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Options to Fix the AMT

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The individual alternative minimum tax (AMT) was originally designed to limit the amount of tax sheltering that taxpayers could pursue and to assure that high-income filers paid at least some tax. The current AMT, however, has strayed far from those original goals. Under current law, the tax will affect over 23 million taxpayers in 2007—many of them solidly middle-class—and mainly for reasons that have little or nothing to do with what most people would consider tax sheltering.

One policy response would be to extend the temporary AMT provisions that expired at the end of 2006. This would keep the number of AMT taxpayers at about 4 million for another year, but it would cost more than $40 billion in 2007 alone and would grow more expensive in subsequent years. For these and other reasons, many policy makers, including House Ways and Means Committee Chairman Charles Rangel, Senate Finance Committee Chairman Max Baucus, and Finance Committee Ranking Member Charles Grassley have proposed permanent reform or repeal of the AMT.

This brief examines a variety of implications of AMT repeal or reform and an array of options for offsetting the revenues lost under such options. It begins with a description of the taxpayers affected by the AMT and an explanation of the dramatic growth projected for the tax as the context for evaluating reform options.[1]

Who is Affected by the AMT?

To understand the options for reforming the AMT, it is important to understand how the tax works and who is affected. Under current law, taxpayers must calculate their income tax liability under two sets of rules. The first are those applying under the regular income tax. Taxpayers add up income from a range of sources (e.g., wages and salaries, interest, dividends, capital gains, alimony, etc.) net of a limited number of above-the-line deductions (such as contributions to IRAs) to calculate adjusted gross income (AGI). They may deduct from AGI personal exemptions for each dependent and either a standard deduction (a fixed dollar amount that depends on filing status) or itemized deductions (the sum of deductions for large medical expenses, mortgage interest, state and local taxes, contributions to charity, and certain other items).[2] Taxpayers then calculate ordinary income tax liability under a progressive tax rate schedule, which currently includes six rates ranging from 10 to 35 percent. Qualifying dividends and long-term capital gains are taxed at lower tax rates than other income, subject to a maximum rate of 15 percent. Most of the income tax parameters are adjusted annually for inflation, meaning that a taxpayer whose income only just keeps up with inflation will not get pushed into higher tax brackets.

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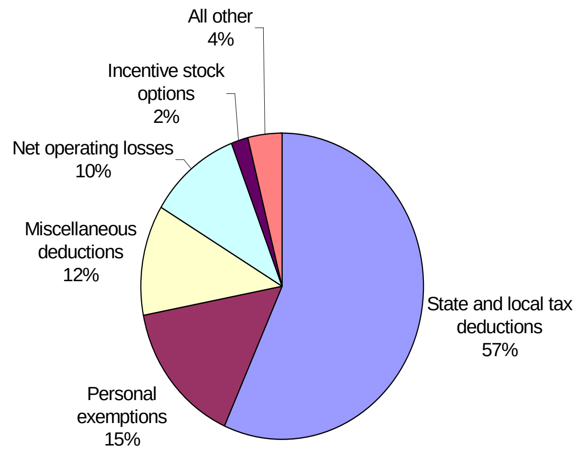
[1] For more background on the AMT, see Burman, Koch and Leiserson (2006); Leiserson and Rohaly (2006); or Burman, Gale and Rohaly (2005). An updated and expanded background paper on the AMT will be released by the Tax Policy Center in 2007 (Burman, et al., forthcoming). All estimates in this paper have been produced by a recently updated version of The Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).

[2] There are many complications under the ordinary income tax, even in the abbreviated description provided here. For example, above-the-line deductions for contributions to IRAs are only available to taxpayers with incomes below certain thresholds unless they lack access to a company retirement plan and itemized deductions and personal exemptions are reduced for taxpayers with high incomes (although the phase-out of itemized deductions and personal exemptions is scheduled to be fully eliminated by 2010).

After calculating regular income tax liability, many taxpayers are supposed to calculate their tax again under the AMT rules. To do this, they add back in certain items, the largest of which are the deduction for state and local taxes, personal exemptions, so-called miscellaneous itemized deductions, net operating losses, and incentive stock options. (See Figure 1.)[3] This broader measure of income is called alternative minimum taxable income (AMTI). Taxpayers may deduct from AMTI a special exemption, $45,000 for couples and $33,750 for singles and heads of household.[4] However, the AMT exemption phases out for taxpayers filing joint returns with AMTI over $150,000 ($112,500 for singles and heads of household). AMTI less any applicable exemption is taxed at two rates—26 percent on the first $175,000 and 28 percent above that amount. As under the regular income tax, capital gains and dividends are subject to lower tax rates. If tax calculated under the AMT rules (called "tentative AMT") is greater than tax before credits calculated under the regular income tax, the difference is payable as AMT.[5] Thus anything that reduces the regular income tax relative to the AMT or that increases the tentative AMT relative to the regular income tax will move taxpayers onto the AMT, and vice versa.

Figure 1. Top 5 AMT Preference Items as Percentage of Positive Preferences and Adjustments, 2004



Source: US Department of the Treasury, Office of Tax Analysis, and author's calculations. For source data, see: http://www.taxpolicycenter.org/TaxFacts/Tfdb/TFTemplate.cfm?DocID=468&Topic2id=30&Topic3id=36.

Box 1 shows the calculation of AMT for a married couple with four children earning $75,000 in 2007. It illustrates how middle-class families with very straightforward tax returns will get ensnared in the AMT if Congress does not act.

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[3] The items that are added back into income are somewhat incongruously called "AMT preference items."

[4] In recent years, the temporary patches enacted by Congress have increased the AMT exemption amount substantially. For 2006, the exemption was $62,550 for couples and $42,500 for single filers and heads of household.

[5] To be exact, the foreign tax credit is calculated before calculating the AMT and incorporated into the comparison between regular tax liability and AMT liability. Most credits, however, are calculated after both regular tax and AMT liability and do not affect the taxpayer's direct AMT liability. Moreover, in recent years, the temporary patches passed by Congress to increase the AMT exemption also allowed the use of personal nonrefundable credits against the AMT. However, since the most recent patch expired at the end of 2006, Congress will need to pass additional legislation to continue the use of the credits in 2007. Other personal credits, such as the Earned Income Tax Credit, were allowed against the AMT by tax law changes included in EGTRRA and will remain in place through 2010. If the credits are not allowed against the AMT liability, the value of the credits to the taxpayer may be reduced by the AMT.

Box 1. Calculating the AMT

A married couple with four children have an income of $75,000 from salaries and interest on their savings account. Under the regular income tax, the family can deduct $20,400 in personal exemptions for themselves and their children. They can also claim a $10,700 standard deduction. For the regular tax, their taxable income of $43,900 places them in the 15 percent tax bracket, and they owe $5,803 in taxes before calculating the AMT or tax credits. Some, but not all, tax credits are allowed against both the AMT and the regular tax in 2007. Most importantly for this family, the child tax credit is allowed against both.

To calculate AMT liability, the couple adds their preference items—personal exemptions of $20,400 and the standard deduction of $10,700—to taxable income and subtracts the married-couple exemption of $45,000, yielding $30,000 in income subject to AMT. That amount is taxed at the first AMT rate of 26 percent, for a tentative AMT liability of $7,800. The AMT equals the difference between the couple's tentative AMT and their regular income tax, or $1,997.

Several points about this example are worth noting. First, the family is on the AMT because they have four children, not because they are rich or aggressive tax shelterers. Second, this tax situation is about as simple as it gets; the family has no deferral preferences, no itemized deductions, no capital gains, no AMT credits from previous years, and no other complicating factors. Third, the couple will receive no long-term benefit from regular tax rate reductions, because their income tax liability is set by the AMT, not the regular income tax. Finally, as long as the AMT is not indexed to inflation, the couple's future tax payments as a share of their income will rise, even if their real (inflation-adjusted) income does not change.

AMT Calculation
Married couple filing jointly with four children, 2007

Calculate Regular Tax		**Calculate Tentative AMT**	
Gross income	$75,000	Taxable income	$43,900
Subtract deductions		*Add preference items*	
Personal exemptions	$20,400	Personal exemptions	$20,400
(6 x $3,400)		Standard deduction	$10,700
Standard deduction	$10,700	**AMTI**	**$75,000**
Taxable income	**$43,900**	*Subtract AMT exemption*	
Tax before credits*	**$5,803**	AMT exemption	$45,000
(Tax bracket)	15%	**Taxable under AMT**	**$30,000**
		Tax (tentative AMT)*	**$7,800**
First $15,650 taxed at 10%			
Next $48,050 taxed at 15%		(AMT bracket)	26%
		First $175,000 taxed at 26%	

AMT = the excess of tentative AMT over regular income tax
AMT = $7,800 - $5,803 = $1,997

* If the children are under age 17 the family could reduce its tax liability by $4,000 because of the child tax credit. This credit is allowed against both the regular income tax and the AMT

Taxpayers with any of several common situations (most of which have little or nothing to do with what is generally thought of as tax sheltering) are more likely than others to find themselves on the AMT:

High State and Local Taxes. State and local taxes are deductible under the regular income tax, but not the AMT. Thus, high state and local taxes reduce regular tax liability relative to AMT, increasing the likelihood that a taxpayer will owe AMT. This helps explain why, in 2004, taxpayers in the New York area, the District of Columbia, and California were most likely to owe AMT. (Burman and Rosenberg, 2006) They not only faced higher than average state and local tax burdens, but they also have higher than average incomes, making them substantially more likely than the average taxpayer to be subject to AMT.

Large Families. Personal exemptions are allowed against the regular income tax, but not the AMT. Taxpayers with large families have many personal exemptions, which significantly reduce their regular income tax liability relative to tentative AMT. In 2006, taxpayers with three or more children were almost four times as likely to owe AMT as those with no children (Table 1).

Marriage. Most married couples pay less tax under the regular income tax than they would if they were single. (That is, most "marriage penalties" have been eliminated and many families receive "marriage bonuses.") This is not true under the AMT. AMT tax rate thresholds are identical for married and single taxpayers. The AMT exemption is only 33 percent larger for couples than for singles (except for those for whom the exemption has been phased out), but under the regular income tax, the standard deduction is twice for couples what it is for singles. As a result of the AMT marriage penalties, the fact that married couples often have children, and the fact that married couples tend to have higher household incomes, married couples are more than five times as likely to owe AMT as singles in 2006. In 2007, when the temporary AMT fix expires, married couples will be 15 times more likely to owe AMT than singles (Table 1).

Standard deduction. Most AMT taxpayers itemize deductions, but for the few who claim the standard deduction, it is worthless under the AMT. Thus it reduces regular tax liability while leaving tentative AMT unaffected.

High medical expenses. Taxpayers may deduct medical expenses in excess of 7.5 percent of AGI under the regular income tax, but the threshold is 10 percent of AGI under the AMT. Thus, taxpayers with both high incomes and high medical expenses can be hit hard by the AMT.

Legal fees for taxable damages. Under the regular tax, filers may deduct legal fees incurred in cases that generate taxable damages, such as punitive damages or damages for nonphysical injuries, as miscellaneous itemized deductions to the extent that they exceed two percent of adjusted gross income. However, miscellaneous deductions are not allowed under the AMT. As a result, a taxpayer with substantial legal fees will have much less taxable income under the regular tax than under the AMT. If the legal fees are quite high relative to the damage award, the taxpayer can actually owe more AMT than her net gain from a lawsuit (Johnston, 2003).

Table 1
AMT Participation Rate (percent) by Individual Characteristics

	Current Law				Current Law Extended[a]	Pre-EGTRRA Law	
Group	**2006**	**2007**	**2010**	**2017**	**2017**	**2007**	**2010**
All Taxpayers[b]	4.0	25.9	33.6	34.7	48.6	10.6	16.0
All Tax Filers	2.8	18.4	24.5	27.8	37.4	8.0	12.4
Tax Filers by Cash Income (thousands of 2006$)[c]							
Less than 30	*	*	*	0.1	0.1	*	*
30-50	*	1.3	3.0	12.2	13.0	1.4	2.9
50-75	0.2	9.0	17.1	30.1	38.8	6.9	13.1
75-100	0.7	36.2	49.9	53.7	67.2	18.1	26.1
100-200	4.8	70.8	80.4	61.7	92.3	23.4	32.0
200-500	50.9	89.7	94.3	77.7	96.8	41.3	54.2
500-1,000	49.3	57.2	72.2	27.0	73.8	22.0	22.6
1,000 and more	31.4	33.8	38.8	20.3	40.1	20.3	19.1
Tax Filers by Number of Children[d]							
0	1.9	11.4	16.8	15.9	28.5	2.4	3.9
1	2.7	24.8	32.4	40.9	48.4	7.1	16.0
2	5.0	34.5	42.0	54.8	56.6	22.2	34.0
3 or more	7.4	39.6	48.4	65.3	64.4	39.8	50.3
Tax Filers By State Tax Level							
High	4.6	21.8	27.7	31.6	40.7	10.9	16.2
Middle	2.3	18.5	25.0	28.3	37.9	7.7	12.0
Low	1.6	15.3	21.1	23.8	33.9	5.7	9.2
Tax Filers by Filing Status							
Single	0.9	2.4	3.8	4.7	10.5	1.1	1.7
Married Filing Joint	5.1	36.7	47.9	49.7	67.2	14.5	22.2
Head of Household	1.3	10.4	17.0	33.1	35.0	8.3	14.5
Married Filing Separate	5.7	34.5	47.4	48.7	62.9	12.8	17.6
Married Couple, 2+ Kids, 75k<Cash Income<100k	0.2	59.1	73.6	92.3	92.8	57.5	74.3
Married Couple, 2+ Kids, 75k<AGI<100k	0.8	78.2	88.6	97.7	97.8	68.8	86.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).
Notes:
Includes returns with AMT liability on Form 6251, with lost credits, and with reduced deductions. Tax Units who are dependents of other tax units are excluded fom the analysis.
* Less than 0.05 percent.
(a) Includes all 2010 sunset provisions in current law.
(b) Taxpayers are defined as returns with positive income tax liability net of refundable credits.
(c) Tax units with negative cash income are excluded from the lowest income class. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm
(d) Number of children is defined as number of exemptions taken for children living at home.

Incentive stock options. The exercise of incentive stock options generally creates income that is immediately taxable under the AMT, but that is not taxable under the regular income tax until the stock is actually sold. Individuals must include in AMTI the excess of the fair market value of the stock over the purchase price of the stock at the date of exercise (JCT 2006). This can cause taxpayers with very modest cash incomes to owe substantial AMT. If the stock is ultimately sold at a profit, the AMT paid earlier can be taken as a credit against the regular income tax owed. But if the stock price falls, the taxpayer can end up with a substantial AMT liability even though no income is ever realized.[6]

Why is the AMT Becoming a "Mass Tax"?

Although the factors described above help explain why individual taxpayers are affected by the AMT, they do not explain the dramatic growth in the AMT. Two factors reduce regular income tax liabilities relative to tentative AMT over time and largely explain the explosive growth in AMT projected through 2010 and beyond.

Inflation: The AMT is not adjusted for inflation whereas the regular income tax is. This means that if an individual's income just keeps pace with inflation each year, his or her regular income tax would remain constant (in real terms) while AMT liability would rise.

