our historical baseline is above Tempalski's. It is also possible that both models understate future AMT participation. Direct AMT liability was $6.5 billion in 1999 and was, according to preliminary data, $8.9 billion in 2000 (SOI 2001, 2002).

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Table 1

Determination of AMT Liability: An Overview

- Calculate AMT tax base

  Regular taxable income for AMT purposes
  \+ AMT preferences
  \+ AMT adjustments
  = Alternative minimum taxable income
  - Allowable AMT exemption
  = Line 23 of form 6251 (AMT tax base)

- Calculate pre-credit tentative AMT liability

  Apply the AMT tax rate schedule and AMT exemption phase-out schedule to the AMT tax base

- Calculate tentative AMT liability

  Pre-credit tentative AMT liability
  - Allowable AMT foreign tax credit
  = Tentative AMT liability

- Calculate regular tax liability for AMT purposes

  Regular tax before credits (line 40 of the 1040)
  - Taxes due to lump sum distributions
  - Allowable regular tax foreign tax credits
  = Regular tax liability for AMT purposes

- Calculate AMT liability

  AMT liability is the maximum of zero and the following calculation:

  Tentative AMT liability
  - Regular tax liability for AMT purposes

Table 2

Historical Features of Individual Minimum Taxes

Legislation	Married Joint Exemption	Single Exemption	Tax Rates (percent)[1]	Comments
		Add-On Tax		
TRA 1969	$30,000+regular tax	$30,000+regular tax	10	Main preference item is capital gains. Also, stock options, depreciation and depletion allowances.
TRA 1976	Greater of $10,000 or 1/2 regular tax	Greater of $10,000 or 1/2 regular tax	15	Certain itemized deductions added as preferences.
Revenue Act of 1978	NC	NC	15	Capital gains and itemized deductions moved to AMT.
TEFRA 1982				Repealed
		Alternative Minimum Tax		
Revenue Act of 1978	$20,000	$20,000	10 on 0-40k 20 on 40k-80k 25 on 80k+	Tax base is capital gains and certain itemized deductions.
ERTA 1981	NC	NC	10 on 0-40 k 20 on 40k+	Top AMT rate reduced 20 percent.
TEFRA 1982	$40,000	$30,000	20	Preferences from add-on tax moved to AMT.
TRA 1986	NC	NC	21	Regular tax taxes all capital gains, restricts passive losses. AMT base is explanded to include deferral items. AMT credit for deferral items and exemption phase-out introduced.
OBRA 1990	NC	NC	24	-----
RRA 1993	$45,000	$33,750	26 on 0-175k 28 on 175k+	-----
TREA 1999	NC	NC	NC	Use of all personal nonrefundable credits regardless of AMT extended through 2001.
EGTRRA 2001	$49,000 (2001-2004) $45,000 (2005+)	$35,750 (2001-2004) $33,750 (2005+)	NC	Use of child, adoption, and IRA credits regardless of AMT extended through 2010.
JCWAA 2002	NC	NC	NC	Use of all personal nonrefundable credits regardless of AMT extended through 2003.

Sources:
TRA 1969: Public Law 91-172, TRA 1976: Public Law 94-455, Revenue Act of 1978: Public Law 95-600, ERTA 1981: Public Law 97-34, TEFRA 1982: Public Law 97-248, TRA 1986: Public Law 99-514, OBRA 1990: Public Law 101-508, RRA 1993: Public Law 103-66, TREA 1999: Public Law 106-70, EGTRRA 2001: Public Law 107-16, JCWAA 2002: Public Law 107-47.

(1) Rates apply to minimum tax income above exemption level.
NC=no change.

Table 3

Aggregate AMT Projections, 2001-2012[1]

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total 2003-12
Current Law (with EGTRRA extended)[2]													
Number of Returns													
With Direct AMT Liability (millions)	1.7	2.4	2.9	4.6	12.1	19.0	23.7	28.6	31.6	34.4	37.2	39.8	
With Lost Credits (millions)	0.3	0.3	0.3	1.6	4.1	4.9	5.4	5.9	6.3	6.6	6.9	7.2	
With Either (millions) [3]	1.8	2.6	3.0	5.5	13.8	20.3	25.0	29.9	32.9	35.6	38.3	41.0	
As Percent of Taxpayers [4]	1.9	2.7	3.0	5.5	13.7	19.9	24.1	28.4	30.9	33.0	35.1	36.9	
As Percent of Tax Filers	1.4	1.9	2.2	4.1	10.1	14.6	17.7	20.9	22.7	24.2	25.7	27.1	
AMT Revenue													
Direct AMT Liability (billions)	7.9	9.7	11.0	15.9	29.5	52.3	65.1	90.0	107.2	130.0	150.3	172.8	824.2
Lost Credits (billions)	3.1	3.3	3.5	4.7	7.0	8.3	9.0	10.0	10.7	11.4	12.1	12.8	89.5
Total ($ billions)	11.1	13.0	14.4	20.7	36.4	60.7	74.2	100.0	117.9	141.4	162.5	185.6	913.7
As Percent of Income Tax Revenue	1.2	1.4	1.5	2.0	3.4	5.5	6.3	8.0	8.8	9.9	10.7	11.4	7.5[5]
Memo													
Percent of AGI on AMT Returns	7.0	8.9	9.6	15.0	27.5	39.0	44.3	50.1	52.6	55.5	57.5	59.2	
Cost of Income Tax Repeal ($ billions)[6]	221.6	204.0	206.2	181.3	125.0	90.5	85.5	72.5	62.5	47.0	42.9	38.7	
Pre-EGTRRA Law													
Number of Returns													
With Direct AMT Liability (millions)	1.8	2.3	2.8	3.4	4.3	5.7	6.9	8.7	11.1	13.3	15.9	19.1	
With Lost Credits (millions)	0.3	3.5	3.9	4.6	5.7	6.9	7.8	8.9	9.8	11.0	12.0	12.8	
With Either (millions)	2.0	4.8	5.5	6.5	8.1	9.9	11.4	13.4	15.5	17.9	20.5	23.3	
As Percent of Taxpayers	2.0	4.8	5.5	6.4	7.9	9.4	10.7	12.5	14.2	16.1	18.2	20.4	
As Percent of Tax Filers	1.5	3.6	4.1	4.8	5.9	7.1	8.1	9.4	10.7	12.1	13.7	15.4	
AMT Revenue													
Direct AMT Liability (billions)	7.8	8.8	9.9	11.4	13.4	15.9	18.7	22.4	27.2	32.6	39.6	48.1	239.1
Lost Credits (billions)	3.1	5.9	6.5	7.4	8.5	9.7	10.7	12.2	13.4	14.4	15.7	16.8	115.2
Total (billions)	10.9	14.7	16.5	18.8	21.8	25.5	29.4	34.6	40.6	47.0	55.3	64.9	354.4
As Percent of Income Tax Revenue	1.1	1.5	1.6	1.7	1.9	2.1	2.2	2.5	2.7	3.0	3.3	3.6	2.7[5]
Memo													
Percent of AGI on AMT Returns	6.9	10.6	11.4	12.8	14.9	17.1	19.0	21.4	23.9	26.4	29.3	32.2	
Cost of Income Tax Repeal ($ billions)[6]	241.4	230.5	233.6	231.6	227.5	223.6	221.9	217.9	213.9	211.6	208.2	204.9	

Source: Urban-Brookings Tax Policy Center Microsimulation Model.

Notes:

(1) Calendar years. Numbers may not add due to rounding.

(2) Includes the effect of the Job Creation and Worker Assistance Act of 2002. For 2011 and 2012, the current law estimates assume that EGTRRA is extended through 2012. If EGTRRA is not extended, the estimates under current law for 2011 and 2012 would be approximately equal to the estimates under pre-EGTRRA law.

(3) Because taxpayers can have both AMT liability on Form 6251 and lost credits, the number of taxpayers with either is less than the sum of those with direct AMT liability and those with lost credits.

(4) Taxpayers are defined as returns with positive income tax net of refundable credits.

(5) Calculated as total AMT revenue, 2003-12, divided by total income tax revenue, including the AMT, 2003-12.

(6) Includes repeal of the child tax credit and the earned income tax credit for all years as well as nonrefundable tax credits in the years in which they are not allowed for AMT purposes under current law.

