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Repeal the Alternative Minimum Tax

PROBLEM

The Alternative Minimum Tax (AMT) does not achieve its original goal — to ensure that wealthy taxpayers pay at least some tax.¹ By one projection, about 1,000 millionaires will pay no federal income tax in 2013.² Those with the highest incomes are less likely to be affected by the AMT than those just below them.³

To help prevent the AMT from hitting the middle class, the American Taxpayer Relief Act of 2012 (ATRA) increased the AMT exemption amount.⁴ While this change reduces the number of people subject to the AMT, it does nothing to fix the system's flaws. Today's AMT primarily affects taxpayers for paying state and local taxes and having children.⁵ While it is hard to imagine the drafters of the original AMT provision would view the expenses of having children or paying local taxes as tax-avoidance loopholes, that is how those expenses are treated today.

More importantly, the AMT is unnecessarily complex and burdensome for everyone. It requires taxpayers — even if they do not owe AMT — to compute their taxes twice, once under the regular tax rules and again under the AMT rules.

Moreover, the complexity of the AMT reduces the transparency of the tax system, making it more difficult for people to know their marginal tax rate and predict what they will owe. When people owe more than anticipated, voluntary compliance suffers.⁶

Even without any decline in voluntary compliance, the AMT is only projected to bring in \$25.6 billion in 2013.⁷ Thus, tax simplicity, transparency, voluntary compliance, and taxpayers who live in high-tax states or have children have become collateral damage in the battle to prevent middle- and high-income people from reducing their taxes by applying the regular tax rules enacted by Congress. If Congress does not like those rules, it should change them rather than applying an AMT. After ATRA, repealing the AMT might

¹ The 1969 Economic Report of the President: Hearings before the Joint Economic Comm., 91st Cong., pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury).

² Tax Policy Center (TPC), Distribution of Tax Units That Pay No Individual Income Tax; by Expanded Cash Income Level, Current Law, 2013, T13-0230 (Aug. 29, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3989.

³ See TPC, Characteristics of AMT Taxpayers, 2012–2014, 2023, T13-0210 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab. cfm?DocID=3969 (projecting that about 18 percent of millionaires will owe AMT for 2013, as compared to about 64 percent of those earning between \$500,000 and \$1 million, and 29 percent of those earning between \$200,000 and \$500,000).

⁴ ATRA, Pub. L. No. 112-240, 126 Stat. 2317 (Jan. 2, 2013).

⁵ See TPC, Reconciling AMTI and Taxable Income for AMT Taxpayers in 2008 (Dec. 21, 2010), http://taxpolicycenter.org/taxfacts/displayafact.cfm?DoclD=468&Topic2id=30&Topic3id=36.

⁶ Studies suggest that unexpected tax liabilities reduce filing, payment, and reporting compliance. See National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, at 30-35 (summarizing various studies).

⁷ TPC, Aggregate AMT Projections and Recent History, 1970-2023, T13-0208 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3967&DocTypeID=7.

cost \$384 billion over ten years (down from the pre-ATRA cost of about \$1.3 trillion), an amount that could be replaced by changes to the regular tax system.⁸

EXAMPLES

Example 1: Wealthy investor not hit by the AMT. A single childless investor earns \$100 million in 2012 from tax-exempt bonds. The investor does not owe any federal income tax and is not subject to the AMT.⁹

Example 2: Single parent living in a high tax state hit by the AMT. A single mother earns \$100,000 in wages in 2012, which she uses to support her mother and three children. She deducts \$22,000 in state and local property and income taxes and ineligible mortgage interest (*i.e.*, interest subject to AMT), and claims \$19,000 in personal exemptions. In the absence of the AMT, she would owe \$9,401 under the regular tax system (the tax on \$59,000 in taxable income). She owes another \$3,443 in AMT because she loses these deductions and exemptions under the AMT, bringing her total federal tax bill to \$12,844. Because she did not anticipate owing so much, she did not have enough withheld from her paycheck and cannot timely pay the full amount, triggering penalties and interest.

RECOMMENDATION

Repeal the AMT.11

PRESENT LAW

The AMT is a separate system from the regular income tax, with unique rules governing the recognition of income and the timing of deductions and credits. Taxpayers are often required to maintain two sets of records — one for regular income tax purposes and one for AMT purposes.

As discussed in other reports, it is difficult for taxpayers to compute their AMT liability, if any.¹² The IRS has developed an online assistant to help taxpayers determine if they are *potentially* subject to the AMT, and must complete Form 6251, *Alternative Minimum Tax – Individuals.*¹³ Some taxpayers complete Form 6251, only to find that they do not owe AMT.

