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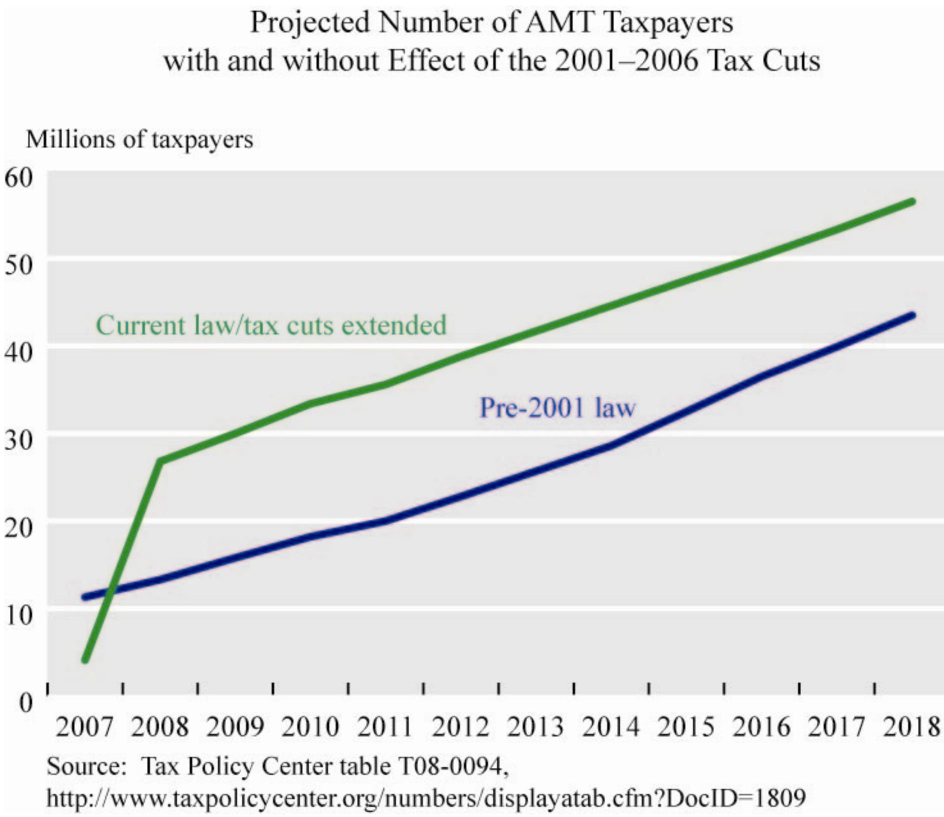
Congress originally enacted a minimum tax in 1969 to guarantee that high-income individuals paid at least a minimal amount of tax. Under today's alternative minimum tax (AMT), middle- and upper-income taxpayers must add a number of "preference items" to their taxable income, subtract a special AMT exemption, and calculate their tax according to the AMT rules. If the tax under those rules turns out to be higher than their regular income tax, taxpayers pay the difference as AMT.



1. The AMT is exploding. Unless Congress acts, 26.8 million taxpayers will be affected by the AMT in 2008. In 2007, only 4.1 million taxpayers owed the tax because of the temporary AMT "patch," which has now expired. By comparison, in 1970, just 20,000 taxpayers were affected by the AMT. If the 2001–2006 tax cuts expire as scheduled at the end of 2010, 43 million taxpayers (almost two-fifths) will be hit by the AMT in 2018. If the tax cuts are extended, the number jumps to 57 million taxpayers (more than half) (tables T08-0094 and T08-0095).

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2. The AMT is encroaching on the middle class. Although the AMT is highly progressive, the distribution of AMT liability will shift toward tax units with lower incomes. In 2007, tax units with $500,000 or more in income paid 50 percent of the tax; by 2010, they will pay only 18 percent. About 78 percent of households with incomes between $100,000 and $200,000 and 46 percent of those with incomes between $75,000 and $100,000 will pay the AMT by 2010 (compared with 3.6 percent and 0.6 percent in 2007) (tables T08-0096 and T08-0098).