Table 4
AMT Projections by Individual Characteristics

	AMT Participation Rate (percent) [1]			
				Pre-EGTRRA Law
Characteristic	**2002**		**2010**	**2010**
All Taxpayers[3]	2.7	13.7	33.0	16.1
All Tax Filers	1.9	10.1	24.2	12.1
Filers by AGI (thousands of 2001$)				
Less than 0	0.5	0.5	0.7	0.7
0-15	*	*	*	*
15-30	*	0.1	0.4	0.5
30-50	0.2	2.1	8.7	6.9
50-75	1.4	12.8	43.2	25.6
75-100	3.0	32.1	78.6	34.6
100-200	10.9	51.4	94.0	40.2
200-500	35.6	73.7	96.7	53.2
500-1,000	19.4	21.3	54.1	13.2
1,000 and more	15.4	15.8	26.9	12.3
Filers by Number of Children[4]				
0	1.1	3.5	15.8	3.4
1	1.7	12.2	31.5	15.4
2	3.4	28.7	46.1	36.3
3 or more	8.7	39.1	53.5	53.4
Filers by State Tax Level[5]				
Low	0.8	6.6	20.6	8.9
Middle	1.1	9.5	25.1	12.0
High	2.9	12.9	25.2	15.2
Filers by Filing Status				
Single	0.5	1.0	2.6	1.1
Married Filing Joint	3.7	23.0	57.5	27.7
Head of Household	1.3	4.8	10.1	8.4
Married Filing Separate	5.0	19.2	53.6	21.5

Source : Urban-Brookings Tax Policy Center Microsimulation Model.
Notes :
(1) Includes returns with AMT liability on Form 6251 and those with lost credits.
(2) Current law includes the effect of the Job Creation and Worker Assistance Act of 2002.
(3) Taxpayers are defined as returns with positive income tax liability net of refundable credits.
(4) Number of children is defined as number of exemptions taken for children living at home.
(5) State codes are not provided on the SOI public-use file for individuals with 1996 AGI above $200,000. Figures here include only those taxpayers for which we have state-of-residence information.

* Less than 0.05 percent.

Table 5
Distribution of AMT and Regular Income Tax, by AGI

2002

AGI Class (thousands of 2001$)	Returns (thousands)		Percent of Returns		Percent of AGI		Percent of Tax Liability	
	AMT Taxpayers[1]	All Returns	AMT Taxpayers	All Returns	AMT Taxpayers	All Returns	AMT[2]	All Income Tax[3]
Less than 0	5	961	0.2	0.7	-0.8	-1.1	1.4	*
0-15	1	37,483	*	28.4	*	4.2	0.2	-1.8
15-30	6	30,115	0.2	22.8	*	10.1	0.2	1.6
30-50	56	23,592	2.2	17.9	0.4	14.0	0.4	8.1
50-75	250	17,876	9.7	13.5	2.7	16.7	2.2	12.3
75-100	292	9,753	11.4	7.4	4.4	12.8	3.4	11.4
100-200	1,027	9,400	40.0	7.1	25.5	18.8	21.0	21.8
200-500	815	2,286	31.8	1.7	39.9	10.0	38.4	16.8
500-1,000	78	404	3.1	0.3	8.8	4.1	12.3	8.3
1,000 and more	34	222	1.3	0.2	19.0	10.3	20.5	21.6
All	2,564	132,093	100.0	100.0	100.0	100.0	100.0	100.0

2010

AGI Class (thousands of 2001$)	Returns (thousands)		Percent of Returns		Percent of AGI		Percent of Tax Liability	
	AMT Taxpayers[1]	All Returns	AMT Taxpayers	All Returns	AMT Taxpayers	All Returns	AMT[2]	All Income Tax[3]
Less than 0	8	1,040	*	0.7	-0.1	-1.1	0.2	*
0-15	1	41,681	*	28.3	*	3.9	*	-1.9
15-30	136	31,730	0.4	21.6	0.1	8.8	0.1	1.0
30-50	2,220	25,401	6.2	17.3	2.1	12.6	1.4	7.0
50-75	7,815	18,082	22.0	12.3	11.4	14.1	8.1	10.5
75-100	8,926	11,364	25.1	7.7	17.7	12.5	14.7	11.1
100-200	13,036	13,862	36.7	9.4	39.7	23.2	38.2	27.1
200-500	3,052	3,156	8.6	2.1	19.8	11.5	28.5	18.6
500-1,000	287	531	0.8	0.4	4.2	4.5	3.9	8.0
1,000 and more	72	267	0.2	0.2	5.1	10.1	5.0	18.5
All	35,554	147,114	100.0	100.0	100.0	100.0	100.0	100.0

Source : Urban-Brookings Tax Policy Center Microsimulation Model.

Notes :

(1) AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.

(2) Includes direct AMT liability and lost credits.

(3) All income tax is the sum of regular income tax net of refundable credits plus direct AMT liability.

* Less than 0.05 percent.

Table 6
Effect of the AMT on EGTRRA Income Tax Cuts, 2010

AGI Class (thousands of 2001$)	Percent of Tax Filers with No Cut Due to AMT	Percent of Cut Taken Back by AMT
All	4.9	36.3
Less than 0	*	*
0-15	*	*
15-30	*	*
30-50	1.0	1.0
50-75	3.2	17.6
75-100	4.8	42.3
100-200	30.0	71.2
200-500	49.6	73.8
500-1,000	10.3	18.8
More than 1,000	8.1	8.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model.

* Less than 0.05 percent.

Table 7
Income Subject to Tax and Effective Marginal Tax Rates in the Regular Income Tax and the AMT, AMT Taxpayers[1]

2002

AGI Class (thousands of 2001$)	Percent with More Income Subject to Tax in[2]		Average Adjustments and Preferences[3]	Percent with a Higher Marginal Tax Rate in[4]		Average Effective Marginal Tax Rate (percent)[5]	
	Regular Tax	AMT		Regular Tax	AMT	Before AMT	After AMT
All	**65.7**	**34.3**	**42,792**	**64.2**	**35.2**	**29.6**	**29.9**
Less than 0	0.0	100.0	1,232,866	0.0	100.0	-0.7	25.2
0-15	0.0	100.0	148,523	0.0	99.7	2.2	27.6
15-30	0.1	99.9	44,023	0.0	95.7	10.7	25.3
30-50	77.1	22.9	24,051	15.7	83.9	15.6	26.5
50-75	93.1	6.9	26,413	44.9	54.2	20.3	26.2
75-100	93.0	7.0	30,706	65.9	33.5	24.9	27.2
100-200	85.2	14.8	33,604	62.8	36.5	29.5	30.0
200-500	31.6	68.4	39,067	72.6	26.8	35.0	32.7
500-1,000	4.2	95.8	92,086	86.2	13.1	33.6	27.7
More than 1,000	5.6	94.4	385,916	81.3	16.9	32.0	27.3

2010

AGI Class (thousands of 2001$)	Percent with More Income Subject to Tax in[2]		Average Adjustments and Preferences[3]	Percent with a Higher Marginal Tax Rate in[4]		Average Effective Marginal Tax Rate (percent)[5]	
	Regular Tax	AMT		Regular Tax	AMT	Before AMT	After AMT
All	**87.0**	**13.0**	**25,751**	**7.0**	**92.8**	**24.5**	**28.7**
Less than 0	0.0	100.0	1,071,634	0.0	99.9	-0.5	24.5
0-15	0.0	100.0	90,360	0.0	99.7	0.6	26.9
15-30	94.9	5.1	18,682	0.0	95.1	18.1	30.2
30-50	98.1	1.9	18,711	5.1	94.7	18.0	26.4
50-75	99.1	0.9	21,972	0.3	99.7	18.4	27.1
75-100	98.7	1.3	21,863	7.8	92.2	25.4	27.7
100-200	91.1	8.9	24,193	1.2	98.7	26.9	30.1
200-500	6.1	93.9	39,597	39.5	59.5	32.0	32.0
500-1,000	0.3	99.7	99,471	89.9	6.7	33.6	27.9
More than 1,000	1.2	98.8	438,096	76.1	14.9	31.2	27.6

Source : Urban-Brookings Tax Policy Center Microsimulation Model.
(1) AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.
(2) Income subject to tax for the regular income tax is taxable income; for the AMT it is AMTI net of the AMT exemption.
(3) Amounts are in nominal dollars to facilitate comparison with AMT exemption amounts. For 2002, the AMT exemption is $49,000 for married couples filing jointly and surviving spouses; $35,750 for unmarried individuals other than surviving spouses; and $24,500 for married individuals filing separately. For 2010, the exemption amounts are $45,000, $33,750, and $22,500 respectively.
(4) The marginal tax rate for each return is calculated by adding $1,000 to wages, recomputing income tax net of refundable credits, and dividing the resulting change in tax liability by 1,000.
(5) Marginal tax rates represent a simple average across individuals.