Form 6251 requires the taxpayer to compute alternative minimum taxable income (AMTI) by giving up the benefit of tax preference items to which they are entitled under the regular tax system (e.g., personal

⁸ TPC, Aggregate AMT Projections and Recent History, 1970-2023, T13-0208 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3967&DocTypeID=7.

⁹ Assume the bonds are not private activity bonds, which are subject to the AMT. See IRC § 56(b)(1)(C)(iii) and 57(a)(5).

After subtracting her \$50,600 AMT exemption, her AMT income is \$49,400, and it is taxed at a flat 26 percent rate (\$49,400 x 26% = \$12,844). As noted below, the AMT contains a marriage penalty because the exemption amount for married persons is less than double that for singles. As this example illustrates, however, it may also be said to contain a head of household penalty because a head of household must claim the same exemption amount as a single filer. The computations for this example are before any applicable tax credits (e.g., withholding, estimated tax payments, and potentially, \$1,750 in child tax credits).

¹¹ The AMT is codified at IRC § 55 et. seq.

¹² See, e.g., National Taxpayer Advocate 2003 Annual Report to Congress 5-19.

¹³ Instructions for Form 1040, *U.S. Individual Income Tax Return* 42 (2012). The assistant is at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Alternative-Minimum-Tax-(AMT)-Assistant-for-Individuals. Alternatively, a taxpayer may follow the instructions to Form 6251 regarding "Who Must File."

and dependency exemptions and itemized deductions for state and local taxes, employee business expenses, and legal fees). ¹⁴ On Form 6251, the AMT "exemption amount" replaces the standard deduction and personal exemptions for purposes of the AMT. ¹⁵ In addition, one rate applies to income taxed at AMT rates and another (lower) rate to income taxed as long term capital gains or qualified dividends. ¹⁶

After these computations and others, the AMT is equal to the excess, if any, of the taxpayer's "tentative minimum tax" over his or her regular tax liability. For purposes of this comparison, however, the taxpayer must *recompute* his or her regular tax liability if he or she reported any tax from lump sum distributions (from Form 4972, *Tax on Lump Sum Distributions*), claimed a foreign tax credit, or used income averaging (on Form 1040, Schedule J).

A taxpayer who is subject to the AMT may accrue an AMT credit.¹⁷ However, this credit is earned only for AMT liability attributable to timing items — not exclusion items.¹⁸ Timing items are those that are accounted for in different tax years in the regular tax and AMT systems. For example, the AMT may require taxpayers to depreciate property over a longer period than under the regular tax system. Exclusion items are adjustments and tax preference items that result in the permanent disallowance of certain tax benefits, such as the standard deduction, personal exemptions, and certain itemized deductions. In addition, AMT credits can only be used in taxable years in which the taxpayer's regular tax liability, reduced by other nonrefundable credits, exceeds his or her tentative minimum tax.¹⁹ To claim AMT credits, taxpayers must complete Form 8801 *Credit for Prior Year Minimum Tax – Individuals, Estates, and Trusts*, which the IRS estimates will take more than seven hours.²⁰

¹⁴ Required adjustments include: medical and dental expenses, state and local taxes, certain non-allowable home mortgage interest, miscellaneous itemized deductions, tax refunds, investment interest, depletion, certain net operating losses, interest from specified private activity bonds, qualified small business stock, the exercise of incentive stock options, estates and trusts, electing large partnerships, property dispositions, depreciation on certain assets, passive activities, loss limitations, circulation costs, long-term contracts, mining costs, research and experimental costs, income from pre-1987 installment sales, intangible drilling costs, certain other adjustments and alternative tax net operating loss deductions. See IRC § 56 and 57; Form 6251, Alternative Minimum Tax – Individuals, Part I (2012).

¹⁵ Instructions for Form 6251, Alternative Minimum Tax – Individuals 9 (2012); IRC § 55(d) and 56(b)(1)(E). The AMT exemption is phased out for married taxpayers and qualified widowers with AMTI exceeding \$150,000, and single head of household taxpayers with AMTI exceeding \$112,500. IRC § 55(d)(3); Instructions for Form 6251, Alternative Minimum Tax – Individuals 9 (2012). The AMT exemption amount may also be limited for certain people under age 24. Id.

