addition of new preferences tailored to ensure that the AMT targets high-income taxpayers who aggregate preferences to avoid taxation and by eliminating the regular tax rate cuts for taxpayers in the highest income brackets.

COUNTERPOINT: THE INDIVIDUAL AMT SHOULD BE REPEALED

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The minimum tax, the predecessor to the current AMT, was enacted in 1969 to prevent "higher income individuals from substantially eliminating income tax liability through the excessive use of preferences." Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, JCS-10-87, at 7. Congress reiterated that objective when it replaced the minimum tax with the AMT in 1978 and when it strengthened and expanded the AMT in the Tax Reform Act of 1986. Thus, the AMT was expected to enhance horizontal and vertical equity. It could also make the income tax system more efficient by limiting the use of preferences. Although administrability and revenue were not primary concerns when the tax was first enacted, the pendulum has now shifted, so that there are now calls for retaining the AMT for revenue considerations, and the difficulties of administering the tax have become a major drawback. This essay explores the AMT from these policy perspectives and concludes that the AMT hardly serves the purpose that originally justified its enactment. It should therefore be repealed. While some commentators call for retaining the AMT while fixing its current flaws, as discussed below, it will more efficient to repeal the AMT and fix the current flaws in the regular income tax system.

REVENUE

Since the scope of the AMT has significantly expanded, AMT revenue has increased. In the near future, most of the revenue from the AMT will come from "ability to pay" preferences. A recent estimate provides that over the next ten years, the revenue loss from repealing the AMT could reach $800 billion. Dep't of the Treasury, *Fact Sheet: The Toll of Two Taxes: The Regular Individual Income Tax and the AMT*, (JS-1293)(April 2, 2004). Nevertheless, this loss could be significantly reduced if AMT repeal is combined with the imposition of phase-outs on preferences. In any event, the sooner the AMT is repealed, the lower the costs of repealing it will be.

EFFICIENCY/NEUTRALITY

Some commentators believe that a tax is efficient if it promotes economic growth. Congress uses the regular tax to achieve social and economic objectives by providing preferences, including investment incentives. Nevertheless, the Joint Committee on Taxation explained that such preferences "become counterproductive when taxpayers are allowed to use them to avoid virtually all tax liability." Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, JCS-10-87, at 432-433. Taxing such preferences (which is equal to limiting them if the AMT and regular tax rates are equal, as is almost the case today) frustrates the purpose for enacting them. Thus, to the extent that it limits the use of preferences whose purpose is to encourage economic growth, the AMT is inefficient.

By contrast, a tax is viewed as efficient (neutral) if it does not interfere with a taxpayer's economic behavior. A neutral tax, therefore, is one without preferences. Prior to enacting the AMT, Congress considered limiting the use of certain preferences as an alternative to imposing a separate tax. Ultimately, Congress chose to achieve its equity objective by imposing a second level of tax on the sum of such preferences over an exemption amount. Having separate systems allows Congress to retain various preferences within the regular tax system while ensuring that the AMT limits their use. Such a dual system is even less neutral than the limitation method originally proposed.

In a dual system, one must question what types of preferences ought to be taxed in order to create a more efficient system. Under an all-inclusive regime, a preference would be any deduction, credit or exemption that reduces tax liability. Such a regime would create a tax base free from preferences, so taxpayers pay tax on their economic income. Under a narrower approach, only preferences that violate neutrality in a taxpayer's decision-making (tax-motivated activities) ought to be taxed.

The AMT has never had a tax base that approximates true economic income, largely because the AMT is subject to the same political pressures as the regular tax. The AMT has always targeted only selected preferences. In other words, it has discouraged activities that give rise to preferences on a limited basis. The original preferences generally included items related to investment activities. Subjecting such preferences to the AMT caused taxpayers to change their investment behavior solely to avoid the AMT. Thus, even in its original form, the AMT was inefficient. Attempts in 1986 to move the AMT closer to its intended purpose, with the addition of the book income preference, basically failed. In conclusion, Congress ought to focus on how to make the regular income tax more efficient rather than trying to keep two parallel systems, each of which is inefficient.

EQUITY

A study conducted in the late 1960s revealed that in 1967, 155 individuals with income above $200,000 paid no income tax. *See* Hearings on the 1969 Economic Report of the President before the J. Comm., 91st Cong. 46 (Govt. Printing Office 1969). Congress reacted quickly to this perceived unfairness by enacting the minimum tax. Congress assumed that the percentage of taxpayers subject to the tax would increase as income increased, thereby creating a more equitable tax system. In 1970, Alan Schenk observed that "[t]he net effect of this new tax thus makes the entire tax structure more progressive." Alan

Schenk, *Minimum Tax for Tax Preferences*, 48 TAXES 201 (1970).