Table 8
AMT Reform Options: Overview

AMT Status	Number of AMT Taxpayers, 2010[1] (millions)	Number of Zero-Tax Returns, 2010 (thousands)		Effect on Revenue, 2010 ($ billions)	Effect on Revenue, 2003-12 ($ billions)		Effect on Budget,[3] 2003-12 ($ billions)	
		AGI > $200K[2]	AGI > $1,100K[2]		EGTRRA Sunsets	EGTRRA Extended	EGTRRA Sunsets	EGTRRA Extended
Maintain Current Law	35.6	2.9	0.3	0.0				
Plan 1: Index after 2002[4]	10.4	3.3	0.3	-88.8	-368	-468	-438	-542
Plan 2: Plan 1, plus								
Allow dependent exemptions[5]								
Allow personal nonrefundable credits	6.0	3.4	0.3	-99.2	-423	-535	-507	-624
Plan 3: Plan 2, plus								
Allow deductions for expenses and taxes[6]								
Repeal AMT exemption phaseout	0.3	6.2	0.5	-134.2	-597	-749	-725	-883
Repeal after 2002	0.0	17.2	1.3	-141.4	-647	-802	-788	-951
Index after 2004	13.6	3.3	0.3	-79.6	-319	-408	-377	-470

Source : Urban-Brookings Tax Policy Center Microsimulation Model and authors' calculations.
(1) Numbers are for calendar years except ten-year revenue and budget effects, which cover fiscal years. AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.
(2) AGI measured in 2001 dollars.
(3) Includes the revenue effect calculated using the Urban-Brookings Tax Policy Center Microsimulation Model and the interest effect calculated using the CBO interest rate matrix.
(4) Index the AMT for inflation beginning after 2002 (including the exemption, tax bracket threshold, and exemption phaseout threshold).
(5) Dependent exemptions are not subject to phaseout.
(6) Includes deductions for miscellaneous expenses above the 2 percent of AGI floor, and state and local taxes.

Table 9
AMT Reform Options: Distribution of Tax Burdens, 2010

	AGI Class (thousands of 2001$)[1]									
	All	**< 15**	**15-30**	**30-50**	**50-75**	**75-100**	**100-200**	**200-500**	**500-1,000**	**> 1,000**
Percent Reduction in AMT Taxpayers[2]										
Index after 2002[3]	70.9	55.7	95.0	93.9	92.3	84.1	61.9	6.1	2.8	1.4
Plan 2	83.1	55.7	95.1	98.8	98.3	96.7	81.2	9.4	7.8	3.1
Plan 3	99.1	55.7	98.4	99.7	99.7	99.7	99.0	97.0	90.3	72.4
Repeal	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Index after 2004	61.8	55.7	95.0	88.7	87.7	72.0	49.7	3.2	2.3	1.1
Share of Tax Cut (Percent)										
Index after 2002	100.0	*	0.1	2.1	12.2	21.3	47.7	16.4	0.2	*
Plan 2	100.0	*	0.1	2.0	11.3	20.3	47.8	17.9	0.5	0.1
Plan 3	100.0	*	*	1.5	8.5	15.4	39.5	28.6	3.3	3.2
Repeal	100.0	*	0.1	1.4	8.1	14.7	38.2	28.5	3.9	4.9
Index after 2004	100.0	*	0.1	2.3	13.1	22.4	47.5	14.4	0.2	*
Average Tax Change ($)										
AMT Taxpayers										
Index after 2002	-2,498	-1,613	-404	-842	-1,385	-2,122	-3,248	-4,764	-676	-558
Plan 2	-2,791	-2,055	-409	-874	-1,438	-2,261	-3,639	-5,816	-1,741	-1,323
Plan 3	-3,776	-2,931	-489	-890	-1,459	-2,310	-4,071	-12,569	-15,376	-60,028
Repeal	-3,973	-7,989	-846	-898	-1,464	-2,326	-4,142	-13,187	-18,993	-97,258
Index after 2004	-2,238	-1,351	-385	-812	-1,334	-1,992	-2,901	-3,765	-517	-424
All Filers										
Index after 2002	-604	**	-2	-74	-599	-1,667	-3,054	-4,607	-366	-150
Plan 2	-675	**	-2	-76	-622	-1,776	-3,423	-5,625	-941	-355
Plan 3	-913	**	-2	-78	-630	-1,815	-3,828	-12,155	-8,314	-16,120
Repeal	-960	**	-4	-78	-633	-1,827	-3,896	-12,752	-10,270	-26,120
Index after 2004	-541	**	-2	-71	-577	-1,565	-2,729	-3,641	-279	-114
Percent Change in After-Tax Income										
AMT Taxpayers										
Index after 2002	2.0	49.5	1.2	1.7	1.9	2.2	2.4	1.8	0.1	*
Plan 2	2.2	63.0	1.3	1.8	2.0	2.4	2.6	2.1	0.3	*
Plan 3	3.0	89.9	1.5	1.8	2.0	2.4	3.0	4.6	2.5	2.0
Repeal	3.1	245.0	2.6	1.8	2.0	2.5	3.0	4.9	3.1	3.2
Index after 2004	1.8	41.5	1.2	1.7	1.9	2.1	2.1	1.4	0.1	*
All Filers										
Index after 2002	1.1	*	*	0.2	0.9	1.8	2.2	1.7	0.1	*
Plan 2	1.2	*	*	0.2	0.9	1.9	2.5	2.1	0.2	*
Plan 3	1.6	*	*	0.2	0.9	1.9	2.8	4.4	1.3	0.6
Repeal	1.7	*	*	0.2	0.9	1.9	2.9	4.7	1.6	1.0
Index after 2004	0.9	*	*	0.2	0.8	1.7	2.0	1.3	*	*

Source : Urban-Brookings Tax Policy Center Microsimulation Model.

(1) Returns with negative AGI have been excluded from the lowest income class but are included in the total.

(2) AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.

(3) The reform plans are defined in Table 8.

* Less than 0.05 percent.

** Less than $1 in absolute value.

Table 10
Paying for AMT Reform Options: Overview

Revenue Offset and AMT Status	Number of AMT Taxpayers, 2010[1] (millions)	Effect on Revenue, 2010 ($ billions)	Effect on Revenue, 2003-12 ($ billions)		Effect on Budget,[2] 2003-12 ($ billions)	
			EGTRRA Sunsets[3]	EGTRRA Extended	EGTRRA Sunsets[3]	EGTRRA Extended
Freeze EGTRRA Income Tax Rate Cuts at 2002 Levels[4]						
With Indexing after 2002[5]	7.2	-39.8	-100	-126	-99	-125
With Plan 2	3.8	-47.0	-139	-172	-148	-182
With Plan 3	0.3	-68.2	-257	-308	-297	-350
With Repeal	0.0	-74.2	-302	-354	-354	-408
With Indexing after 2004	9.9	-33.3	-65	-83	-55	-74
Freeze EGTRRA Income Tax Rate Cuts and Estate Tax Changes at 2002 Levels[4,6]						
With Indexing after 2002	7.2	4.2	-38	-16	-31	-9
With Plan 2	3.8	-3.0	-76	-62	-79	-65
With Plan 3	0.3	-24.2	-194	-199	-228	-234
With Repeal	0.0	-30.2	-239	-245	-285	-292
With Indexing after 2004	9.9	10.7	-2	26	13	42
Revenue-Neutral Stand-Alone Plan[7]	16.8	-5.0	20	19	36	36

Source : Urban-Brookings Tax Policy Center Microsimulation Model and authors' calculations.

(1) Numbers are for calendar years except ten-year revenue and budget effects, which cover fiscal years. AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.

(2) Includes the revenue effect calculated using the Urban-Brookings Tax Policy Center Microsimulation Model and the interest effect calculated using the CBO interest rate matrix.

(3) The revenue offsets would be repealed when EGTRRA sunsets.

(4) The top four statutory income tax rates would be 27, 30, 35, and 38.6 percent.

(5) The reform plans are defined in table 8.

(6) The 5 percent surtax would be repealed, the top estate tax rate would be 50 percent, the unified credit would be $1 million, and state tax credit rates would be reduced by 25 percent.

(7) Index the AMT exemption for inflation; raise the top AMT rate to 35 percent; repeal the phaseout of the AMT exemption; lower the AMT rate bracket thresholds to $65,000 for married couples filing jointly, $48,750 for singles and heads of household, and $32,500 for married individuals filing separately, all effective after 2004. Index the AMT rate bracket thresholds after 2010. Allow personal nonrefundable credits regardless of AMT liability after 2003.