¹⁶ Form 6251, Alternative Minimum Tax – Individuals (2012) (line 31 and part III). In general, the first \$175,000 of income subject to AMT is taxed at a 26 percent rate and any excess is taxed at a 28 percent rate. IRC § 55(b)(1)(A). As noted above, capital gains and qualified dividend income are taxed at preferential AMT rates. IRC § 55(b)(3).

¹⁷ IRC § 53.

¹⁸ IRC § 53(d).

¹⁹ IRC § 53(c).

²⁰ Instructions for Form 8801, Credit for Prior Year Minimum Tax – Individuals, Estates, and Trusts (2012) (2 hours 4 minutes for recordkeeping, 2 hours 19 minutes to learn about the law, 2 hours 3 minutes to complete the form, and 48 minutes to copy, assemble and send).

REASONS FOR CHANGE

In 1969, Congress enacted a minimum tax (the predecessor of the AMT) after hearing testimony that 155 taxpayers with adjusted gross incomes (AGI) above \$200,000 (about \$1,438,698 in 2013 dollars)²¹ paid no federal income tax for the 1966 tax year, due to tax preferences or loopholes.²² Today, the AMT fails to ensure that those with the highest incomes pay federal income tax.²³

The AMT hits the "wrong" taxpayers.

Thousands of U.S. taxpayers with incomes of more than \$200,000 paid no income tax anywhere in the world in 2010 (the most recent year for which complete data is available), and by one projection about 1,000 millionaires will pay no federal income tax in 2013.²⁴ Those with the highest incomes are actually less likely to be hit by the AMT than those just below them.²⁵ One reason for this is the exclusion of interest on certain tax-exempt bonds (and the allowance of certain deductions) under both regular tax and the AMT.²⁶ For example, wealthy individuals who invest in certain tax-exempt municipal bonds generally pay no federal income tax on the interest they receive.²⁷

Even when high income taxpayers are subject to AMT, they can pay lower rates than moderate income taxpayers because preferential low rates apply to investment income under both the regular tax system and the AMT. In general, the AMT regime taxes upper-income taxpayers at a flat rate of 28 percent.²⁸ Before 1997, capital gains were considered a preference item and taxed at the same flat rate as other AMT income.²⁹ Under current law, however, long-term capital gains and qualified dividend income are subject

- 21 See Bureau of Labor Statistics, CPI Inflation Calculator, available at http://www.bls.gov/data/inflation_calculator.htm (last visited Dec. 18, 2013).
- 22 The 1969 Economic Report of the President: Hearings before the Joint Economic Comm., 91st Cong., pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury).
- Perhaps because the AMT does not fulfill its original purpose, the administration has proposed (1) to cap, at 28 percent, the value of itemized deductions and specified exclusions, and (2) a new minimum tax, called the Fair Share Tax (FST) (a.k.a. the "Buffet rule"), on those making over \$1 million (\$500,000 in the case of a married individual filing a separate return). Treasury Department, General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals 134-137 (Apr. 2013), http://www.treasury.gov/resource-center/tax-policy/Documents/ General-Explanations-FY2014.pdf. In addition, ATRA recently reinstated the Pease limit that phases out itemized deductions for higher income taxpayers. See ATRA, Pub. L. No. 112-240, Title I, § 101(b)(2)(A)(iii), 126 Stat. 2317 (Jan. 2, 2013). ATRA also reinstated a personal exemption phase out (PEP). Id. The National Taxpayer Advocate has long opposed phase outs as unnecessarily complicated substitutes for increasing tax rates or eliminating tax preferences. See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 410-413 (Legislative Recommendation: Eliminate (or Simplify) Phase-outs).
- 24 Justin Bryan, High-Income Tax Returns for 2010, 32 SOI Bulletin 4, 11 (Spring 2013), http://www.irs.gov/uac/SOI-Tax-Stats-SOI-Bulletin-Spring-2013 (For 2010, "8,046 returns with no worldwide income tax had an AGI of \$200,000 or more; 16,082 returns with no worldwide income tax had expanded income of \$200,000 or more; and 4,782 returns with no worldwide income tax had both AGI and expanded income of \$200,000 or more."); TPC, Distribution of Tax Units That Pay No Individual Income Tax; by Expanded Cash Income Level, Current Law, 2013, T13-0230 (Aug. 29, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3989 (number of millionaires).
- 25 See TPC, Characteristics of AMT Taxpayers, 2012-2014, 2023, T13-0210 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3969 (projecting that about 18 percent of millionaires will owe AMT for 2013, as compared to about 64 percent of those earning between \$500,000 and \$1 million, and 29 percent of those earning between \$200,000 and \$500,000).
- Justin Bryan, *High-Income Tax Returns for 2009*, 31 SOI Bulletin 6, 15-17 (Spring 2012), http://www.irs.gov/pub/irs-soi/12soisprbul.pdf ("non-taxable returns under the expanded income concept, were much more likely to have tax-exempt interest than were taxable returns.... Similarly, nontaxable returns were much less likely to have any income from salaries and wages.... Because they do not generate AMT adjustments or preferences, tax-exempt bond interest, itemized deductions for interest expense, miscellaneous itemized deductions not subject to the 2-percent-of-AGI floor, casualty or theft losses, and medical expenses (exceeding 10 percent of AGI) could, by themselves, produce nontaxability.").
- 27 In theory, they are "taxed" in the sense that they receive a lower rate of interest than they might receive on bonds that produce taxable interest income. However, even if this rate reduction is considered a tax, it is probably not imposed at the investor's marginal income tax rate.
- 28 The 28 percent rate applies after a phase out of the exemption amount and a 26-percent rate that applies to the first \$175,000 of income. See generally IRC § 55.
- 29 Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 311(b), 111 Stat. 788 (1997) (reducing the rate applicable to long-term capital gains under both the regular tax system and the AMT).

