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Minimum tax likely to cause more pain

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FIVE YEARS AGO, almost no one had ever heard of it.

By last year it was being talked about, but almost no one understood it.

A few years from now, if nothing changes, it will be making spring tax season miserable for millions of Americans.

What is it? Why, it's the alternative minimum tax, set up decades ago by the geniuses on Capitol Hill to make sure that rich people don't duck out of paying taxes by using other provisions those same geniuses wrote into the law.

Under current law, according to experts at the Tax Policy Center of the Brookings Institution and the Urban Institute, almost 30 million taxpayers will be hit by the AMT in 2010, and if the tax cuts of 2001 and 2003 are extended, as President Bush is asking, that number will climb to almost 40 million by 2014. And under that scenario, by 2014 the AMT will account for more than 11 percent of federal revenue.

The AMT is inflicting pain already. The Tax Policy Center folks, in a new study, figure that people hit by the AMT this year will have to pay an extra \$6,000, on average, over what their regular taxes would be.

Further, the taxpayers most likely to be hit by the AMT are not the truly rich. In fact, within a few years, taxpayers with incomes in the range of \$75,000 will face a serious chance of being caught by the tax.

"The likelihood of being on the AMT increases with income, but only up to a point -- households with income above \$1 million are always less likely to be on the AMT than those with somewhat smaller incomes," the new study found. (The reason is that the top regular tax brackets are higher than the AMT's top rate of 28 percent, making the tax bills of the very wealthy likely to be higher when calculated by the regular method.) "Moreover, the percentage of middle-class returns on the AMT explodes over time. By 2010, more than half of tax returns with incomes between \$75,000 and

\$100,000 will be affected."

Even now, the levy falls most frequently on those taxpayers who range from upper-middle-class to quite well off -- those making \$200,000 to \$1 million a year.

Although it sneaks up on taxpayers, in concept, the AMT is fairly simple.

After figuring your taxes the normal way, you start over, adding back to your income many of the things you were able to subtract on your regular return. These include such things as personal exemptions and the deduction for state and local taxes.

After figuring your AMT income, you take what amounts to a big standard deduction -- \$58,000 for a couple this year, \$40,250 for a single -- then apply special tax rates of 26 percent on the first \$175,000 of taxable income and 28 percent income above that. You then compare your tax calculated the AMT way to your tax calculated the regular way, and pay whichever is higher.

There are lots of twists and turns to the AMT. The big standard deduction, known formally as the AMT exemption amount, was given a special boost for 2003 and 2004, but falls back to \$45,000 for a couple and \$33,750 for a single next year. Also, the exemption phases out for high-income taxpayers.

There are two main reasons for the AMT's expanding reach. First, it is not indexed for inflation, so the exemption has become less and less meaningful. Congress recognizes this problem, which is why the special two-year boost was adopted. Second, the recent cuts in regular tax rates have meant that when taxpayers compare their regular tax to their AMT tax, it's more likely they will find the AMT higher.

So why doesn't Congress fix this?

As the rappers say, it all comes down to the money.

At a time when federal deficits are at record levels, the AMT is raising huge amounts of money. The AMT is the government's ATM -- a cash machine.

In fact, the AMT brings in so much money that the Tax Policy Center study calculates that by 2009 it would be cheaper from the government's point of view to repeal the regular income tax than to repeal the AMT.

Further, the AMT's existence allows politicians to trumpet tax cuts without mentioning that a big chunk of those cuts will be "clawed back" just as taxpayers reach for them. The study figures that in 2010, the AMT will take back 29 percent of the 2001 and 2003 tax cuts.

"The claw back rises to 47 percent for households with cash income between \$100,000 and \$200,000, and 70 percent for those with income between \$200,000 and \$500,000," the study said. It added that about 3 percent of taxpayers would see all benefit of those tax cuts eliminated.

You might think Republicans would make AMT reform a top priority, given their rhetoric, because the tax is profoundly anti-family. "A striking fact is that married couples are more than six times as likely to be on the AMT as singles," the study found.

This is primarily because of the treatment of personal exemptions. But the AMT also whacks blue states with its disallowance of state and local tax deductions.

And "combining risk factors," the study said, "virtually all (94 percent) of married couples with two or more children and (adjusted gross income) between \$75,000 and \$100,000 will be on the AMT in 2010."

Reform is not impossible. The Tax Policy Center experts -- Leonard E. Burman and William G. Gale of Brookings, and Mathew Hall, Jeffrey Rohaly and Mohammed Adeel Saleem of the Urban Institute -- suggest a number of possible solutions. Some would replace more than all of the lost revenue, possibly reducing the budget deficit.

But fixing the AMT without busting the budget is going to require something that will look to some people like an out-in-the-open tax increase, and those haven't been very popular lately.