3. The average AMT liability in 2007 was $6,577. Barring legislative action, the average is projected to decline this year to $3,264 as millions of middle-class families—that tend to owe a smaller amount of the tax—join the ranks of AMT taxpayers (table T08-0097).

4. There are two main factors behind the explosive growth in the AMT: it is not indexed for inflation and the 2001–2006 tax cuts cut regular income tax without a permanent AMT fix. The AMT is not indexed for inflation and, therefore, affects taxpayers with lower real incomes over time. The 2001–2006 tax cuts almost doubled the projected share of taxpayers who will face the AMT in 2010 from 17.8 to 34.8 percent. If the tax cuts had not been enacted and the AMT had been indexed for inflation along with the regular income tax in 1985, the number of AMT taxpayers would have remained between 300,000 and 400,000 through 2010 (table T08-0096).

5. The AMT raises effective marginal tax rates. Marginal tax rates affect the incentive to work, save, and comply with the tax system. In 2007, 72 percent of AMT taxpayers faced *higher* effective tax rates because of the AMT. In 2010, 89 percent will face higher rates (table T08-0099).

6. The AMT claws back the 2001–2006 tax cuts. In 2010, the AMT will take back a quarter of the regular income-tax cut that taxpayers otherwise would have received. More than 2 percent of taxpayers will have their tax cuts completely eliminated by the AMT. This assumes that the AMT remains in full force. If it is scaled back or eliminated, the tax cuts will be much more expensive than originally estimated (table T08-0100).

7. The AMT is notoriously and pointlessly complex. The Internal Revenue Service and the Taxpayer Advocate have flagged the AMT as one of the most complicated tax provisions to comply with and administer. Most people required to fill out the AMT forms end up owing no additional taxes. The AMT also creates complicated interactions with the regular income tax.

8. Because the AMT disallows dependent exemptions and imposes significant marriage penalties, it hits some taxpayers harder than others. Families with children are more likely to be subject to the AMT than those without children: in 2010, 44 percent of those with two children will face the AMT compared with only 17 percent of those without children. Married couples will be more than 12 times as likely as singles to face the AMT in 2010. AMT participation for married families with two or more children and AGI between $75,000 and $100,000 will increase dramatically from less than 0.5 percent in 2007 to 87 percent in 2010 (table T08-0096).

9. Since the AMT disallows the state and local tax deduction, residents in high-tax states are more likely to pay the tax. In 2007, families in high-tax states were almost three times more likely to face the AMT than those in low-tax states (5.0 vs. 1.8 percent). As more taxpayers are ensnared by the AMT, that differential will fall to about one-fourth in 2010 (28.8 vs. 21.5 percent).

10. Repeal would be expensive and regressive. Repealing the AMT in 2008 would reduce revenues by $960 billion through the end of the budget window in 2018 if the 2001–2006 tax cuts expire as scheduled. The cost rises to more than $1.8 trillion if the tax cuts are extended. More than 90 percent of the benefits of repeal would go to households with incomes above $100,000 in 2009 (tables T08-0123 and T08-0134).

11. Extending and indexing the AMT "patch" for inflation could spare most taxpayers from the tax. Since 2001, Congress has enacted a series of one- or two-year patches that raised the AMT exemption and allowed personal credits against the AMT. Extending the patch and indexing the exemption for inflation would reduce the number of AMT taxpayers in 2010 by about 84 percent (table T08-0134).

12. Paying for reform or repeal is a key issue. Assuming the 2001–2006 tax cuts expire as scheduled, extending and indexing the AMT patch for inflation would reduce revenues by $710 billion through the end of the budget window in 2018. That figure rises to $1.3 trillion if the tax cuts are extended. Various options exist to offset the revenue loss from AMT reform or repeal (Burman et al. 2007). A surtax of 4 percent of adjusted gross income above certain thresholds would roughly offset the cost of full AMT repeal and would be much simpler (table T08-0134; Burman and Leiserson 2007).

Further Reading:

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