The Individual Alternative Minimum Tax and the Intersection of the Bush Tax Cuts: A Proposal for Permanent Reform

Gabriel Aitsebaomo

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THE INDIVIDUAL ALTERNATIVE MINIMUM TAX AND THE INTERSECTION OF THE BUSH TAX CUTS: A PROPOSAL FOR PERMANENT REFORM

Gabriel Aitsebaomo*

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I. INTRODUCTION

As the House Ways and Means Committee postpones its consideration of the individual alternative minimum tax (the “AMT”) reform legislation until after the August congressional recess,¹ a pertinent question is whether the AMT has lost its purpose and policy objective to warrant continued retention in its current form. The AMT was originally enacted in 1969 as add-on minimum tax² with the overriding policy objective of ensuring that no wealthy individual with substantial economic income can avoid paying any federal income tax by utilizing various deductions, credits, or exclusions (tax loopholes) to virtually eliminate his or her taxable income.³

The foregoing article begins with a critical examination of the AMT, its purpose, policy rationale, and the manner that it is calculated.

¹ Wesley Elmore, AMT Action Unlikely Until After August Recess Rangel Says, TAX NOTES TODAY, June 22, 2007, LEXIS 2007 TNT 121-24, ¶¶ 1-2. According to the report, “House Ways and Means Committee Chair Charles B. Rangel, D-N.Y., said June 21 that House scheduling issues will likely cause consideration of alternative minimum tax reform legislation to be delayed until after the August congressional recess. Rangel said a Ways and Means markup of AMT legislation, which had been expected to occur in July, will also slip until after the recess.” Id.
Next, the article discusses the mushrooming number of individuals subject to the AMT, and the author posits that the AMT, in its current form, is neither achieving its intended purpose nor fulfilling its policy objective given the increasing number of unintended middle and upper middle class taxpayers subject to the tax. Next, the author critically examines the Bush tax cuts from 2001 to 2004, and concludes that the Bush tax cuts, and the fact that the AMT parameters are not indexed for inflation, are primarily responsible for the increasing number of middle and upper middle class taxpayers subject to the AMT.

Next, the article discusses and criticizes as inadequate band-aid fixes, current Congressional use of yearly AMT exemption amount increases to temporarily mitigate the increasing number of individuals subject to the AMT. Finally, the article proposes several permanent AMT solutions, which include exempting from the AMT altogether taxpayers with AGI of $250,000 or less. The article concludes that such exemption would not only align the AMT with its original purpose and policy objective, but would also restore confidence in our voluntary self-assessment system by permanently eliminating middle and upper middle class taxpayers from the burden and complexities of computing the AMT.

II. EXAMINATION OF THE AMT

A. AMT Defined

The AMT is the amount (if any) by which the tax liability calculated under the AMT system exceeds the tax liability calculated under the regular federal income tax system. For example, if an individual's tax liability calculated under the AMT system is $3,000 whereas the individual's tax liability calculated under the regular federal income tax system is $2,000, then the individual's AMT liability is $1,000 (i.e., $3,000 - $2,000) before any applicable tax credits. Because the AMT system runs parallel to the regular federal income tax system, the individual's final tax liability for the taxable year (before any applicable tax credits) would be $3,000, which consists of the

---

4. See I.R.C. § 55(a) (2007). Regular tax liability is defined under I.R.C. § 26(b) (2007) as “the tax imposed by this chapter for the taxable year.”
6. Under I.R.C. § 55(a) (2007) the AMT is imposed “in addition to any other tax imposed by this subtitle.” Accordingly, the AMT runs parallel to the regular federal income tax system.
$2,000 of regular federal income tax liability and the $1,000 of AMT liability.\textsuperscript{7}

B. Purpose and Policy Objectives of the AMT

The AMT was enacted after treasury secretary Joseph Barr testified before Congress in 1966 that 154 individuals with adjusted gross income (AGI) of over $200,000 (about $1.5 million by 2007 estimate\textsuperscript{8}) did not pay any federal income tax in 1966 by using substantial deductions and exclusions to completely eliminate their taxable income.\textsuperscript{9} Embarrassed by this revelation, Congress first enacted the add-on minimum tax in 1969\textsuperscript{10} and then its successor the AMT in 1978,\textsuperscript{11} to ensure that no individual with substantial economic income can avoid paying any federal income tax.\textsuperscript{12} In enunciating the purpose and policy objectives of the AMT, Congress stated that:

Congress 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. Although these provisions provide incentives for worthy goals, they become counterproductive when individuals are allowed to use them to avoid virtually all tax liability. The ability of high-income individuals to pay little or no tax undermines respect for the entire tax system and, thus, for the incentive provisions themselves. Therefore, Congress provided an alternative minimum tax which was intended to insure that, when an individual's ability to pay taxes is measured by a broad-based concept of income, a measure which can be reduced by only a few of the incentive provisions, tax liability is at least a minimum percentage of that broad measure. The only deductions allowed, other than costs of producing

\textsuperscript{7} See I.R.C. § 55(a) (2007) (stating that the AMT is “imposed . . . in addition to any other tax imposed”).

\textsuperscript{8} The $1.5 million amount was derived by projecting the future value of $200,000, paying 5% compounded semi-annually for 41 years (1966-2007), where n (number of years) equals 41, and i (interest) equal 5%. Thus, $200,000 \times (1.05)^{41} = 7.391988148 \times 200,000 = $1.5 million.

\textsuperscript{9} See S. Rep. No. 91-552, 2039 (1969). As stated in the Senate Report, “there were 154 persons with adjusted gross income in excess of $200,000 who paid no income tax. Twenty-one of these had incomes over $1 million.”


\textsuperscript{11} The Revenue Act of 1978, supra note 2, § 421.

\textsuperscript{12} GENERAL EXPLANATION OF THE REVENUE PROVISIONS, supra note 3. See also S. Rep. No. 91-552, supra note 9, at 2027. “The committee agrees with the House that this is an intolerable situation. It should not have been possible for 154 individuals with adjusted incomes of $200,000 or more to pay no Federal income tax.” Id.
income, are for important personal or unavoidable expenditures (housing interest, medical expenses and casualty losses) or for charitable contributions, the deduction of which is already limited to a percentage of adjusted gross income.\footnote{13}

As would be seen from the foregoing article, the AMT has not only failed to achieve its purpose, but has also lost its policy objective.

III. CALCULATING THE AMT

A. Overview

Given that the AMT is defined as the excess, if any, of tentative minimum tax for the taxable year over the regular tax\footnote{14} for the taxable year, it is imperative to first determine an individual’s regular tax liability before determining his or her AMT liability.\footnote{15}

B. Determination of Regular Tax Liability

The first step in calculating an individual’s regular tax liability is to determine the individual’s gross income. Gross income is income from whatever source derived, including but not limited to salaries, wages, royalties, dividend, and interest, to mention just a few.\footnote{16} After gross income is determined, it is necessary to reduce gross income by certain deductible expenses\footnote{17} to arrive at AGI.\footnote{18} Next, AGI is reduced by the higher of the individual’s basic standard deduction\footnote{19} or itemized deductions,\footnote{20} as well as any applicable personal or dependency exemptions\footnote{21} to arrive at taxable income.\footnote{22} Taxable income is multiplied

\begin{flushleft}
\footnote{13. **Joint Committee on Taxation**, *Study of the Overall State of the Federal Tax System and Recommendation for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986* 107 (Comm. Print 2001).} \\
\footnote{14. Under I.R.C. § 55(c)(1) (2007) regular tax is defined as “the regular tax liability for the taxable year (as defined in section 26(b)) reduced by the foreign tax credit allowable.”} \\
\footnote{15. I.R.C. § 55(a) (2007).} \\
\footnote{16. I.R.C. § 61(a) (2007).} \\
\footnote{17. These expenses include but are not limited to (1) reimbursed expenses of employees, (2) certain expenses of performing artists, (3) certain expenses of officials, (4) certain expenses of elementary and secondary school teachers, (5) losses from sale or exchange of property, (6) alimony, (7) moving expenses, etc. See generally I.R.C. § 62(a) (2007) for a laundry list.} \\
\footnote{18. I.R.C. § 62(a) (2007).} \\
\footnote{19. I.R.C. § 63(c)(2) (2007).} \\
\footnote{20. I.R.C. § 63(d) (2007).} \\
\footnote{21. I.R.C. § 151(b) and (c) (2007) (describing personal and dependency exemptions).} \\
\footnote{22. See I.R.C. § 63(a) (2007) (defining taxable income).} 
\end{flushleft}
by the applicable tax rates\textsuperscript{23} to arrive at the tax liability under the regular federal income tax system. The aforementioned steps can be illustrated in the following schema:

\begin{align*}
\text{Gross Income} & \rightarrow \text{Deductions} \\
\text{Minus:} & \rightarrow \text{Adjusted Gross Income} \\
\text{Equals:} & \rightarrow \text{Taxable Income} \\
\text{Minus:} & \rightarrow (1)\text{ personal exemptions, and (2) basic standard or itemized deductions} \\
\text{Equals:} & \rightarrow \text{Tax liability under the regular tax system}
\end{align*}