In 1986, Congress stated objective in strengthening and expanding the scope of the AMT continued to be equity: "[T]he minimum tax should serve one overriding objective: to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions and credits." Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, JCS, 10-87, at 7.

Nevertheless, the term "minimum tax" implies that Congress did not intend to enhance progressivity significantly and expected only some minimum achievement. In fact, the AMT added very few wealthy taxpayers to the income tax payment pool. Despite its presence, some wealthy taxpayers continue not to pay tax, and many others pay insignificant amounts.

Additionally, the AMT's burden has shifted to middle-class taxpayers. This shift is attributable to: (i) the significant expansion of the AMT base; (ii) the failure to index the AMT exemption for inflation; and (iii) the recent reductions in regular income tax rates. Due to the latter two factors, the pattern of more middle-class taxpayers being subject to the AMT will continue. As to the AMT base expansion, the targeted preferences in 1969 included excess investment interest, accelerated depreciation on real property and personal property subject to a net lease, rapid amortization of certified pollution control facilities, the exercise of certain stock options, percentage depletion, and capital gains.

Congress has since expanded the AMT base to include such "ability to pay" amounts as personal exemptions, the standard deduction, and certain miscellaneous itemized deductions.

Additionally, several regular income tax credits, such as those for education, are limited to the difference between AMT and regular tax liability, the effect of which is to partially establish that such credits are subject to the AMT. Finally, some preferences, which in 1969 were available to wealthy people, are available today to middle-income taxpayers; stock options are an example of this phenomenon. In 1969, stock options were generally limited to high-level executives; since then, their use as a compensation tool has broadened considerably.

Clearly, Congress' intention in enacting the AMT was not to impose a surtax on the middle class. The preferences that trigger the AMT today do not correspond to its original objective for two reasons: (i) Congress expanded the scope of the targeted preferences significantly; and (ii) Congress did not anticipate that preferences originally available only to wealthy taxpayers would become available to more taxpayers.

To conclude, as the commentators observed, the AMT has changed from a "class tax" to a "mass tax." Leonard Burman, William Gale, Jeffrey Rohaly and Benjamin Harris, *The Individual AMT: Problems and Potential Solutions*, 55 NAT'L TAX J. 555 (2002). Daniel Shaviro has stated that despite this shift, "the AMT unmistakably increases the overall progressivity of the fiscal system." Daniel Shaviro, *Tax Simplification and the Alternative Minimum Tax*, 91 TAX NOTES 1455, 1460-61 (May 28, 2001). He agrees, however, that in the long-run, repealing the AMT would not create a more regressive tax system. In my view, although the AMT still prevents certain taxpayers from paying no tax, that equitable feature is insufficient to justify retaining it. A major motivation for the original minimum tax was to remove the most visible form of inequity—wealthy taxpayers paying no tax. Now that the AMT has become a "mass tax," it has precisely the opposite effect. Instead of giving middle class taxpayers comfort that wealthy individuals cannot avoid paying their fair share of tax, it subjects them to a complex tax that they don't understand and perceive as unfair. It is true that the regular income tax system has become less progressive in recent years. In my view, however, this development further supports repealing the AMT and focusing on retaining progressivity in the regular income tax system.

ADMINISTRABILITY

A complex tax regime is undesirable because it creates "deadweight loss." The original minimum tax was relatively easy to calculate. Numerous structural changes, particularly the shift from a minimum tax to an "alternative" minimum tax, have resulted in a more complex calculation scheme. Simply stated, taxpayers are now required, in addition to calculating regular tax liability, to determine if they are subject to the AMT, to calculate their AMT liability (if applicable), to compare their regular tax and AMT liabilities, and to pay the greater amount.

Opponents of the AMT state that its complexity should be a predominant factor in determining whether to repeal it. The National Taxpayer Advocate identified complexity as the most serious problem affecting individual taxpayers today and continues to recommend AMT repeal. While the increasing use of tax software simplifies the AMT calculation for tax return purposes, AMT planning is very difficult for most individuals. Repealing the AMT, therefore, will promote simplicity in the tax system. In contrast, retaining the AMT and trying to fix its current flaws will result, in my view, in even more complexity. Finally, the President's call for simplicity in the tax system further signals that administrability will play a greater role in tax policy in the near future.

CONCLUSION

Ideally, taxable preferences ought to be preferences used primarily by wealthy people and preferences that arise from tax-motivated activities. A system that taxed such preferences would be equitable and efficient. Nevertheless, the current AMT base includes as preferences items not reasonably classified as tax-motivated and preferences that may be used by middle-class taxpayers. Thus, the current AMT is not only inefficient, it fails to serve its original equity objective. It also imposes enormous compliance costs. While eliminating the AMT would create a significant revenue loss, that should not prevent the repeal of the AMT. ■