Table 11
Distributional Effects of AMT and Income Tax Reform, 2010

	AGI Class (thousands of 2001$)[1]									
	All	**< 15**	**15-30**	**30-50**	**50-75**	**75-100**	**100-200**	**200-500**	**500-1,000**	**> 1,000**
Percent Reduction in AMT Taxpayers[2]										
AMT Repeal with Neutral Rates[3]	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
AMT Repeal with Rate Freeze[4]	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Indexing after 2002 with Rate Freeze[4]	79.7	55.7	95.0	93.9	93.0	85.9	77.2	30.6	52.4	29.5
Revenue-Neutral Stand-Alone Plan	52.7	55.7	95.0	91.9	90.5	75.7	24.4	-1.3	-80.9	-262.1
Percent of Filers with Tax Increase										
AMT Repeal with Neutral Rates	62.3	36.3	85.6	92.2	68.4	42.3	47.4	51.3	81.9	41.3
AMT Repeal with Rate Freeze	12.3	*	*	28.6	31.9	20.7	12.2	10.9	73.4	80.8
Indexing after 2002 with Rate Freeze	12.3	*	*	28.6	31.9	20.7	12.2	11.0	73.8	81.3
Revenue-Neutral Stand-Alone Plan	4.4	*	*	*	0.1	1.5	21.3	81.0	92.5	92.5
Percent of Filers with Tax Decrease										
AMT Repeal with Neutral Rates	15.5	*	0.3	6.1	31.0	57.3	52.3	48.6	18.0	58.5
AMT Repeal with Rate Freeze	22.8	*	0.4	8.6	42.5	75.1	86.8	89.0	26.5	19.0
Indexing after 2002 with Rate Freeze	22.8	*	0.4	8.6	42.5	75.1	86.8	87.6	22.7	14.1
Revenue-Neutral Stand-Alone Plan	20.2	*	0.4	8.7	43.1	77.1	73.4	18.6	6.6	6.2
Share of Tax Cut (Percent)										
AMT Repeal with Neutral Rates[5]										
AMT Repeal with Rate Freeze	100.0	*	0.2	1.1	11.0	22.6	51.4	36.3	-3.8	-19.1
Indexing after 2002 with Rate Freeze	100.0	*	0.1	1.7	19.1	38.2	77.5	28.1	-15.4	-49.4
Revenue-Neutral Stand-Alone Plan	100.0	*	1.0	37.1	209.4	357.8	288.8	-141.6	-225.4	-427.1
Average Tax Change ($)										
AMT Taxpayers										
AMT Repeal with Neutral Rates	-946	-7,987	-679	-497	-752	-1,018	-794	6	-1,043	-92,222
AMT Repeal with Rate Freeze	-2,967	-7,989	-846	-871	-1,405	-2,059	-2,993	-9,124	-7,230	-68,272
Indexing after 2002 with Rate Freeze	-2,001	-1,613	-404	-816	-1,333	-1,886	-2,438	-3,959	4,306	8,935
Revenue-Neutral Stand-Alone Plan	-773	-1,202	-385	-841	-1,349	-2,019	-1,119	2,041	21,019	74,099
All Filers										
AMT Repeal with Neutral Rates	**	11	117	331	245	-382	-563	696	7,399	-40,248
AMT Repeal with Rate Freeze	-504	**	-4	-32	-452	-1,476	-2,750	-8,541	5,357	52,914
Indexing after 2002 with Rate Freeze	-271	**	-2	-27	-421	-1,339	-2,228	-3,547	11,594	73,648
Revenue-Neutral Stand-Alone Plan	-34	**	-2	-74	-583	-1,586	-1,049	2,260	21,397	80,503
Percent Change in After-Tax Income										
AMT Taxpayers										
AMT Repeal with Neutral Rates	0.7	244.9	2.1	1.0	1.0	1.1	0.6	*	0.2	3.0
AMT Repeal with Rate Freeze	2.3	245.0	2.6	1.8	2.0	2.2	2.2	3.4	1.2	2.2
Indexing after 2002 with Rate Freeze	1.6	49.5	1.2	1.7	1.9	2.0	1.8	1.5	-0.7	-0.3
Revenue-Neutral Stand-Alone Plan	0.6	36.9	1.2	1.7	1.9	2.1	0.8	-0.8	-3.5	-2.4
All Filers										
AMT Repeal with Neutral Rates	*	-0.1	-0.4	-0.7	-0.4	0.4	0.4	-0.3	-1.2	1.5
AMT Repeal with Rate Freeze	0.9	*	*	0.1	0.7	1.6	2.0	3.1	-0.9	-1.9
Indexing after 2002 with Rate Freeze	0.5	*	*	0.1	0.6	1.4	1.6	1.3	-1.9	-2.7
Revenue-Neutral Stand-Alone Plan	0.1	*	*	0.2	0.9	1.7	0.8	-0.8	-3.4	-2.9

Source : Urban-Brookings Tax Policy Center Microsimulation Model.

(1) Returns with negative AGI have been excluded from the lowest income class but are included in the total.

(2) AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.

(3) The statutory income tax rates would be 10.7, 16.3, 29.2, 33.8, 43, and 33.2 percent.

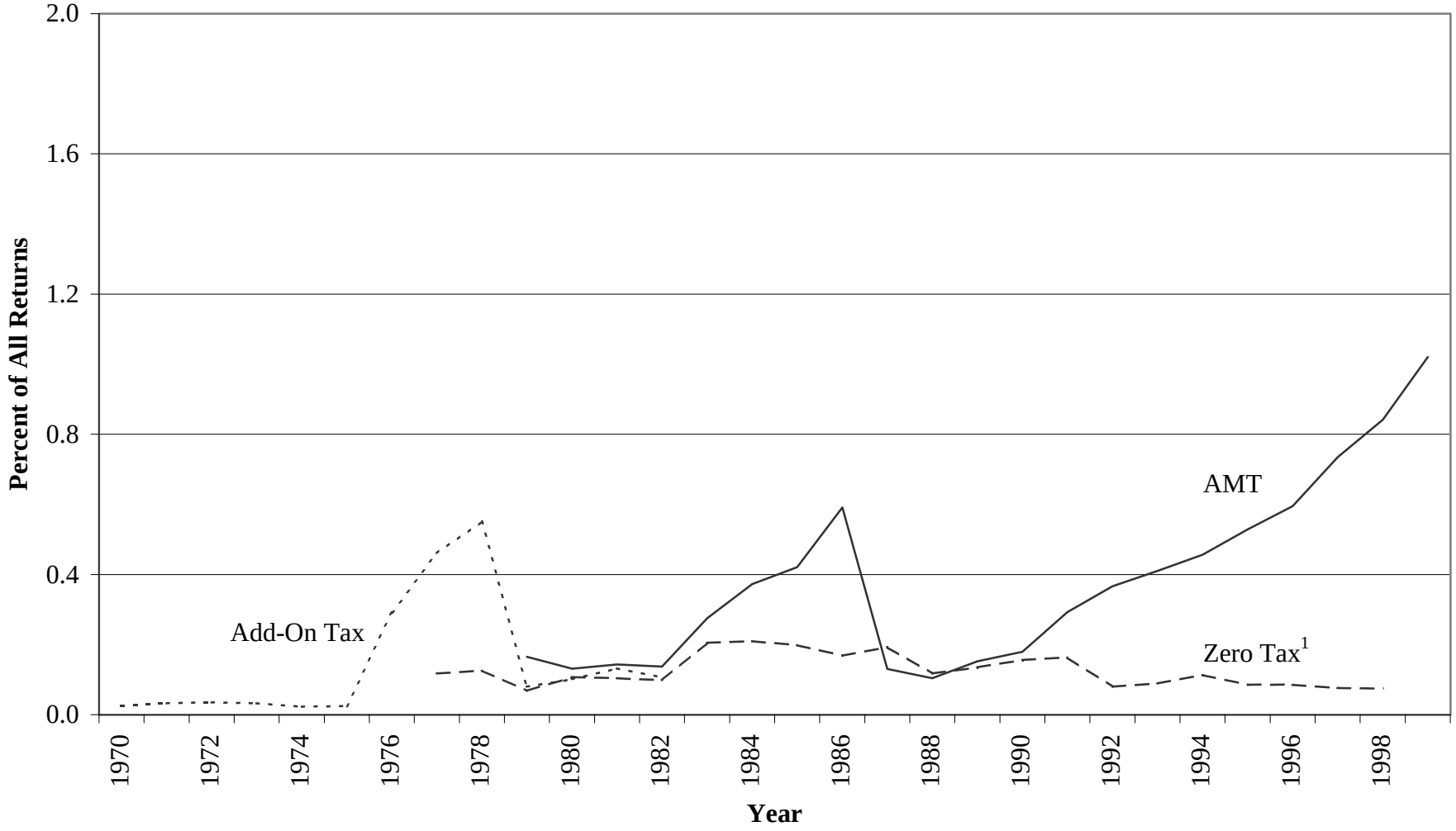
(4) The top four rates would be 27, 30, 35, and 38.6 percent.

(5) This option does not provide a tax cut in the aggregate.

* Less than 0.05 percent.