C. \textit{Does Taxpayer Owe Any AMT Liability?}

After calculating regular federal income tax liability as discussed above, taxpayer must next determine whether he or she is liable for any AMT in addition to his or her regular federal income tax liability. The first step in calculating the AMT liability is to ascertain whether AMT applies. To do so, a taxpayer completes a worksheet consisting of several questions and answers aimed at determining whether or not the taxpayer would be subject to the AMT and hence must execute AMT Form 6251\textsuperscript{24} If the worksheet indicates that the taxpayer is subject to AMT liability, the individual must execute Form 6251 to calculate and report the AMT liability.

D. \textit{Determination of AMT Liability}

1. Overview

The starting point in determining an individual’s AMT liability is to calculate the individual’s alternative minimum taxable income (AMTI)\textsuperscript{25} for the taxable year. Essentially, AMTI is taxable income determined under the regular federal income tax system adjusted upwards or downwards by the items provided under I.R.C. §§ 56 and 58, and then increased by the tax preference items provided under I.R.C. § 57.\textsuperscript{26}

\begin{footnotesize}
\textsuperscript{23} See I.R.C. § 1 (2007).
\textsuperscript{25} I.R.C. § 55(b)(2) (2007).
\textsuperscript{26} \textit{Id.}
\end{footnotesize}
Typical adjustments include depreciation deduction,\textsuperscript{27} mining exploration and development costs,\textsuperscript{28} certain long term contracts,\textsuperscript{29} alternative tax net operating loss deductions,\textsuperscript{30} pollution control facilities,\textsuperscript{31} and the limitations on itemized deductions.\textsuperscript{32} These adjustments have the effect of expanding the AMT base by either disallowing the deduction of items that are normally allowed in computing regular taxable income or accelerating the inclusion of income that is normally deferred when calculating regular taxable income.\textsuperscript{33}

Additionally, AMTI is increased by requiring a taxpayer to add back to taxable income previously deducted tax preference items such as: excess depletion deduction,\textsuperscript{34} excess intangible drilling costs,\textsuperscript{35} tax exempt interest on private activity bonds,\textsuperscript{36} accelerated depreciation on certain properties,\textsuperscript{37} and exclusion of gains on sale of certain small business stock.\textsuperscript{38} The inclusion of these tax preference items have the effect of further broadening the AMT base before the application of the AMT rate.

After making the aforementioned adjustments, the grossed-up AMTI is reduced by the applicable AMT exemption amounts provided under I.R.C. § 55(d) to produce the taxable excess.\textsuperscript{39} For 2006, the AMT exemption for a married taxpayer filing a joint return and a surviving spouse is $62,550,\textsuperscript{40} while the AMT exemption for an unmarried taxpayer (who is not a surviving spouse) is $42,500.\textsuperscript{41} Taxable excess is multiplied by a two-tiered 26% and 28% tax rate\textsuperscript{42}

\begin{itemize}
\item \textsuperscript{27} I.R.C. § 56(a)(1) (2007).
\item \textsuperscript{28} I.R.C. § 56(a)(2) (2007).
\item \textsuperscript{29} I.R.C. § 56(a)(3) (2007).
\item \textsuperscript{30} I.R.C. § 56(a)(4) (2007).
\item \textsuperscript{31} I.R.C. § 56(a)(5) (2007).
\item \textsuperscript{32} I.R.C. § 56(b)(1) (2007).
\item \textsuperscript{33} See generally I.R.C. §§ 56, 58 (2007).
\item \textsuperscript{34} I.R.C. § 57(a)(1) (2007).
\item \textsuperscript{35} I.R.C. § 57(a)(2) (2007).
\item \textsuperscript{36} I.R.C. § 57(a)(5) (2007).
\item \textsuperscript{37} I.R.C. § 57(a)(6) (2007).
\item \textsuperscript{38} I.R.C. § 57(a)(7) (2007).
\item \textsuperscript{40} I.R.C. § 55(d)(1)(A) (2007).
\item \textsuperscript{41} I.R.C. § 55(d)(1)(B) (2007).
\end{itemize}
structure to produce the tentative minimum tax liability for the taxable year.\textsuperscript{43} Under I.R.C. §55(b)(1)(A)(i), the first $175,000 of taxable excess is multiplied by 26% while any taxable excess over $175,000 is multiplied by 28%. As indicated previously, the product of the application of the two rate structure is the tentative minimum tax liability for the taxable year.\textsuperscript{44} If the resulting AMT liability is greater than the tax liability calculated under the regular federal income tax system, the excess is the AMT liability for the taxable year before any applicable tax credits.\textsuperscript{45} If the AMT liability is less than the regular federal income tax liability, then the taxpayer only pays the regular federal income tax liability and does not owe any AMT liability.\textsuperscript{46} The aforementioned rules and steps can be illustrated in the following example.

2. Example Illustrating the Calculation of the AMT and How Easy it is For Middle and Upper Middle Class Taxpayers to be Subject to the AMT at Modest Income Levels

Assume that Howard and Wendy are married and live in Westchester County, New York with their four children. Howard and Wendy’s combined income in 2006 is $120,000. Howard and Wendy paid $28,500 in mortgage interest in 2006 on their principal residence in Westchester County, New York, and $11,500 in real property taxes. Howard and Wendy’s regular federal income tax liability and AMT liability, before any applicable child tax credits, for 2006 are calculated as follows:

<table>
<thead>
<tr>
<th>Calculation of Regular Tax Liability</th>
<th>Calculation of AMT Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Income............$120,000</td>
<td>Taxable income.............$60,200</td>
</tr>
<tr>
<td>Less Deduction:</td>
<td>Add:</td>
</tr>
<tr>
<td>Itemized deductions:</td>
<td>Itemized deductions..... $40,000</td>
</tr>
<tr>
<td></td>
<td>Personal exemptions..... $19,800</td>
</tr>
</tbody>
</table>

\textsuperscript{43} I.R.C. § 55(b) (2007).
\textsuperscript{45} I.R.C. § 55(a) (2007).
\textsuperscript{46} Id.
\textsuperscript{47} Under I.R.C. § 63(d) and (e) (2007), taxpayers are allowed the higher of the basic standard deduction or itemized deductions.
As indicated in the above example, Howard and Wendy’s regular federal income tax liability is $8,275 while their tentative minimum tax is $14,937. Because their tentative minimum tax of $14,939 exceeded their regular federal income tax liability of $8,275 by $6,662 ($14,937 - $8,275 = $6,662), Howard and Wendy are subject to an AMT liability (before any applicable tax credits) in the amount of $6,662 in addition to their regular federal income tax liability of $8,275.56

At a combined gross income of only $120,000, Howard and Wendy are clearly not the wealthy individuals that the AMT was designed to target. Nevertheless, they became subject to the AMT due to its poor design and implementation. Accordingly, the pertinent question is whether the AMT is achieving its intended purpose and policy objectives to warrant its continued retention in its current form?

