

**Written Comments of Frank Degen, EA  
On behalf of  
The National Association of Enrolled Agents**

**Senate Finance Committee Hearing  
The Stealth Tax That's No Longer a Wealth Tax:  
How to Stop the AMT From Sneaking Up on  
Unsuspecting Taxpayers**

**Wednesday, June 27, 2007**

**Testimony of Frank Degen, EA  
Government Relations Committee Chair,  
National Association of Enrolled Agents<sup>i</sup>  
before the Senate Finance Committee  
June 27, 2007**

Thank you, Mr. Chairman and members of the Committee for inviting the National Association of Enrolled Agents (NAEA) to testify before you today on the alternative minimum tax (AMT). My name is Frank Degen. I am an enrolled agent and I am speaking on behalf of NAEA, the premier organization representing the interests of the 46,000 enrolled agents (EAs) across the country. As the *only* tax practitioners the IRS directly tests and regulates, enrolled agents are committed to increasing industry professionalism, improving the integrity of the nation's tax administration system, and protecting taxpayers' rights to representation. We believe that NAEA is well-positioned to offer an informed perspective on the real-world effects of the individual AMT.

The AMT as it exists today is a failed public policy, with few if any public—or private—defenders. Its history is well-known. In 1969, reports that 155 people with adjusted gross incomes (AGIs) over \$200,000 paid no federal income tax caused Congress to enact the AMT, which was intended to ensure that those with high incomes would pay at least some income tax. The AMT requires an additional calculation of tax (this calculation disallows many of the credits and deductions allowed under the regular income tax). An exemption amount is subtracted from alternative minimum taxable income (AMTI), and one of two rates (currently 26 or 28 percent) is applied to the taxable AMTI. The taxpayer pays the larger of the AMT or the regular income tax. *Given this process, one could argue that the AMT should more truthfully be termed the Mandatory Maximum Tax.*

Millions of people are subject to the AMT every year. In 2004, for instance, roughly three million taxpayers had AMT liability – including some with AGIs in the mid-\$50,000 range. Were it not for a temporary increase in the exemption, about 12 million taxpayers would have been ensnared. Interestingly, in the thirty-eight years since the AMT was enacted, while the reach of the AMT has so vastly expanded, the number of tax returns with AGIs over \$200,000 without any income tax liability has ballooned—to 2,420 in tax year 2004<sup>1</sup>. While we acknowledge that inflation and population growth distort the comparison between today and 1969, we believe the statistics demonstrate that the AMT has failed to accomplish Congress' clear intent. Most obviously, the AMT has not prevented all high-income taxpayers from avoiding federal income tax liability altogether. Further, and more alarmingly, the AMT's reach now includes millions of taxpayers it was never intended to touch.

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<sup>1</sup> Brian Balkovic. "High-Income Tax Returns for 2004." IRS Publication 1136, *Statement of Income Bulletin*, Spring 2007.

The AMT's lack of inflation-indexed income exemptions presents Congress with an increasingly unpleasant trade-off. If Congress leaves the income exemptions untouched, roughly ten million taxpayers would unexpectedly see their tax bills increase. If Congress adjusts the income exemptions upward, it necessarily forgoes significant tax revenues. In recent years, Congress has regularly renewed increased AMT exemption amounts. And to minimize the budget pain of these decisions, Congress has chosen to implement one and two year patches instead of engineering a permanent fix.

Enrolled agents and sophisticated taxpayers understand this to be a band-aid approach to dealing with the AMT, while the unsophisticated (both taxpayers and preparers) may not even be aware that they are dodging the AMT bullet. The net result, however, is that the current environment of temporary, short-term AMT fixes makes meaningful, long-term tax planning impossible for millions of taxpayers. Simply stated, the lack of a permanent AMT solution severely limits the ability of enrolled agents to help our clients. Without the certainty of a permanent fix, the AMT becomes nothing more than a perennial political football, with taxpayers, enrolled agents and IRS relegated to the sidelines as spectators. While most believe the broad result of the game is not in question (the AMT temporary fix will ultimately come to pass), the essential specifics (the exemption size and the timing of the decision) result in a lot of nail-biting.

