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The Alternative Minimum Tax for Individuals: Legislative Initiatives in the 110th Congress

Gregg A. Esenwein
Specialist in Public Finance
Government and Finance Division

Summary

The alternative minimum tax (AMT) for individuals was originally enacted to ensure that all taxpayers, especially high-income taxpayers, pay at least a minimum amount of federal taxes. However, the AMT is not indexed for inflation, and this factor, combined with the recent reductions in the regular income tax, has greatly expanded the potential impact of the AMT.

Temporary provisions intended to mitigate the effects of the AMT will expire at the end of 2006. As a result, the number of taxpayers subject to the AMT will increase from 3.5 million in 2006 to 23 million in 2007. The Congressional Budget Office estimates that extending AMT tax relief would reduce federal revenue by $282 billion over the period FY2007 through FY2011.

On January 4, 2007, Senate Finance Committee Chairman Senator Max Baucus and ranking member Senator Charles Grassley introduced S. 55, legislation that would repeal the AMT effective for tax years after 2006. The conference report to S.Con.Res. 21, the FY2008 budget resolution, calls for a one-year patch for the AMT. This report will be updated as legislative action warrants.

The alternative minimum tax (AMT) for individuals was originally enacted to ensure that all taxpayers, especially high-income taxpayers, pay at least a minimum amount of federal taxes.[1] It was designed so that individuals could not take unfair advantage of the various preferences and incentives under the regular income tax to substantially reduce their regular income tax liability below what was considered appropriate for their income level. The AMT functions as a parallel tax system to the regular income tax. Taxpayers calculate their regular income tax and then calculate their AMT. If their AMT liability is larger than their regular income tax liability, then they pay the AMT.

However, absent legislative action, there will be a significant increase in the number of middle- to upper-middle-income taxpayers affected by the AMT in the near future. In 2005, about 3.6 million taxpayers were subject to the AMT, but by 2007, up to 23 million taxpayers could be subject to the AMT.[2]

There are two main reasons for the increase in the number of taxpayers affected by the AMT. First, the regular income tax is indexed for inflation, but the AMT is not. Over time this has produced a reduction in the differences between regular income tax liabilities and AMT liabilities at any given nominal income level, differences that will continue to shrink in the absence of AMT indexation. The second reason is that the 2001 and 2003 reductions in the regular income tax have further narrowed the differences between regular and AMT tax liabilities. The combination of these two factors means that, absent legislative changes, there will be significant growth in the number of taxpayers affected by the AMT.[3]

Since 1998, the effects of the AMT have been mitigated through temporary provisions allowing certain personal tax credits to offset AMT liability and temporary increases in the basic exemption for the AMT. The Tax and Trade Relief Extension Act of 1998, allowed taxpayers to use nonrefundable personal tax credits in full against their regular income tax even though the use of the credits might reduce a taxpayers regular income tax liability below their AMT liability.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) temporarily increased the AMT exemption amounts from $45,000 to $49,000 for joint returns and from $33,750 to $35,750 for unmarried individuals with the changes effective for tax years between 2001 and 2004.

The Job Creation and Worker Assistance Act of 2002 extended the temporary provisions, first enacted in 1998 and then extended in 1999, that allowed individuals to use all personal tax credits against both their regular and AMT tax liabilities. This change was effective through December 31, 2003.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) increased the basic AMT exemption amount to $58,000 for joint returns and to $40,250 for unmarried taxpayers. These increases were in effect for tax years 2003 and 2004. JGTRRA also established that the new maximum tax rate of 15% applicable to capital gains and dividend income under the regular income tax would also apply to the taxation of capital gains and dividend income under the AMT.

The Working Families Tax Relief Act of 2004 (WFTRA) extended through 2005 JGTRRAs increase in the basic AMT exemption amounts. WFTRA also extended the provision allowing nonrefundable personal tax credits to offset both regular and AMT tax liability in full for taxable years 2004 and 2005.

The American Jobs Creation Act of 2004 made several changes to the AMT. It coordinated farmer and fisherman income averaging with the AMT so that the use of income averaging did not push taxpayers into the AMT. It repealed the 90% limitation on the use of the AMT foreign tax credit. The act also allowed the credits for alcohol used as a fuel and electricity produced by renewable resources to be used in full against the AMT.

Legislative Action in the 109th Congress

In May 2006, Congress approved the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) that included a one-year extension (through 2006) of both the AMT's personal-credit and increased-exemption provisions. For 2005, the exemption amount was $58,000 for joint returns and $40,250 for unmarried taxpayers. TIPRA increased the 2006 AMT exemption to $62,550 for joint returns and $42,500 for unmarried taxpayers. According to estimates by the Joint Committee on Taxation, the one-year cost of these AMT provisions would be $33.9 billion.