<table>
<thead>
<tr>
<th>Mortgage interest</th>
<th>$28,500</th>
<th>AMT $14,937 - $8,275</th>
<th>$6,662</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property taxes</td>
<td>$11,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total itemized</td>
<td>$40,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal Exemptions $51</td>
<td>6 x $3,300</td>
<td>$19,800</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$19,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable income</td>
<td>$60,200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax rate $53</td>
<td>$15,100 x 10%</td>
<td>$1,510</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$45,100 x 15%</td>
<td>$6,765</td>
<td></td>
</tr>
<tr>
<td>Total regular tax</td>
<td>$8,275</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

51. Personal exemption deduction is allowed under I.R.C. § 151(a) (2007).
55. See supra section III, D, 2.
56. Under I.R.C. § 55(a) (2007), the AMT is “imposed . . . in addition to any other tax imposed by this subtitle”.
57. See Donaldson, supra note 3, at 705. “The AMT is a backstop measure designed to ensure that wealthy taxpayers pay at least a certain minimum amount of income tax.” Id.
IV. AMT NOT ACHIEVING ITS INTENDED PURPOSE AND POLICY OBJECTIVE

A. Explosion in the Number of Individuals Subject to the AMT

As the foregoing example illustrates, the AMT has clearly lost its purpose and policy objective by needlessly subjecting unintended middle and upper middle class taxpayers to its wrath while failing to subject wealthy taxpayers, the class for whom the tax was designed, to its incidence. Congress enacted the AMT several decades ago with the overriding policy objective of ensuring that no wealthy individuals can avoid paying any federal income tax by utilizing various deductions and exclusions to eliminate their taxable income. Since its enactment, however, the AMT has not only failed to fulfill its policy objective (of ensuring that wealthy individuals do not escape paying any federal income tax) but has also lost its purpose by seemingly becoming a de facto government automatic teller machine (ATM) for generating additional tax revenue from middle and upper middle class individuals—a purpose that was not intended by Congress when it enacted the AMT.

In 1970 for example, only about 20,000 individuals were subject to the add-on minimum tax, the predecessor of the AMT, and only about $100 million was collected in add-on minimum tax revenue. By contrast, in 2002, the number of individuals subject to the AMT had risen to 1.9 million while the amount of AMT revenue increased to $6.9 billion. Similarly, in 2003, the number of individuals subject to the AMT increased from 1.9 million to 2.4 million for a percentage increase of 23.4%, while the amount of AMT revenue increased from $6.9 billion to $9.5 billion for a percentage increase of 38.2%. Likewise, in 2004,
the number of individuals subject to the AMT mushroomed from 2.4 million to 3.1 million for a percentage increase of 31.3%, while the amount of AMT revenue jumped from $9.5 billion to $13 billion for a percentage increase of 38%. In terms of income category, for example, more than 85 percent of the number of individuals subject to the AMT in 2004 had incomes of between $100,000 and $500,000, and future growth in the number of individuals subject to the AMT is expected to come from taxpayers with incomes of between $50,000 and $200,000.

Ironically, wealthy individuals, the class for whom the AMT was designed, are less likely to be subject to the tax while middle and upper middle class taxpayers, the class for whom the tax was not designed, are more likely to be subject to it. The reason why wealthy individuals are less likely to be subject to the AMT is because wealthy individuals generally pay taxes at higher marginal tax rates of between 33 and 35 percent, respectively, whereas the AMT marginal tax rates are lower at 26 and 28 percent, respectively. Consequently, the individual AMT would not achieve its policy objectives under the current structure unless it is permanently reformed to exclude middle and upper middle class taxpayers from the tax. Such reform would permanently align the AMT with its original purpose and policy objective.

V. PRINCIPAL FACTORS RESPONSIBLE FOR THE AMT GROWTH

A. Overview

Since his inauguration as President on January 20, 2001, George W. Bush has successfully implemented a number of his campaign tax cut initiatives into law. These individual tax cut initiatives include The

__References__


67. Gregg Esenwein & Steven Maguire, CRS Updates Report on Possible AMT Distributional Effects, TAX NOTES TODAY, June 20, 2007, LEXIS 2007 TNT 126-18, ¶ 19. “Although the AMT was originally intended to make sure that high-income taxpayers paid at least a minimum amount of federal income taxes, they will not be the group most adversely affected by the AMT in the future.” Id.

Economic Growth and Tax Relief Reconciliation Act of 2001, 69 The Jobs and Growth Tax Relief Reconciliation Act of 2003, 70 and The Working Families Tax Relief Act of 2004 71 (hereinafter the "Bush tax cuts"). Although publicized as providing the much needed tax relief to taxpayers, 72 the Bush tax cuts have become one of the major contributors to the recent increase in the number of individuals subject to the AMT. 73 By reducing the tax rates of the regular federal income tax system without a corresponding reduction in the tax rates of the AMT system, the Bush tax cuts have had the effect of pushing many taxpayers into the AMT system. The following is a critical examination of the significant aspects of the various Bush tax cut legislations.

B. The Economic Growth and Tax Relief Reconciliation Act of 2001

1. Overview

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which ushered in the era of the Bush tax cuts is remarkable for a number of reasons. First, it marked the largest tax cut in decades and it was estimated to cost the government about $1.35 trillion in lost revenue over 10 years. 74 The main features of EGTRRA are as follows.

2. Reduction of the Individual Marginal Tax Rates

One of the most significant aspects of EGTRRA legislation is its overall reduction of the individual marginal tax rates. 75 Oddly, this tax rate reduction is a principal reason for the increasing number of individuals subject to the AMT. 76 Prior to the enactment of EGTRRA,

75. EGTRRA, supra note 69, § 101 (reducing income tax rates for individuals).
the individual marginal tax rate brackets were 15%, 28%, 31%, 36%, and 39.6%, respectively. EGTRRA reduced the top marginal tax rate brackets over a 10-year period to 25%, 28%, 33%, and 35%, respectively. Additionally, EGTRRA created a new 10% tax rate bracket out of the existing 15% tax rate bracket for taxable years beginning January 1, 2001. The new 10% tax rate applied to the first $12,000 of taxable income of married taxpayers filing a joint return, the first $6,000 of taxable income of unmarried (single) taxpayers, and first $10,000 of taxable income of heads of households.

To ensure that taxpayers received immediate benefits from the new 10% tax rate bracket, Congress accelerated the rate reduction by authorizing the Department of Treasury to issue 5% rebate checks to qualified taxpayers, which is equal to the difference between the original 15% tax rate bracket and the new 10% tax rate bracket (15% - 10% = 5%). As a result, taxpayers received rebate checks from the Department of Treasury in the amounts of $300, $500, or $600, depending on whether they were single, heads of households, or married filing a joint return. The effect of these tax rates reductions was an overall reduction in the regular federal income tax liabilities of the benefited taxpayers.

However, because EGTRRA did not make any corresponding reduction in the marginal tax rates of the AMT system, the tax liability computed under the AMT system would generally be higher (since the reducing the regular income taxes but providing only temporary AMT adjustments, EGTRRA and JGTRRA (if they are made permanent) will increase the number of AMT taxpayers to 29.5 million by 2010 and 39.8 million in 2014."

77. I.R.C. § 1(i) (2007); EGTRRA, supra note 69, § 101(a)(2).
78. See EGTRRA, supra note 69, § 101(a)(2).
79. See id. § 101(a)(1)(A).
80. Id. § 101(a) (increasing the initial bracket amount to $14,000 for taxable years 2008 and thereafter).
81. Id. § 101(a) (increasing the initial bracket amount to $7,000 for taxable years 2008 and thereafter).
82. Id. § 101(a).
83. See id. § 6428(a) (stating that "there shall be allowed as a credit . . . an amount equal to 5 percent . . . ").
84. Id. See also Warren Rojas, Rebate Checks Amount To Little More Than Snowball in AMT Hell, TAX NOTES TODAY, Sept, 17, 2001, 92 TNT 1514, ¶ 2.
85. With the reduction of the marginal tax rates overall tax liability reduces.
rates were not reduced) than the tax liability computed under the regular federal income tax system.\textsuperscript{86} As a result, the affected taxpayers are more likely to owe AMT liability, given that taxpayers are subject to the AMT if the tax calculated under the AMT system is higher than the tax liability calculated under the regular federal income tax system.\textsuperscript{87}

