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The Alternative Minimum Tax for Individuals: Legislative Initiatives in the 109th Congress

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Summary

The alternative minimum tax (AMT) for individuals was originally enacted to ensure that all taxpayers, especially high-income taxpayers, paid at least a minimum amount of federal taxes.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

Temporary provisions intended to mitigate the effects of the AMT will expire at the end of 2006. As a result, the number of taxpayers subject to the AMT will increase from 3.6 million in 2005 to 23 million in 2007. The Congressional Budget Office estimates that extending AMT tax relief would reduce federal revenue by $282 billion over the period FY2007 through FY2011.

In May 2006, Congress passed the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA). This act increased the basic AMT exemption to $62,550 for joint returns and $42,500 for unmarried taxpayers. It also extended the provision allowing certain personal tax credits to offset AMT liability. These two changes are only effective through 2006.

This report will not be updated.

The alternative minimum tax (AMT) for individuals was originally enacted to ensure that all taxpayers, especially high-income taxpayers, paid at least a minimum amount of federal taxes.[1] However, absent legislative action, there will be a significant increase in the number of middle- to upper-middle-income taxpayers affected by the AMT in the near future. In 2005, about 3.6 million taxpayers were subject to the AMT, but by 2007, up to 23 million taxpayers could be subject to the AMT.

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

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

The effects of the AMT have been temporarily mitigated through an increase in the basic exemption for the AMT and temporary provisions allowing certain personal tax credits to offset AMT liability. For 2006, the AMT exemption is $62,550 for joint returns and $42,500 for unmarried taxpayers. Absent legislation, in 2007, the basic AMT exemption is scheduled to decrease to $45,000 for joint returns and $35,750 for unmarried taxpayers. In addition, starting in 2007, several personal tax credits will not be allowed against the AMT.

Revenue Effects of Modifying the AMT

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

When discussing the long-run (beyond 2010) revenue implications of modifying the AMT, it is critical to specify whether it is assumed that the 2001/2003 tax cuts are allowed to expire after 2010 as scheduled or whether it is assumed that the tax cuts are extended beyond 2010. Allowing the 2001 tax cuts to expire as scheduled will reduce the costs of modifying the AMT. If the tax cuts are extended beyond 2010, then the costs of modifying the AMT will increase dramatically. Indeed, if the 2001/2003 tax cuts are extended, then, as a rough estimate, the cost of most options for modifying the AMT will almost double. The revenue effects of several modifications to the AMT are shown in **Table 1**.

To keep the AMT from affecting more taxpayers in the out years than it will in 2006 would, at the least, require maintaining higher exemption levels and indexing the AMT for inflation. According to the Congressional Budget Office (CBO), this option, which assumes using basic exemption levels of $58,000/$40,250 and indexing these amounts for inflation after 2005, will cost $282 billion over the period FY2007 through FY2011. It will cost $544 billion over the FY2007 through FY2016 period if the 2001/2003 reductions in the regular income tax are allowed to expire as scheduled. If the 2001/2003

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

tax cuts are extended beyond 2010, then this option would reduce revenues by $865 billion over the same time period.

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

Policy Option	**FY07-11**	**FY07-16 (2001 tax cuts expire)**	**FY07-16 (2001 tax cuts extended)**
Basic AMT exemption levels of $58,000/$40,250, index exemption and bracket amounts for inflation after 2005	$282[d]	$544[d]	$865[d]
Repeal the AMT	$391[d]	$696[d]	$1,160[e]
Additional Policy Options	**FY06-10**	**FY06-15 (2001 tax cuts expire)**	**FY06-15 (2001 tax cuts extended)**
Allow AMT taxpayers to take personal exemptions, the standard deduction and deductions for state/local taxes. (AMT basic exemption reverts to prior law levels)	$282[b]	$530[b]	N/A
Allow personal exemptions under AMT	$176[a]	$343[c]	N/A
Allow state/local tax deductions under AMT	$228[a]	$423[c]	N/A