to a special low rate, which is generally 15 or 20 percent, under both the regular tax and the AMT.³⁰ Therefore, taxpayers who have sufficient resources to live off investment income pay tax at 20 percent (or perhaps less if they have tax-exempt bond income), which is less than the 25 percent marginal rate applicable to a single person who earns just \$35,351 from wages.³¹

The AMT stealthily increases marginal rates for middle income taxpayers and reduces transparency.

In addition to eliminating tax preferences that taxpayers may expect to claim, the AMT exemption phase out stealthily increases marginal rates for those who are not in the highest tax bracket. Under the regular tax system, the highest marginal rate of 35 percent generally applies to those with taxable income of more than \$388,350.³² As described above, the AMT rules generally impose tax at a rate of 26 percent up to \$175,000 and 28 percent on higher amounts. However, the AMT exemptions phase out, costing taxpayers \$0.25 for every dollar their AMTI exceeds \$150,000 for married filers (or \$112,500 for non-married filers).³³ Therefore, the marginal tax rate for those in the AMT exemption phase-out range could exceed 35 percent (the highest regular marginal rate), even if they are subject to lower marginal rates under the regular tax system.³⁴

The AMT penalizes families.

The AMT eliminates the tax "benefit" of children (dependency exemptions are lost under the AMT) and marriage (the AMT contains marriage penalties).³⁵ As a result, having two children is estimated to double a person's likelihood of being hit by AMT in tax year (TY) 2013.³⁶ Similarly, married taxpayers will be more than five times as likely as single ones to pay AMT in TY 2013.³⁷ While it is hard to imagine that the drafters of the original AMT provision would view incurring expenses to raise a family as a tax-avoidance loophole, that is essentially the way they are viewed under today's archaic AMT.

³⁰ IRC § 1(h) and 55(b)(3), as amended by ATRA, Pub. L. No. 112-240, § 102(b) (extending preferential rates that were set to expire, but increasing the long term capital gain rate from 15 to 20 percent for taxpayers in the 39.6 tax bracket). Upper middle income taxpayers who benefit from the AMT exemption face a higher marginal tax rate on long-term capital gains and dividend income because it decreases the value of the AMT exemption. See, e.g., Benjamin H. Harris and Christopher Geissler, Tax Rates on Capital Gains and Dividends Under the AMT, 118 Tax Notes 1031 (Mar. 3, 2008). An IRS analysis of the 400 taxpayers reporting the highest income found that capital gains constituted between 46 and 72 percent of their total income in years 2009 to 2000. See IRS, SOI, The 400 Individual Income Tax Returns Reporting the Largest Adjusted Gross Incomes Each Year, 1992–2009 (2009) (Table 1 – Net capital gains less loss in AGI), http://www.irs.gov/pub/irs-soi/09intop400.pdf.

³¹ Instructions for Form 1040, U.S. Individual Income Tax Return 105 (2012).

³² IRC § 1(h); Instructions for Form 1040, U.S. Individual Income Tax Return 105 (2012). Those married, but filing separately hit the maximum marginal rate when they earn over \$194,175. Id.

