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Creeping Minimum Tax Hard to Justify or Reform

Government Benefits as Tax Hits Middle Class

By Chet Currier
Bloomberg News
Sunday, August 14, 2005; F06

Imagine a teenager who gets caught dipping into the family cookie-jar fund to support his video-game habit.

He throws himself on his parents' mercy. "I know I must stop doing this, and I will," he says. "But I need a raise in my allowance to make up for the loss to my cash flow."

Outrageous, wouldn't you say? Even in this pampered age, the youngster has crossed the bounds of effrontery. Well, in the debate over reform of the U.S. income tax system, some very similar claims have been made lately, with hardly a peep of protest.

The subject of this chutzpah is the alternative minimum tax, a brainchild of the 1960s that has grown over the years from a special provision aimed at the rich to become a main-line Internal Revenue Service cash cow. Originally devised as a catchall for wealthy people who otherwise might avoid paying any taxes through skillful planning, it now stands as the very embodiment of the law of unintended consequences.

"Until recently, the AMT affected less than 1 percent of taxpayers," said the Tax Foundation, a nonpartisan educational organization in Washington. "Since 2000, the AMT has steadily grown, hitting roughly 3 percent of taxpayers in 2005. If left unchanged, the AMT will penalize nearly 20 percent of taxpayers by 2010, some 30 million Americans in total."

That puts it well into the ranks of the middle class, the ordinary hard-working, mutual-fund-owning, voting-in-large-numbers core of the U.S. economy.

Oh, well, some might say, they can take it. They are more prosperous than any middle class anywhere ever has been before.

Before jumping to this conclusion, check out some of the comments submitted to a presidential panel studying tax reform at <http://www.taxreformpanel.gov/>, particularly from workers who got incentive stock options from their employers.

"When the stock market took a nosedive, we were stuck with huge amount of AMT which we could not pay even if we sold all the stocks that we exercised," said one recent letter. "My brother was hit by the AMT and is now facing financial ruin," said another.

For a host of worthy reasons, Connie Mack, a former U.S. senator who chairs the panel, reported it will recommend repealing the AMT.

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He had no sooner uttered these words when a chorus of voices said the government's accounts couldn't stand the revenue loss, which would have to be made up some other way. One suggestion advanced immediately was to abolish the deduction on federal tax returns for state and local income taxes.

Crunch! And so was struck the reef on which so many tax-reform proposals founder. We can't consider the idea, however worthy it might be, because we simply can't afford it -- or, if we are going to make the change affordable, some other time-honored element of the system must be sacrificed.

Usually that's about where most discussions of reforming the tax system die. Why should this time be any different?

There is an unusual force at work now. Inertia is on the reformers' side, for once, because the AMT will ensnare more people the longer it stands in its present form.

"My tax return is in a sense very ordinary," wrote Robert Anderson of Massachusetts in a July 20 comment letter to the reform panel, reporting that he was hit by the AMT in 2004. "My wife and I work hard to put our children through college and take care of our elderly parents. My tax situation is not the reason that the AMT was originally enacted.

"The anger of the common citizen is growing as people realize they will soon be caught in this trap for the unwary. This is simply bad policy and must be abolished."

Are no repairs to the AMT possible that would allow it to continue? It can be indexed for inflation, perhaps. But that won't do anything about the real problem, the basic fact that the AMT lacks any legitimacy as a source of broad-based revenue for Uncle Sam. Other than expediency, there is no legal or moral principle on which it can be defended.

The more tax money it brings in, the more people it touches, the more blatantly apparent this illegitimacy will become. The longer Congress waits, the more political pressure will build. Sooner or later that should take us to the point where reform doesn't look so impossible after all.

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