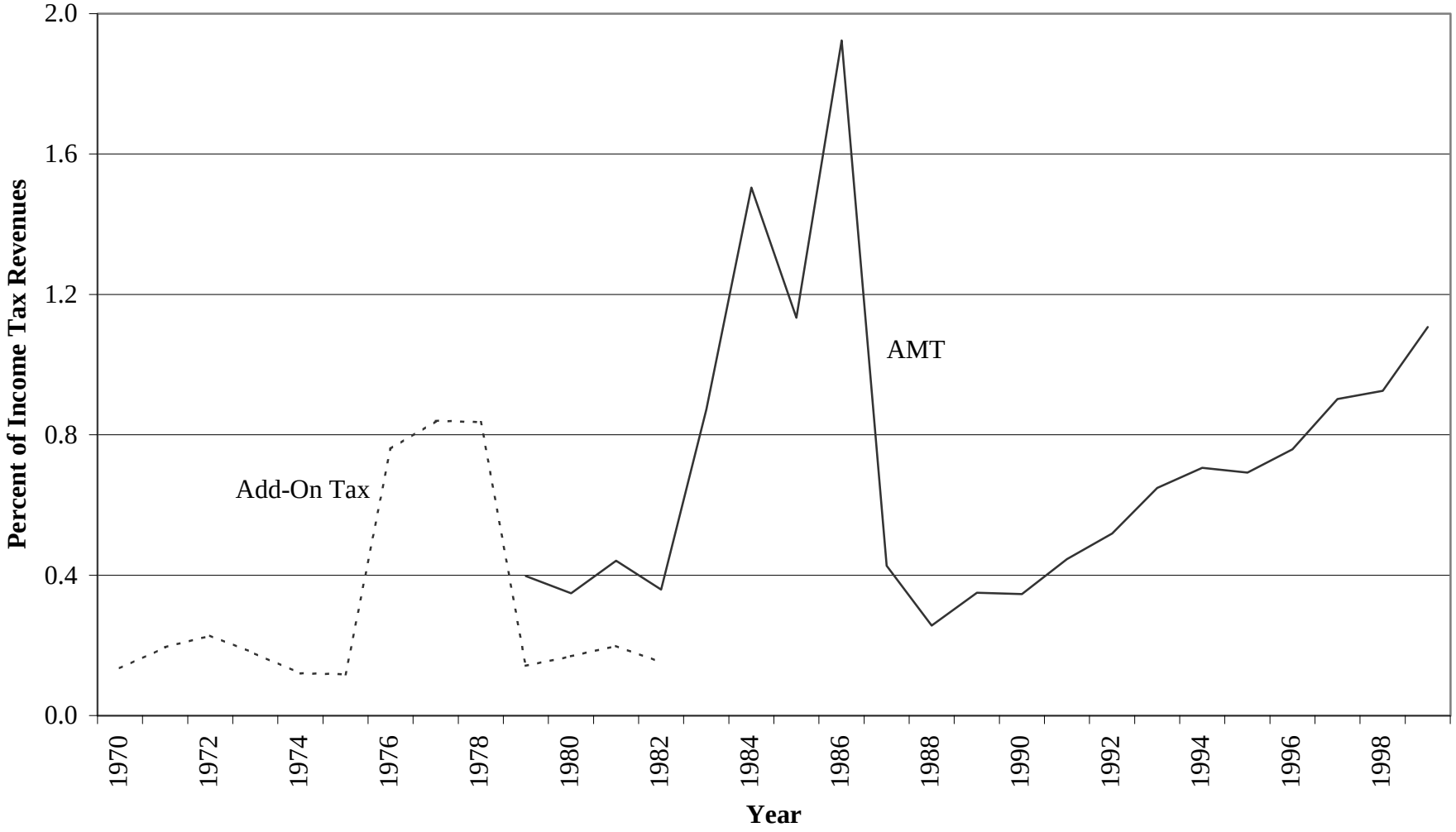
** Less than $1 in absolute value.

Figure 1
Minimum Tax and Zero-Tax Returns, 1970-1999



Sources: Harvey and Tempalski (1997); Jerry Tempalski (private communication); SOI (2000-2001, 2001).
(1) The zero tax line reports the percentage of returns with AGI above $200,000 (1966 $) that pay no federal income tax.

Figure 2
Minimum Tax Revenue, 1970-99



Sources: Harvey and Tempalski (1997); Jerry Tempalski (private communication); CBO (2002).

Figure 3

The Rise in AMT Taxpayers

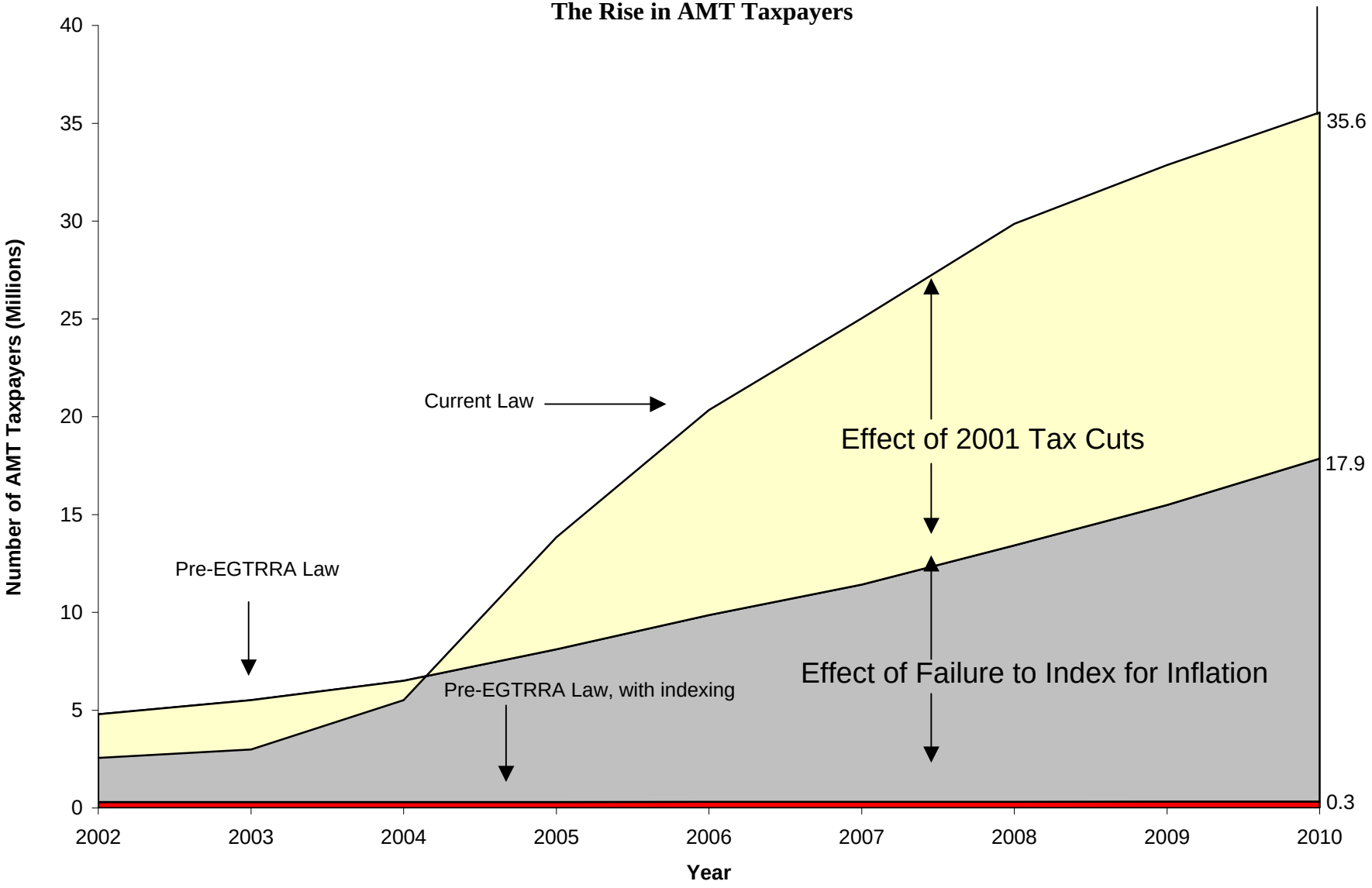
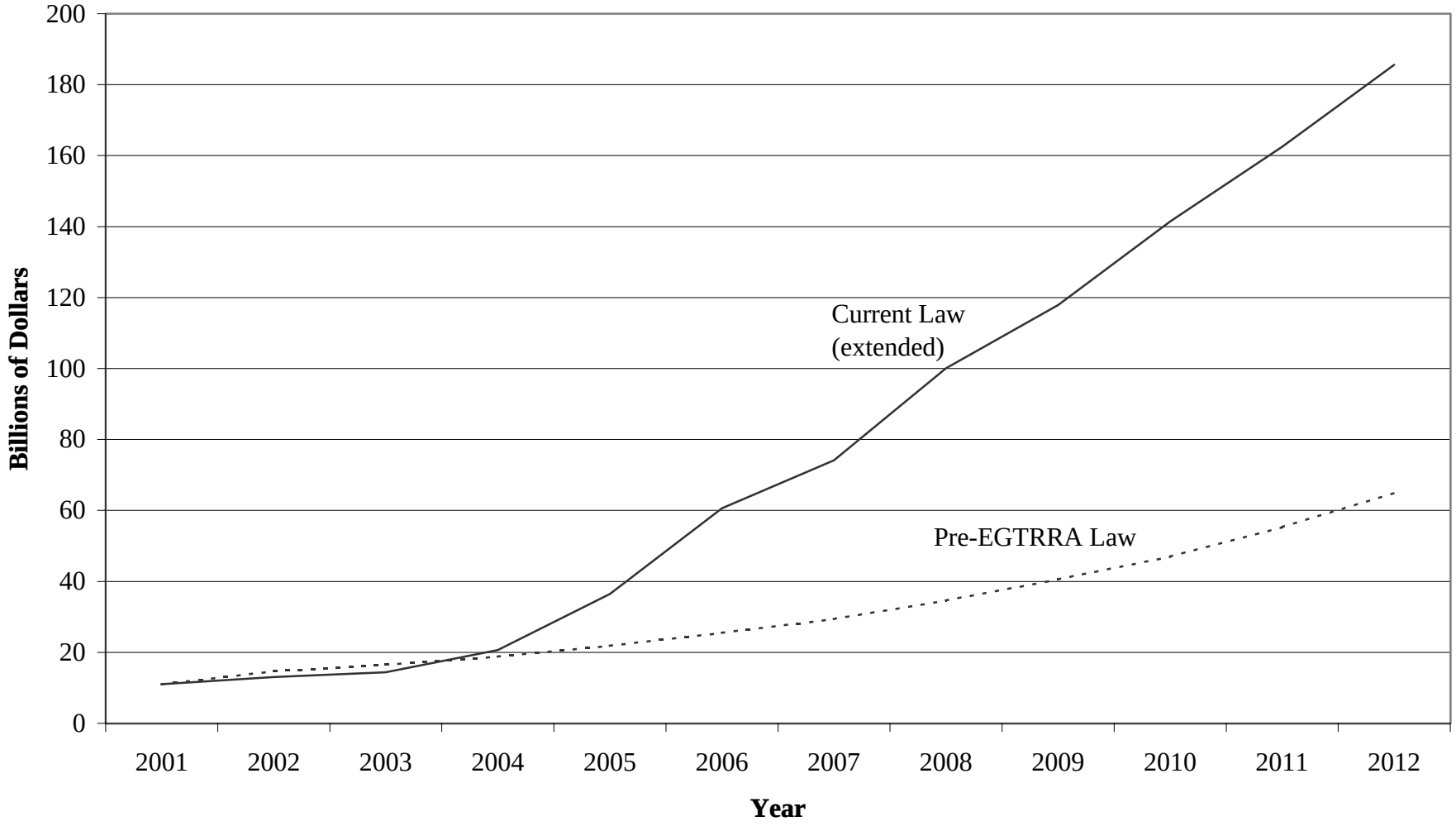