³³ IRC § 55(d)(3); Instructions for Form 6251, Alternative Minimum Tax – Individuals 9 (2012). The phase out begins at \$75,000 for those who are married, but filing separately. Id.

³⁴ In the AMT exemption phase-out range an additional \$1,000 of income could reduce the exemption amount by \$250, increasing the amount subject to the 28 percent rate to \$1,250, and increasing the AMT by \$350 (\$1,250*28%=\$350) or 35 percent. If the same dollars of income also trigger other phase outs on the return, then the marginal rate could exceed 35 percent.

³⁵ See IRC §§ 56 and 57; Form 6251, Alternative Minimum Tax – Individuals (2012).

See TPC, Characteristics of AMT Taxpayers, 2012–2014, 2023, T13-0210 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab. cfm?DocID=3969 (projecting that 4.1 percent of those with two children will be hit by AMT, as compared to 2.1 percent with no children for TY 2013).

³⁷ See id., (projecting that 4.3 percent of married joint filers will be hit by AMT in TY 2013, as compared to 0.8 percent of single filers).

The AMT penalizes those with high expenses.

An individual taxpayer must add back certain itemized deductions when computing AMT.³⁸ This requirement affects taxpayers with large expenses such as legal fees in court settlements, state and local taxes, or employee business expenses. Thus, the AMT may hit those with relatively high expenses and a reduced ability to pay.

The AMT treats seemingly similar deductions differently.

The AMT does not treat itemized deductions uniformly. A married couple with three children living in a high tax area or incurring high employee business expenses is more likely to owe AMT than a similar family that has other itemized deductions, such as deductions for mortgage interest or charitable contributions, which are deductible for AMT purposes.

EXAMPLE 3: The AMT treats similar itemized deductions differently. In 2012, a married couple with six children had combined wages of \$125,000 and paid \$20,000 in state and local taxes. This couple was subject to \$1,309 in AMT. If they had incurred \$20,000 in employee business expenses or jobrelated legal fees instead, the couple would have been subject to AMT of \$684.³⁹ However, if the \$20,000 in itemized deductions were a combination of \$10,000 of mortgage interest and \$10,000 of local taxes, they would not owe AMT, as shown on Table 1 (below). Therefore, even though the couple had the same total income and itemized deductions under the regular tax rules, the difference in treatment of taxes and deductions under the AMT would produce different liabilities.

TABLE 2.1.1, The AMT and Itemized Deductions

	Tax Year 2012: High Tax	Tax Year 2012: High EBE or Legal Fees	Tax Year 2012: Tax and Mortgage Interest Split
Filing Status	MFJ	MFJ	MFJ
Adjusted Gross Income (AGI)	\$125,000	\$125,000	\$125,000
State and Local Taxes	\$20,000		\$10,000
Schedule A Miscellaneous		\$20,000	
Mortgage Interest			\$10,000
Tentative Minimum Tax	\$12,025	\$12,025	\$9,425 40
Regular Tax	\$10,716	\$11,341	\$10,716
AMT	\$1,309	\$684	\$0
Total Tax	\$12,025	\$12,025	\$10,716

³⁸ IRC § 56(b) and (e). Common itemized deductions that must be added back to income include, but are not limited to: state and local taxes, real estate and personal property taxes, mortgage interest not used for the purchase or improvement of a personal residence, medical expenses exceeding 7.5 percent but less than 10 percent of adjusted gross income, and certain miscellaneous itemized deductions such as employee business expenses and legal fees. *Id*.

³⁹ Unreimbursed employee business expenses are generally deductible under the regular tax system, but not deductible under the AMT. See, e.g., Treas. Reg. § 1.62-1T(e)(3) (employee business expenses); Alexander v. IRS, 72 F.3d 938 (1st Cir. 1995) (legal fees); IRC §§ 55 and 56 (AMT).

⁴⁰ The tentative minimum tax was computed by taking \$125,000 of taxable income, minus the \$10,000 mortgage interest deduction allowable under the AMT, minus the \$78,750 AMT exemption, leaving a taxable excess of \$36,250, which was multiplied by the 26 percent AMT rate.

The AMT is complicated and burdensome.

Although the IRS has not measured the compliance costs of the AMT, it estimates that taxpayers spent over 18 million hours in 2000 completing and filing AMT tax forms or determining whether they needed to do so — more than 12 hours for each person who actually paid the AMT.⁴¹ Other research from TY 2000 suggested that those who filed a Form 6251, *Alternative Minimum Tax – Individuals*, spent nearly double the time on their returns (13.7 hours for individuals and 56.6 hours for self-employed filers) than those who did not (24.6 hours for individuals and 97.3 hours for self-employed filers).⁴² Thus, the AMT nearly doubles the burden of filing a federal income tax return. The following points illustrate some of the complexity of the AMT.

