United States Senate
Committee on Finance

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Floor Statement of Sen. Chuck Grassley of Iowa
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The Alternative Minimum Tax, Part 1

Mr. President, today I will discuss the Alternative Minimum Tax or AMT. Lately, we have heard a lot about the AMT and the difficulties involved in fixing it. In the next few days I will go into greater detail regarding some of those problems and what we need to do to fix the AMT, but right now I want to explain how we got into the situation we are in. As with anything, I think it would be foolish to go forward on this issue without looking back to see how we got here. The AMT is not a new problem and has been with us for several decades.

The individual minimum tax, the precursor to our AMT, was originally enacted in 1969, about 38 years ago. This chart highlights a few of the important and most recent milestones in the evolution of the AMT.

Congress had discovered that 155 taxpayers with incomes greater than $200,000 were not paying any taxes at all. These taxpayers were able to use legitimate deductions and exemptions to eliminate their entire tax liabilities. What they were doing was not illegal, but Congress determined that wealthy Americans ought to pay some amount of their incomes to the government. It was originally calculated that the new individual minimum tax would only affect 1 in 500,000 taxpayers. According to the Bureau of the Census, the population of the United States in 1970 was about 203 million people.

Making the assumption that every single American was a taxpayer, the individual minimum tax was originally calculated to affect around 406 people, which is 203 million divided by 500,000. So in 1969, Congress was motivated by the situations of 155 taxpayers to enact a tax calculated to impact about 406 people. Clearly the situation has changed dramatically in the last 38 years.

Though not its only flaw, the AMT's most significant defect is that it is not indexed for inflation. This failure to index the exemption and rate brackets, the parameters of the AMT system, is also a bipartisan problem. Perhaps the most notable missed opportunity to index the AMT for inflation was the passage of the Tax Reform Act of 1986.

That law was passed by a Democratic House and a Republican Senate, and it was signed by a Republican President. I think it is worth pointing out that at that time indexing was a relatively new concept. You can argue that the indexing of the AMT should have received more attention, but the fact is it did not.

Today it is impossible for any of us to use the excuse that indexing is a new concept. In the regular tax system, the personal exemption, standard deduction, and rate brackets are indexed for inflation. Government payments such as Social Security benefits are indexed for inflation. I bet you would be hard pressed to go into most schools and find a student who did not at least know that inflation was something to be avoided.

Despite what must be a nearly universal awareness of inflation, the AMT, the Internal Revenue Code's equivalent of a time capsule, remains the same year after year as the world changes around it.

I think it must be obvious to everyone that the value of a buck has changed a lot in the last 38 years, and I think all of us here are experienced enough to have witnessed that change. More than anything else, the problems posed by the AMT exist because of a failure to index for inflation. Though $200,000 was an incredible amount of money in 1969, the situation is different today. I'm not saying $200,000 is not a lot of money, because it is, but $200,000 will buy less today than it did in 1969.

I also want to emphasize that I am not the only one saying that a failure to index the AMT for inflation is what is causing it to consume more and more middle-income taxpayers. On May 23, 2005, the Subcommittee on Taxation and IRS Oversight of the Finance Committee held a hearing titled "Blowing the Cover on the Stealth Tax: Exposing the Individual AMT." At that hearing, National Taxpayer Advocate Nina Olson said that "[t]he absence of an AMT indexing provision is largely responsible for the increasing numbers of middle-class taxpayers who are subject to the AMT regime." Robert Carroll, who is now deputy assistant Treasury secretary for tax analysis (and at the time was "acting" in that position), testified that "[t]he major reason the AMT has become such a growing problem is that, unlike the regular tax, this parallel tax system is not indexed for inflation."

Additionally, Douglas Holtz-Eakin who at the time was Director of the nonpartisan Congressional Budget Office testified "If the 2005 [increased AMT] exemptions were made permanent and, along with the other AMT parameters, indexed for inflation after 2006, most of the increase over the coming decade in the number of taxpayers with AMT liability would disappear." Clearly, there is a consensus among many knowledgeable people that the failure to index the AMT for inflation has been and continues to be a serious problem.

What makes the failure to index the AMT in 1986 and other years more disastrous are the repeated failures to deal with the problem in additional legislation that has actually compounded the problems posed by the AMT.

Before I continue I want to catalogue the evolution of the AMT rate for a moment. The

1969 bill that gave birth to the AMT established a minimum income tax of 10 percent in excess of an exemption of $30,000. In 1976 that rate was increased to 15 percent. In 1978 graduated rates of 10 percent, 20 percent, and 25 percent were introduced. In 1982 the AMT rate was set at a flat rate of 20 percent and was increased to 21 percent in 1986.

I don't mean for this to be a complete list of legislative changes and fixes, and I'm sure no one would want me to recite that full list now anyway, but I want to make sure everyone realizes that Congress has a long history of trying to fiddle with the AMT in various ways. Now I will speak in greater detail to more recent bills impacting the AMT.

