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# The Alternative Minimum Tax for Individuals: In Brief

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May 10, 2016

**Congressional Research Service**

7-5700

[www.crs.gov](http://www.crs.gov)

R44494

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In addition to raising revenue, the individual income tax has been used as a vehicle to promote various social and economic goals. This has been accomplished by according preferential tax treatment to certain items of income and expense. The net result, however, has been an erosion of the individual income tax base. By utilizing the preferences and incentives in the tax code, some individuals can substantially reduce their income taxes.

To make sure that everyone paid at least some taxes and still preserve the economic and social incentives in the tax code, Congress, in 1969, enacted the predecessor to the current individual alternative minimum tax (AMT).<sup>1</sup> Since then, the federal individual income tax has consisted of two parallel tax systems—the regular income tax and the AMT. Since its inception, the value and effectiveness of the minimum tax has been the subject of congressional debate, and it has been modified numerous times.

This report provides a brief history and overview of the alternative minimum tax for individuals (AMT). While the AMT is not the subject of current legislative activity, that may change if efforts to reform the tax code move forward. The report will be updated as legislative action warrants.

## History of the AMT

The first individual minimum tax was enacted in 1969 and was an add-on minimum tax. That is, it was a tax that was paid in addition to the regular income tax. The tax rate for the add-on minimum tax was 10%, and its tax base consisted of eight tax preference items. The most significant of these tax preference items was the portion of capital gains income that was excluded from the regular income tax.

A major change occurred under the Revenue Act of 1978, which created the predecessor of the current alternative minimum tax (AMT) but left the add-on minimum tax intact. This was an entirely new tax which was assessed on a taxpayer’s regular taxable income, plus the amount of certain tax preferences that were excluded under the regular income tax. Taxpayers paid the alternative minimum tax only if it exceeded the sum of their regular income tax liability and their add-on minimum tax liability.

The Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248) repealed the add-on minimum tax, but left in place a modified version of the modern AMT (i.e., the separate, parallel tax system). The committee report accompanying the legislation stated, “The committee has amended the present minimum tax provisions applying to individuals with one overriding objective: no taxpayer with substantial economic income should be able to avoid all tax liability by using exclusions, deductions, and credits.”<sup>2</sup> Since then, the AMT has been modified numerous times. A legislative history of the AMT is provided in **Table 1**.

**Table 1. Selected Legislative History of the Alternative Minimum Tax**

Public Law	Description
Tax Reform Act of 1969 (P.L. 91-172)	Introduced “add-on” minimum tax at rate of 10%
Tax Reform Act of 1976 (P.L. 94-455)	Raised minimum tax rate to 15%

<sup>1</sup> In addition to the individual AMT discussed in this report, there is a corporate AMT. A discussion of the corporate AMT is beyond the scope of this report.

<sup>2</sup> U.S. Congress, Senate Committee on Finance, *Tax Equity and Fiscal Responsibility Act of 1982*, committee print, 97<sup>th</sup> Cong., July 12, 1982, S. Rept. 97-494.

Public Law	Description
Revenue Act of 1978 (P.L. 95-600)	Introduced AMT alongside minimum tax. AMT had graduated rates of 10%, 20%, and 25%, and an exemption of \$20,000.
Economic Recovery Tax Act of 1981 (P.L. 97-34)	Lowered AMT rates to correspond with reductions in rates of regular income tax.
Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248)	Repealed "add-on" minimum tax. Made AMT rate a flat 20% of AMT income after exemptions of \$30,000 for individuals and \$40,000 for joint returns.
Tax Reform Act of 1986 (P.L. 99-514)	Raised AMT rate to 21%. Made high-income taxpayers subject to phase-out of exemptions. Increased number of tax preferences. Allowed an income tax credit for prior year AMT liability.
Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508)	Raised AMT rate to 24%.
Omnibus Reconciliation Act of 1993 (P.L. 103-66)	Introduced graduated AMT rates of 26% and 28%.
Tax Relief Extension Act of 1999 (P.L. 106-170)	Changed rules about nonrefundable credits.
Economic Growth and Tax Relief Act of 2001 (P.L. 107-16)	Temporarily increased AMT exemption.
Jobs and Growth Tax Reconciliation Act of 2003 (P.L. 108-27)	Temporarily increased AMT exemption.
The Working Families Tax Relief Act of 2004 (P.L. 108-311)	Temporarily increased AMT exemption.
Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222)	Temporarily increased AMT exemption and allowed nonrefundable personal tax credits to offset AMT.
Tax Increase Prevention Act of 2007 (P.L. 110-166)	Temporarily increased AMT exemption and allowed all personal and business tax credits to offset AMT.
Emergency Economic Stabilization Act of 2008 (P.L. 110-343)	Temporarily increased AMT exemption.
American Recovery and Reinvestment Act of 2009 (P.L. 111-5)	Temporarily increased AMT exemption.
Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)	Temporarily increased AMT exemption.
The American Taxpayer Relief Act of 2012 (P.L. 112-240)	Permanently indexed AMT parameters for inflation.