Note: These estimates do not take the revenue effects of TIPRA05 into account.
a. Joint Committee on Taxation, *Estimated Revenue Effects of Various AMT Options*, May 17, 2005, unpublished data that formed the basis for the ten-year estimates in the CBO testimony of May 23, 2005.
b. Congressional Budget Office, *Budget Option*s, February 2005, p. 275.
c. Congressional Budget Office, CBO Testimony, *The Individual Alternative Minimum Tax*, May 23, 2005, p. 8.
d. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016*, January 2006, p. 15 and unpublished data that forms the basis for the chart in Box 4-3 pp. 90 - 91.
e. U.S. Department of the Treasury, *Fact Sheet: The Toll of Two Taxes: The Regular Income Tax and the AMT*, March 2, 2005. Revenue estimate covers the period FY2006 through FY2015.
f. Joint Committee on Taxation, *Estimated Revenue Effects of H.R. 4096*, JCX-83-05, December 9, 2005. Revenue estimate covers the period FY2006 through FY2007.

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

Repeal of the AMT would be the most expensive policy option. According to CBO, repeal of the AMT would reduce federal revenues by approximately $391 billion over five years and by $696 billion over the period FY2007 through FY2016 if the tax cuts expire as scheduled. The Treasury Department estimates that if the 2001/2003 tax cuts are extended, then repealing the AMT would reduce federal revenues by over a trillion dollars between FY2006 and FY2015.[3] In fact, the Treasury Department has estimated that by 2013, it would be less expensive to repeal the regular income tax than it would be to repeal the AMT.

Legislative Initiatives in the 109th Congress

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

The conference agreement on the 2006 budget resolution, H.Con.Res. 95, was approved by both chambers on April 28, 2005, and contained $106 billion in tax relief over the next five years, approximately $70 billion of which would be protected through the reconciliation process. Under reconciliation, $11 billion of tax relief was allocated for 2006. Although the budget resolution did not identify specific changes to the tax code, it did not provide enough tax relief to hold the AMT harmless over the five-year budget horizon. Holding the AMT harmless would require extension and indexation of the increased AMT exemption levels and extension of the provision allowing taxpayers to use personal tax credits against the AMT[4].

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

Specifically, this bill included an increase in the AMT exemption level ($62,550 for joint returns and $42,500 for other returns) through 2006 and a two-year extension of the treatment of nonrefundable credits against the AMT. It was estimated that these changes would reduce federal revenues by $37 billion.

On November 15, 2005, as part of its reconciliation legislation, the Committee on Ways and Means approved H.R. 4297 which, among other things, would have provided partial AMT relief through a one-year extension of the treatment of nonrefundable personal tax credits under the AMT. This bill, however, did not include an extension of the higher AMT exemption amount. As a result, it would have provided only minimal relief from the expected impact of the AMT in 2006. The provision extending the

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

[4] Effective in 2007, certain personal tax credits (for example, the dependent care credit, the HOPE Scholarship and Lifetime Learning credit, and the D.C. homebuyer's credit) cannot be used to reduce a taxpayer's regular income tax below their AMT liability.

treatment of nonrefundable credits under the AMT was estimated to cost $2.8 billion. The full House approved H.R. 4297 on December 8, 2005.

On December 7, 2005, the House approved a stand-alone measure, H.R. 4096, extending the higher AMT exemption for one year and indexing the exemption for inflation. This legislation did not address the tax treatment of nonrefundable tax credits under the AMT, and hence, did not fully mitigate the impact of the AMT. It was estimated that the one-year cost of this legislation would be $30 billion.

In May 2006, Congress approved a budget reconciliation bill (H.R. 4297; the Tax Increase Prevention and Reconciliation Act of 2005- TIPRA) that included a one-year extension (through 2006) of both the AMT's personal-credit and increased-exemption provisions. For 2005, the exemption amount was $58,000 for joint returns and $40,250 for unmarried taxpayers. TIPRA increased the 2006 AMT exemption to $62,550 for joint returns and $42,500 for unmarried taxpayers. According to estimates by the Joint Committee on Taxation, the one-year cost of these AMT provisions would be $33.9 billion.