In 1990 the Omnibus Budget Reconciliation Act of 1990 was passed. That bill was the result of the Andrews Air Force Summit. That legislation raised the AMT rate from 21 percent to 24 percent and did not adjust the exemption levels. This means that every person who had been hit by the AMT would continue to be hit by the AMT, but it would cost them more.

In the Omnibus Budget Reconciliation Act of 1993 the exemption level was increased to $33,750 for individuals and $45,000 for joint returns, but this was accompanied by an additional rate increase. By the way, the 1993 tax increase passed with only Democratic votes. Once again, graduated rates were introduced, except this time they were 26 percent and 28 percent. By tinkering with the rate and exemption level of the AMT, these bills were only doing what Congress has been doing on a bipartisan basis for almost 40 years, which is to undertake a wholly inadequate approach to a problem that kept getting bigger.

Aside from this futile tinkering that has been done every few years, Congress has in other circumstances completely ignored the impact of tax legislation on taxpayers caught by the AMT. In the 1990s a series of tax credits, such as the child tax credit and lifetime learning credit, were adopted without any regard to the AMT. The AMT limited the use of nonrefundable credits, and that did not change. Congress quickly realized the ridiculousness of this situation and waived the AMT disallowance of nonrefundable personal credits, but it only did so through 1998. In 1999 the issue again had to be dealt with. The Congress passed the Taxpayer Refund and Relief Act of 1999. In the Senate, only Republicans voted for the bill. That bill included a provision to repeal the AMT. President Clinton vetoed the bill.

Later on in 1999, an extenders bill including a fix good through 2001 was enacted to hold the AMT back for a little longer.

In 2001 we departed from these temporary piecemeal solutions a little bit with the Economic Growth and Tax Relief Reconciliation Act of 2001. The 2001 bill permanently allows the child tax credit, the adoption tax credit, and the IRA contribution credit to be claimed against a taxpayer's AMT. While this was certainly not a complete solution, it was a step in the right direction. More importantly, the 2001 bill was a bipartisan effort to stop the further intrusion of the AMT into the middle class. The package that Senator Baucus and I put together effectively prevented inflation from pulling anyone else into the AMT through the end of 2005.

Our friends in the House originally wanted to enact a hold-harmless only through the end of 2001, but the final bill signed by the President increased the AMT exemption amount through 2005. Since the 2001 tax relief bill, the Finance Committee has produced bipartisan packages to continue to increase exemption amounts to keep taxpayers ahead of inflation, with the most recent being the Tax Increase Prevention and Reconciliation Act of 2005, which increased the AMT exemption to $62,550 for joint returns and $42,500 for individuals through the end of 2006.

These packages put together since 2001 are unique in that they are the first sustained attempt undertaken by Congress to stem the spread of the AMT through inflation. Admittedly, these are all short term fixes, but they illustrate a comprehension of the AMT inflation problem and what needs to be done to solve it.

This leads us to the present day and the situation we currently face. In 2004, the most recent year for which the IRS has complete tax data, more than 3 million families and individuals were hit by the AMT. In this chart you can see a breakdown by state of families and individuals who paid the AMT, even with our hold-harmless provision in place.

This doesn't even begin to hint at what will happen if we do not continue to protect taxpayers from the AMT. Barring an extension in the hold harmless contained in the 2006 tax bill, AMT exemptions will return to their pre-2001 levels. At the end of 2006, provisions allowing nonrefundable personal tax credits to offset AMT tax liability expired. If further action is not taken it is estimated that the AMT could claim 35 million families and individuals by the end of this decade. Think of it, a tax originally conceived to counter the actions of 155 taxpayers could consume 35 million filers in just a few years. Some analyses show that in the next decade it may be less costly to repeal the regular income tax than the AMT.

Aside from considering the increased financial burden the AMT puts on families, we also should consider the opportunity cost. In this case, the opportunity cost of the AMT for taxpayers is what they could do with the time they now spend calculating their AMT liabilities. The IRS has estimated that taxpayers spend an average of 63 hours annually complying with the requirements of the AMT system.

As I have illustrated, the AMT is a problem that has been developing for a while-almost 40 years. On numerous occasions, Congress has made adjustments to the exemptions and rates, though not as part of a sustained effort to keep the AMT from further absorbing our nation's middle class until 2001.

Despite these temporary measures, the AMT is still a very real threat to millions of taxpayers who were never supposed to be subject to a minimum tax. That the AMT has grown grossly beyond its original purpose, which was to ensure that the wealthy were not exempt from an income tax, is indisputable, and that the AMT is inherently flawed would seem to be common sense. Despite a widespread sense that something needs to be done, there is still disagreement on what exactly that something should be.

Tomorrow, I will explore in detail the question as to whether revenue "lost" by AMT reform or repeal ought to be offset as a condition of solving the problem. In another speech I will examine solutions to the AMT and how we can finally deal with this instead of putting it off for another few or 40 years.

Despite these questions, everyone needs to realize that the AMT as a policy has completely failed to accomplish its original intentions, and actions taken so far have not been adequate in dealing with the problem in a meaningful way. I yield the floor.