3. Repeal of the Phase-Out of Personal Exemptions

Apart from the reduction in the individual marginal tax rates, EGTRRA repealed the existing restrictions on the deductibility of personal exemptions by certain individuals.\textsuperscript{88} In general, taxpayers are allowed a personal exemption deduction when computing their federal income tax liability.\textsuperscript{89} Prior to EGTRRA, the deduction of the personal exemption was reduced proportionally or completely disallowed for certain individuals when their AGI exceeded certain income limits.\textsuperscript{90} With the advent of EGTRRA, the restrictions on the deductibility of personal exemptions when a taxpayer’s AGI reached certain income limits were gradually lifted or completely removed, in some cases, for taxable years beginning after 2009.\textsuperscript{91}

\begin{enumerate}
\item To mitigate this effect, Congress adopted yearly temporary increases in the AMT exemption amounts. But this still did not eliminate the push into AMT.
\item See generally I.R.C. § 55(a) (2007) (defining the AMT).
\item EGTRRA, \textit{supra} note 69, § 102(a).
\item I.R.C. § 151(d)(1) (2007).
\item I.R.C. § 151(d)(3) (2007). Paragraph 3 provides the following:
\begin{enumerate}
\item (A) In general. – In the case of any taxpayer whose adjusted gross income for the taxable year exceeds the threshold amount, the exemption amount shall be reduced by the applicable percentage.
\item (B) Applicable percentage. – For purposes of subparagraph (A), the term 'applicable percentage' means 2 percentage points for each $2,500 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds the threshold amount. In the case of a married individual filing a separate return, the preceding sentence shall be applied by substituting '$1,250' for '$2,500'. In no event shall the applicable percentage exceed 100 percent.
\item (C) Threshold amount. For purposes of this paragraph, the term 'threshold amount' means—
\begin{enumerate}
\item $150,000 in the case of a joint return or a surviving spouse (as defined in section 2(a) [26 USCS § 2(a)]),
\item $125,000 in the case of a head of a household (as defined in section 2(b) [26 USCS § 2(b)]),
\item $100,000 in the case of an individual who is not married and who is not a surviving spouse or head of a household, and
\item $75,000 in the case of a married individual filing a separate return.
\end{enumerate}
\end{enumerate}
\item See EGTRRA, \textit{supra} note 69, § 102(a). Section 102(a) provides as follows:
\begin{enumerate}
\item REPEAL OF PHASEOUT OF PERSONAL EXEMPTIONS.
\end{enumerate}
\end{enumerate}
The effect of the repeal of these restrictions is a general reduction in the regular tax liability of the benefited taxpayers. However, since there was no similar repeal in the AMT system, taxpayers would be more likely to be subject to the AMT than otherwise.

4. Phase-Out of Overall Limitation on Itemized Deductions

In general, taxpayers are allowed a deduction of the higher of the basic standard deduction or itemized deductions in computing regular federal income tax liability. Prior to EGTRRA, I.R.C. § 68(a) imposed limitations on the ability of taxpayers to deduct their itemized deductions when their AGI exceeded certain income threshold. The enactment of EGTRRA not only reduced these restrictions, but completely eliminated them for taxable years beginning after 2009. The reduction or elimination of these restrictions has the effect of allowing taxpayers more deductions which, in turn, leads to less tax liability. Given that there were no corresponding restrictions, reductions, or eliminations under the AMT system, the tax liability calculated under the AMT system would tend to be higher than the tax liability calculated under the regular system.

5. Modification of the Child Care Tax Credit

Prior to EGTRRA, taxpayers were allowed a child care tax credit in the amount of $500 for each qualifying child. The credit, however,

(a) IN GENERAL.—Paragraph (3) of section 151(d) (relating to exemption amount) is amended by adding at the end the following new subparagraphs:

(E) REDUCTION OF PHASEOUT.—

(i) IN GENERAL.—In the case of taxable years beginning after December 31, 2005, and before January 1, 2010, the reduction under subparagraph (A) shall be equal to the applicable fraction of the amount which would (but for this subparagraph) be the amount of such reduction. (ii) APPLICABLE FRACTION.—For purposes of clause (i), the applicable fraction shall be determined in accordance with the following table: For taxable years beginning The applicable
in calendar year—fraction is—
2006 and 2007 .......................................................... 2/3
2008 and 2009 .......................................................... 1/3.

92. I.R.C. § 68(c) and (d) (2007).
93. I.R.C. § 68(a) (2007) provides in relevant part:
In the case of an individual whose adjusted gross income exceeds the applicable amount, the amount of the itemized deductions otherwise allowable for the taxable year shall be reduced by the lesser of—(1) 3 percent of the excess of adjusted gross income over the applicable amount, or (2) 80 percent of the amount of the itemized deductions otherwise allowable for such taxable year.
94. See EGTRRA, supra note 69, § 103(a).
was reduced by $50 for each $1,000 by which a taxpayer’s modified adjusted gross income exceeded $75,000, in the case of unmarried (single) taxpayers, or $110,000 in the case of married taxpayers filing a joint return. Although the child tax credit is generally nonrefundable, families with three or more qualifying children are allowed a refund of the credit if the taxpayer’s social security taxes exceeded the taxpayer’s earned income credit. With the passage of EGTRRA, Congress increased the child care tax credit from $500 to $1,000 over a ten-year period beginning in 2001 for each qualifying child as provided below.

<table>
<thead>
<tr>
<th>Taxable year</th>
<th>Allowable credit per child</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-2004</td>
<td>$600</td>
</tr>
<tr>
<td>2005-2008</td>
<td>$700</td>
</tr>
<tr>
<td>2009</td>
<td>$800</td>
</tr>
<tr>
<td>2010</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

The effect of this tax credit increase is a reduction in the tax liability of the affected taxpayers. If the credit is not similarly allowed for AMT purposes, the affected taxpayers would be pushed into the AMT brackets.

6. Expansion of Adoption Credit and Adoption Assistance Programs

In general, I.R.C. § 23(a) allows a taxpayer a tax credit for “qualified adoption expenses” paid or incurred during the taxable

98. EGTRRA, supra note 69, § 201(a)(2).
[R]easonable and necessary adoption fees, court costs, attorney fees, and other expenses-(A) which are directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer, (B) which are not incurred in violation of State or Federal law or in carrying out any surrogate parenting arrangement, (C) which are not expenses in connection with the adoption by an individual of a child who is the
Prior to EGTRRA, the maximum credit allowed was $5,000 per eligible child and $6,000 per special needs child. With respect to amounts paid to or reimbursed to an employee by an employer pursuant to an adoption assistance program, the maximum amount allowed to be excluded from the gross income of the employee is $5,000 per eligible child and $6,000 per special needs child. An eligible child is defined as an:

- An individual who (A) has not attained the age of 18 or (B) is physically or mentally incapable of caring for himself.
- A special needs child, on the other hand, is a child who is a resident or citizen of the United States whom a state has determined (1) cannot or should not be returned to the home of the birth parents, and (2) has specific factors or conditions (such as his ethnic background, age, or membership in a minority or sibling group, or the presence of factors such as medical conditions or physical, mental, or emotional handicaps) because of which it is reasonable to conclude that such child cannot be placed with adoptive parents without providing adoption assistance.

Prior to EGTRRA, adoption credit for special needs children was permanent while the adoption credit for other children was limited to expenses incurred on or before December 31, 2001. With the advent of EGTRRA, the adoption credit for eligible expenses (currently allowed at a maximum of $5,000) and the special needs adoption credit (currently allowed at a maximum of $6,000) were both increased to $10,000. Additionally, EGTRRA made permanent the adoption credit for other than special needs children, including employer provided adoption assistance. The result of these increases in amount of credits is that taxpayers would experience an overall reduction in their regular federal

100. I.R.C. § 23(a) (2007).
105. See EGTRRA, supra note 69, § 202(b). Section 202(b)(1) provides as follows:

A) ADOPTION EXPENSES.—Section 23(b)(1) (relating to allowance of credit) is amended — (i) by striking "$5,000" and inserting "$10,000", (ii) by striking "($6,000, in the case of a child with special needs)", and (iii) by striking "subsection (a)" and inserting "subsection (a)(1)(A)". (B) ADOPTION ASSISTANCE PROGRAMS.—Section 137(b)(1) (relating to dollar limitations for adoption assistance programs) is amended — (i) by striking "$5,000" and inserting "$10,000", and (ii) by striking "($6,000, in the case of a child with special needs)".

106. See id. § 202(d).
income tax liability. However, if there is no similar credit allowed under
the AMT system, the benefited taxpayers would likely wind up being
subject to the AMT because their tax liability computed under the
regular tax system would be less than their tax liability computed under
the AMT system.

7. Marriage Penalty Relief

In general, taxpayers are allowed to deduct the higher of the basic
standard deduction or itemized deduction in calculating their AGI for
purposes of determining their regular federal income tax liability.\(^{107}\) In
2001, the amount of the basic standard deduction for unmarried (single)
taxpayers was $4,550 while the basic standard deduction for married
taxpayers filing a joint return was $7,600.\(^{108}\) Because the basic standard
deduction for married taxpayers filing a joint return ($7,600) was less
than two-times the basic standard deduction of an unmarried taxpayer
(i.e., less than $9,100, $4,550 \times 2 = $9,100), there was a perceived
marriage penalty\(^{109}\) with respect to the deductions because married
taxpayers filing joint returns were not able to deduct two times the
deduction available to unmarried taxpayers.\(^{110}\) To address this perceived
marriage penalty, EGTRRA gradually increased the basic standard
deduction of married taxpayers filing joint returns to two times the basic
standard deduction of unmarried taxpayers effective 2005.\(^{111}\) The effect
of the increase is an overall reduction of the regular tax liability of the
benefited taxpayers. However, in the absence of a similar reduction in
the AMT system, this tax benefit, coupled with others, would cause
many taxpayers to be subject to the AMT.