The 2001-2006 tax cuts: The Bush tax cuts reduced regular income tax liability while making only minor and temporary changes to the AMT. As a result, regular income tax declined relative to AMT liability, increasing the number of taxpayers subject to the AMT—dramatically. In 2007, the number of taxpayers subject to the AMT will be 23.4 million, more than double the 10.2 million that would have been affected had the tax cuts not been enacted.[7]

Options for Reducing or Eliminating the AMT, with No Other Policy Changes

The preceding discussion suggests a number of ways to reduce the number of taxpayers subject to the AMT. The options differ with respect to (a) which taxpayers (by income level or other characteristics) are removed from the AMT and (b) how much revenue is lost.

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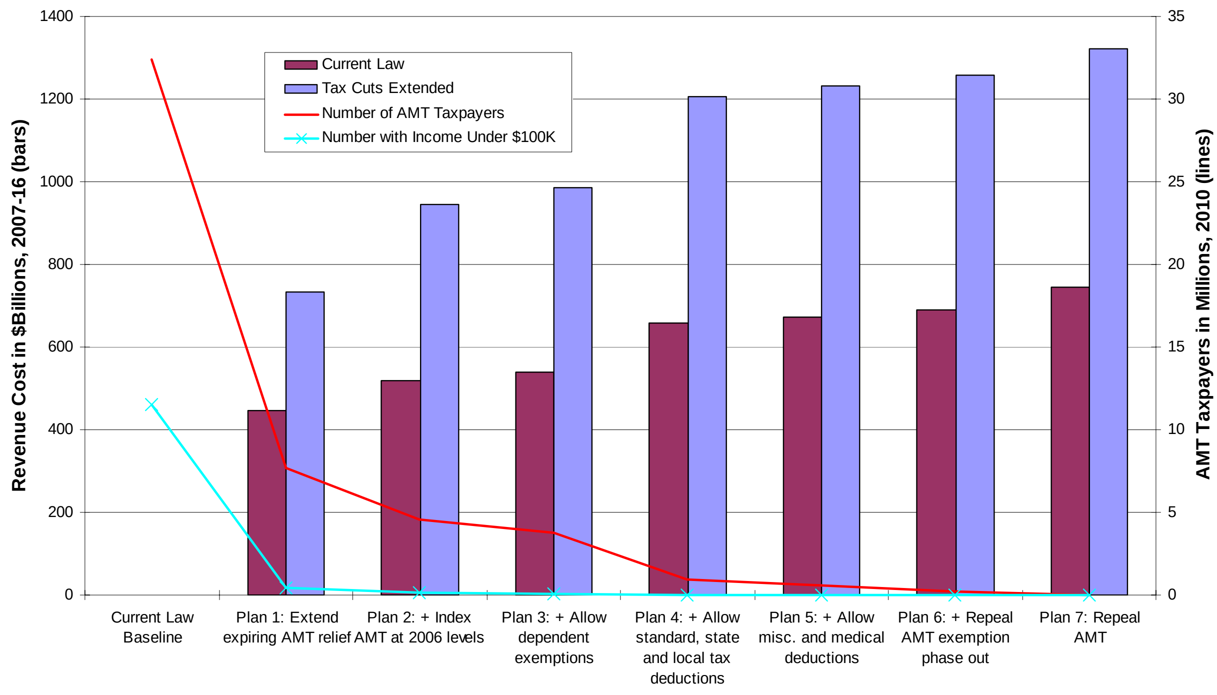
[6] The Tax Relief and Health Care Act of 2006 allows certain taxpayers to claim a refundable credit for 20 percent of their unused long-term alternative minimum tax (AMT) credits (up to $5,000) per year. The refundable credit phases out for high-income taxpayers; the phase-out is based on the personal exemption phase-out. The refundable AMT credits can generally only be claimed for tax years 2007 – 2012 (JCT 2006 and personal communication from Jerry Tempalski).

[7] Real income growth also causes more taxpayers to become subject to the AMT over time because *effective* AMT tax rates are much higher than under the regular income tax for most taxpayers. (See Burman, Gale, and Rohaly 2005 for a discussion.) Thus, the more income that is subject to AMT, the more likely it is that tentative AMT will exceed regular income tax. This is especially a problem for taxpayers in the phase-out range for the AMT exemption who are effectively taxed at rates 25 percent higher than the statutory AMT rate. The 26 percent rate becomes 32.5 percent; the 28 percent rate becomes 35 percent. This explains why almost all taxpayers with incomes between $200,000 and $500,000 are affected by the AMT (see table 1). Real income growth is a minor factor in projected AMT growth compared to the lack of indexation and the impact of the tax cuts, however. The number of taxpayers subject to the AMT would have remained between 300,000 and 400,000 through 2010 if the AMT had been indexed along with the regular income tax in 1985 and if the tax cuts had not been enacted.

Figure 2 shows the 10-year revenue cost of seven incremental options for reducing or eliminating the AMT, under the assumption of both current law as well as extension of the Bush tax cuts. It also shows the impact of the options on the overall number of AMT taxpayers and on the number of AMT taxpayers with incomes less than $100,000.[8]

Figure 2. Impact on Revenue and Number of AMT Taxpayers of Incremental AMT Reform Options



Source: Tax Policy Center

Plan 1. *Extend the temporary increase in the exemption.* This is Congress's traditional approach. Raising the AMT exemption reduces tentative AMT relative to the regular income tax, and reduces the number of taxpayers subject to AMT. In 2007, simply extending the 2006 exemption levels (and the provision allowing AMT taxpayers to claim certain non-refundable tax credits) would reduce the number of AMT taxpayers by 19 million, from 23.4 million to 4.3 million. However, if the AMT exemption is not indexed, the number would then continue to grow over time—to 7.7 million by 2010.

Plan 2. *Extend the exemption increase and index the AMT for inflation.* This would prevent inflation from increasing tentative AMT (in real terms) and conform the AMT treatment with that under the regular income tax.[9] If indexation is applied to rate brackets and the phase-out as

[8] Appendix tables 1 and 2 provide more detailed data on the impact of the plans.
[9] The AMT exemption was increased between 2005 and 2006 as an ad hoc inflation adjustment, but it has never been formally indexed for inflation.

well as the exemption, only 3.6 million taxpayers would be subject to the AMT in 2007, and 4.6 million in 2010. The number increases because of real income growth.

Plan 3. Plan 2 plus *allow dependent exemptions.* This would allow taxpayers to deduct personal exemptions for their children and other dependents against the AMT as they do under the regular income tax. It would cut another 900,000 households from the AMT rolls in 2007 (and about the same number in 2010).

Plan 4. Plan 3 plus *allow standard deduction and state and local tax deduction.* The state and local tax deduction is the single biggest AMT preference item. Allowing the deduction against the AMT would reduce the number of AMT taxpayers to fewer than 1 million throughout the budget period. Since state and local taxes tend to grow with income, this provision would disproportionately benefit the well off (especially if enacted together with the other reforms above, which largely eliminate the AMT for all but the very rich).

Plan 5. Plan 4 plus *allow miscellaneous and medical deductions.* This option would cut the number of AMT taxpayers below 500,000 in 2007. For practical purposes, the AMT would only apply to taxpayers with incomes above $200,000.

Plan 6. Plan 5 plus *eliminate AMT exemption phase-out*. The AMT exemption phase-out creates high effective marginal tax rates and, in combination with the Bush tax cuts, causes virtually all taxpayers with incomes between $200,000 and $500,000 to owe AMT. Eliminating the phase-out would cut the number of AMT taxpayers to about 180,000 per year until 2010, and 140,000 per year after the Bush tax cuts expire.

Plan 7. *Repeal the AMT.* This would (obviously) reduce the number of AMT taxpayers to zero. It would also maximize the revenue loss (see figure 2). To the extent that the AMT actually does deter tax sheltering, this option could also have undesirable side effects. However, the best way to deal with tax shelters would be to build appropriate anti-tax shelter measures into the regular income tax. For example, if expensing of intangible drilling costs and oil depletion allowances are fueling tax shelters, it would make sense to eliminate these tax preferences under the regular income tax—rather than retaining the AMT as a way to do this on a selective basis (applying only to AMT taxpayers). It is also worth noting that the revenue loss estimate for repealing the AMT will be understated to the extent that the AMT is deterring tax shelters. This is another compelling argument for correcting these tax preferences under the regular income tax if the AMT is repealed.

Options for Revenue-Neutral AMT Reform or Repeal

A significant concern is that all of the options above would reduce revenues substantially over the next 10 years (and beyond). Below, we show options to reform or repeal the AMT that are approximately revenue neutral—meaning that they do not significantly increase or decrease revenues over a selected budget horizon. Most of the options are designed to offset revenue losses over the 10-year budget window, but some tables also show the effect of options that would be revenue neutral in 2016. This distinction is important because it is possible for an option to be revenue neutral over the 10-year period, but to be very expensive in the long-term.

In contrast, options that are revenue-neutral in 2016 and are extended into the future are more likely to be revenue-neutral in the longer-term as well.

Importantly, all of the options assume that the Bush tax cuts expire as scheduled at the end of 2010. If the Bush tax cuts for the regular income tax were extended, each of the options would generally lose (substantial amounts of) revenue over the budget window and (many) more people would be subject to the AMT after 2010.

Box 2. JCT Revenue Estimates will Likely Differ

Congress's Joint Committee on Taxation (JCT) will score any actual legislation proposing to repeal or reform the AMT. JCT's estimates will likely differ from the ones presented here for several reasons. First, the JCT estimates will be in terms of the new budget baseline that will be prepared by the Congressional Budget Office at the end of January. It will incorporate new economic projections and another year in the 10-year window, 2017. The new economic projections are not likely to be markedly different, but the additional year could be significant for some options. For example, adding fiscal year 2017 would convert the 10-year revenue change from option 7 from about zero to a $45 billion loss. However, eliminating that ten-year revenue loss would involve relatively modest changes in income tax rates—no more than 0.3 percentage points. Most of the other options would require smaller adjustments to maintain revenue neutrality.

The second factor is potentially more significant. The JCT incorporates microeconomic behavioral effects in its estimates of the effects of tax law changes, whereas our estimates are static. It is unclear, however, how behavioral effects would alter the estimates. We have shown in other research that most people face higher marginal tax rates under the AMT than they do under the income tax. For them, eliminating the AMT, even if accompanied by modest increases in regular income tax rates, would be expected to increase their taxable income. For others, who are not on the AMT in the baseline, the higher marginal tax rates will be the dominant effect, and they would be expected to report less taxable income. In addition, for the options that raise tax rates on capital gains, the JCT would assume that people would report less gains. The combined effect of all of these factors is uncertain, although it is probably true that the options that increase progressivity in the tax system would be more likely to lose revenue by JCT scoring than the ones that decrease it.

The JCT estimators can estimate the tax rates or other changes that would be needed to produce revenue neutrality (or hit any other revenue target) under their estimating model. We would expect that the required changes would not be large, but cannot be certain until they prepare their own estimates.

We examine a large number of options, but they can be grouped into several sets that clarify the AMT changes and the income tax changes that are involved:

- AMT repeal: financed with (a) increases in income tax rates, (b) repeal of the state and local income tax deduction, or (c) removal of reduced tax rates for capital gains and dividends

- AMT basic clean-up: a combination including at least one of the following: extending expiring AMT relief, indexing the AMT for inflation, and allowing dependent exemptions financed in a variety of ways.

- AMT overhaul: all elements of basic clean-up plus a combination including at least one of the following: allowing the standard deduction, allowing specified itemized deductions, increasing the first AMT rate to 28 percent, repealing the AMT exemption phase-out, and disallowing the preferential treatment of capital gains and dividends in the AMT, financed in a variety of ways.

Tables 2 and 3 provide a summary of the features of each of the options.

How to interpret the option sheets

Each of the options presented below is displayed in a similar format. The option sheet includes a summary of key features—what is done to the AMT and what, if any, adjustments are made to the regular income tax to offset any change in revenue. If regular income tax rates or AMT rates change under the option, the revised rates are compared to those scheduled to take effect under current law. Revenue loss is shown year-by-year and over the first and second five-year periods in the budget window. The revenue losses usually add up to approximately zero over 10 years. The options that reform the AMT rather than repealing it also include a comparison with current law of the number of people on the AMT by income in four years, 2007, 2010, 2011, and 2016.[10]

Each sheet includes a chart showing how tax filing units are affected in each quintile (20 percent) of the income distribution, with additional detail for the top 10 percent.[11] The chart shows the percentage change in after-tax income for each group and for the four years. Income groups that see an increase in after-tax income are better off on average from the tax change, although there may be losers within those groups. Groups that see a decrease lose on average although, again, there may be winners with those groups. The first and last years (2007 and 2016) are chosen because they are the beginning and end of the 10-year budget period. The middle two years

[10] For comparison purposes, appendix table 3 shows, by income class, the number of tax units and taxpayers – defined as those tax units that pay a positive amount of individual income tax net of refundable credits – for those same four years.

[11] In 2007, the bottom 20 percent corresponds to a cash income of $14,244 or less; the 40th percentile earns $27,465; the 60th, $48,165; the 80th, $85,706; the 90th, $126,454; the 95th, $178,030; and the 99th earns $434,766. To see cash income percentiles for other years, see http://www.taxpolicycenter.org/TaxModel/percentiles.cfm. Cash income is a broader measure of income than what is reported on income tax returns and includes tax-exempt bond interest, transfer payments such as welfare and food stamps, and certain non-taxable fringe benefits. See http://www.taxpolicycenter.org/TaxModel/income.cfm for details.

Table 2
Revenue-Neutral AMT Repeal: Summary of Options

	Option	Repeal AMT	Repeal state and local tax deduction	Roll back rates on gains and dividends	Percent change in all income tax rates	Percent change in top 3 tax rates	No change in top rates in 2011
1	Repeal AMT & Increase Income Tax Rates	X			6		
2	Repeal AMT & Increase Top Income Tax Rates	X				15	
3	Repeal AMT & Increase Top Income Tax Rates with No Change in 2011	X				24	X
4	Repeal AMT, State and Local Tax Deduction & Decrease Income Tax Rates	X	X		-2		
5	Repeal AMT, State and Local Tax Deduction & Decrease Top Income Tax Rates	X	X			-5	
6	Repeal AMT, State and Local Tax Deduction & Adjust Top Income Tax Rates with No Change in 2011	X	X		2		X
7	Repeal AMT, Roll Back Capital Gains Rates & Increase Top Income Tax Rates with No Change in 2011	X		X		8	X
8	Repeal AMT, Roll Back Capital Gains Rates & Increase Top Income Tax Rates with No Change in 2011, Revenue-Neutral in 2016	X		X		13	X

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1) and authors' calculations.