Absent legislation the basic AMT exemption is scheduled to decrease to $45,000 for joint returns and $35,750 for unmarried taxpayers in 2007. In addition, in 2007, several personal tax credits will not be allowed against the AMT.

Legislative Action in the 110th Congress

On January 4, 2007, Senate Finance Committee Chairman Senator Max Baucus and ranking member Senator Charles Grassley introduced S. 55, legislation that would repeal the AMT effective for tax years after 2006.

On January 4, 2007, Senator John Kerry introduced S. 102. This legislation would increase the basic AMT exemption to $67,100 for joint returns and $44,800 for single returns. It would also extend the provision that allows personal tax credits to offset AMT liability. These changes would be effective for 2007. The legislation offsets part of the cost of these AMT changes by repealing, in 2009 and 2010, the lower tax rates on dividends and capital gains income that are currently available under the regular income tax.

On February 15, 2007, Senator Charles Schumer introduced S. 614, the Middle Class Opportunity Act of 2007. Among other things, this bill would increase the basic AMT exemption for tax years 2007 and 2008 and permit personal tax credits to offset AMT liabilities in full.

On February 16, 2007, Representative Thomas Reynolds introduced H.R. 1112, the Stealth Tax Relief Extension Act of 2007. This bill increases the basic AMT exemption to $66,400 for joint returns and $45,100 for unmarried taxpayers. It also allows personal tax credits to offset AMT liabilities in full.

On March 1, 2007, Senator Arlen Specter introduced S. 734, the AMT Rate Reduction Act of 2007. This bill reduces the AMT tax rate to 24%.

On March 7, 2007, Representative Phil English introduced H.R. 1366. This bill would repeal the AMT starting in 2007.

On March 20, 2007, Representative David Obey introduced H.R. 1591, U.S. Troop Readiness, Veterans' Health, and Iraq Accountability Act, 2007. Among other things, this legislation would permanently allow the work opportunity tax credit and the credit for taxes paid with respect to employee tips to offset AMT liability. This legislation was passed by the House and the Senate, but was vetoed by President Bush on May 1, 2007.

On April 17, 2007, Senator Jon Kyl introduced S. 14, which among other things, would repeal the AMT effective in 2007.

On April 18, 2007, Representative Kevin McCarthy introduced H.R. 1923. This bill would increase and index the basic exemption for the AMT, and increase the point at which the basic exemption is phased-out.

On April 19, 2007, Representative Scott Garrett introduced H.R. 1942. This bill would allow deductions for state and local taxes and would index the basic AMT exemption.

On May 9, 2007, Representative Edward Royce introduced H.R. 2253. This bill would reduce the AMT tax rate to 24%.

On May 15, 2007, Representative Robert Andrews introduced H.R. 2318. This bill would allow state and local property taxes to be deducted from the AMT tax base.

On May 17, 2007, the House and Senate adopted S.Con.Res. 21, the FY2008 budget resolution. The resolution calls for a one-year patch for the AMT.

Administration's Proposals

In its FY2005 budget proposal, the Administration proposed a one-year extension for both the increased AMT exemption levels and the provision allowing personal credits to offset AMT tax liability. Both of these proposals were ultimately enacted as part of the Working Families Tax Relief Act of 2004.

In its FY2006 budget proposal, the Administration did not address the AMT issue. Subsequent statements by the Administration indicated that the AMT issue was to be addressed by the tax reform panel appointed by the Administration. In November 2005, the tax reform panel recommended that the AMT be repealed.

The Administration's FY2007 budget proposal included a provision to extend, through 2006, the higher AMT exemption levels and a provision allowing nonrefundable personal credits to apply to the AMT.

The Administration's FY2008 budget proposal includes a one-year patch for the AMT. The Administration's proposal would increase the basic AMT exemption to $65,350 for joint returns and to $43,900 for unmarried taxpayers. It would also allow personal tax credits to offset AMT liability in full. These changes would be effective for 2007.

ENDNOTES

[1]There is also a corporate minimum tax, but it is not addressed in this report.

[2] Urban-Brookings Tax Policy Center. *The Individual Alternative Minimum Tax: Historical Data and Projections*, November 2006.

[3] For more detailed information on which taxpayers will be affected by the AMT, see CRS Report RS21817, *The Alternative Minimum Tax (AMT): Income Entry Points and "Take Back Effects,"* by Gregg Esenwein; CRS Report RS22200, *The Potential Distribution Effects of the Alternative Minimum Tax,* by Gregg Esenwein; and CRS Report RS22083, *Alternative Minimum Taxpayers By State: 2003, 2004, and Projections for 2007*, by Gregg Esenwein.