To further emphasize the disadvantages to taxpayers and tax practitioners resulting from the atmosphere of uncertainty and surprise surrounding the AMT (exacerbated by the use of short-term patches), I want to offer some observations from the field. These are real-life examples of how the AMT can blindside and disillusion ordinary taxpayers as well as disrupt practical financial and tax planning:

- Bill and Liz are air traffic controllers. Because the AMT calculation doesn't allow their five exemptions (Bill, Liz and three children) and their Schedule A taxes, they owed an extra \$6,400 in tax due solely to the AMT. Bill exclaimed "This is crazy. I don't have **any** tax loopholes."
- Laura is a mid-level executive in New York City. Her income tax return was relatively straightforward—for instance, no Schedules K-1, no passive activity bonds (which cause their own AMT headaches), and no other tax preferences. When I told her the AMT calculation on her return created a balance due of \$1,050 rather than a refund of \$6,450 (an AMT tax liability increase of \$7,500), she asked me a question for which I had no answer. "Didn't Congress say it was lowering taxes?" And adding insult to injury, I was unable to calculate with certainty Laura's withholding schedule for 2007 because I did not know when I prepared her return (and do not know today) what the 2007 AMT patch would be and the extent to which she will be subject to AMT.

- Karen has four children, files as Head of Household, claims the standard deduction and has an AGI of \$75,000. Imagine her surprise when I told her she has an AMT liability. Her only comment was "I read in the papers the AMT was supposed to be for rich guys." I suspect few in the halls of Congress would argue that she is rich or that she is resorting to sophisticated tax planning to reduce her federal income tax liability.

It is time Congress enacted a substantive and lasting solution to the AMT problem. We believe that both taxpayers and tax practitioners would prefer a complete repeal of the individual AMT. Chairman Baucus and Ranking Member Grassley have introduced a bill that would do just that. We applaud their efforts and hope that Congress passes their legislation. Repealing the full AMT would be a huge step in the simplification of the tax code.

Practically, we admit that full repeal of the AMT may be a bridge too far. At the same time, we consider that any proposal short of full repeal must satisfy three criteria:

1. It must limit the AMT's scope. If the AMT persists, it should affect only taxpayers Congress believes are engaging in the most egregious tax avoidance. At a minimum, the personal exemptions and standard deductions allowed under the regular income tax should not be disallowed under the AMT, as they currently are. Further, Schedule A exclusion items, such as medical expenses, all taxes, and miscellaneous deductions, should also be permitted.
2. It must make the AMT permanent. One, two, and even five-year bills will not provide the necessary amount of certainty to taxpayers trying to plan their finances.
3. It must index any new income exemptions to inflation. The lack of indexing is the root cause of the current AMT troubles. Indexed exemptions would prevent the AMT from hitting those taxpayers whose real incomes stay constant. If Congress, in 1969, had indexed exemption amounts so that the AMT applied only to those 155 taxpayers with AGIs above \$200,000, today, the AMT would only affect those with AGIs over roughly \$1.1 million.

In closing, I would like to take a moment to make a broader point about tax return preparation: producing an accurate return is often a complex and non-intuitive exercise. A preparer must demonstrate his/her ability to interpret the tax code, especially when AMT comes into play, and therefore the preparation of complex returns, like those with the AMT, should not be left to amateurs. One wonders how many mistakes are made in preparing returns with the AMT.

A 2006 GAO study (*Paid Tax Return Preparers: In a Limited Study Chain Preparers Make Serious Errors*) estimated that more than half of individual income tax returns filed are prepared by a paid tax preparer. In the same study, GAO found several instances of incompetent preparation by chain preparers, often resulting in large refund overclaims. Congress could act to improve competence and

ethical standards in the tax preparation industry by enacting S. 1219, the Taxpayer Protection and Assistance Act. By requiring a) an initial competence examination of all unenrolled preparers, and b) continuing education for all paid tax preparers, Congress would bring more taxpayers into compliance by improving the accuracy of tax return preparation.

As always, the NAEA and its members stand ready to work closely with Congress in assessing the merits of various AMT proposals.

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<sup>i</sup> The **National Association of Enrolled Agents (NAEA)** is the professional society representing enrolled agents (EAs), which number some 46,000 nationwide. Its 12,000+ members are licensed by the U.S. Department of the Treasury to represent taxpayers before all administrative levels of the Internal Revenue Service (IRS), including examination, collection and appeals functions.

While the enrolled agent license was created in 1884 and has a long and storied past, today's EAs are the only tax professionals tested by IRS on their knowledge of tax law and regulations. They provide tax preparation, representation, tax planning and other financial services to millions of individual and business taxpayers. EAs adhere to a code of ethics and professional conduct and are required by IRS to take continuing professional education. Like attorneys and certified public accountants, enrolled agents are governed by Treasury Circular 230 in their practice before IRS.

Since its founding in 1972, NAEA has been the enrolled agents' primary advocate before Congress and IRS. NAEA has affiliates and chapters in 42 states. For additional information about NAEA, please go to our website at [www.naea.org](http://www.naea.org).