Table 3
Revenue-Neutral AMT Reform: Summary of Options

	Option	Extend expiring provisions	Index AMT at 2006 levels	Allow dependent exemptions	Allow standard deduction	Allow state and local tax, misc. & medical deductions	Repeal AMT exemption phase-out	Increase 26 percent AMT rate to 28 percent	Convert state and local tax deduction to credit	Disallow pref. rates on gains and div. in AMT	Percent increase in top 3 income tax rates	Percent increase in AMT rates
9	Extend and Index 2006 Law & Increase Top Income Tax Rates	X	X								12	
10	Extend and Index 2006 Law & Increase AMT Rates	X	X									2
11	Extend and Index 2006 Law, Disallow Preferential Rates on Capital Gains in AMT & Increase Top Income Tax Rates	X	X							X	2	
12	Extend and Index 2006 Law, Disallow Preferential Rates on Capital Gains in AMT & Increase AMT Rates	X	X							X		3
13	Extend and Index 2006 Law, Convert State and Local Tax Deduction to Credit & Disallow Preferential Rates on Capital Gains in AMT	X	X						X	X		
14	Family Relief & Increase Top Income Tax Rates	X	X	X							12	
15	Family Relief & Increase AMT Rates	X	X	X								22
16	Family Relief, Disallow Preferential Rates on Capital Gains in AMT & Increase Top Income Tax Rates	X	X	X						X	3	
17	Family Relief, Disallow Preferential Rates on Capital Gains in AMT & Increase AMT Rates	X	X	X						X		4
18	Broad Reform & Increase Top Income Tax Rates	X	X	X	X	X					14	
19	Broad Reform & Increase AMT Rates	X	X	X	X	X						38
20	Broad Reform, Disallow Preferential Rates on Capital Gains in AMT & Increase Top Income Tax Rates	X	X	X	X	X				X	7	
21	Broad Reform, Disallow Preferential Rates on Capital Gains in AMT & Increase AMT Rates	X	X	X	X	X				X		16
22	Flat Tax & Increase Top Income Tax Rates	X	X	X	X	X	X	X		X	8	
23	Flat Tax & Increase AMT Rates	X	X	X	X	X	X	X		X		21

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1) and authors' calculations.

include the last year the Bush tax cuts are in effect (2010) and the year immediately following (2011), in which regular income tax rates increase. For many options, there is a significant change in the distribution of tax changes after the Bush tax cuts expire.

The option sheets presume a current law baseline, meaning that all estimates are based on current law. This assumption is important in light of the sunset provision of the recent tax cuts, as described above. It also carries key implications for the distribution of the tax burden as a result of the AMT. Since current law includes no AMT relief, the baseline presented in the option sheets implies a large increase in AMT liability in future years relative to 2006. As a result, options that show a zero percent change (relative to the baseline) in after-tax income in future years for taxpayers who have been protected from the AMT by the temporary patches in recent years reflect a substantial tax increase for those taxpayers in future years compared to 2006**.**

Repeal Options

Option 1: Repeal AMT & Increase Income Tax Rates

Key Features

• Repeal the AMT
• 6 percent increase in income tax rates*

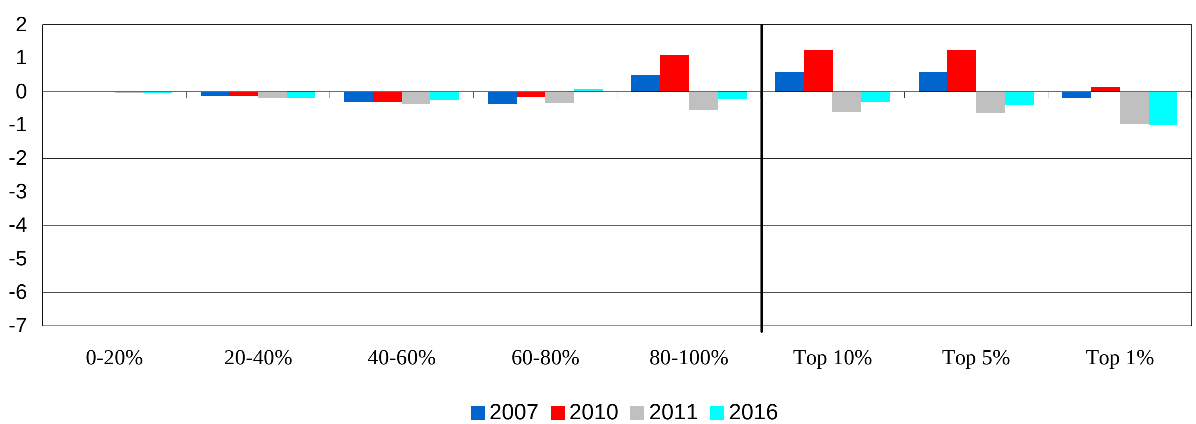
Income Tax Rates

	2007-10							2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0		15.0	28.0	31.0	36.0	39.6
Option 1	10.6	15.9	26.4	29.6	34.9	37.0		15.9	29.6	32.8	38.0	41.9

Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 1	-6.1	-20.6	-31.5	-42.6	-18.0	32.4	29.1	25.2	20.5	13.8	-118.8	121.1

Percent Change in After-Tax Income, by Year and Cash Income Percentile



* Percentage increase may not exactly match rates in the table because of rounding.

In this option, the AMT is repealed and all income tax rates are raised by 6 percent (not percentage points). The 10-percent bracket would become 10.6 percent and the 35-percent bracket would become 37.0 percent. In 2011, when the Bush tax cuts expire, the rates would range from 15.9 percent to 41.9 percent.

This would make the tax system less progressive overall, although the exact pattern changes over time as explained below. In general, it would raise taxes on those least likely to owe AMT under current law—those in the bottom 90 percent of the income distribution—and cut taxes substantially on those with incomes between \$100,000 and \$500,000—roughly the 90th to the 99th percentiles. No income group, however, experiences a tax increase of more than 1 percent of income. The tax rate changes have almost no effect on the bottom quintile because most have incomes well below the point at which income tax is owed.

Although the option is roughly revenue neutral over the next decade, it cuts overall revenues by \$119 billion over the first five years and then raises revenue in the next five years.

During the first five years, while the Bush tax cuts are largely still in effect, the loss in revenue from AMT repeal is relatively large and the gain in income tax revenue is relatively small (compared to the next five years). Even so, through 2010, low-income filers pay more in taxes, while high-income filers pay less. In the second five years, with the tax cuts expired, the elimination of the AMT results in a smaller tax cut, and the income tax surcharge is larger in absolute terms because the income tax rates are higher. In consequence, every income group pays more in overall taxes in 2011 under this option than under current law. By 2016, inflation swells the AMT rolls and repealing it becomes more valuable. As a result, the overall tax increase is much smaller in every income group except the lowest- and highest-income groups, which are largely immune from the AMT under current law.

Option 2: Repeal AMT & Increase Top Income Tax Rates

Key Features

- Repeal the AMT
- 15 percent increase in top three income tax rates

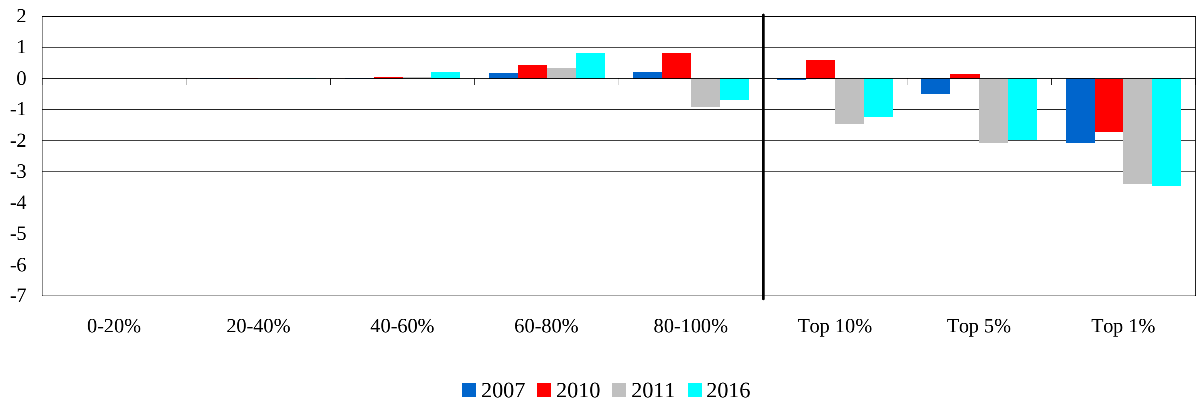
Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 2	10.0	15.0	25.0	32.3	38.1	40.4	15.0	28.0	35.8	41.5	45.7

Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 2	-6.4	-21.5	-32.9	-44.4	-19.5	32.1	29.4	26.0	21.9	16.0	-124.6	125.4

Percent Change in After-Tax Income, by Year and Cash Income Percentile



Since repealing the AMT primarily benefits higher-income taxpayers, it makes sense to offset the revenue losses by increasing only the top income tax rates. This option would increase the top 3 rates by 15 percent, raising the top rate from 35 percent to 40.4 percent in 2007 and from 39.6 percent to 45.7 percent after 2010 when the Bush tax cuts expire. The rate changes are much bigger than in option 1 because the tax increases are concentrated among the highest-income 10 percent.

As in option 1, this option cuts taxes in the first five years and increases them in the second five after the Bush tax cuts expire. Most of the net tax increases are within the top 5 percent. The top 1 percent face the largest tax increases—averaging over 3 percent of income after 2010. They are most affected by the rate increases and benefit relatively less from repeal of the AMT since many taxpayers in this group do not owe AMT.

Option 3: Repeal AMT & Increase Top Income Tax Rates with No Change in 2011

Key Features

- Repeal the AMT
- 24 percent increase in top three income tax rates
- No change in top income tax rates in 2011

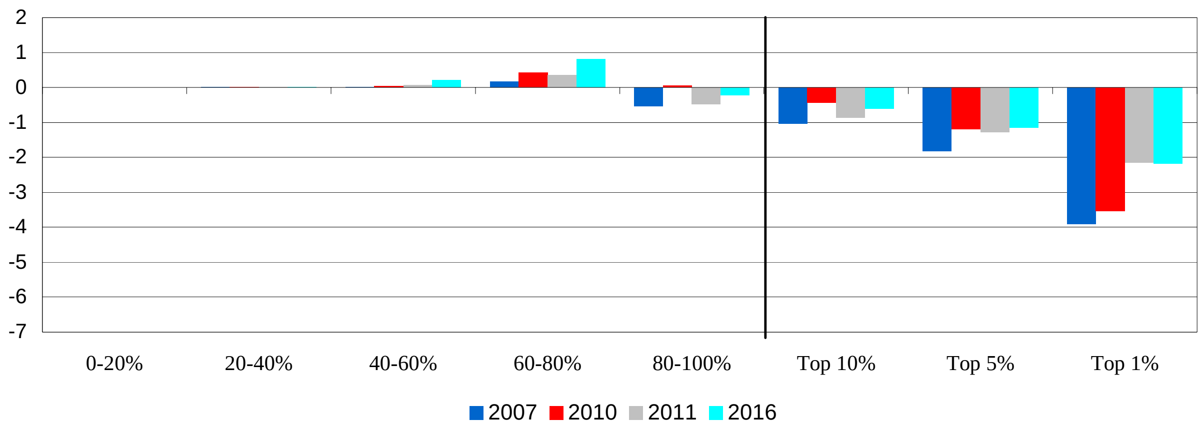
Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 3	10.0	15.0	25.0	34.8	41.0	43.5	15.0	28.0	34.8	41.0	43.5

Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 3	6.0	10.2	0.6	-9.1	-6.4	9.7	5.5	0.7	-5.0	-12.5	1.3	-1.5

Percent Change in After-Tax Income, by Year and Cash Income Percentile



The significant shift of revenue from current to future years that occurs in options 1 and 2 could be avoided by setting the top three income tax rates at constant levels over the next 10 years. This option increases the current top three income tax rates by 24 percent and includes no additional changes after 2010. The rates required are substantially higher than those in place before EGTRRA, but because less revenue is lost before 2010, the necessary top rate after 2010 is lower than in option 2. The top rate increases to 43.5 percent. This option is effectively revenue neutral over the first and second five-year periods of the budget window. The rate increases are larger than in option 2 through 2010, but smaller after that. Since the years before 2010 also see the largest number of AMT taxpayers (fueled by the Bush income tax cuts), this change has the effect of raising revenues when they are most needed and, at the same time, diminishing the size of the AMT problem (and thus the cost of repeal).

The option would have very small effects on the distribution of tax burdens by income quintile—less than 1 percent of after-tax income in any year. But it would raise taxes significantly on high-income taxpayers, especially those in the top 1 percent. The tax increases for that group amount to almost 4 percent of income before 2011 and average about 2 percent after 2010.

Option 4: Repeal AMT, State and Local Tax Deduction & Decrease Income Tax Rates

Key Features
- Repeal the AMT
- Repeal the state and local tax deduction
- 2 percent decrease in income tax rates

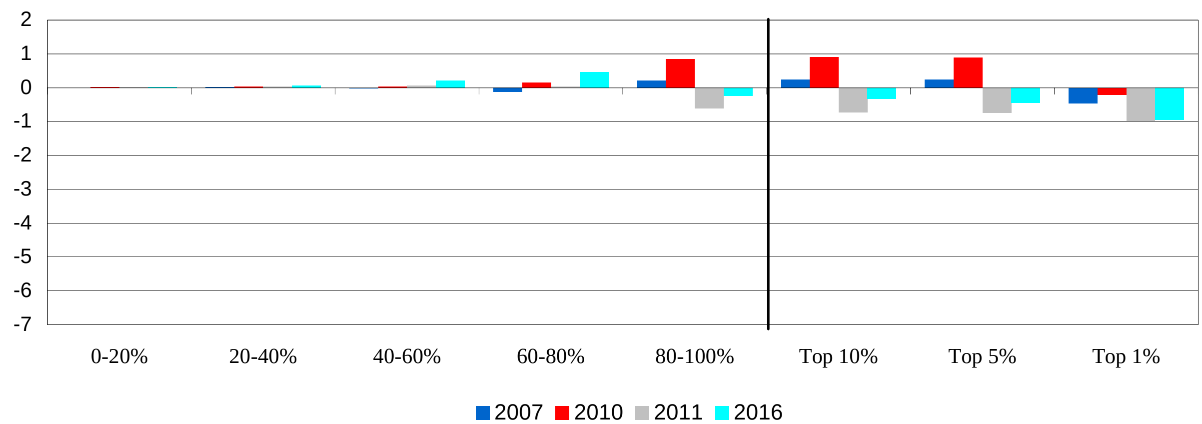
Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 4	9.8	14.7	24.5	27.4	32.4	34.3	14.7	27.4	30.4	35.3	38.8

Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 4	-3.1	-14.7	-28.1	-38.4	-15.8	29.5	25.3	20.5	14.7	7.0	-100.0	96.9

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option significantly broadens the tax base by eliminating the deduction for state and local taxes, as was proposed by President Bush's tax reform advisory panel. Recall that this deduction accounted for more than half of all AMT preferences. Table 4 provides some additional background information on the distribution of the state and local tax deduction for 2007. Note that very few individuals in the bottom sixty percent of the income distribution will benefit from the deduction since most of those tax units do not itemize deductions. In addition, since the deduction is not allowed for AMT purposes, the primary beneficiaries are those at the very top of the income scale who escape the AMT. More than 70 percent of those in the top one percent benefit from the deduction, with an average tax savings of almost $11,965 or 1.3 percent of income.