\(^{107}\) I.R.C. § 63(c) and (d) (2007).
\(^{108}\) I.R.C. § 63(c)(2) and (4) (2001).
\(^{109}\) Robert S. McIntyre & Michael J. McIntyre, Fixing The "Marriage Penalty" Problem, 33
VAL. U. L. REV. 907, 915 (1999); See also Lawrence Zelenak, Doing Something About Marriage
\(^{110}\) Zelenak, supra note 109, at 1-4.
\(^{111}\) See EGTRRA, supra note 69, § 301(a). The increase in the basic standard deduction is
accomplished by gradually multiplying the basic standard deduction of an unmarried taxpayer by
the following percentages beginning 2005 and ending 2009:

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>174</td>
</tr>
<tr>
<td>2006</td>
<td>184</td>
</tr>
<tr>
<td>2007</td>
<td>187</td>
</tr>
<tr>
<td>2008</td>
<td>190</td>
</tr>
<tr>
<td>2009 and thereafter</td>
<td>200</td>
</tr>
</tbody>
</table>
C. The Jobs and Growth Tax Relief Reconciliation Act of 2003

1. In General

Congress passed the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) to accelerate the implementation of a number of Bush's tax cut provisions enacted as part of EGTRRA. The result of such acceleration is that taxpayers would experience an immediate decrease in their regular federal income tax liability without a corresponding decrease in their AMT liability. The main features of JGTRRA are as follows.

2. Acceleration of the Child Care Tax Credit

One of the highlights of EGTRRA is its increase of the individual child care tax credit from $500 to $1,000 over a ten-year period. To accelerate the benefits of the child tax credit, JGTRRA increased the child care tax credit from $600 to $1,000 for the taxable years 2003 and 2004 only. After 2004, the child care tax credit reverted back to the pre-JGTRRA scheduled gradual increase of $700 for the years 2005 through 2008, $800 for the year 2009, and $1,000 for the year 2010.

3. Expansion of the 15% Tax Rate Bracket for Married Taxpayers

In general, an individual calculates his or her tax liability by multiplying taxable income by the tax rates provided under I.R.C. § 1. The tax rates are graduated, which means that as an individual's taxable income increases over a certain threshold or bracket, the applicable marginal tax rate increases as well. The marginal tax rate increases are also governed by a taxpayer's filing status. For example, an
unmarried taxpayer’s marginal tax rate brackets are different than those of a married taxpayer filing a joint return or a head-of-household.\textsuperscript{121}

However, because the tax rate bracket differentials for a married taxpayer filing a joint return were not twice the rates of an unmarried taxpayer, there was a perceived marriage penalty with respect to the implementation of the tax rate brackets.\textsuperscript{122} Accordingly, EGTRRA sought to correct this perceived marriage penalty by gradually increasing the size of 15\% tax rate bracket differential between a married taxpayer filing a joint return and an unmarried taxpayer by multiplying the tax rate brackets of an unmarried taxpayer by the percentages provided below until the tax rate bracket of a married taxpayer filing a joint return amounted to twice that of an unmarried taxpayer by the year 2010.\textsuperscript{123}

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Applicable Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>180%</td>
</tr>
<tr>
<td>2006</td>
<td>187%</td>
</tr>
<tr>
<td>2007</td>
<td>193%</td>
</tr>
<tr>
<td>2008-2010</td>
<td>200%</td>
</tr>
</tbody>
</table>

Rather than wait until 2010 before the tax rate bracket of a married taxpayer filing a joint return becomes twice that of an unmarried taxpayer, JGTRRA increased the size of the 15\% tax rate bracket of a married taxpayer filing a joint return to twice that of an unmarried taxpayer for taxable years 2003 and 2004 only.\textsuperscript{124} Accordingly, after 2004, the 15\% tax rate bracket of a married taxpayer filing a joint tax return would revert to the EGTRRA scheduled gradual phase-in of 180\% of the amount for an unmarried taxpayer in 2005, 187\% of the amount for an unmarried taxpayer in 2006, 193\% of the amount for an unmarried taxpayer in 2007, and 200\% of the amount for an unmarried taxpayer in 2008 through 2010.\textsuperscript{125}

4. Acceleration of the Basic Standard Deduction Marriage Penalty Relief

As previously discussed, taxpayers are allowed a basic standard deduction (or itemized deductions if higher) in computing their taxable

\textsuperscript{121} See I.R.C. § 1(a), (b), (c) (2007).
\textsuperscript{122} See McIntyre, supra note 10909, at 915; See also Zelenak, supra note 109, at 1-4.
\textsuperscript{123} EGTRRA, supra note 69, § 302.
\textsuperscript{124} See JGTRRA, supra note 70, § 102(a).
\textsuperscript{125} See id.
Because the basic standard deduction of a married taxpayer filing a joint return was less than twice the basic standard deduction of two unmarried taxpayers, there was a perceived marriage penalty with respect to the availability of the basic standard deduction to married couples because the married couple would have had a higher combined basic standard deductions had they been two unmarried taxpayers. To rectify this perceived marriage penalty, EGTRRA gradually increased the basic standard deduction of married taxpayers filing a joint return by certain percentages until the deduction equaled twice the amount available to an unmarried taxpayer by 2010.

Rather than wait until 2009 before the basic standard deduction of a married taxpayer filing a joint return becomes twice that of an unmarried taxpayer, JGTRRA accelerated the increase by making the basic standard deduction of a married taxpayer filing a joint return twice the amount available to an unmarried taxpayer for taxable years 2003 and 2004 only. Thus, after 2004, the basic standard deduction of a married taxpayer filing a joint return reverted to the pre-JGTRRA levels of 174% times the basic standard deduction amount of an unmarried taxpayer in 2005, 184% times the basic standard deduction amount of an unmarried taxpayer in 2006, 187% times the basic standard deduction amount of an unmarried taxpayer in 2007, 190% times the basic standard deduction amount of an unmarried taxpayer in 2008, and 200% times the basic standard deduction amount of an unmarried taxpayer in 2009 and thereafter.

5. Acceleration of the Expansion of the 10% Individual Tax Rate Bracket

As previously discussed, EGTRRA created a new 10% tax rate bracket that applied to the first $6,000 of taxable income of an unmarried taxpayer, the first $10,000 of the taxable income of a head-of-household, and the first $12,000 of the taxable income of a married taxpayer filing a joint return. Beginning in 2008, EGTRRA increased the taxable income bracket amount of unmarried taxpayers from $6,000 to $7,000, and the taxable income bracket amount of married taxpayers
filing a joint return from $12,000 to $14,000. Under JGTRRA, the increased taxable income bracket thresholds scheduled to be phased-in beginning 2008 were accelerated and made available to taxpayers in 2003 and 2004. Thus, for taxable years 2003 and 2004, unmarried taxpayers would be taxed at the 10% tax rate bracket on their first $7,000 of taxable income while married taxpayers filing a joint return would be taxed at 10 percent on their first $14,000 of taxable income. As with other JGTRRA provisions, the taxable income bracket levels would revert to their pre-JGTRRA thresholds after 2004.

6. Acceleration of the Reduction in the Individual Marginal Tax Rates

As previously stated, one of the main features of EGTRRA was its reduction of the individual marginal federal income tax rates. Prior to EGTRRA, the individual federal income tax rates were 15%, 28%, 31%, 36%, and 39.6%. EGTRRA retained the 15% tax rate bracket, but created a new 10% tax rate and gradually reduced the remaining tax rates to 25%, 28%, 33%, and 35%, respectively, beginning 2001 through 2006. Under JGTRRA, the new reduced tax rate structure over the 15% tax rate (of 25%, 28%, 33%, and 35%) that was scheduled to be fully phased-in by 2006 was accelerated to commence in 2003.