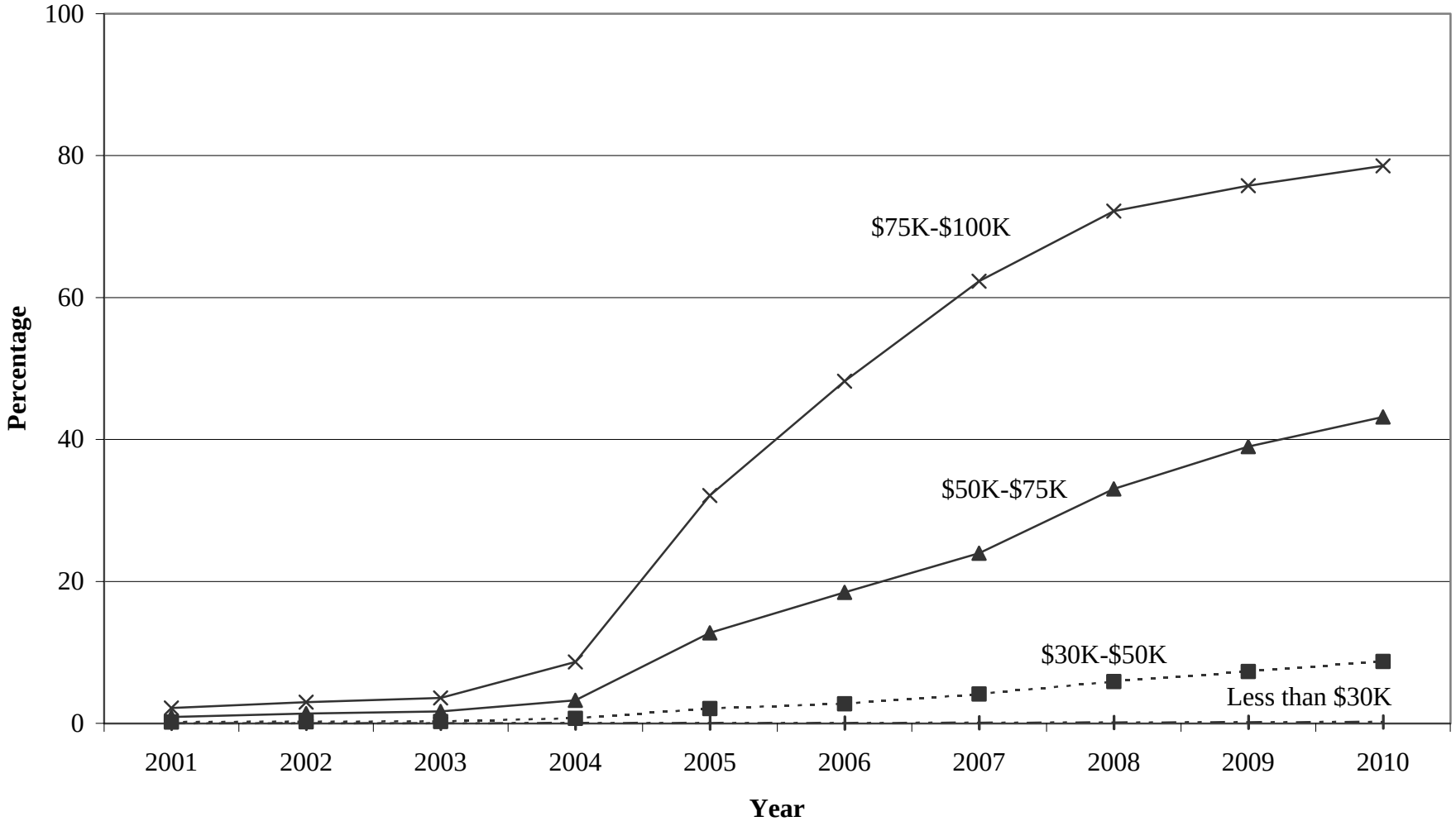
Figure 4
Total AMT Revenue, 2001-12[1]



Source: Urban-Brookings Tax Policy Center Microsimulation Model.
(1) Assumes current law as defined in Table 3.

Figure 5

Filers Affected by the AMT under Current Law, AGI Less than $100,000, 2001-10[1]