This option raises more than enough money to pay for repeal of the AMT (although it would not if the Bush tax cuts were extended). As a result, under this option, income tax rates can be *reduced* by 2 percent across the board. The option cuts taxes on net in the first five years

Table 4
Curent Law Distribution of AMT Liability and Benefits from the State and Local Tax Deduction and Preferential Rates on Capital Gains & Dividends by Cash Income Percentile, 2007

Cash Income Percentile[a,b]	Effect of the AMT			State and Local Tax Deduction					Preferential Rates on Capital Gains & Dividends				
	Percent With Tax Increase	Average Tax Increase Due to AMT		Percent With Benefit[d]	Average Tax Savings		Taxes Paid Deduction[e]		Percent With Benefit[g]	Average Tax Savings		Eligible Gains & Dividends[h]	
		Dollars	% of Income[c]		Dollars	% of Income[c]	Dollars	% of Income[f]		Dollars	% of Income[c]	Dollars	% of Income[f]
Lowest Quintile	0.0	0	0.0	0.2	0	0.0	1,873	15.1	0.3	0	0.0	74	0.9
Second Quintile	0.0	2	0.0	3.1	5	0.0	1,945	8.8	3.4	3	0.0	168	0.8
Middle Quintile	1.0	5	0.0	14.0	38	0.1	2,511	6.4	8.2	12	0.0	301	0.8
Fourth Quintile	11.9	90	0.2	40.1	224	0.4	4,006	5.9	21.4	64	0.1	864	1.3
Top Quintile	65.4	2,224	1.5	58.5	1,085	0.7	11,781	5.6	25.4	2,798	1.9	20,482	10.1
All	15.7	465	0.9	23.2	270	0.5	8,193	5.7	11.7	575	1.1	4,402	6.6
Top 10 Percent	78.8	3,721	1.7	53.7	1,649	0.8	17,008	5.6	24.4	5,442	2.5	39,071	12.9
Top 5 Percent	81.9	5,823	1.8	46.1	2,694	0.8	25,490	5.6	27.5	10,552	3.2	73,802	16.1
Top 1 Percent	55.2	10,001	1.1	70.3	11,965	1.3	69,577	5.4	59.8	48,133	5.4	303,705	23.6

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).
Notes:
Calendar year
(a) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see
http://www.taxpolicycenter.org/TaxModel/income.cfm
(b) For the income levels at each quintile and the top income percentiles used in this table, see
http://www.taxpolicycenter.org/TaxModel/percentiles.cfm
(c) Average tax increase and savings are shown as a percentage of after-tax income. After-tax income is cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.
(d) Tax units are considered to have a benefit from the state and local tax deduction if their individual income tax increases if the deduction were to be repealed for 2007 and taxable refunds were excluded from AGI.
(e) Taxes paid, in dollars and as a percentage of income, are calculated only for taxpayers who itemize. The value of taxes paid is the value reported on Schedule A regardless of whether the taxpayer is subject to the AMT or the deduction is otherwise limited.
(f) Preferences as a percentage of income are shown using pre-tax income (cash income).
(g) Tax units are considered to have a benefit from the preferential rates on capital gains and dividends if their individual income tax increases if the alternative rates were to be repealed for 2007.
(h) Eligible gains and dividends is the sum of net positive long-term gains and qualifying dividends.

because repealing the state tax deduction does not raise enough revenue to finance repeal while the Bush tax cuts are still in place, but it increases taxes after the Bush tax cuts expire.

The option has very small effects on overall tax burdens by income group—amounting to less than 1 percent of income in any year. Middle-income taxpayers receive a very small benefit from the tax rate reduction and are not much affected by the elimination of the deduction since few taxpayers itemize in that income range. Itemizers in the fourth quintile lose more than they gain in 2007, because most itemize, but many have not become affected by the AMT in that year. By 2010, that group overall experiences a modest tax cut. Within the top quintile, elimination of the AMT is more significant than the loss of the state and local tax deduction until 2010. After that, this income group loses more than they gain, but the net losses are never large, even within the top 1 percent.

Overall, this option makes the tax system modestly more progressive.[12]

[12] A number of other issues arise in considering whether to finance AMT repeal by eliminating the state and local tax deduction. See Rueben (2006) for a general discussion, or Burman and Gale (2005) in the context of the tax reform panel's proposal.

Option 5: Repeal AMT, State and Local Tax Deduction, & Decrease Top Income Tax Rates

Key Features

- Repeal the AMT
- Repeal the state and local tax deduction
- 5 percent decrease in top three income tax rates

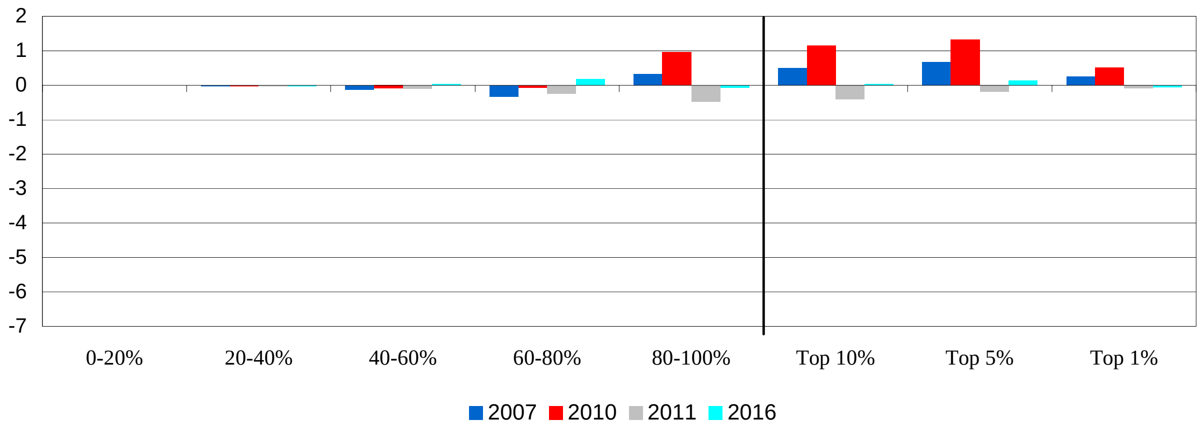
Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 5	10.0	15.0	25.0	26.5	31.3	33.1	15.0	28.0	29.4	34.1	37.5

Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 5	-3.1	-14.7	-28.0	-38.3	-15.4	30.2	25.9	20.9	14.9	6.9	-99.5	98.7

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option also repeals the state and local tax deduction, but targets the rate cuts at those in the top three brackets. By 2011, this option is effectively distributionally neutral. The tax changes as a share of income are small to negligible for all income groups. Before 2011, there is some redistribution. Middle-income families –especially those in the fourth quintile experience a tax increase on average because the income tax rate cuts largely leave them unaffected, whereas the state and local tax deduction is a substantial tax benefit. By 2010, however, the net tax becomes very close to zero because so many households in that income category are subject to the AMT (and thus unaffected by repeal of the state and local tax deduction).[13] Higher-income households are better off under this proposal, especially before 2011, because so many are subject to the AMT and also because they benefit from the reduction in income tax rates. After 2010, the

[13] Note that some taxpayers who are on the AMT are affected by repeal of the state and local tax deduction. This can happen if eliminating the deduction would cause them to stop being subject to the AMT. In that case, the taxpayer receives a partial benefit from the deduction—basically up to the amount of state and local tax deduction that would cause him or her to become subject to the AMT.

effects are more mixed in this income group because the number of AMT taxpayers declines (which make the state and local tax deduction more valuable).

This proposal reduces revenue by nearly $100 billion during the first five years and increases revenues by a similar amount in the second five years. This is because repealing the AMT is so costly before the tax cuts expire.

Option 6: Repeal AMT, State and Local Tax Deduction, & Adjust Top Income Tax Rates with No Change in 2011

Key Features

- Repeal the AMT
- Repeal the state and local tax deduction
- Increase top three income tax rates by 2 percent
- No change in top three income tax rates in 2011

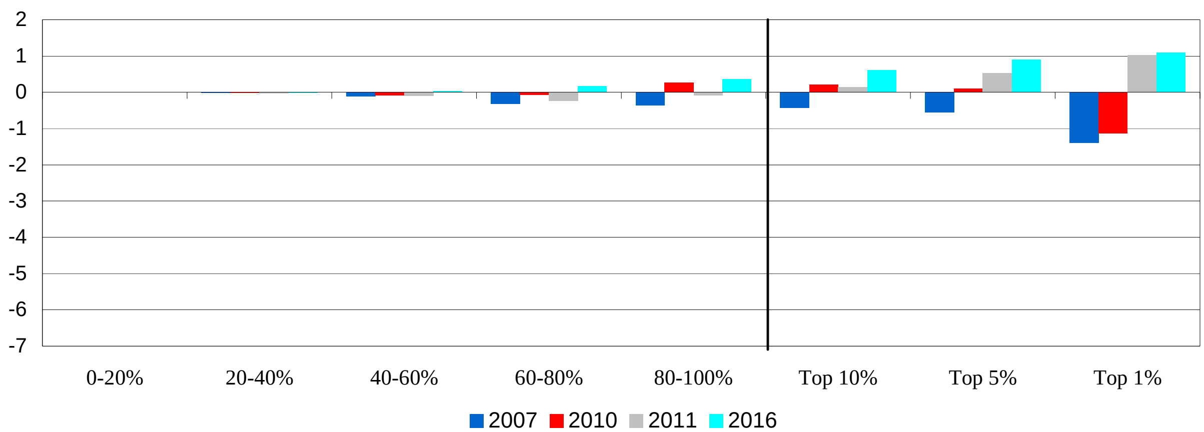
Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 6	10.0	15.0	25.0	28.6	33.6	35.7	15.0	28.0	28.6	33.6	35.7

Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 6	8.5	15.0	3.3	-5.1	-3.0	9.5	3.8	-2.5	-9.9	-19.4	18.7	-18.6

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option is similar to option 5, but the income tax rates do not change in 2011. Under this option, there is a small revenue gain (less than $19 billion) in the first five years and a similar loss in the second five years. Top income tax rates actually increase slightly before 2011, but the change is more dramatic after 2010 when the rates would otherwise increase significantly. The net effect is similar to making permanent the cuts in the top 3 brackets, albeit at rates slightly higher than those applying under current law. Repeal of the state and local tax deduction plus the small increase in top marginal rates before 2011 is enough to pay for this and repeal of the AMT.

Overall, the distributional effects of this option are very small—less than 1 percent of income for every group but the top 1 percent. Very high-income taxpayers pay slightly higher taxes before 2011 because of the slight rate increase and repeal of the state and local tax deduction. After 2010, they pay slightly lower taxes than under current law because the reduction in top income tax rates more than offsets the effect of eliminating the state and local tax deduction.

Option 7: Repeal AMT, Roll Back Capital Gains Rates & Increase Top Income Tax Rates, No Change in 2011

Key Features

- Repeal the AMT
- Roll back the top three income tax rates and increase by 8 Percent
- Roll back rates on capital gains and dividends to pre-EGTRRA levels
- No change in top three income tax rates in 2011

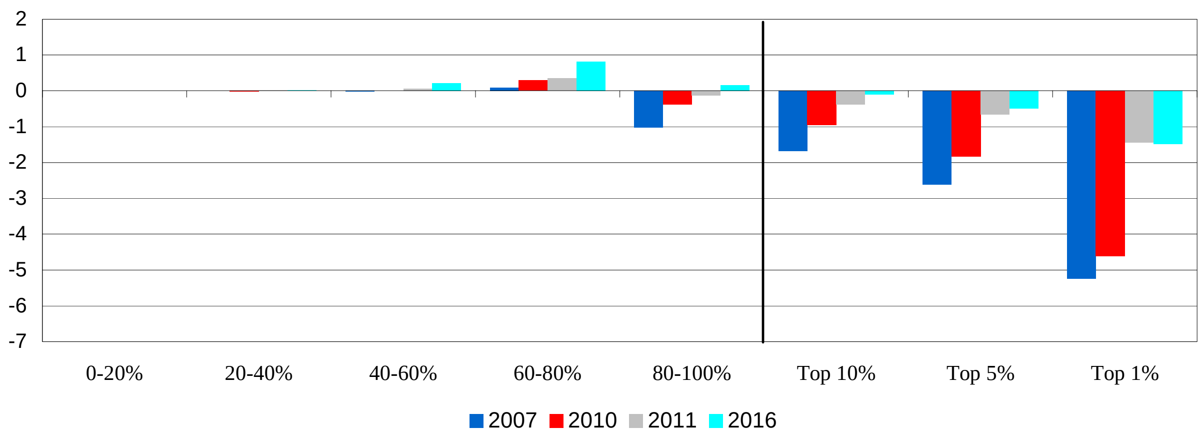
Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 7	10.0	15.0	25.0	33.5	39.0	42.8	15.0	28.0	33.5	39.0	42.8

Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 7	16.0	38.1	29.0	15.0	2.7	-7.8	-13.1	-19.1	-26.1	-35.0	100.9	-101.1

Percent Change in After-Tax Income, by Year and Cash Income Percentile



Another possible way to partially finance AMT repeal would be to roll back the special tax breaks created for capital gains and dividends in 2003. Table 4 provides some background information on the distribution of the benefits of the preferential rates on dividends and capital gains for the 2007 tax year. The benefits are heavily concentrated at the top of the income scale. More than a quarter of the tax units in the top quintile receive a tax savings; the average savings for this group is $2,798 or 1.9 percent of income. Close to 60 percent of the top one percent of income earners benefit from the preferential rates; the average tax savings among this group is more than $48,000, representing 5.4 percent of income.

Under this option, dividends would be taxed the same as ordinary income (such as wages and salaries) starting in 2007 and the maximum tax rate on long-term capital gains would return to 20 percent—its pre-EGTRRA level. Option 7 would do that and also set the top three income tax rates at a level about 8 percent higher than their post-2010 levels. This means that the top rate would increase to 42.8 percent compared with 35 percent in 2007 under current law and 39.6 percent after 2010.

This option would cut taxes by a modest amount for middle- and upper-middle-income taxpayers, with the largest tax cuts in 2016. It would increase taxes significantly for high-income taxpayers, especially before 2011 when current law allows for substantial reductions in the rates on capital gains and dividends. Taxpayers in the top 1 percent of the income distribution would, on average, pay additional taxes equal to more than 5 percent of after-tax income in 2007. These households lose out for three reasons—they are most affected by the income tax rate increases, they have a large amount of capital gains and dividends, and many taxpayers in this group do not owe AMT (and thus receive no benefit from repeal). After 2010, the tax increase would average less than 2 percent of income.

This option would increase revenues by about $100 billion in the first five years of the budget period and reduce revenues by the same amount in the second five. Beyond the budget period, it would lose increasing amounts of revenue.

Option 8: Repeal AMT, Roll Back Capital Gains Rates and Increase Top Income Tax Rates, No Change in 2011 Revenue-Neutral in 2016

Key Features

- Repeal the AMT
- Roll back the top three income tax rates to pre-EGTRRA levels and increase by 13 percent
- Roll back rates on capital gains and dividends to pre-EGTRRA levels

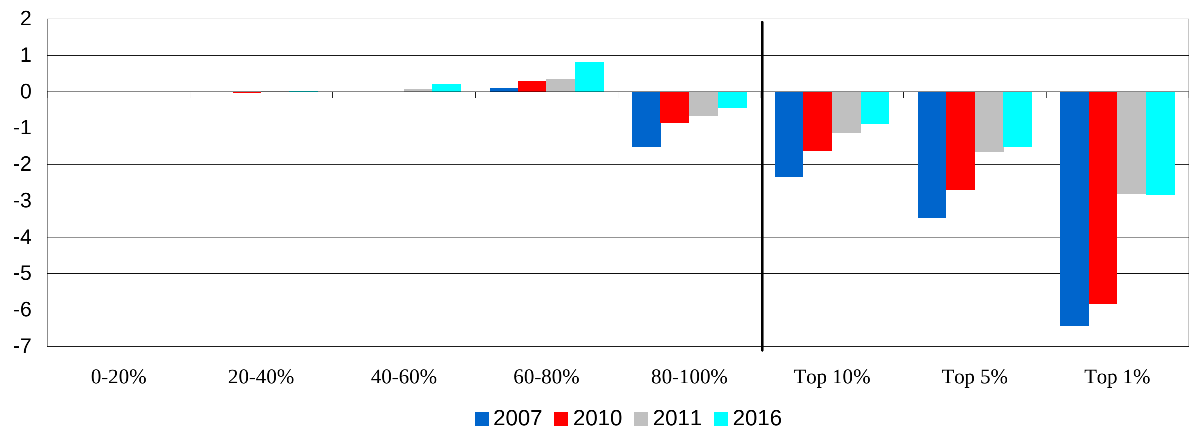
Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 8	10.0	15.0	25.0	35.1	40.7	44.8	15.0	28.0	35.1	40.7	44.8

Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 8	24.1	58.9	50.9	38.2	27.8	19.7	16.2	12.0	6.9	0.2	199.9	55.0

Percent Change in After-Tax Income, by Year and Cash Income Percentile



There is reason to be concerned about the out-year revenue losses in options such as option 7. As is well known, the retirement of the baby boom generation and growing health care costs will put great pressure on the federal budget in years to come. In light of that reality, the ideal option might be one that gained revenue throughout the budget period.