7. Increased Expensing in Lieu of Depreciation Deduction

In general, under I.R.C. §179, a taxpayer is allowed to deduct, as a current expense, up to $25,000 of the cost of qualified property placed in service during the taxable year. The $25,000 limit is, however, reduced (but not below zero) by the amount by which the cost of the qualifying property placed in service during the taxable year exceeds $200,000. Under JGTRRA, the maximum expense limit was increased from $25,000 to $100,000 while the limitation on the cost of

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132. Id. § 101(a)(i)(1)(B).
133. JGTRRA, supra note 70, § 104(a).
134. See id.
135. See id.
136. See ETGRRA, supra note 69, § 101.
137. I.R.C. § 1 (2000); see ETGRRA, supra note 69, § 101(a)(2).
138. ETGRRA, supra note 69, § 101(a)(2).
139. JGTRRA, supra note 70, § 105(a). “2003 and thereafter ... 25.0% 28.0% 33.0% 35.0%.”
qualifying property was increased from $200,000 to $400,000.\textsuperscript{142} The result of these increases in the amount that taxpayers are allowed to expense in a given year is an overall reduction in taxable income, which culminates in an overall lower regular federal income tax liability. However, because JGTRRA did not make a similar reduction in the AMT system, the benefited taxpayers would be pushed into the AMT system.

8. Reduction of Capital Gains Tax Rate for Individuals

Prior to JGTRRA, the maximum tax rates on adjusted net capital gains of an individual were 10\% and 20\%, respectively.\textsuperscript{143} JGTRRA reduced the 10\% tax rate on adjusted net capital gains to 5\% (0\% in the case of taxable years beginning January 1, 2008) and the 20\% tax rate to 15\%.\textsuperscript{144} Because the new capital gains tax rates applied to assets held for more than one year, JGTRRA repealed the previous 5-year holding period requirement.\textsuperscript{145} The result of these reductions is an overall decrease in the regular federal income tax liability of benefited taxpayers. In the absence of a similar reduction under the AMT system, the benefited taxpayers would likely be subject to the AMT.

9. Taxation of Dividends Received at Capital Gains Rate

Prior to JGTRRA, qualified dividends\textsuperscript{146} received by an individual were included in gross income and taxed at ordinary income tax rates.\textsuperscript{147} With the advent of JGTRRA, qualified dividend income received by an individual was taxed at the same rates that applied to net capital gains of 5\% and 15\% respectively.\textsuperscript{148}

D. Working Families Tax Relief Act of 2004

1. Overview

As the foregoing discussion reveals, Congress enacted EGTRRA to
provide individual taxpayers with substantial tax cuts that were gradually implemented over a 10-year period beginning in 2001 and ending December 31, 2010.149 Because the full benefits of EGTRRA tax cuts would not be enjoyed by taxpayers until 2010, Congress enacted JGTRRA in 2003 to accelerate the availability of the full benefits of some of the EGTRRA tax cuts to individual taxpayers for the years 2003 and 2004 only by allowing the tax cuts to revert to their EGTRRA gradual phase-in implementation schedule after 2004.150 Given that JGTRRA’s acceleration of EGTRRA tax cuts was scheduled to expire after 2004, Congress enacted the Working Families Tax Relief Act of 2004 (WFTRA) to extend JGTRRA’s acceleration of EGTRRA tax cuts beyond 2004 to 2009.151 Below are the relevant provisions of WFTRA.

2. Repeal of Gradual Phase-in of $1,000 Child Care Tax Credit

As noted previously, JGTRRA made the child care tax credit of $1,000 available to taxpayers effective for 2003 and 2004 only.152 After 2004, the child care tax credit reverted to the EGTRRA reduced gradual phase-in of $700 per child in 2005 through 2008, $800 per child in 2009, and $1,000 per child in 2010.153 With the enactment of WFTRA in 2004, Congress extended the child care tax credit of $1,000 to all years after 2004 by repealing the provision reverting the credits to the lower EGTRRA gradual phase-in schedule after 2004.154

3. Repeal of Scheduled Reduction in Basic Standard Deduction of Married Taxpayers

The basic standard deduction amount for married taxpayers filing a joint return was increased to two times (double) the basic standard deduction of unmarried taxpayers under JGTRRA for the years 2003 and 2004 only.155 Thereafter, the deductions reverted to the gradual phase-in schedule of EGTRRA.156 WFTRA repealed the 2004 sunset of the double basic standard deduction for married taxpayers filing a joint return by extending the double deduction beyond 2004 to 2009.157

149. See generally EGTRRA, supra note 69, § 101.
150. See generally JGTRRA, supra note 70.
151. WFTRA, supra note 71, §§ 101-103.
152. JGTRRA, supra note 70, § 101(a).
153. EGTRRA, supra note 69, § 201(a).
154. WFTRA, supra note 71, § 101(a).
155. JGTRRA, supra note 70, § 103(a).
156. See id.
157. WFTRA, supra note 71, § 101(b).
Accordingly, the basic standard deduction of married taxpayers filing a joint tax return is two times the basic standard deduction of unmarried taxpayers for the years 2005-2010.\textsuperscript{158}

4. Marriage Penalty Relief in the 15-percent Income Tax Bracket

As previously discussed, EGTRRA gradually increased the size of the 15\% federal income tax bracket for married taxpayers filing joint returns to two times the size of the tax rate bracket of unmarried taxpayers.\textsuperscript{159} Because the full benefit of these increases was implemented gradually beginning in 2005, Congress enacted JGTRRA to make the increase effective for tax years 2003 and 2004 only.\textsuperscript{160} Under WFTRA, Congress extended the size of the 15\% federal income tax rate bracket for married taxpayers filing a joint return to two times the size of the bracket of unmarried taxpayers for taxable years 2005 through 2007.\textsuperscript{161} With this increase, the size of the 15\% tax rate bracket for married taxpayers filing a joint return would be twice the size of the bracket of unmarried taxpayers for the years 2005-2010.\textsuperscript{162}

5. Extension of the Size of the 10\% Tax Rate Bracket

EGTRRA created a new 10\% tax rate bracket that applied to the first $6,000 of taxable income of unmarried individuals, the first $10,000 of taxable income of heads-of-households, and the first $12,000 of taxable income of married taxpayers filing joint returns.\textsuperscript{163} Beginning in 2008, EGTRRA increased the $6,000 limit to $7,000, for unmarried taxpayers, and the $12,000 limit to $14,000, with respect to married taxpayers filing a joint return.\textsuperscript{164} JGTRRA, however, accelerated to 2003 and 2004, the $7,000 and $14,000 limits that were originally scheduled to be phased-in beginning in 2008.\textsuperscript{165} Under WFTRA, these increased limits were further extended from 2005 through 2007.\textsuperscript{166}

\textsuperscript{158} Id.
\textsuperscript{159} EGTRRA, supra note 69, § 302(a). The gradual increase is from 2005 to 2008. For years 2008 and thereafter, the size of the 15\% rate bracket for married taxpayers filing a joint return is double the size of the rate bracket for unmarried taxpayers.
\textsuperscript{160} See JGTRRA, supra note 70, § 102(a).
\textsuperscript{161} WFTRA, supra note 71, § 101(c).
\textsuperscript{162} Id. See also EGTRRA, supra note 69, § 302(a). Under this provision, the size of the 15\% tax rate bracket for married taxpayers filing a joint return was made twice the size of unmarried taxpayers beginning 2008 and thereafter, but the law sunsets after December 31, 2010. Id. § 901(b).
\textsuperscript{163} Id. § 101(a).
\textsuperscript{164} Id.
\textsuperscript{165} JGTRRA, supra note 70, § 104(a).
\textsuperscript{166} WFTRA, supra note 71, § 101(d)(1).
result of this extension is that the increased $7,000 and $14,000 limits would be available to taxpayers through 2010.\footnote{167}

E. Effect of the Bush Tax Cuts on the Number of Individuals Subject to the AMT

1. Overview

As the foregoing discussion reveals, the premise of the Bush tax cuts was to reduce the individual marginal tax rates under the regular federal income tax system. In general, such reduction should produce an overall reduction in federal income tax liability of individuals. However, because taxpayers are required to calculate their federal income tax liability under both the regular tax system and the AMT system and pay the higher of the two, a reduction in the individual tax rates of the regular federal income tax system without a corresponding reduction in the tax rates of the AMT system has the effect of pushing taxpayers (whose regular income tax rates have been reduced) into the AMT system. Rather than seek a permanent solution to the problem, Congress resorted, instead, to mechanical band-aid solution that involves yearly temporary increases in the AMT exemption amounts.