The AMT multiplies complexity and recordkeeping for owning and selling property.

Taxpayers must claim depreciation over different periods under the AMT. For example, if a taxpayer placed an office building into service prior to 1999 and is claiming straight-line depreciation, the taxpayer would depreciate it over a 39-year period for regular tax purposes.⁴³ For AMT purposes, the taxpayer would have to depreciate the building over a 40-year period instead.⁴⁴ Thus, the taxpayer would have to compute depreciation under both tax systems.

The portion of AMT attributable to timing items (such as depreciation) reflects the difference between when certain deductions are allowable under the AMT and when the same deductions are allowable under the regular income tax. As noted above, a taxpayer can only claim an AMT credit with respect to timing items in subsequent years when the regular tax exceeds the tentative minimum tax. Accordingly, the taxpayer must track his or her AMT credits.⁴⁵

In addition, because depreciation deductions (and other tax adjustments that affect basis) may be different under the AMT, an asset may have a different tax basis under the AMT than for regular tax purposes. A taxpayer's gain on the sale of property is computed as the difference between the amount realized on the sale (e.g., the sale price) and its adjusted tax basis (e.g., the amount paid, as adjusted for tax purposes). As a result, selling a single asset could produce a different gain under each system. Thus, a taxpayer must keep two sets of books to track each asset's basis under each tax system.

⁴¹ Allen H. Lerman and Peter S. Lee, Evaluating the Ability of the Individual Taxpayer Burden Model To Measure Components of Taxpayer Burden: The Alternative Minimum Tax as a Case Study, 2004 IRS Research Conference 140, 151, 166 (Feb. 2005), http://www.irs.gov/file_source/pub/irs-soi/04lerman.pdf (estimating the AMT added 18.4 million hours in burden (including burden for those who did not owe AMT), and that between 1.4 and 1.5 million taxpayers actually had AMT liability or a reduced credit in TY 2000).

⁴² See John Guyton et. al., Estimating the Compliance Cost of the U.S. Individual Income Tax, NTA Symposium (2003) (Table 6), www.irs.gov/pub/irs-soi/toder.pdf. By comparison, the IRS estimates that it takes 13 hours, on average, to fill out the entire Form 1040, U.S. Individual Income Tax Return. Instructions for Form 1040, U.S. Individual Income Tax Return 102 (2012).

⁴³ IRC § 168(c).

⁴⁴ IRC § 56(a)(1)(A)(i) (referencing IRC § 168(g)).

⁴⁵ IRC 8 53

⁴⁶ See, e.g., IRC §§ 56(a)(6), 1011, and 1012.

⁴⁷ See generally IRC § 1011.

The AMT multiplies complexity and recordkeeping for the foreign tax credit.

In order to prevent double taxation of foreign earned income, a taxpayer generally may claim a foreign tax credit (FTC) to offset U.S. income tax liability for income taxes paid to a foreign country or U.S. possession.⁴⁸ A taxpayer may be required to claim a different amount of FTC under the AMT than under the regular tax system.⁴⁹ Unused foreign tax credits generally may be carried back one year and forward ten years.⁵⁰ Thus, in addition to requiring two sets of FTC computations each year, the AMT requires a taxpayer to track FTC carryovers for purposes of both the AMT and the regular tax system.

The AMT multiplies complexity and recordkeeping for tax credits.

Some credits are allowed under the AMT and some are not. When a credit is disallowed under the AMT, it may sometimes be carried over and used in another tax year. When credits may be carried over to other years, the carryover periods vary from item to item. Because different credit limitations and carryover periods apply to the AMT, the AMT multiplies the complexity and burden of these already-complicated rules. For example, a taxpayer cannot carry over an unused credit for placing a qualified electric vehicle into service.⁵¹ If the taxpayer cannot use the credit in the year the vehicle is placed into service, he or she loses the credit. On the other hand, when the AMT limits general business credits, it usually allows the taxpayer to carry them back one year and forward 20 years.⁵² By contrast, when the home mortgage interest credit is limited, it may be carried forward three years but may not be carried back.⁵³ Similarly, when the adoption assistance credit is limited, it may be carried forward five years but may not be carried back.⁵⁴ Not only do these complicated credit carryover rules vary widely, but they require taxpayers to track multiple types of credit carryovers from year to year under both the AMT and the regular tax systems.