Option 8 is identical to option 7, but it adjusts income tax rates so as to eliminate the revenue loss in the year 2016, rather than over the entire 10-year period. Under this option, rates have to increase by almost 13 percent—to a top rate of 44.8 percent, 2 percentage points higher than in option 7. This option would increase revenues over the 10-year budget period by about $255 billion. The bottom 80 percent of the population is largely unaffected by the higher income tax rates (only about 5 percent of tax filing units are in the top 3 tax brackets) and the middle-income taxpayers benefit from AMT repeal so they would still benefit from this option, but people at the top would pay significantly higher taxes.

If policymakers wished to avoid the revenue gain in earlier years, they could phase in the tax rate increases.

Reform Options

Rather than repealing the AMT, it could be retargeted at higher income taxpayers who are more likely to be engaged in tax shelters. To the extent that the AMT deters tax shelters, it could continue to serve that purpose. And some changes, such as taxing capital gains and dividends the same as other income under the AMT (see box 3), could make it more effective as an anti-tax shelter tool. In addition, preserving the AMT lowers somewhat the revenue hurdle needed to finance reform.

Box 3. Scaling Back Capital Gains and Dividends Tax Preferences as Anti-Tax Shelter Measure

Currently, long-term capital gains and most dividends are taxed at rates of 15 percent or less under the regular income and under the AMT. The rationale for the lower rates is that corporate stock is already taxed under the corporate income tax and thus a second level of tax under the individual income tax constitutes "double taxation

This creates significant complexity under both the regular income tax and the AMT as taxpayers must effectively calculate tax on these two preferred forms of income under an alternative tax rate schedule.

Moreover, the lower tax rates create opportunities for tax sheltering. The lower capital gains tax rates do not require that the appreciated asset actually be a corporation subject to the entity-level tax and qualifying for the dividends tax break even if the company paying dividends never paid any corporate income tax. Thus, some tax experts fear that non-taxpaying corporations could be used as a way to channel income tax-free through to owners in the form of lightly-taxed dividends and/or capital gains. Other business entities (such as sole proprietorships or partnerships) have also been used in the past as a way to convert ordinary income into capital gains.

If the purpose of the AMT is to restrain tax shelters, capital gains and dividends should be taxed like other income. Indeed, before the Tax Reform Act of 1986 temporarily eliminated a capital gains preference under the regular income tax, capital gains were the single largest preference item under the AMT.

If the AMT is eliminated, making the capital gains tax rate as close to the ordinary income tax rate as possible would reduce the ability to create tax shelters.

We consider four base reform options in tandem with different ways of financing the revenue loss:

1. *Extend and Index 2006 Law***:** This option would index for inflation the AMT exemption, the income level where the exemption begins to phase out, and the point at which the 28-percent bracket takes effect starting in 2007. It would also allow personal credits to be claimed against the AMT on a permanent basis. (Personal nonrefundable credits have been allowed on a temporary basis in the patches that also increase the AMT exemption, but currently all such patches have expired.)

2. *Family Relief:* This option includes the reforms in option 1 plus it allows taxpayers to claim personal exemptions for their children and other dependents against the AMT.

3. *Broad Reform:* In addition to family relief, this option would allow taxpayers who itemize deductions to claim deductions for state and local taxes, medical deductions, and miscellaneous itemized deductions against the AMT. Non-itemizers would be able to claim the standard deduction against the AMT.

4. *Flat Tax:* In addition to broad reform, this option would convert the AMT into a flat-rate tax. It would eliminate the second AMT rate bracket and the phase-out of the AMT exemption (which creates effective AMT rates as high as 35 percent under current law). The same flat AMT rate would apply to all forms of income, including capital gains and dividends.

Option 9: Extend and Index 2006 Law & Increase Top Income Tax Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits against the AMT
- 12 percent increase in top three income tax rates

Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 9	10.0	15.0	25.0	31.3	36.9	39.1	15.0	28.0	34.6	40.2	44.3

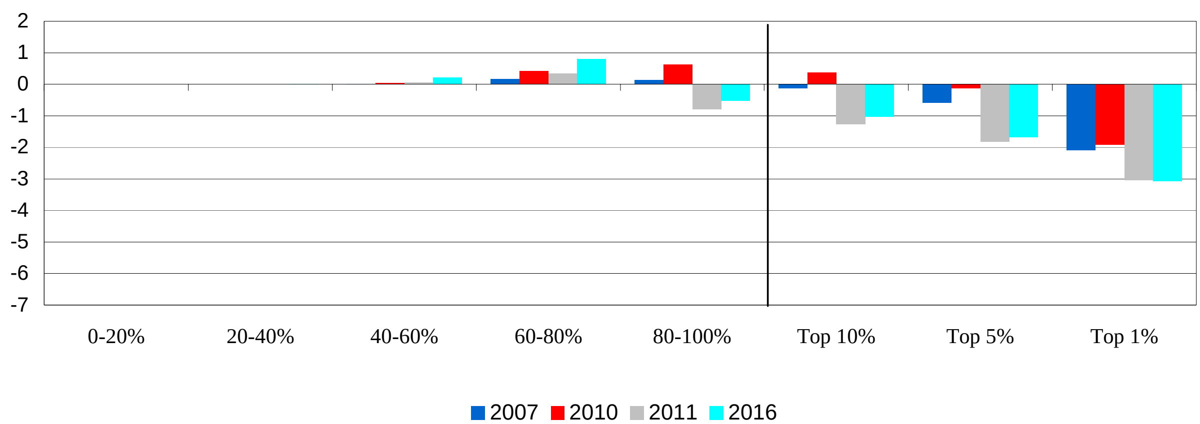
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 9	-4.3	-14.9	-24.7	-35.0	-14.4	26.9	23.5	19.5	14.7	8.2	-93.2	92.9

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.1	0.1	0.1	0.1
100 - 200	11.8	15.1	6.7	12.9	0.7	0.7	0.3	0.3
200 - 1,000	4.4	5.6	3.5	5.4	1.5	2.3	0.5	0.6
More than 1,000	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
All	23.4	32.4	18.5	35.1	2.4	3.3	0.9	1.1

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option would reduce the number of AMT taxpayers two ways. First, it would raise the exemption significantly—from $45,000 to $64,950 for a couple in 2007—and it would index all of the AMT parameters so that they grow with inflation. Second, it finances the revenue loss by raising the top three regular income tax rates by about 12 percent. The top rate would increase from 35 percent to 39.1 percent through 2010 and from 39.6 percent to 44.3 percent thereafter. By raising regular income tax liability, it reduces the number of people for whom regular income tax is less than tentative AMT and thus reduces the number of AMT taxpayers.

The option would cut the number of AMT taxpayers by about 90 percent in 2007. Fewer than 1 million taxpayers with incomes under $200,000 would be subject to the tax, compared with almost 19 million under current law. The number of higher-income taxpayers would also drop, but less dramatically. Overall, 2.4 million taxpayers would owe AMT in 2007 under this option compared with 23.4 million under current law. After 2010, when the Bush tax cuts expire, the number drops below 1 million, although it then begins to creep up as real income growth pushes more taxpayers onto the AMT.

The change in tax burdens by income quintiles is small—never more than 1 percent of income. The 95 percent of taxpayers who are in the bottom three tax brackets are unaffected by the income tax rate changes, and they have relatively little AMT liability so indexing it does not affect them much. However, the highest income taxpayers do pay more tax. By 2011, the top 1 percent pays additional tax equal to about 3 percent of income.

Option 10: Extend and Index 2006 Law & Increase AMT Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits against the AMT
- 20 percent increase in AMT rates

AMT Rates

Current Law	26.0	28.0
Option 10	31.1	33.5

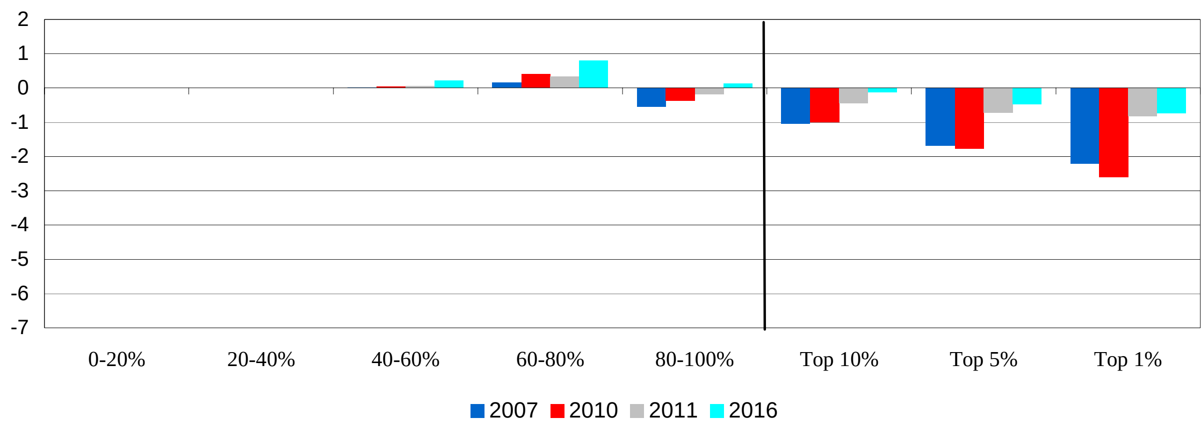
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 10	7.9	19.0	15.7	10.8	5.7	-0.5	-5.7	-11.6	-18.5	-27.2	59.1	-63.5

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.4	0.6	0.2	0.3
100 - 200	11.8	15.1	6.7	12.9	4.0	4.8	1.3	1.7
200 - 1,000	4.4	5.6	3.5	5.4	4.5	5.4	4.2	5.1
More than 1,000	0.1	0.2	0.1	0.1	0.3	0.4	0.1	0.2
All	23.4	32.4	18.5	35.1	9.3	11.2	5.9	7.3

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option is similar to option 9, but the revenue loss is made up by increasing AMT rates instead of rates under the regular income tax. AMT rates would have to increase by 20 percent and the top rate would become 33.5 percent. For those in the phase-out range for the exemption, effective rates could be almost 42 percent.

Since the option raises AMT rates, rather than regular income tax rates, many more people would be subject to the AMT than in option 9. In 2007, 9.3 million people would be subject to the tax, compared with 2.4 million under the previous option. The higher exemption would spare all but a few taxpayers with incomes under $100,000, but 4 million taxpayers with incomes between $100,000 and $200,000 would owe AMT.

AMT liabilities would also increase for many higher-income households. As a result, they would pay higher taxes on average. Households in the top 10 percent would experience a tax increase of about 1 percent of income until 2010, and those in the top 1 percent would pay additional taxes equal to more than 2 percent of income. After 2010, the tax increase is much smaller because the higher AMT exemption in combination with the pre-EGTRRA income tax rates results in fewer upper-income households owing AMT.

Option 11: Extend and Index 2006 Law, Disallow Preferential Rates on Capital Gains in AMT & Increase Top Income Tax Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits against the AMT
- Disallow preferential rates on capital gains and dividends in the AMT
- 2 percent increase in top three income tax rates

Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 11	10.0	15.0	25.0	28.6	33.7	35.8	15.0	28.0	31.7	36.8	40.4

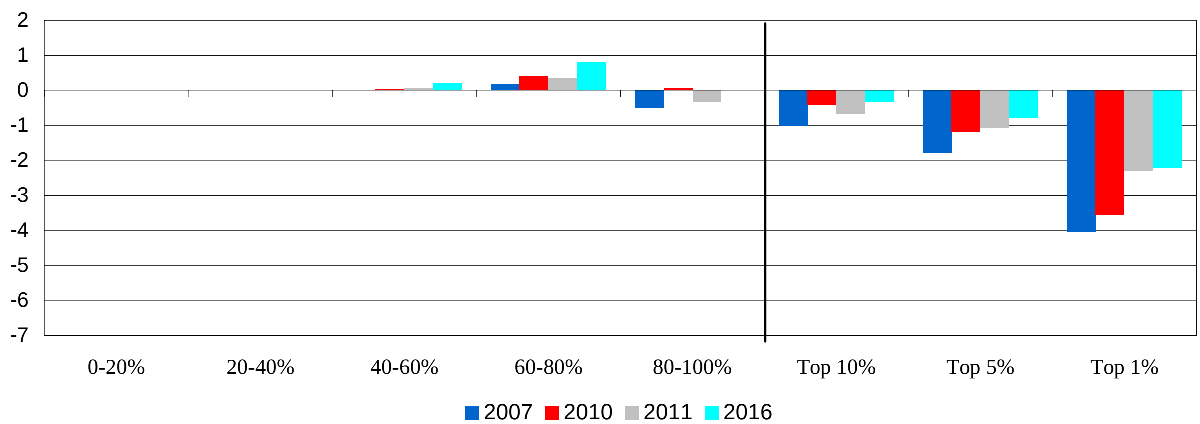
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 11	8.3	21.9	10.3	-9.8	-2.8	6.4	1.1	-4.9	-11.9	-20.7	28.0	-30.1

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law 2007	Current Law 2010	Current Law 2011	Current Law 2016	Option 2007	Option 2010	Option 2011	Option 2016
Less than 100	7.0	11.5	8.2	16.7	0.2	0.2	0.1	0.1
100 - 200	11.8	15.1	6.7	12.9	1.3	1.4	0.4	0.5
200 - 1,000	4.4	5.6	3.5	5.4	2.9	3.7	1.0	1.1
More than 1,000	0.1	0.2	0.1	0.1	0.2	0.2	0.1	0.1
All	23.4	32.4	18.5	35.1	4.5	5.5	1.5	1.8

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option would extend and index 2006 law and tax capital gains and dividends like other income under the AMT. Eliminating the preference for capital gains and dividends raises enough revenue that only very modest increases in the top three income tax rates would be necessary to achieve revenue neutrality—about 2 percent. Top income tax rates would increase by about 0.8 percentage points.

This option would reduce the number of AMT taxpayers overall by about 80 percent—to 4.5 million in 2007. Under this option, the AMT would be much more targeted at those with very high incomes—and more consistent with its original intent. About 1.5 million households with incomes below $200,000 would owe AMT, a slight increase over 2006 levels, but less than 10 percent of what would occur in 2007 with no change in law. The change is less dramatic for those with incomes between $200,000 and $1 million—the number is reduced by about one-third. Very high-income taxpayers—those with incomes over $1 million—would actually be more likely to owe AMT under this option than under current law.

