Alternative minimum tax, personal

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An additional tax paid by some individuals that can result from the use of certain tax preferences. (See also Alternative minimum tax, corporate.)

The personal alternative minimum tax (AMT) requires individuals to calculate their income tax a second way, differently from the regular income tax. Separate tax rates and definitions of taxable income apply in each of these tax systems. The AMT limits the use of certain tax preferences, or exceptions to a comprehensive measure of income. A taxpayer’s final liability is the greater of the tax liabilities calculated under the regular tax system and the AMT system. The AMT is defined as the amount by which the tax calculated under the broader AMT base, the tentative minimum tax, exceeds regular tax liability. The tax base under the AMT is broader than that under the regular tax, and the top marginal tax rates are lower than under the regular tax. Relatively few taxpayers pay AMT, and the amount collected from the AMT has been small relative to that collected from the regular income tax (table 1).

History of the AMT

The AMT has its origins in the “add-on” minimum tax, which was first introduced into the tax system in 1969. Unlike the dual tax systems of the AMT, the minimum tax was a separate tax in which a flat 10 percent rate was applied to certain tax preferences in excess of an exempted amount of $30,000. A taxpayer’s total liability was the sum of the regular tax and the minimum tax. The minimum tax was strengthened in 1976 when the exemption amount was changed to the greater of $10,000 or half the taxes paid under the regular tax. The rate was also increased to 15 percent.

The AMT was introduced into the tax system by the Revenue Act of 1978, coexisting with the minimum tax. The preferences for certain itemized deductions and excluded capital gains were moved from the minimum tax to the AMT. By using the AMT rather than the minimum tax, taxpayers would only pay additional tax on capital gains income if their AMT exceeded their regular tax liability. Congress anticipated that “capital formation will be facilitated and every individual will pay at least a reasonable amount of tax with respect to large capital gains.” The AMT exempted the first $20,000 from tax and had a graduated rate schedule of 10, 20, and 25 percent.

In 1982, Congress repealed the minimum tax and expanded the AMT. Most preference items under the minimum tax were moved to the AMT. The exemption was increased to $30,000 for a single taxpayer and $40,000 for taxpayers filing jointly. A flat rate of 20 percent was applied to alternative minimum taxable income after the exemption was deducted.

The next major revision to the AMT occurred with the Tax Reform Act of 1986. Additional preference items were added to expand the AMT base. One of the largest preference items—the excluded portion of long-term capital gains—was eliminated from the regular tax (and thus as a preference under the AMT). The AMT rate was raised to 21 percent, and the AMT exemption was phased out for high-income taxpayers. For each dollar that the alternative minimum taxable income exceeded a specified threshold, the exemption amount was reduced by 25 cents. For taxpayers with large amounts of income, the exemption was completely eliminated. Finally, AMT generated in the current year could in some circumstances be taken as a credit against regular tax liability in future years.

In 1990, Congress raised the top marginal income tax rate to 31 percent and the AMT rate to 24 percent. The top marginal income tax rate was increased again in 1993, and a graduated rate schedule of 26 and 28 percent was introduced to the AMT. The exemption amounts were increased to $45,000 for married individuals and $33,750 for unmarried individuals.

Harvey and Tempalski (1997) claim that the AMT will grow rapidly because regular tax exemptions are indexed and AMT exemptions are not; they

### Table 1

#### AMT Statistics for Selected Years

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>1983</th>
<th>1988</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td>Returns with Income Tax; Adjustments</td>
<td>78,016</td>
<td>87,135</td>
<td>87,619</td>
</tr>
<tr>
<td>Returns with AMT</td>
<td>265</td>
<td>114</td>
<td>369</td>
</tr>
<tr>
<td>Total Income Tax Liability</td>
<td>$274.2</td>
<td>$412.9</td>
<td>$559.1</td>
</tr>
<tr>
<td>AMT Liability</td>
<td>$2.5</td>
<td>$1.0</td>
<td>$2.2</td>
</tr>
</tbody>
</table>

predict 9 million taxpayers will be affected within 10 years.

The 1997 tax reduction added two important credits: the child credit and education credits, which will cause some additional taxpayers to be subject to the AMT.

Tax preferences

Tax preferences are exceptions to a comprehensive measure of income under an ideal income tax. The items considered tax preferences for purposes of the AMT have changed over time. These preferences are items that can be excluded from regular taxable income or deductions allowed under the regular tax that would not be allowed under a comprehensive income tax. Not all tax preferences are included in the AMT, and the list has changed over time. The preferences described below are among those included under the tax law in effect in 1993.

The use of exemptions and deductions is limited under the AMT. While the AMT has its own exemption level, it does not allow deductions for personal exemptions or the standard deductions allowed under the regular tax. Some itemized deductions, including miscellaneous itemized deductions and deductions for taxes paid, are completely disallowed. Others are more limited. For example, medical deductions are allowed only to the extent that they exceed 10 percent of adjusted gross income, compared with 7.5 percent under the regular tax. Deductions for investment interest and home mortgage interest are subject to separate rules under the AMT, which can reduce the size of the deduction compared with the regular tax. The itemized deductions allowed under the minimum tax are not, however, subject to the itemized deduction limitation that applies to higher-income individuals under the regular tax.

Many of the other preferences under the AMT are associated with the timing of income and deductions for investors in noncorporate businesses. Deductions for depreciation of equipment, oil depletion allowances, allowances for intangible drilling costs, or mining exploration and development costs are allowed at a slower rate under the AMT than under the regular tax. The difference between deductions allowed under the regular tax and the AMT is included in the alternative minimum taxable income. Other examples of timing preferences include deductions associated with a financial institution’s bad debt, deductions for newspaper circulation expenses, deductions for research and experimentation expenses, and the use of the “percentage-of-completion” or the “installment” methods of accounting. It is these timing preferences that generate credits that can be taken against future regular tax liability.

Justification for the AMT

The minimum tax and the AMT were originally designed to ensure that wealthy individuals pay some income tax. These individuals would not be able to avoid paying income taxes through the use of certain tax preferences or tax shelters. Aside from a general sense of fairness, it has been argued that overall confidence and compliance with the tax system could be undermined if nonwealthy taxpayers feel that wealthy taxpayers pay little or no income tax.

While the minimum tax provided a disincentive for the use of any specified tax preferences, the AMT only discourages the use of an “excessive” amount of tax preferences. That is, individuals with tax preferences are affected by the AMT only to the extent that their tentative minimum tax is greater than their regular tax. For example, most taxpayers with itemized deductions take a deduction for state and local income taxes. While this is a preference item under the AMT, most taxpayers are unaffected because this deduction by itself is not enough to generate a tentative minimum tax greater than the regular tax.

The AMT has been associated with efforts to expand the tax base to a more comprehensive measure of income. The most recent significant change to the AMT took place with the Tax Reform Act of 1986, which expanded the income tax base under both the regular tax and the AMT. While the AMT tax base is broader than that under the regular tax, the list of preference items is much smaller than comprehensive lists of tax preferences such as those in the tax expenditure budget.

The AMT does limit the advantage of certain tax preferences for some taxpayers, but it is not without cost. While relatively few taxpayers pay the AMT, many taxpayers must calculate their tax under both the AMT and the regular tax to determine if they owe any AMT liability. The AMT, with its separate schedule of itemized deductions, exemptions, depreciation schedules, and rates, adds significantly to the complexity of tax calculations.

Additional readings


Cross reference: income tax, federal.