The AMT creates a trap for the unwary by taxing paper gains on incentive stock options.

A taxpayer's exercise of incentive stock options (ISOs) creates paper (phantom) gain in the year the stock is purchased (the option exercise). The gain is the difference between the option price and the market value of the stock on the date the option is exercised to purchase the shares. This gain is not taxed under the regular tax rules but is taxed for AMT purposes.⁵⁵ Because paper gains can disappear before the taxpayer sells the stock or pays the tax — as they often do in a sharp economic downturn — some taxpayers are subject to AMT on phantom gains that they cannot pay (*i.e.*, the so-called "ISO-AMT problem"). While a taxpayer who is subject to AMT on the exercise of an ISO receives AMT credits, he or she generally cannot recover these credits very fast.⁵⁶ Congress has partially addressed the ISO-AMT problem by

- 48 IRC § 27 and 901.
- 49 See IRC § 59 and 904.
- 50 IRC § 904(c).
- 51 A credit may be carried to another taxable year only if the IRC expressly provides for it. In the case of the credit for placing a qualified electric vehicle into service, carryovers are not authorized. See IRC § 30(a).
- 52 IRC § 39(a).
- 53 See IRC § 26 and 25(e).
- 54 IRC § 23C.
- 55 Compare IRC § 422(c)(2) with IRC § 56(b)(3).
- AMT credits generally can only be used in future years to the extent the taxpayer's regular tax liability exceeds his or her "tentative minimum tax" for the year. IRC § 53. Moreover, any AMT capital losses on a sale of the stock can only be offset against AMT capital gains plus \$3,000 of ordinary AMT income per year. See, e.g., Guzak v. U.S., 75 Fed. Cl. 304 (Feb. 15, 2007).

accelerating the availability of AMT credits taxpayers may claim in years before 2013, but the ISO-AMT problem remains a trap for the unwary.⁵⁷

The AMT is less predictable than the regular tax system.

The complexity of the AMT makes it less predictable than the regular tax system. By one projection for tax year (TY) 2013, those who earn less than \$200,000 and are hit by the AMT will be subject to an average effective marginal tax rate more than ten points higher, on average, than they would face under the regular tax system. ⁵⁸ The AMT is so complicated that the IRS's wage withholding calculator does not even consider the AMT in determining how much taxpayers should withhold. ⁵⁹ Many taxpayers first learn they are subject to the AMT only after preparing their returns, when it is too late to increase their withholding or estimated tax payments.

Taxpayers who do not withhold or pay enough estimated tax are subject to penalties. While we cannot determine how many taxpayers were subject to estimated tax penalties solely because of the AMT, IRS data show that for tax year 2012, about 18 percent of those subject to the AMT were liable for estimated tax penalties, as compared to four percent of individual taxpayers overall. Some taxpayers cannot afford to pay their tax (or penalties) in one lump sum at the end of the year. Thus, the unpredictability of the AMT likely reduces voluntary compliance.

EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate first recommended repeal of the AMT in her 2001 Annual Report to Congress and has consistently advocated for its repeal since then.⁶² In 1999, Congress voted to repeal the individual AMT, but the legislation was vetoed.⁶³ The American Bar Association Section of Taxation, the American Institute of Certified Public Accountants Tax Division, and the Tax Executives Institute have