This option has very small effects on tax burdens by income quintiles—in all cases changing tax liability by less than 1 percent of income. However, the tax change is much more significant for those with very high incomes. The top 1 percent would see an average tax increase of about 4 percent of after-tax income in 2007. Even in this income group, however, the size of the tax change would decline over time.

Part of the reason the tax increases on high-income earners fall over time is because the option would tend to lose more revenue each year relative to current law. The option raises $28 million in the first five years and loses a similar amount in the second five. By the end of the budget window, the option is losing almost $21 million annually.

Option 12: Extend and Index 2006 Law, Disallow Preferential Rates on Capital Gains in AMT & Increase AMT Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits against the AMT
- Disallow pref. rates on capital gains/dividends in the AMT
- 3 percent increase in AMT rates

AMT Rates

Current Law	26.0	28.0
Option 12	26.8	28.9

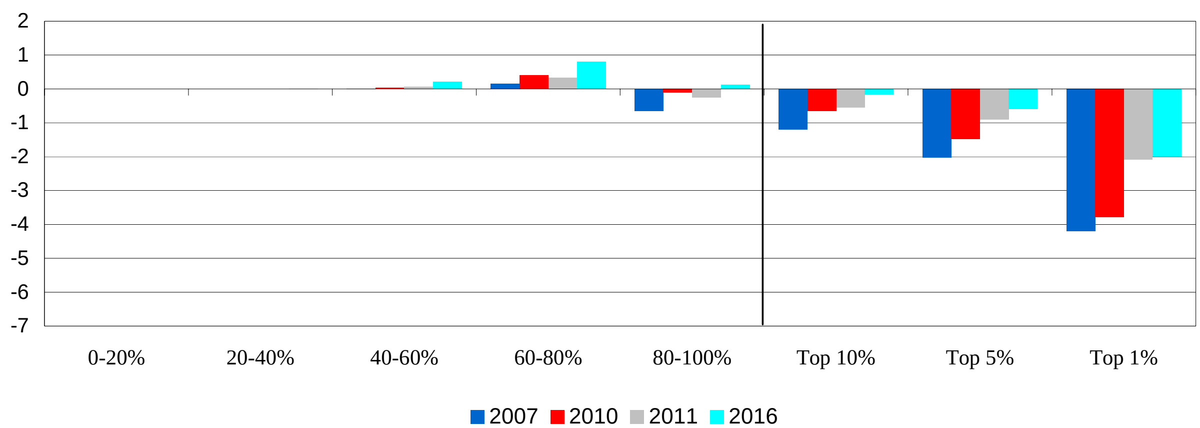
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 12	10.9	29.2	18.3	-1.9	1.1	2.1	-3.7	-10.1	-17.5	-26.8	57.6	-55.9

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.2	0.3	0.1	0.2
100 - 200	11.8	15.1	6.7	12.9	1.6	1.8	0.5	0.9
200 - 1,000	4.4	5.6	3.5	5.4	3.6	4.5	1.3	2.0
More than 1,000	0.1	0.2	0.1	0.1	0.2	0.2	0.1	0.2
All	23.4	32.4	18.5	35.1	5.6	6.8	2.0	3.2

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option is similar to option 11, but the revenue loss is made up by increasing AMT rates rather than income tax rates. The rate changes are very modest—3 percent. The top AMT rate increases from 28 percent to 28.9 percent. The distributional and revenue effects are very similar, but the number of AMT taxpayers increases by about 1 million compared with option 11.

Option 13: Extend and Index 2006 Law, Convert State and Local Deduction to Credit & Disallow Preferential Rates on Capital Gains in AMT

Key Features

- Index the AMT exemption at 2006 levels
- Allow personal credits against the AMT
- Convert the state and local tax deduction to a 16 percent credit
- Disallow preferential rates on capital gains and dividends in the AMT

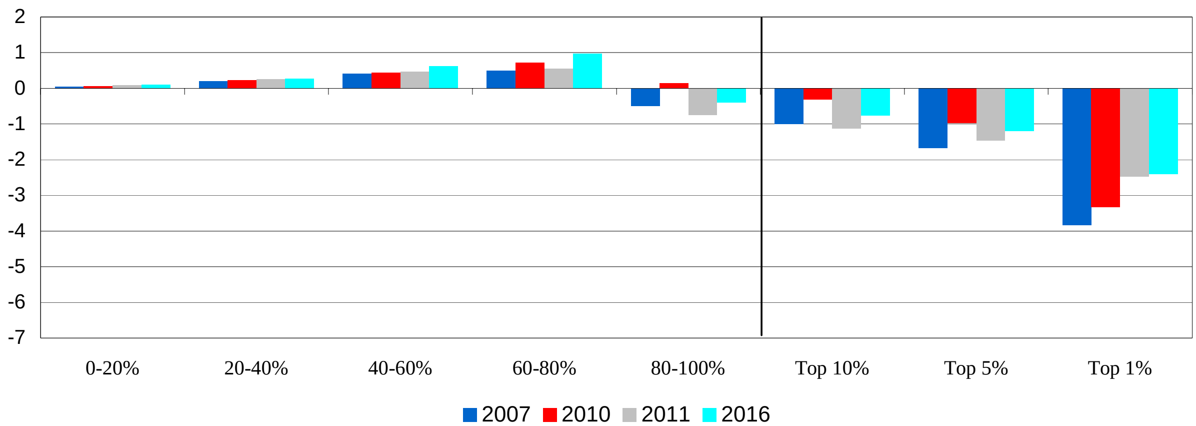
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 13	3.4	8.3	-4.9	-25.6	-9.2	16.2	11.6	6.4	0.3	-7.6	-28.0	26.9

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.1	0.2	0.1	0.1
100 - 200	11.8	15.1	6.7	12.9	0.7	0.8	0.2	0.2
200 - 1,000	4.4	5.6	3.5	5.4	1.5	1.9	0.6	0.7
More than 1,000	0.1	0.2	0.1	0.1	0.1	0.2	0.1	0.1
All	23.4	32.4	18.5	35.1	2.5	3.1	1.0	1.1

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option would extend and index 2006 law and tax capital gains and dividends as ordinary income, as in the previous options. It would also replace the itemized deduction for state and local taxes with a flat 16 percent tax credit, which would be allowed against the AMT as well as the regular income tax. It would reduce the number of AMT taxpayers below 2006 levels. Fewer than 1 million taxpayers with incomes below $200,000 would be subject to the tax. Overall, 2.5 million taxpayers would owe AMT, almost a 90-percent reduction from current-law levels in 2007, and almost 30 percent below 2006 levels.

This option would cut taxes for the bottom 80 percent of taxpayers. Those with lower incomes would benefit from the tax credit two ways. First, most lower-income taxpayers do not itemize deductions and thus cannot benefit from the current deduction for state and local taxes. Second, even for moderate-income households who itemized deductions, the credit is at least as valuable because they are in the 15 percent or lower tax bracket. (A 16-percent credit is worth more than a deduction at a 15- or 10-percent income tax rate.)

Even within the top quintile, the overall tax changes are very modest. As with the previous options, however, this plan raises taxes noticeably on those in the top 1 percent. They are adversely affected by both the end of the tax preference for capital gains and dividends under the AMT as well as the conversion of the state and local tax deduction to a credit.

Option 14: Family Relief & Increase Top Income Tax Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits against the AMT
- Allow dependent exemptions in the AMT
- 12 percent increase in top three income tax rates

Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 14	10.0	15.0	25.0	31.4	37.0	39.2	15.0	28.0	34.7	40.3	44.4

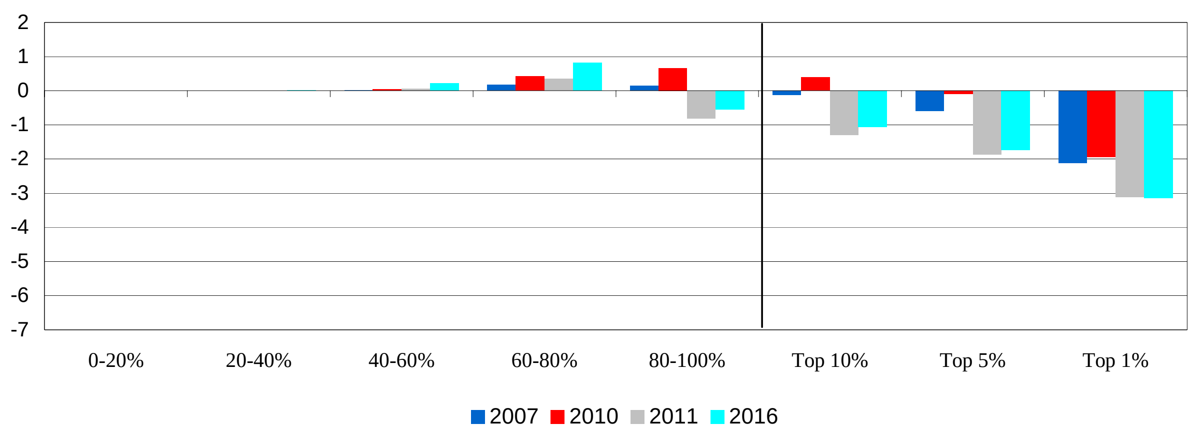
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 14	-4.6	-15.9	-26.0	-36.5	-15.2	27.7	24.4	20.5	15.8	9.3	-98.1	97.7

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.1	0.1	0.0	0.0
100 - 200	11.8	15.1	6.7	12.9	0.3	0.4	0.2	0.2
200 - 1,000	4.4	5.6	3.5	5.4	1.2	1.8	0.5	0.5
More than 1,000	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
All	23.4	32.4	18.5	35.1	1.7	2.4	0.8	0.9

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option would provide broader relief for middle-income families. In addition to extending and indexing 2006 law, it would also allow families to claim personal exemptions for children and other dependents against the AMT. Top income tax rates would have to increase by 12 percent to make up the lost revenue.

Under this option, fewer than 2 million taxpayers would be subject to the AMT in 2007 and virtually all middle-income households would be exempt. Accordingly, the bottom 80 percent of taxpayers would experience a tax cut, on average. Overall, the option cuts taxes on average before 2010 and raises them afterwards. As a result, even many higher-income taxpayers are better off than under current law. Only the top 5 percent experiences significant tax increases before 2010. After 2010, the top 10 percent sees an average tax increase of about 1 percent of income, although very high-income taxpayers see larger increases.

Option 15: Family Relief & Increase AMT Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits against the AMT
- Allow dependent exemptions in the AMT
- 22 percent increase in AMT rates

AMT Rates

Current Law	26.0	28.0
Option 15	31.6	34.1

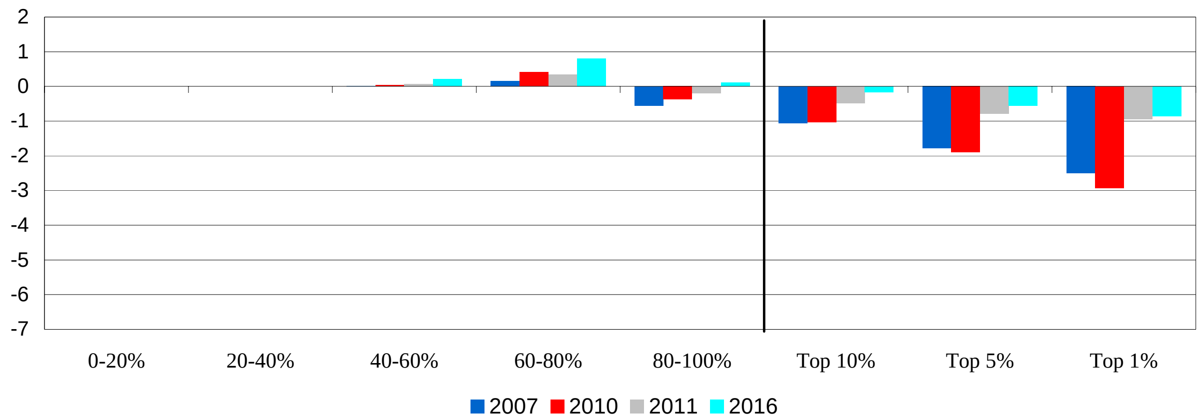
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 15	8.0	19.3	16.1	11.4	6.5	0.3	-4.8	-10.6	-17.4	-26.1	61.2	-58.7

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law 2007	Current Law 2010	Current Law 2011	Current Law 2016	Option 2007	Option 2010	Option 2011	Option 2016
Less than 100	7.0	11.5	8.2	16.7	0.2	0.3	0.1	0.1
100 - 200	11.8	15.1	6.7	12.9	2.8	3.6	1.0	1.3
200 - 1,000	4.4	5.6	3.5	5.4	4.5	5.3	4.0	5.0
More than 1,000	0.1	0.2	0.1	0.1	0.4	0.4	0.2	0.2
All	23.4	32.4	18.5	35.1	7.8	9.6	5.3	6.6

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option is identical to option 14, but the revenue loss is made up by raising AMT rates rather than raising ordinary income tax rates. The result is that many more people become subject to the AMT than in option 14, including 3 million with incomes below $200,000. Overall, about 7.8 million taxpayers would owe AMT in 2007 and almost 10 million by 2010.

Option 16: Family Relief, Disallow Preferential Rates on Capital Gains in AMT & Increase Top Income Tax Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits against the AMT
- Allow dependent exemptions in the AMT
- Disallow preferential rates on capital gains and dividends in the AMT
- 3 percent increase in top three income tax rates

Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 16	10.0	15.0	25.0	28.8	33.9	35.9	15.0	28.0	31.8	37.0	40.7

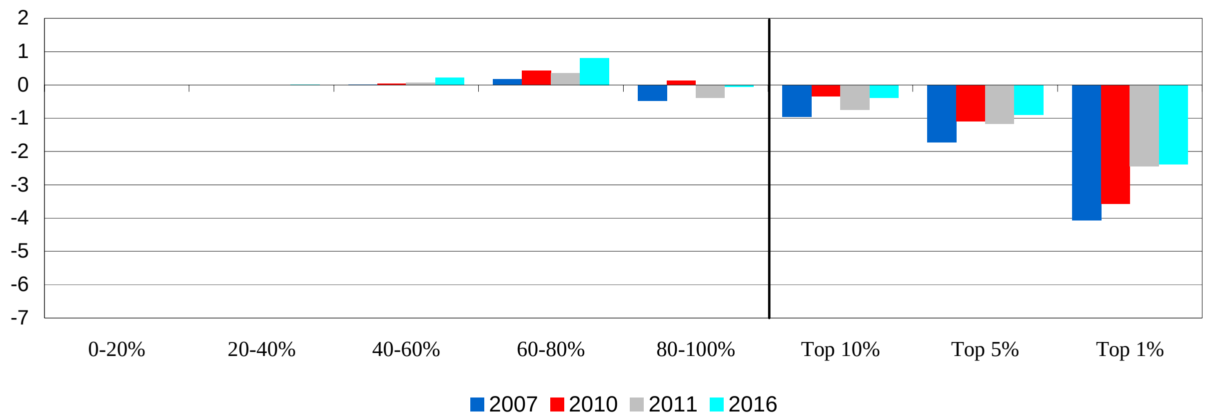
Change in Tax Liability (Fiscal Years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 16	7.5	19.5	7.6	-12.7	-3.9	8.6	3.4	-2.5	-9.3	-17.9	18.0	-17.7

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law 2007	2010	2011	2016	Option 2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.1	0.2	0.1	0.0
100 - 200	11.8	15.1	6.7	12.9	0.9	1.0	0.3	0.3
200 - 1,000	4.4	5.6	3.5	5.4	2.4	3.2	0.9	1.0
More than 1,000	0.1	0.2	0.1	0.1	0.2	0.2	0.1	0.1
All	23.4	32.4	18.5	35.1	3.5	4.6	1.3	1.5

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option couples family relief with an end to the preferential taxation of capital gains and dividends under the AMT. The combination means that only modest income tax rate increases are required to achieve revenue neutrality—about 1 percentage point added to the top rates. The option would result in about the same number of people being subject to the AMT as in 2006—3.5 million—and 2.6 million of them would be those with incomes over $200,000.