In addition to the bills mentioned above, other legislation affecting the AMT that has been introduced in the 109th Congress includes:

- **S. 1099.** Tax Simplification Act of 2005. Introduced on May 5, 2005, by Senator Richard Shelby. This bill would repeal the AMT.
- **S. 1103.** Introduced on May 23, 2005, by Senators Baucus, Grassley, Wyden, Kyl, Schumer, and Crapo. This bill would repeal the AMT for individuals effective for tax years beginning after December 31, 2005.
- **S. 1229.** Renewable Energy Incentives Act. Introduced on June 13, 2005, by Senator Harry Reid. This bill would allow the credit for electricity produced from renewable resources against the AMT.
- **S. 1240.** Introduced on June 14, 2005, by Senator Gordon Smith. This bill would allow a new investment credit for the purchase of trucks with new diesel engine technologies to be take against the AMT.
- **S. 2826**. Introduced on May 17, 2006, by Senator John Kerry. For 2007, this bill increases the AMT exemption amounts and allows personal tax credits to offset AMT liability.
- **H.R. 206.** Introduced on January 4, 2005, by Representative José Serrano. This bill would provide a business credit for the use of clean-fuel vehicles by businesses located within designated areas. The credit would be allowed against both the regular income tax and the AMT for both individuals and corporations.
- **H.R. 703.** The Middle Class Fairness Act of 2005. Introduced February 9, 2005, by Representative Scott Garrett. This bill would repeal the AMT limitation on the use of state and local tax deductions. It would also index, beginning in 2005, the AMT exemption amount for inflation.
- **H.R. 1091**. Introduced on March 3, 2005, by Representative Phil English. This bill would allow the work opportunity, welfare-to-work, and the research credit against the AMT.
- **H.R. 1186.** Alternative Minimum Tax Repeal Act of 2005. Introduced on March 9, 2005, by Representative Phil English. This bill would repeal the AMT starting in 2006.

- **H.R. 1538.** Introduced April 8, 2005, by Representative Steve Israel. Increases the AMT exemption to $100,000 for joint returns and $75,000 for all other returns. Increases the AMT exemption phase-out threshold. Indexes the AMT exemptions and phase-out thresholds.
- **H.R. 1599.** Introduced April 13, 2005, by Representative Jeb Bradley. Extends and indexes the increased AMT exemption amounts through 2007.
- **H.R. 2950.** The Individual Tax Simplification Act of 2005. Introduced on June 16, 2005, by Representative Richard Neal. Among other things, this bill would repeal the AMT.
- **H.R. 2987.** Introduced June 20, 2005, by Representative Robert Andrews. Allows a deduction for state and local income and property taxes under the AMT.
- **H.R. 3180.** Introduced on June 30, 2005, by Representative Ron Paul. This bill would allow a deduction against the AMT for qualified attorney fees and court costs associated with settlements of civil actions.
- **H.R. 3301.** Introduced July 14, 2005, by Representative J.D. Hayworth. This bill would allow a new investment credit for the purchase of trucks with new diesel engine technologies to be take against the AMT.
- **H.R. 3385.** AMT Credit Fairness Act of 2005. Introduced on July 21, 2005, by Representative Sam Johnson. This bill would increase the allowable credit for prior year AMT liability and make it refundable.
- **H.R. 5590**. Stealth Tax Relief Act of 2006. Introduced June 13, 2006, by Representative Thomas Reynolds. For 2007, this bill increases the AMT exemptions and allows personal tax credits to offset AMT liability.

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

Administration's Proposals

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

In its 2006 budget proposal, the Administration did not address the AMT issue. Subsequent statements by Secretary of the Treasury John Snow indicate that the AMT issue was to be addressed by the tax reform panel appointed by the Administration. As part of its reform proposals, the tax reform panel recommended that the AMT be repealed. The Administration's 2007 budget proposal includes a provision extending, through 2006, the higher AMT exemption levels and a provision allowing nonrefundable personal credits to apply to the AMT.