2. Temporary Increases in AMT Exemption – A Band-Aid Fix

When calculating AMT liability, a taxpayer is allowed an exemption depending on his or her filing status.\footnote{168} Prior to EGTRRA, the AMT exemption amounts were $33,750 for unmarried taxpayers and $45,000 for surviving spouse and married taxpayers filing a joint tax return.\footnote{169} EGTRRA increased the AMT exemption amounts from $45,000 to $49,000 for married taxpayers filing a joint return and surviving spouse, and from $33,750 to $35,750 for unmarried taxpayers.\footnote{170} Because these increases were only effective for taxable years 2001 through 2004,\footnote{171} the AMT exemption amounts reverted to the pre-EGTRRA levels after 2004.\footnote{172} Realizing that these temporary increases may not have been sufficient to mitigate the increasing number

\footnote{167. JGTRRA, supra note 70, § 104(a). See also EGTRRA, supra note 69, § 101(a).}
\footnote{168. See I.R.C. § 55(d)(1) (2007) providing for varying exemption amounts depending on whether the taxpayer is married filing a joint return, a surviving spouse, or unmarried.}
\footnote{169. I.R.C. § 55(d)(1) (2000).}
\footnote{170. EGTRRA, supra note 77, § 701(a).}
\footnote{171. Id.}
\footnote{172. Id.}
of taxpayers subject to the AMT, Congress increased the AMT exemption amounts under JGTRRA to $58,000 for married taxpayers filing a joint return and surviving spouses, and $40,250 for unmarried taxpayers.\footnote{JGTRRA, supra note 78, § 106(a).} These new increases were effective for taxable years 2003 and 2004 only.\footnote{I.R.C. § 55(d)(1) (2007); see JGTRRA, supra note 78, § 106(a).} Accordingly, after 2004, the AMT exemption amounts reverted to the pre-EGTRRA levels of $45,000 for surviving spouses and married taxpayers filing joint returns, and $33,750 for unmarried taxpayers.\footnote{See I.R.C. § 55(d)(1)(2007).}

For the year 2005, Congress voted to extend, for one year only, JGTRRA AMT exemption amount increases.\footnote{See WFTRA, supra note 79, § 103.} Accordingly, in 2005, the AMT exemption amounts remained at $58,000 for married taxpayers filing a joint return and surviving spouses, and $40,250 for unmarried taxpayers.\footnote{Id.} Because these temporary increases were essentially mechanical band-aid patches as opposed to real permanent solutions, the number of taxpayers subject to the AMT continued to climb, particularly among middle and upper middle class taxpayers.\footnote{See Michael Parisi & Scott Hollenbeck, Individual Income Tax Returns, 2003 I.R.S. STATISTICS OF INCOME BULLETIN, available at http://www.irs.gov/pub/irs-soi/03indtr.pdf. “For the second year in a row, the alternative minimum tax increased. For 2003, the increase was by $2.6 billion, or 38.2 percent, to almost $9.5 billion. The increase in AMT occurred even though the AMT exemption was raised as part of JGTRRA ...” Id.}

Consequently, in 2006, Congress embarked on yet another temporary increase in the AMT exemption amounts aimed at mitigating the number of taxpayers subject to the AMT.\footnote{See Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No 109-222, 120 Stat 345, § 301 (2006) [hereinafter called “TIPRA”]. See also Esenwein, supra note 68.} But this time, Congress increased the AMT exemption amounts, effective for 2006 only, from $58,000 to $62,550 for married taxpayers filing joint returns and surviving spouses, and from $40,250 to $42,500, for unmarried taxpayers.\footnote{TIPRA, supra note 179, § 301.} Thus, unless Congress acts again, the AMT exemption amounts would revert to the pre-EGTRRA levels of $45,000 for married taxpayers filing joint returns and $33,750 for unmarried taxpayers.\footnote{See I.R.C. § 55(d)(1) (2007) for the pre-EGTRRA levels of AMT exemption amounts.} As the example below illustrates, such reversion would subject a substantial number of middle and upper middle class taxpayers to the AMT.
3. Example Illustrating the Effect of Bush Tax Cuts on the Number of Taxpayers Subject to the AMT if Congress Allows AMT Exemption Amount Increases to Lapse without Retention or Further Increases.

Assume that Henry and Winnie, both schools teachers, are married and live with their four children in Port Arthur, Texas. Assume that the couple’s total income for 2007 is $80,000. With the Bush tax cuts, Henry and Winnie would enjoy a reduced regular federal income tax liability. However, because the AMT temporary exemption amounts sunset in 2007 unless Congress grants an extension, Henry and Winnie would be subject to AMT liability of $2,547.50 before any applicable credits as follows:

**Calculation of Henry and Winnie’s Regular Tax Liability For 2007**

<table>
<thead>
<tr>
<th>Gross Income</th>
<th>$80,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less Deduction:</td>
<td></td>
</tr>
<tr>
<td>Six Personal Exemptions</td>
<td></td>
</tr>
<tr>
<td>6 x $3,400</td>
<td>$20,400</td>
</tr>
<tr>
<td>Standard Deduction</td>
<td>$10,700</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$48,900</td>
</tr>
<tr>
<td>Tax Rates:</td>
<td></td>
</tr>
<tr>
<td>$15,650 x 10%</td>
<td>$1,565</td>
</tr>
<tr>
<td>$33,250 x 15%</td>
<td>$4,987.50</td>
</tr>
<tr>
<td>Regular federal income tax liability</td>
<td>$6,552.50</td>
</tr>
</tbody>
</table>

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182. See I.R.C. § 151(a), (b), and (d) (2007) (dealing with the allowance of personal exemptions for taxpayer, spouse, and dependents). The personal exemption amount for 2007 is $3,400 for each individual.


185. Id.
Calculation of Henry and Winnie’s AMT Liability

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable income</td>
<td>$48,900</td>
</tr>
<tr>
<td>Add Back Adjustments</td>
<td></td>
</tr>
<tr>
<td>Personal exemptions...</td>
<td>$20,400</td>
</tr>
<tr>
<td>Standard deduction...</td>
<td>$10,700</td>
</tr>
<tr>
<td>AMT</td>
<td>$80,000</td>
</tr>
<tr>
<td>Less: 2007 AMT exemption</td>
<td>$45,000</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$35,000</td>
</tr>
<tr>
<td>AMT Rate: 26%</td>
<td></td>
</tr>
<tr>
<td>Tentative minimum tax</td>
<td>$9,100</td>
</tr>
<tr>
<td>AMT liability $9,100 - $6,552.5</td>
<td>$2,547.50</td>
</tr>
</tbody>
</table>

As the above example illustrates, at a combined gross income of only $80,000, Henry and Winnie had a regular federal income tax liability of only $6,552.50 but a tentative minimum tax liability of $9,100. Because the tentative minimum tax liability was greater than the regular federal income tax liability, Henry and Winnie would be subject to an AMT liability of $2,547.50 ($9,100 - $6,552.50) before any applicable tax credits. As this example illustrates, even though the Bush tax cuts lowered Henry and Winnie’s overall regular federal income tax liability to only $6,552.50, the couple are still subject to an additional AMT liability of $2,547 because the Bush tax cuts did not make a corresponding reduction in the tax rates of the AMT system and Congress has not yet extended the AMT temporary exemption amount increases that it had used in the past to mitigate the number of taxpayers subject to the AMT. 193

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186. Taxable income is the same taxable income amount derived from calculating the couple’s regular federal income tax liability.
193. On November 9, 2007, the House of Representatives voted 216-193 to pass a temporary AMT relief that would extend the AMT exemptions for one more year to 2008. According to reports, not a single House Republican voted for the measure because they were opposed to a provision in the Bill requiring the relief to be paid for with a tax increase. In addition to facing an uncertain future in the Senate, the White House has threatened to veto the Bill. See Tax Analysts.
F. Effect of Lack of Indexation on the Number of Individuals Subject to the AMT

Apart from the Bush tax cuts, another principal cause of the rise in the number of individuals subject to the AMT is the failure of Congress to index the AMT parameters for inflation as it does the parameters of the regular federal income tax system. In general, employers award employees cost-of-living pay increases to mitigate the effects of inflation on their real incomes and purchasing power. Because these cost-of-living pay increases could have the unintended consequence of pushing taxpayers from a lower tax bracket to a higher tax bracket, Congress mandated that a number of the provisions of the regular federal income tax system be adjusted annually for inflation to combat this unintended effect.