The option would cut taxes on the bottom 80 percent of taxpayers and raise it on those with very high incomes. The top 1 percent would pay an average additional tax of 4 percent of after-tax income in 2007, although the additional burden would decline somewhat over time.

Option 17: Family Relief, Disallow Preferential Rates on Capital Gains in AMT & Increase AMT Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits against the AMT
- Allow dependent exemptions in the AMT
- Disallow preferential rates on capital gains and dividends in the AMT
- 4 percent increase in AMT rates

AMT Rates

Current Law	26.0	28.0
Option 17	27.1	29.1

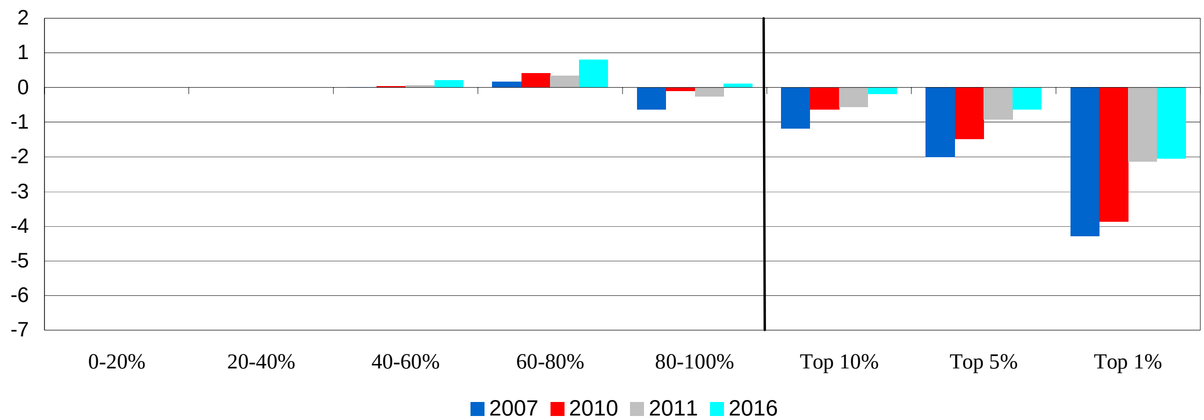
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 17	10.6	28.4	17.3	-3.0	0.6	2.5	-3.2	-9.6	-17.1	-26.3	53.9	-53.6

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.1	0.2	0.1	0.1
100 - 200	11.8	15.1	6.7	12.9	1.2	1.4	0.4	0.4
200 - 1,000	4.4	5.6	3.5	5.4	3.4	4.3	1.2	1.4
More than 1,000	0.1	0.2	0.1	0.1	0.2	0.2	0.1	0.1
All	23.4	32.4	18.5	35.1	4.9	6.0	1.8	2.0

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option is identical to option 16, except that the revenue loss is made up by raising AMT rates by about 1 percentage point rather than raising income tax rates. About 1.4 million additional taxpayers would owe AMT compared with option 16 and the tax increases for high-income taxpayers would be slightly larger.

Option 18: Broad Reform & Increase Top Income Tax Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits and dependent exemptions in the AMT
- Allow standard deduction in the AMT
- Allow state and local tax, misc., and medical deductions in the AMT
- 14 percent increase in top income tax rates

Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 18	10.0	15.0	25.0	31.9	37.6	39.9	15.0	28.0	35.4	41.1	45.2

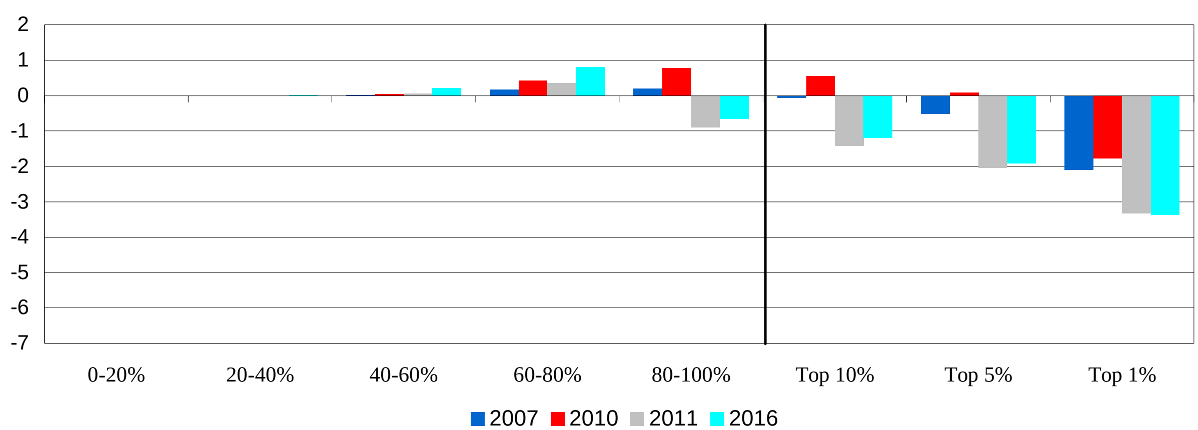
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 18	-6.0	-20.1	-31.4	-43.0	-18.6	31.3	28.4	24.9	20.6	14.5	-119.1	119.7

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law 2007	Current Law 2010	Current Law 2011	Current Law 2016	Option 2007	Option 2010	Option 2011	Option 2016
Less than 100	7.0	11.5	8.2	16.7	0.0	0.0	0.0	0.0
100 - 200	11.8	15.1	6.7	12.9	0.1	0.1	0.0	0.0
200 - 1,000	4.4	5.6	3.5	5.4	0.2	0.3	0.1	0.2
More than 1,000	0.1	0.2	0.1	0.1	0.0	0.1	0.0	0.0
All	23.4	32.4	18.5	35.1	0.3	0.5	0.2	0.2

Percent Change in After-Tax Income, by Year and Cash Income Percentile



Option 18 comprises what we call broad reform. In addition to extending and indexing 2006 law and allowing dependent exemptions, this option would allow those who itemize deductions to claim their state and local tax, miscellaneous, and medical deductions against the AMT. Nonitemizers would be allowed to take the standard deduction. To achieve revenue neutrality, top income tax rates would have to increase by about 14 percent. The top income tax rate would be 39.9 percent until 2010 and 45.2 percent thereafter.

This option reduces the number of AMT taxpayers by almost 90 percent in 2007, to 0.3 million. Only 100,000 taxpayers with incomes below $200,000 would owe the tax. The tax changes by income quintile are modest—less than 1 percent of income in any year—but they are more significant for those in the top 10 percent. Since this option reduces tax revenues in the first five years and raises revenues in the second five-year period, the largest tax increases occur after 2010. The average tax increase is about 3 percent for those in the top 1 percent of the income distribution after 2010.

Option 19: Broad Reform & Increase AMT Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits and dependent exemptions in the AMT
- Allow standard deduction in the AMT
- Allow state and local tax, misc., and medical deductions in the AMT
- 38 percent increase in AMT rates

AMT Rates

Current Law	26.0	28.0
Option 19	36.0	38.7

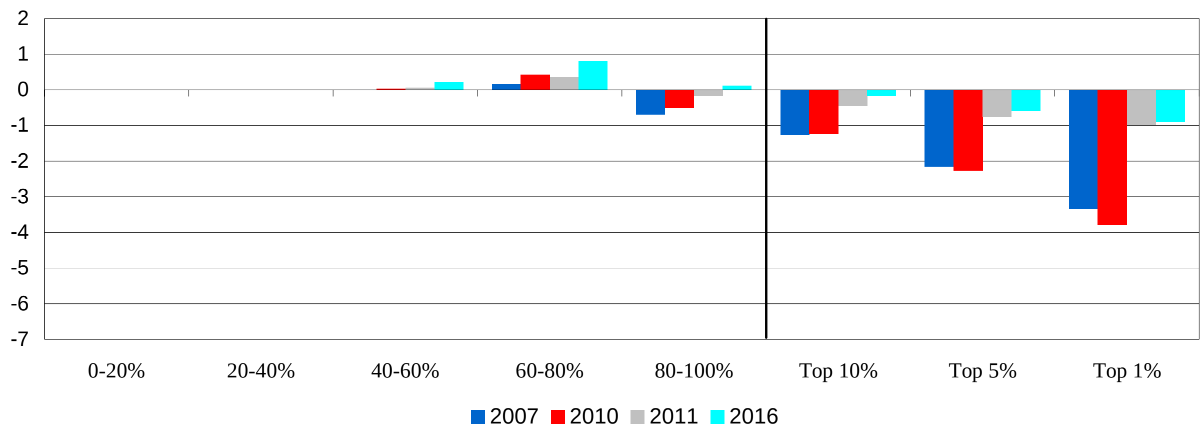
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 19	9.6	23.3	19.9	15.1	7.3	-3.6	-8.6	-14.4	-21.1	-29.7	75.2	-77.4

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.1	0.0	0.0	0.0
100 - 200	11.8	15.1	6.7	12.9	1.6	2.1	0.5	0.6
200 - 1,000	4.4	5.6	3.5	5.4	4.2	5.1	3.8	4.7
More than 1,000	0.1	0.2	0.1	0.1	0.4	0.4	0.2	0.3
All	23.4	32.4	18.5	35.1	6.2	7.6	4.5	5.7

Percent Change in After-Tax Income, by Year and Cash Income Percentile



Option 19 is identical to option 18, but the revenue is made up by raising AMT rates. The increases are substantial—10 percentage points or more. As a result, over 6 million taxpayers would owe AMT in 2007 under the option. Few taxpayers with incomes under $100,000 would owe the tax, but there would be very little reduction among taxpayers with incomes between $200,000 and $1 million. Virtually all taxpayers with incomes over $1 million would be subject to the tax.

Option 20: Broad Reform, Disallow Preferential Rates on Capital Gains in AMT & Increase Top Income Tax Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits and dependent exemptions in the AMT
- Allow standard deduction in the AMT
- Allow state and local tax, misc., and medical deductions in the AMT
- Disallow preferential rates on capital gains and dividends in the AMT
- 7 percent increase in top three income tax rates

Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 20	10.0	15.0	25.0	29.9	35.2	37.4	15.0	28.0	33.1	38.4	42.3

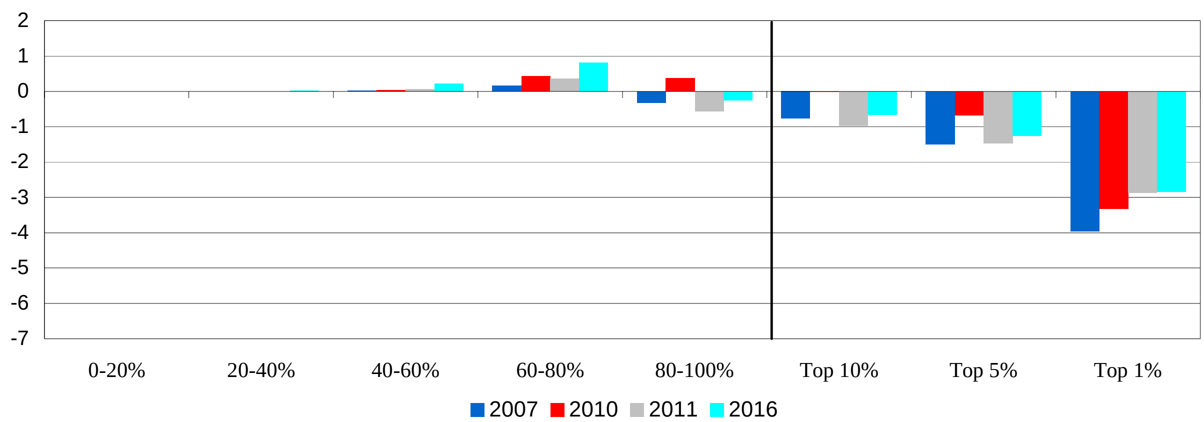
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 20	4.1	9.6	-4.2	-25.7	-10.4	15.9	11.4	6.3	0.2	-7.5	-26.6	26.3

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.0	0.0	0.0	0.0
100 - 200	11.8	15.1	6.7	12.9	0.3	0.3	0.1	0.1
200 - 1,000	4.4	5.6	3.5	5.4	0.8	0.9	0.4	0.5
More than 1,000	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
All	23.4	32.4	18.5	35.1	1.2	1.4	0.6	0.6

Percent Change in After-Tax Income, by Year and Cash Income Percentile



Option 20 combines broad reform with elimination of the tax preference for capital gains and dividends under the AMT. The top three income tax rates would increase by 7 percent compared with current law. The option would reduce the number of AMT taxpayers by about 95 percent, from 23.4 million under current law to 1.2 million under the option. Only 0.3 million taxpayers with incomes under $200,000 would owe the tax, less than 2 percent of the number under current law.

The option would have very small affects on the distribution of tax burdens by quintiles, but would produce significant tax increases on those with very high incomes—over 3 percent of income for those in the top 1 percent before 2010.

Option 21: Broad Reform, Disallow Preferential Rates on Capital Gains in AMT & Increase AMT Rates

Key Features

- Index the AMT exemption at 2006 levels
- Index AMT brackets and phase-out threshold
- Allow personal credits and dependent exemptions in the AMT
- Allow standard deduction in the AMT
- Allow state and local tax, misc., and medical deductions in the AMT
- Disallow preferential rates on capital gains and dividends in the AMT
- 16 percent increase in AMT rates

AMT Rates

Current Law	26.0	28.0
Option 21	30.1	32.4

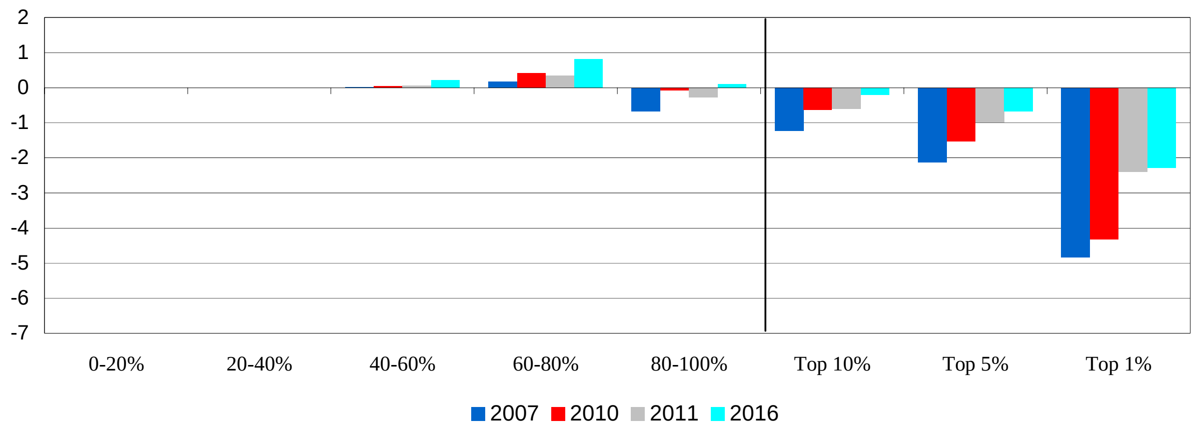
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 21	10.9	30.0	17.4	-5.9	0.0	3.1	-2.8	-9.4	-16.9	-26.2	52.4	-52.2

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.0	0.0	0.0	0.0
100 - 200	11.8	15.1	6.7	12.9	0.5	0.6	0.1	0.1
200 - 1,000	4.4	5.6	3.5	5.4	3.1	3.8	0.8	0.9
More than 1,000	0.1	0.2	0.1	0.1	0.2	0.3	0.1	0.1
All	23.4	32.4	18.5	35.1	3.9	4.7	1.0	1.1

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option is identical to option 20, but the revenue lost is made up by raising AMT rates. The top AMT rate would increase from 28 percent to 32.4 percent. In 2007, 3.9 million taxpayers would owe AMT, which is a slight increase from 2006 levels but a significant reduction from current law projections for 2007. Most of these taxpayers—3.3 million—have incomes over $200,000. Thus, even with the higher AMT rates, the middle class would be largely exempt from AMT under the option.