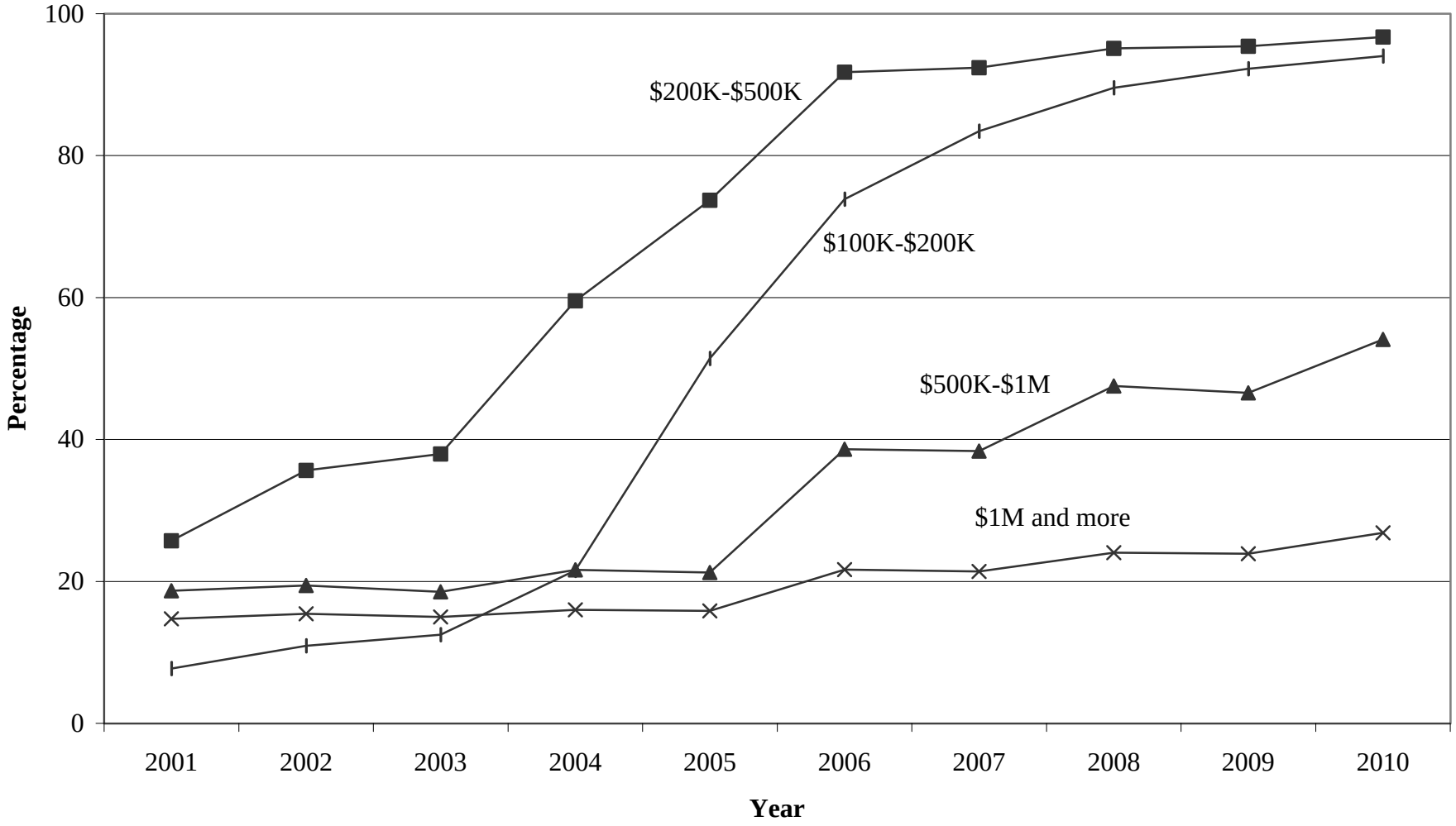


Source: Urban-Brookings Tax Policy Center Microsimulation Model.

(1) See Notes for table 4. AGI classes are measured in 2001 dollars.

Figure 6

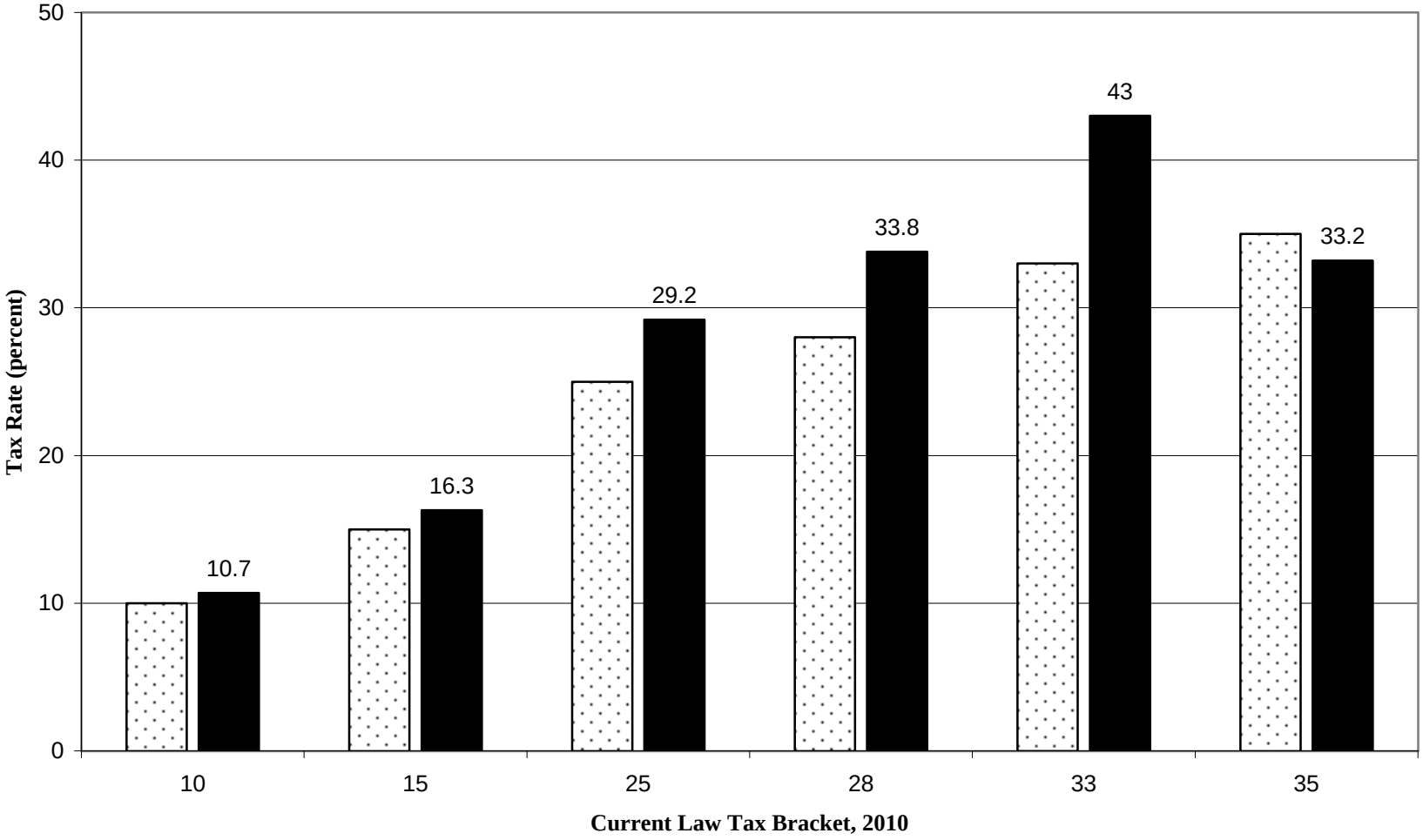
Filers Affected by the AMT under Current Law, AGI Greater than $100,000, 2001-10[1]



Source: Urban-Brookings Tax Policy Center Microsimulation Model.

(1) See Notes for Table 4. AGI classes are measured in 2001 dollars.

Figure 7
Revenue- and Distributionally Neutral Income Tax Rates Coupled With AMT Repeal



Source : Urban-Brookings Tax Policy Center Microsimulation Model.

Appendix Table 1
Comparison with Treasury and JCT Projections, 2001-12[1]

Year	AMT Taxpayers						AMT Revenue			
	Pre-EGTRRA Law			Current Law[2]			Pre-EGTRRA Law		Current Law	
	Treasury[3]	JCT[4]	TPC[5]	Treasury	JCT	TPC[6]	Treasury	TPC	Treasury	TPC
2001	1.8	1.5	2.0	1.7	1.4	1.9	10.2	10.9	10.3	11.1
2002	3.6	3.5	4.8	2.7	2.7	2.6	12.6	14.7	12.6	13.0
2003	4.7	4.3	5.5	3.5	3.3	3.0	14.6	16.5	14.5	14.4
2004	5.8	5.6	6.5	5.6	5.3	5.5	16.8	18.8	20.4	20.7
2005	7.5	7.1	8.1	13.4	13.0	13.8	19.7	21.8	34.9	36.4
2006	9.1	8.7	9.9	20.4	19.6	20.3	22.9	25.5	59.2	60.7
2007	11.1	10.5	11.4	25.3	23.9	25.0	27.2	29.4	72.7	74.2
2008	13.1	12.8	13.4	29.0	29.1	29.9	32.4	34.6	96.0	100.0
2009	15.7	14.9	15.5	32.1	32.1	32.9	38.4	40.6	111.4	117.9
2010	18.0	17.5	17.9	35.1	35.5	35.6	45.0	47.0	133.2	141.4
2011	20.8	20.7	20.5	–	–	38.3	53.2	55.3	–	162.5
2012	–	–	23.3	–	–	41.0	–	64.9	–	185.6

– Estimate not available.

(1) Calendar years. AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits. AMT revenue includes direct AMT liability and lost credits.

(2) Current law as defined in table 3.

(3) Estimates from the Treasury's Individual Income Tax Model as presented in Tempalski (2001). Does not include the effects of the Job Creation and Worker Assistance Act of 2002.

(4) Estimates from Joint Committee on Taxation, JCX-51-01, May 26, 2001. Does not include the effects of the Job Creation and Worker Assistance Act of 2002. JCT has not published projections of AMT revenue.

(5) Estimates from the Urban-Brookings Tax Policy Center Microsimulation Model.

(6) Assumes that the provisions in EGTRRA that expire after 2010 are extended through 2012.

Appendix Table 2
Separate Components of AMT Reform: Overview, 2010[1]

AMT Status	Number of AMT Taxpayers[2] (millions)	Number of Zero-Tax Returns (thousands)		Effect on Revenue ($ billions)
		AGI > $200K[3]	AGI > $1,100K[3]	
Maintain Current Law	35.6	2.9	0.3	0.0
Personal Nonrefundable Credits[4]	34.4	2.9	0.3	-5.7
Miscellaneous expenses[5]	34.3	3.6	0.3	-12.9
Dependent exemptions[6]	29.6	2.9	0.3	-33.0
Repeal AMT exemption phaseout	33.8	3.0	0.3	-42.2
State and local taxes[7]	27.3	5.3	0.4	-68.3

Source : Urban-Brookings Tax Policy Center Microsimulation Model.
(1) Calendar year.
(2) AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.
(3) AGI measured in 2001 dollars.
(4) Allow personal nonrefundable credits to be used against the AMT and regular income tax regardless of AMT liability.
(5) Allow the deduction for miscellaneous expenses above the 2-percent of AGI floor for AMT purposes.
(6) Dependent exemptions for AMT purposes are not subject to phaseout.
(7) Allow the deduction for state and local taxes for AMT purposes.