Regrettably, however, Congress failed to mandate any similar indexation in the parameters of the AMT system. Consequently, a mere cost-of-living pay increase could have the unintended effect of causing a taxpayer to be subject to the AMT even though the taxpayer did not receive any real increase in his or her purchasing power. Accordingly, unless Congress adjusts the AMT parameters to keep up with inflation, the lack of indexation of the AMT parameters would continue to be a significant cause of the rise in the number of individuals subject to the AMT.

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TM, AMT Patch with Extenders Passes House, 2007 TNT 219-H (November 13, 2007). If Congress extends the 2006 AMT exemption amount of $62,550 to 2007, Henry and Winnie will not be subject to the AMT.

194. See Joint Committee on Taxation Report, Present Law and Background Relating to the Individual Alternative Minimum Tax 110 (Comm. Print 2007). The committee report contends that "the number of taxpayers affected by the AMT continues to rise through 2010 as a result of the fact that the AMT exemption levels are not indexed for inflation while the regular income tax is indexed for inflation." Id.

195. See, e.g., I.R.C. § 1(f) (2007) "adjustments in tax tables so that inflation will not result in tax increases. (1) In general. (2) Not later than December 15 of 1993, and each subsequent calendar year, the Secretary shall prescribe tables which shall apply in lieu of the tables contained in subsections (a), (b), (c), (d), or (e) with respect to taxable years beginning in the succeeding calendar year." Id. See also id. § 151(d)(4) (prescribing "[i]nflation adjustments" for the personal exemption deduction); see also id. § 63(c)(4) (dealing with "[a]djustments for inflation" of the basic standard deduction).
VI. PROPOSED PERMANENT SOLUTIONS TO REMEDY THE AMT PROBLEM

A. Exempt Taxpayers with AGI of $250,000 or Less from the AMT

As stated previously, the AMT was enacted over three decades ago to ensure that wealthy individuals pay at least some tax.\footnote{See GENERAL EXPLANATION OF THE REVENUE PROVISIONS, supra note 3.} Due to its poor design, the AMT has not only failed to fulfill its policy objective, (of ensuring that wealthy individuals do not escape paying any federal income tax) but has also lost its purpose by increasingly subjecting millions of middle and upper middle class taxpayers to the AMT — a purpose that was not intended by Congress when it enacted the AMT. Given that the major pitfall of the AMT is its increasing proliferation into the unintended returns of middle and upper middle class taxpayers, a permanent remedy to this unintended spread should be to exempt taxpayers with AGI of $250,000 or less from the AMT altogether. The implementation of such exemption would help align the AMT closer to its original purpose and policy objective of ensuring that wealthy individuals (not middle and upper middle class taxpayers) would be subject to the AMT.

Over the years, Congress has been mitigating the mushrooming of the AMT into the returns of middle and upper middle class taxpayers by temporarily increasing the AMT exemption amounts year after year.\footnote{See EGTRRA, supra note 69, § 701(a) (raising the AMT exemption amounts to: $49,000 for married taxpayers filing a joint return and surviving spouses, $35,750 for unmarried taxpayers); JGTRRA, supra note 70, § 106(a) (increasing the exemptions to: $58,000 for married taxpayers filing a joint return and surviving spouses, $40,250 for unmarried taxpayers).} The most recent increase was in 2006, when Congress raised the AMT exemption amount from $58,000 to $62,250 for married taxpayers filing a joint return and surviving spouses, under the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).\footnote{See TIPRA, supra note 179, § 301. TIPRA also increased the AMT exemption amount for unmarried taxpayers to $42,500 for the year 2006 only.} Because the increase is for the year 2006 only, the AMT exemption amounts would revert to their 2000 levels unless Congress acts further.\footnote{See I.R.C. § 55(d)(1) (2007). These levels are: $45,000 for married taxpayers filing joint returns and surviving spouse, $33,750 for unmarried taxpayers.} Even if Congress increases or extends the current AMT exemption amounts, a solution involving temporary yearly increase of the AMT exemption amounts is profoundly inferior to the proposed permanent exemption of individuals with AGI of $250,000 or less from the AMT for a number of reasons.
First, the current AMT exemption amount increases are temporary only while the proposed exemption of individuals with AGI of $250,000 or less from the AMT is permanent. Second, under the current temporary increases of the AMT exemption amounts, taxpayers are still required to go through the complex and cumbersome process of calculating their AMT liability before getting the benefit of the increased exemption amounts whereas, under the proposed permanent exemption of individuals with AGIs of up to $250,000, no taxpayer with AGI of $250,000 or less would be required to even prepare an AMT return of any kind. Such an exemption from the process of calculating the complex AMT liability would be a tremendous relief to taxpayers and would help restore integrity in our voluntary self-assessment system.  

B. Index the AMT Parameters for Inflation

In the event that Congress is not inclined to exempt taxpayers with AGI of $250,000 or less from the AMT, one other way to mitigate the number of taxpayers subject to the AMT is to index the AMT parameters for inflation. As previously discussed, one of the major flaws of the AMT is that it is not indexed for inflation. Indexing would require the AMT brackets and exemption amounts to be adjusted upward yearly to offset the effects of inflation.

C. Allow Standard or Itemized Deductions and Personal Exemption Deductions for AMT Purposes

One of the flaws of the AMT system that is causing it to creep into the tax returns of unintended middle and upper middle class taxpayers is its disallowance of the basic standard deduction and the personal or dependency exemptions in calculating the AMT liability. In general, a taxpayer is allowed to deduct the higher of the basic standard deduction or itemized deductions in determining regular federal tax. See Aitsebaomo, supra note 58, at 359.

201. See Aitsebaomo, supra note 58, at 359.
202. Id. at 359 (contending that the complexities of the AMT have eroded confidence in our voluntary self-assessment system).
203. Congress may be unwilling to exempt taxpayers with AGI of $250,000 or less from the AMT because of the amount of revenue it would lose from such exemption but the reality is that the AMT was not enacted to be a revenue generating tax. See General Explanation of the Revenue Provisions, supra note 3. Instead, it was enacted to ensure wealthy taxpayers pay at least a minimum tax. Id.
income tax liability. Likewise, taxpayers are allowed a personal exemption deduction\textsuperscript{207} in calculating regular federal income tax liability.\textsuperscript{208} For AMT purposes, however, these deductions are completely disallowed\textsuperscript{209} with the result that taxpayers (mostly middle and upper middle class taxpayers) are pushed into the AMT system because the disallowances have the effect of broadening their AMT base (whereas the regular taxable income base is contracted by the allowance of the deductions).\textsuperscript{210} Accordingly, Congress should mitigate the number of the unintended individuals subject to the AMT by repealing the limitations on itemized deductions as well as allowing the deduction of the personal and dependent exemptions in calculating the AMT liability.\textsuperscript{211}

D. Repeal the AMT

As the discussion in this paper illustrates, Congress enacted the AMT with the overriding policy consideration of ensuring that no individual with substantial economic income can avoid paying any federal income tax by utilizing various deductions and exclusions. The reality is that the AMT has neither fulfilled its objective nor its purpose. Rather, it has become a de facto ATM machine for generating additional tax revenue from middle and upper middle class taxpayers – a purpose not intended by Congress. Apart from that, the calculation of the AMT is cumbersome, complex and poses an unnecessary strain on our voluntary self assessment system of tax compliance.\textsuperscript{212} Consequently, Congress should repeal the AMT.\textsuperscript{213}

VII. CONCLUSION

This article reveals that the AMT has lost its purpose. The principal reasons why the AMT has been infiltrating more and more into the returns of unintended middle and upper class taxpayers are the Bush tax cuts and the fact that the AMT parameters are not indexed for inflation. Rather than seek a permanent solution to the problem, Congress has opted instead, to use yearly temporary AMT exemption

\textsuperscript{207} I.R.C. § 151(a), (b), (d) (2007).
\textsuperscript{208} I.R.C. § 151(a) (2007).
\textsuperscript{209} See I.R.C. § 56(b)(1)(A) (2007) ("No deduction shall be allowed.").
\textsuperscript{211} The effect of such repeal would help contract or reduce the AMT as opposed to broadening it.
\textsuperscript{212} Aitsebaomo, supra note 58, at 359.
\textsuperscript{213} See id. at 363 (arguing that the AMT should be repealed).
amount increases to mitigate the increasing number of taxpayers subject to the AMT. To align the AMT with its original purpose and policy objective, Congress should exempt from the AMT altogether, taxpayers with AGI of $250,000 or less. This exemption approach would not only permanently eliminate middle and upper middle class taxpayers from the AMT but would also spare them from the burden and complexities of having to calculate the AMT in the first place.