**Source:** Internal Revenue Code.

The value and effectiveness of the AMT has often been the subject of congressional debate since its inception in 1978. The Economic Recovery Tax Act of 1981 (P.L. 97-34, ERTA) created what was to become a lingering structural issue. ERTA included rules for automatically adjusting certain income tax parameters for inflation. Previously, inflation adjustments occurred periodically through acts of Congress. However, the parameters of the AMT were not among those to receive automatic adjustments for inflation.

To offset the effects of inflation on the AMT, Congress periodically adjusted AMT parameters through legislation. These occurred eight times between 1999 and 2010, before the American Taxpayer Relief Act of 2012 (P.L. 112-240, ATRA) permanently indexed the AMT based on the FY2012 exemption amounts. ATRA set the exemption amounts for 2012 at \$50,600 for single filers and \$78,750 for joint filers. The permanent indexation of the AMT was estimated to reduce revenues \$1.816 trillion over the 2013 to 2022 budget window.<sup>3</sup> For tax year 2015, the exemption amounts were \$53,600 and \$83,400, respectively.<sup>4</sup>

## Calculating AMT Liability

Under current law, to calculate the AMT, an individual first adds back various tax items, including personal exemptions and certain itemized deductions, to regular taxable income. This grossed-up amount becomes the income base for the AMT.

Tax preference items that are added to the AMT tax base include tax-exempt interest on certain private-activity bonds and excess depletion deductions. Also, for most types of property placed in service before 1987, the excess of accelerated depreciation over straight-line depreciation is considered a tax preference item and is added to the AMT tax base.

In addition, certain adjustments are made to deductions that were allowed under the regular income tax calculation of taxable income. For instance, for certain assets, depreciation rates under the AMT differ from the depreciation rates under the regular income tax. In some cases, the differences will be positive and increase the AMT tax base, while in other cases, the differences will be negative and decrease the AMT tax base.

Another major adjustment to the tax base for the AMT involves itemized deductions that are allowed under the regular income tax. For purposes of the AMT, a taxpayer cannot claim deductions for miscellaneous expenses; for tax payments to state, local, or foreign governments; or for medical expenses unless they exceed 10% of adjusted gross income (as opposed to the 7.5% floor under the regular income tax).<sup>5</sup>

Furthermore, the AMT tax base is not reduced by personal exemptions and the standard deduction applicable under the regular income tax.

Next, the AMT exemption is subtracted from this income base to obtain AMT taxable income. The basic exemptions are phased out for taxpayers with high levels of AMT income.<sup>6</sup> A two-tiered rate structure of 26% and 28% is then assessed against AMT taxable income. The taxpayer compares his AMT tax liability to his regular tax liability and pays the greater of the two. Finally,

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<sup>3</sup> U.S. Congress, Joint Committee on Taxation, "Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. 8, the 'American Taxpayer Relief Act of 2012,' as Passed by the Senate on January 1, 2013," JCX-1-13, January 1, 2013. U.S. Congress, Joint Committee on Taxation, "General Explanation of Tax Legislation Enacted in the 111<sup>th</sup> Congress," JCS-2-11, March 2011, p. 722.

<sup>4</sup> U.S. Internal Revenue Service, Revenue Procedure 2014-61, released October 30, 2014.

<sup>5</sup> Other adjustments to determine the AMT tax base include the following: for long-term contracts, the percentage-of-completion method of accounting must be used rather than the completed-contract or cash-basis method of accounting; mining exploration and development costs must be capitalized and amortized rather than expensed; and the excess of the fair market value over the amount actually paid on incentive stock options must be included in the AMT tax base.

<sup>6</sup> The AMT exemption is reduced by 25% of the amount by which a taxpayer's AMT taxable income exceeds certain threshold amounts. In the case of joint returns, the basic exemption starts to phase out at AMT taxable income levels in excess of \$158,900 in 2015. For unmarried taxpayers, the exemption is phased out starting at AMT taxable income levels of \$119,200. Thus, for each additional dollar of AMT taxable income over these thresholds, the AMT exemption is reduced by \$0.25.

the AMT tax credit is calculated as an item to be carried forward without limit to offset regular income tax liabilities in future years.