Appendix Table 3
Separate Components of AMT Reform: Distribution of Tax Burdens, 2010

	AGI Class (thousands of 2001$)[1]									
	All	**< 15**	**15-30**	**30-50**	**50-75**	**75-100**	**100-200**	**200-500**	**500-1,000**	**> 1,000**
Percent Reduction in AMT Taxpayers										
Personal Nonrefundable Credits	3.1	*	39.7	23.8	5.7	0.9	0.1	*	0.1	*
Miscellaneous Expenses	3.7	*	2.4	7.7	6.9	4.4	1.4	0.2	2.6	3.4
Dependent Exemptions	16.9	0.3	77.2	63.1	36.0	13.4	3.4	0.4	4.7	1.4
Repeal AMT Exemption Phaseout	4.9	*	*	*	*	0.2	5.0	29.8	52.9	23.5
State and Local Taxes	23.3	*	0.1	10.8	17.1	26.1	30.0	8.6	62.4	38.2
Share of Tax Cut (Percent)										
Personal Nonrefundable Credits	100.0	*	0.3	10.9	33.3	31.1	20.6	3.5	0.2	*
Miscellaneous Expenses	100.0	*	0.1	1.9	9.6	17.8	44.3	18.6	3.5	4.1
Dependent Exemptions	100.0	*	0.1	4.2	19.2	26.6	39.0	9.7	0.9	0.2
Repeal AMT Exemption Phaseout	100.0	*	*	*	0.1	0.5	29.4	62.3	5.9	1.7
State and Local Taxes	100.0	*	*	0.4	2.7	10.4	45.5	31.2	4.7	5.0
Average Tax Change ($)										
AMT Taxpayers										
Personal Nonrefundable Credits	-161	-1	-145	-282	-243	-199	-90	-66	-41	-15
Miscellaneous Expenses	-363	-143	-77	-113	-159	-258	-439	-788	-1,588	-7,399
Dependent Exemptions	-927	-463	-281	-627	-810	-983	-987	-1,048	-1,065	-762
Repeal AMT Exemption Phaseout	-1,187	-326	-33	**	-7	-25	-951	-8,610	-8,715	-10,189
State and Local Taxes	-1,922	-479	-26	-110	-240	-799	-2,386	-6,990	-11,107	-48,050
All Filers										
Personal Nonrefundable Credits	-39	**	-1	-25	-105	-156	-85	-64	-22	-4
Miscellaneous Expenses	-88	**	**	-10	-69	-203	-413	-762	-859	-1,987
Dependent Exemptions	-224	**	-1	-55	-350	-772	-928	-1,013	-576	-205
Repeal AMT Exemption Phaseout	-287	**	**	**	-3	-19	-894	-8,326	-4,713	-2,736
State and Local Taxes	-464	**	**	-10	-104	-627	-2,244	-6,759	-6,000	-12,902
Percent Change in After-Tax Income										
AMT Taxpayers										
Personal Nonrefundable Credits	0.1	*	0.4	0.6	0.3	0.2	0.1	*	*	*
Miscellaneous Expenses	0.3	4.4	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.2
Dependent Exemptions	0.7	14.2	0.9	1.3	1.1	1.0	0.7	0.4	0.2	*
Repeal AMT Exemption Phaseout	0.9	10.0	0.1	*	*	*	0.7	3.2	1.4	0.3
State and Local Taxes	1.5	14.7	0.1	0.2	0.3	0.8	1.7	2.6	1.8	1.6
All Filers										
Personal Nonrefundable Credits	0.1	*	*	0.1	0.2	0.2	0.1	*	*	*
Miscellaneous Expenses	0.2	*	*	*	0.1	0.2	0.3	0.3	0.1	0.1
Dependent Exemptions	0.4	*	*	0.1	0.5	0.8	0.7	0.4	0.1	*
Repeal AMT Exemption Phaseout	0.5	*	*	*	*	*	0.7	3.0	0.8	0.1
State and Local Taxes	0.8	*	*	*	0.2	0.7	1.6	2.5	1.0	0.5

Source : Urban-Brookings Tax Policy Center Microsimulation Model.

(1) Returns with negative AGI have been excluded from the lowest income class but are included in the total.

(2) AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.

(3) The reform components are defined in Appendix Table 2.

* Less than 0.05 percent. ** Less than $1 in absolute value.

Appendix Table 4
AMT Tax Rate Reform Options: Overview, 2010[1]

AMT Status	Number of AMT Taxpayers[2] (millions)	Number of Zero-Tax Returns (thousands)		Effect on Revenue ($ billions)
		AGI > $200K[3]	AGI > $1,100K[3]	
Maintain Current Law	35.6	2.9	0.3	0.0
Single 20 Percent Rate[4]	6.1	3.1	0.3	-126.8
10 Percent Cut in Rates[5]	21.0	3.0	0.3	-98.6
20 Percent Cut in Rates[6]	8.3	3.1	0.3	-122.6

Source : Urban-Brookings Tax Policy Center Microsimulation Model.
(1) Calendar year.
(2) AMT taxpayers include those with AMT liability from Form 6251 and those with lost credits.
(3) AGI measured in 2001 dollars.
(4) All three rate reform options also include repeal of the AMT exemption phaseout.
(5) The AMT rates would be 23.4 and 25.2 percent.
(6) The AMT rates would be 20.8 and 22.4 percent.

Appendix Table 5
AMT Tax Rate Reform Options: Distribution of Tax Burdens, 2010

	AGI Class (thousands of 2001$)[1]									
	All	**< 15**	**15-30**	**30-50**	**50-75**	**75-100**	**100-200**	**200-500**	**500-1,000**	**> 1,000**
Percent Reduction in AMT Taxpayers										
Single 20 Percent Rate[2]	82.7	*	52.0	69.4	77.3	78.5	89.0	93.6	88.0	65.5
10 Percent Cut in Rates[3]	40.8	*	19.1	34.6	34.4	28.6	45.8	73.5	77.3	47.4
20 Percent Cut in Rates[4]	76.5	*	52.0	65.3	70.7	70.0	83.2	91.2	85.7	60.3
Share of Tax Cut (Percent)										
Single 20 Percent Rate	100.0	*	*	1.2	7.7	14.6	39.9	29.9	3.5	3.1
10 Percent Cut in Rates	100.0	*	*	1.0	6.2	11.8	39.5	35.4	3.7	2.4
20 Percent Cut in Rates	100.0	*	*	1.2	7.5	14.3	40.2	30.5	3.4	2.8
Average Tax Change ($)										
AMT Taxpayers										
Single 20 Percent Rate	-3,566	-1,526	-359	-678	-1,255	-2,076	-3,881	-12,410	-15,390	-55,055
10 Percent Cut in Rates	-2,772	-824	-221	-425	-776	-1,306	-2,989	-11,415	-12,733	-33,208
20 Percent Cut in Rates	-3,448	-1,321	-330	-636	-1,183	-1,969	-3,785	-12,239	-14,608	-47,283
All Filers										
Single 20 Percent Rate	-862	**	-2	-59	-542	-1,631	-3,650	-12,001	-8,322	-14,786
10 Percent Cut in Rates	-670	**	-1	-37	-335	-1,026	-2,811	-11,038	-6,885	-8,918
20 Percent Cut in Rates	-833	**	-1	-56	-511	-1,547	-3,560	-11,835	-7,899	-12,698
Percent Change in After-Tax Income										
AMT Taxpayers										
Single 20 Percent Rate	2.8	46.8	1.1	1.4	1.8	2.2	2.8	4.6	2.5	1.8
10 Percent Cut in Rates	2.2	25.3	0.7	0.9	1.1	1.4	2.2	4.2	2.1	1.1
20 Percent Cut in Rates	2.7	40.5	1.0	1.3	1.7	2.1	2.8	4.5	2.4	1.6
All Filers										
Single 20 Percent Rate	1.5	*	*	0.1	0.8	1.7	2.7	4.4	1.3	0.5
10 Percent Cut in Rates	1.2	*	*	0.1	0.5	1.1	2.1	4.0	1.1	0.3
20 Percent Cut in Rates	1.5	*	*	0.1	0.7	1.7	2.6	4.3	1.3	0.5

Source : Urban-Brookings Tax Policy Center Microsimulation Model.

(1) Returns with negative AGI have been excluded from the lowest income class but are included in the total.

(2) All three rate reform options also include repeal of the AMT exemption phaseout.

(3) The AMT rates would be 23.4 and 25.2 percent.

(4) The AMT rates would be 20.8 and 22.4 percent.

* Less than 0.05 percent. ** Less than $1 in absolute value.

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