- 57 Congress partially addressed the ISO-AMT problem by providing that for tax years beginning before January 1, 2013, taxpayers may generally recover the AMT credits associated with ISO exercises over a two-year period. IRC § 53(e). It followed up with the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343 (2008), which abated any outstanding amounts attributable to unpaid ISO-AMT liabilities that remained unpaid as of October 3, 2008 the date of enactment. IRC § 53(f). Although this legislation addressed the consequences of the ISO-AMT problem, it has expired.
- 58 See TPC, Income Subject to Tax and Effective Marginal Tax Rates in the Regular Income Tax and the AMT among AMT Taxpayers, Current Law, 2012–2014, T13-0214 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3973&DocTypeID=1.
- The calculator refers taxpayers to Publication 505. See IRS Withholding Calculator (Apr. 4, 2013), http://www.irs.gov/individuals/article/0,,id=96196,00.html ("CAUTION: If you will be subject to alternative minimum tax, self-employment tax, or other taxes; you will probably achieve more accurate withholding by following the instructions in Pub 505: Tax Withholding and Estimated Tax."). Publication 505 instructs tax-payers to project their AMT liability by filling out Form 6251 or the Alternative Minimum Tax Worksheet in the Form 1040A instructions, a daunting task that few are likely to undertake before the end of the year.
- 60 IRS Compliance Data Warehouse, Individual Returns Transaction File (IRTF) and Individual Master File (IMF), TY 2012 (Sept. 2013). The National Taxpayer Advocate has recommended legislation to waive the estimated tax penalty for those who pay at least 100 percent of the amount due for the prior year, are subject to a *de minimis* penalty, or are first-time estimated tax payors and have reasonable cause for the violation. National Taxpayer Advocate 2008 Annual Report to Congress vol. 2 30-35.
- 61 Studies suggest that unexpected tax liabilities reduce filing, payment, and reporting compliance. See National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, at 30-35 (summarizing various studies).
- 62 See, e.g., National Taxpayer Advocate 2001 Annual Report to Congress 56-58; National Taxpayer Advocate 2001 Annual Report to Congress 166177; National Taxpayer Advocate 2003 Annual Report to Congress 5-19; National Taxpayer Advocate 2004 Annual Report to Congress 383-385;
 Blowing the Cover on the Stealth Tax: Exposing the Individual AMT: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm.
 on Finance, 109th Cong. 367 (2005) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2006 Annual Report
 to Congress 3-5; Alternative Minimum Tax: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways & Means,
 110th Cong. 43 (2007) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2008 Annual Report to Congress
 356-362; National Taxpayer Advocate 2012 Annual Report to Congress 24-33.
- 63 Taxpayer Refund and Relief Act of 1999, H.R. 2488, 106th Cong. (1999).

jointly called for its repeal.⁶⁴ The National Association of Enrolled Agents also advocated outright repeal or substantial restructuring of the AMT for individuals.⁶⁵ Similarly, both the 2005 Tax Reform Panel and the 2010 National Commission on Fiscal Responsibility and Reform (the Simpson-Bowles Commission) recommended repealing the AMT.⁶⁶ Leaders of both parties in both the House and Senate have also proposed repealing it.⁶⁷ For all of the reasons stated above, the National Taxpayer Advocate continues to recommend permanent repeal of the individual AMT.

⁶⁴ American Bar Association Section of Taxation, American Institute of Certified Public Accountants Tax Division and Tax Executives Institute, *Tax Simplification Recommendations, reprinted at 2000 TNT 39-*82 (Feb. 28, 2000).

^{65 2003} Tax Return Filing Season and the IRS Budget for Fiscal Year 2004: Hearing before the House Ways and Means Subcommittee on Oversight, 108th Cong. 94 (2003) (statement of Claudia Hill on behalf of the National Association of Enrolled Agents).

The President's Advisory Panel on Federal Tax Reform, Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System xvii (Nov. 2005), http://govinfo.library.unt.edu/taxreformpanel/final-report/index.html; The National Commission on Fiscal Responsibility and Reform, The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform, 2010 TNT 231-35 sec. 2, fig. 7 (Dec. 3, 2010).

⁶⁷ See, e.g., Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong. (2007) (sponsored by Rep. Charles Rangel, Chairman, House Committee on Ways and Means, though the bill limits the benefits of repeal to lower income taxpayers); Individual AMT Repeal Act of 2007, H.R. 1366, 110th Cong. (2007); Taxpayer Choice Act of 2007, H.R. 3818, 110th Cong. (2007); Individual AMT Repeal Act of 2009, H.R. 240, 111th Cong. (2009); End Tax Uncertainty Act of 2011, HR. 86, 112th Cong. (2011); Individual AMT Repeal Act of 2011, H.R. 547, 112th Cong. (2011); Jobs Through Growth Act, H.R. 3400, 112th Cong. (2011); American Opportunity and Freedom Act of 2012, H.R. 3804, 111th Cong. (2012); Individual Alternative Minimum Tax Repeal Act of 2007, S. 55, 110th Cong. (2007) (sponsored by Max Baucus and Chuck Grassley, Senate Finance Committee, Chairman and Ranking Minority member, respectively, among others); Invest in America Act, S. 14, 110th Cong. (2007); Individual Alternative Minimum Tax Repeal Act of 2007, S. 2293, 110th Cong. (2007); AMT Repeal and Tax Freedom Act, S. 2318, 110th Cong. (2007); Bipartisan Tax Fairness and Simplification Act of 2011, S. 727, 112th Cong. (2011).