In 2013, 3.9 million taxpayers paid the alternative minimum tax raising \$27.4 billion in tax revenue.<sup>7</sup> Nearly 97% of the taxpayers paying the AMT had adjusted gross income (AGI) between \$75,000 and \$1,000,000.<sup>8</sup> The remaining 3% of AMT taxpayers is split evenly among those with AGI less than \$75,000 and those with AGI greater than \$1,000,000. This concentration is expected, as the higher AMT standard deduction reduces the likelihood of lower income taxpayers facing the AMT and the graduated rate structure of the regular income tax results in higher marginal tax rates (applied to a narrower base) than the top AMT tax rate of 28%.

## **Economic Analysis of the AMT**

In a perfect world, the regular tax system would fully address the trade-offs between equity, efficiency, and simplicity along with the need to raise revenue. However, the existence of the AMT—a parallel tax system—suggests that the regular tax system does not achieve the desired balance.

### **Equity**

The AMT was originally inspired by a rough idea of vertical equity: that high-income taxpayers should be required to pay at least some income taxes each year. The AMT attempts to achieve this by denying selected tax benefits to high-income taxpayers, which may improve the overall equity of the tax system.

The design of the AMT may raise concerns about horizontal equity: that taxpayers with similar abilities to pay should pay similar taxes. The regular tax system, arguably, addresses this concern by allowing taxpayers with more dependents, those that pay more in state and local taxes, and those with greater charitable contributions to pay less in taxes than otherwise equivalent taxpayers. The AMT retains some of these preferences and disallows others. In cases where the AMT treatment differs from the regular income tax, ability-to-pay arguments may not be taken into account and horizontal equity may be reduced as a result. This may reduce the overall equity of the tax system.

### **Efficiency**

A tax system is considered economically efficient if it does not distort the choices that would be made in its absence. No feasible tax system is efficient. That is, the structural components of a feasible tax system—such as tax rates, deductions, and credits—influence decisions that taxpayers make.

Relative to the regular income tax, the incentives provided by the AMT may affect taxpayer behavior—if taxpayers are aware of how the AMT applies to them. In one example, the AMT can result in taxpayers facing higher marginal tax rates, which could influence work and savings

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<sup>7</sup> IRS, Statistics of Income Division, *Statistics of Income-2013 Individual Income Line Item Estimates*, Publication 4801, Washington, DC, August 2015, <https://www.irs.gov/pub/irs-soi/13inlinecount.pdf>.

<sup>8</sup> In contrast, taxpayers with AGI between \$75,000 and \$1,000,000 represent only 23.2% of all tax returns. CRS analysis of IRS, Statistics of Income Division, *Table 1.4 All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2013*, Publication 1304, Washington, DC, July 2015, <https://www.irs.gov/pub/irs-soi/13in14ar.xls>.

decisions, thus potentially reducing economic efficiency. Higher marginal tax rates reduce after-tax wages, which can both reduce the incentive to work and increase the incentive to work (to achieve the same after-tax level of income). Overall, it is not clear which effect is larger. The overall effect depends upon the taxpayers' awareness of how the AMT applies to them, the taxpayers' responsiveness to this incentive, and other factors.

## **Simplicity and Transparency**

The AMT reduces both the simplicity and transparency of the tax system. For example, many taxpayers are required to complete additional forms to determine if the AMT may apply to them (including some who do not pay the AMT), decreasing the simplicity of the overall tax system. Further, decisions about such matters as whether to claim the standard deduction or to itemize or to incur deductible expenses, may need to be made using different rules under each tax system.

If taxpayers use tax preparation software or paid preparers, the degree to which the AMT reduces the simplicity of the tax code may be lessened. It would, however, result in a decrease in the transparency of the tax system and, for many taxpayers, an increase in the out-of-pocket cost of filing taxes. Also, if taxpayers do not understand how their tax liability is calculated, then they may be less responsive to the intended incentives in the tax code.

The AMT may also complicate tax planning. For example, the decision to pay for potentially deductible activities or whether to make estimated tax payments throughout the year is, in part, dependent upon whether the taxpayer expects to pay the AMT in a given year. The use of tax preparation software or a paid preparer may mitigate, but cannot eliminate, these complications that arise from the AMT.

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