This option would have very small effects on the distribution of tax burdens by quintile, but would increase taxes significantly on those in the top 1 percent. In 2007, they would experience a tax increase of nearly 5 percent of after-tax income. The tax increases at the top moderate over time, in large part because the plan would lose revenue after 2010.

Option 22: Flat Tax & Increase Top Income Tax Rates

Key Features

- Index the AMT exemption at 2006 levels
- Allow personal credits and dependent exemptions in the AMT
- Allow standard deduction in the AMT
- Allow state and local tax, misc., and medical deductions in the AMT
- Repeal AMT exemption phaseout, increase 26% rate to 28%
- Disallow preferential rates on capital gains and dividends in the AMT
- 8 percent increase in top income tax rates

AMT Rates

Current Law	26.0	28.0
Option 22	28.0	28.0

Income Tax Rates

	2007-10						2011-2016				
Current Law	10.0	15.0	25.0	28.0	33.0	35.0	15.0	28.0	31.0	36.0	39.6
Option 22	10.0	15.0	25.0	30.2	35.5	37.7	15.0	28.0	33.4	38.8	42.6

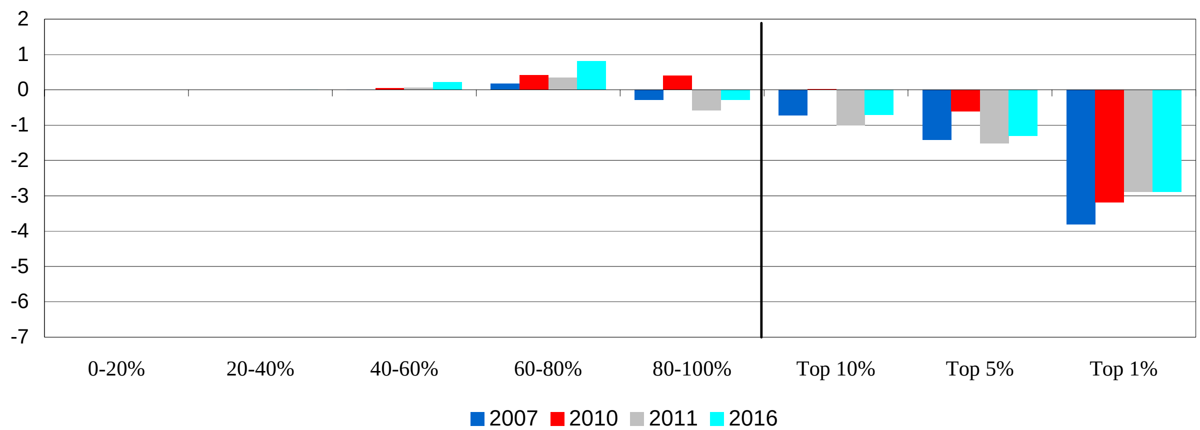
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 22	3.4	7.5	-6.0	-26.9	-11.1	17.0	12.6	7.6	1.8	-5.8	-33.1	33.1

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.0	0.0	0.0	0.0
100 - 200	11.8	15.1	6.7	12.9	0.3	0.4	0.1	0.1
200 - 1,000	4.4	5.6	3.5	5.4	0.8	0.8	0.4	0.4
More than 1,000	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
All	23.4	32.4	18.5	35.1	1.2	1.3	0.5	0.6

Percent Change in After-Tax Income, by Year and Cash Income Percentile



As noted earlier, the phaseout of the AMT exemption creates high implicit tax rates for those in the phaseout range. This option would eliminate the phaseout and replace the two AMT rates with a single 28-percent rate. Capital gains and dividends would be subject to the flat AMT rate along with other income. In addition, this would include all the elements of broad reform (extend and index 2006 law, allow dependent exemptions, allow standard deduction, and allow itemized deductions). To achieve revenue neutrality, the top three regular income tax rates would increase by 8 percent. The top rate would be 37.7 percent before 2010 and 42.6 percent thereafter.

This option would reduce the number of AMT taxpayers to 1.2 million—5 percent of the number under current law and about one third of the number subject to the AMT in 2006. The distributional effects would be nearly identical to those in option 20. There would be very little change in tax burdens by income quintile—uniformly less than 1 percent—but more significant tax increases on those with very high incomes.

Option 23: Flat Tax & Increase AMT Rates

Key Features

- Index the AMT exemption at 2006 levels
- Allow personal credits and dependent exemptions in the AMT
- Allow standard deduction in the AMT
- Allow state and local tax, misc., and medical deductions in the AMT
- Repeal AMT exemption phaseout, increase 26% rate to 28%
- Disallow preferential rates on capital gains and dividends in the AMT
- 21 percent increase in AMT rate

AMT Rates

Current Law	26.0	28.0
Option 23	33.9	33.9

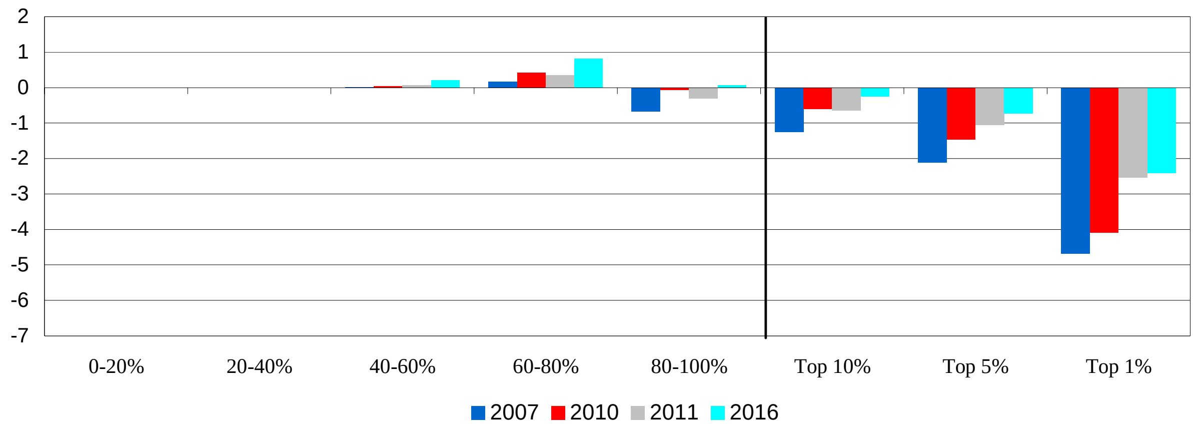
Change in Tax Liability (Fiscal years, billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-11	2012-16
Option 23	10.5	28.9	15.5	-8.9	-0.9	5.0	-0.9	-7.4	-14.9	-24.1	45.0	-42.4

Number of AMT Taxpayers (millions)

Cash Income Class ($ thousands)	Current Law				Option			
	2007	2010	2011	2016	2007	2010	2011	2016
Less than 100	7.0	11.5	8.2	16.7	0.0	0.1	0.0	0.0
100 - 200	11.8	15.1	6.7	12.9	1.2	1.4	0.2	0.2
200 - 1,000	4.4	5.6	3.5	5.4	3.6	4.9	0.8	0.8
More than 1,000	0.1	0.2	0.1	0.1	0.2	0.3	0.1	0.1
All	23.4	32.4	18.5	35.1	5.0	6.7	1.1	1.2

Percent Change in After-Tax Income, by Year and Cash Income Percentile



This option is identical to option 22, except that the revenue loss is made up by increasing the flat AMT rate from 28 percent to 33.9. As a result, many more taxpayers—5 million—would owe AMT than in the previous option. Lower-income taxpayers would be largely exempt, but there would actually be an increase among those with incomes over $1 million. The tax increases on the top 1 percent would also be larger than under the previous option.

Conclusions

A significant barrier to AMT reform has been the challenge of what to do about the lost revenues. Official budget estimates assume that the AMT will provide tax revenues of nearly one trillion dollars over the next 10 years. Even modest reforms, such as indexing the AMT for inflation, would reduce tax revenues over that period by more than half a trillion dollars. Given our fiscal situation, making up that lost revenue would seem to be a necessary pre-condition for reform.

This paper has illustrated a number of options for reforming or repealing the AMT without increasing the deficit over the 10-year budget period. The options show that it would be feasible to repeal or sharply scale back the AMT in a fiscally responsible manner with relatively minor dislocations. All of them produce winners and losers—it would be impossible to design a sensible revenue-neutral alternative to the AMT that didn't—but many would cut taxes modestly on the middle class and have relatively small effects on those with higher incomes.

There are untold numbers of other fiscally responsible options available, and some of them might be preferable to the ones displayed here. For example, Ways and Means Committee Chairman Rangel has proposed to improve tax compliance and collections as a way to raise revenue. To the extent that more of the tax that is due to the IRS could be collected, the revenue needs to finance AMT reform would be reduced. As a result, the options here could be implemented with smaller income tax rate increases or without the use of other offsets such as elimination of the deduction for state and local taxes.

The ideal solution would be to address the AMT in the context of a complete overhaul of the income tax, such as the proposal made by the President's Advisory Panel on Federal Income Tax Reform. Although the AMT is probably the best example of pointless complexity in the tax system, it is far from the only one. Addressing all of the sources of complexity, unfairness, and inefficiency in the tax system at the same time would strengthen the income tax—the major source of federal tax revenues—at a time when unprecedented demands are about to be placed on the federal government because of the impending retirement of the baby boomers.

That said, the perfect should not be the enemy of the good. Many of the incremental options outlined here would significantly improve our tax system.

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Appendix Table 1
Number of AMT Taxpayers and Revenue Cost of Incremental AMT Reform Plans, 2007-2016

Plan	Number of AMT Taxpayers (millions)										Revenue Cost ($ billions)										
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-16
Current Law Baseline	23.4	26.5	29.3	32.4	18.5	20.9	24.0	27.2	31.0	35.1	958.8	1,056.1	1,129.0	1,196.0	1,370.8	1,586.6	1,683.2	1,785.3	1,894.2	2,008.8	14,669.0
Plan 1: Extend expiring AMT relief[a]	4.3	5.5	6.4	7.7	2.4	2.9	3.4	4.2	5.1	6.4	-16.6	-44.7	-52.5	-60.4	-50.9	-31.3	-37.2	-43.5	-50.6	-59.0	-446.5
Plan 2: + Index AMT at 2006 levels	3.6	4.0	4.1	4.6	1.1	1.2	1.2	1.2	1.3	1.3	-17.8	-48.9	-59.5	-71.0	-60.4	-35.7	-43.1	-51.2	-60.5	-71.8	-519.9
Plan 3: + Allow dependent exemptions	2.7	3.2	3.3	3.7	0.9	0.9	1.0	1.0	1.0	1.1	-19.0	-51.9	-63.0	-74.8	-63.1	-36.5	-43.9	-52.1	-61.4	-72.7	-538.4
Plan 4: + Allow standard and state and local tax deductions	0.7	0.8	0.7	0.9	0.4	0.4	0.4	0.4	0.4	0.4	-24.5	-67.2	-80.8	-94.9	-79.9	-44.4	-52.2	-60.7	-70.5	-82.2	-657.2
Plan 5: + Allow misc. and medical deductions	0.4	0.5	0.4	0.6	0.2	0.2	0.2	0.2	0.2	0.2	-25.1	-68.9	-82.8	-97.2	-82.0	-45.8	-53.6	-62.3	-72.1	-83.9	-673.6
Plan 6: + Repeal AMT exemption phase out	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	-25.8	-71.0	-85.1	-99.7	-84.2	-46.9	-54.8	-63.6	-73.5	-85.4	-690.0
Plan 7: Repeal AMT											-27.9	-76.5	-91.0	-105.7	-90.3	-52.5	-60.6	-69.6	-79.8	-92.0	-745.9
Tax Cuts Extended Baseline[b]	23.4	26.5	29.3	32.4	35.1	38.1	41.1	43.6	46.7	49.6	958.8	1,056.1	1,129.0	1,196.0	1,287.2	1,376.3	1,469.9	1,568.7	1,673.9	1,784.6	13,500.6
Plan 1: Extend expiring AMT relief	4.3	5.5	6.4	7.7	8.9	10.5	12.5	14.5	16.8	20.2	-16.6	-44.7	-52.5	-60.4	-68.8	-77.6	-87.7	-98.0	-108.4	-119.6	-734.3
Plan 2: + Index AMT at 2006 levels	3.6	4.0	4.1	4.6	4.8	5.0	5.2	5.4	5.6	5.8	-17.8	-48.9	-59.5	-71.0	-83.8	-97.7	-113.8	-131.2	-149.9	-171.1	-944.8
Plan 3: + Allow dependent exemptions	2.7	3.2	3.3	3.7	3.9	4.1	4.2	4.4	4.5	4.7	-19.0	-51.9	-63.0	-74.8	-87.9	-102.0	-118.5	-136.1	-155.0	-176.6	-984.8
Plan 4: + Allow standard and state and local tax deductions	0.7	0.8	0.7	0.9	1.0	1.0	1.0	1.1	1.1	1.2	-24.5	-67.2	-80.8	-94.9	-111.4	-126.8	-144.7	-163.8	-184.2	-207.4	-1,205.6
Plan 5: + Allow misc. and medical deductions	0.4	0.5	0.4	0.6	0.6	0.6	0.6	0.6	0.7	0.7	-25.1	-68.9	-82.8	-97.2	-113.9	-129.6	-147.6	-166.9	-187.5	-210.9	-1,230.5
Plan 6: + Repeal AMT exemption phase out	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	-25.8	-71.0	-85.1	-99.7	-117.0	-132.8	-151.0	-170.4	-191.2	-214.8	-1,258.8
Plan 7: Repeal AMT											-27.9	-76.5	-91.0	-105.7	-123.6	-139.7	-158.3	-178.0	-199.2	-223.2	-1,323.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).
Notes:
AMT taxpayers reported for calendar years, revenue cost is for fiscal years. Plans take effect 1/1/07.
(a) Expiring provisions limit the use of personal nonrefundable credits after 2006, limit the use of the EITC and the child credit after 2010, and eliminate the increased AMT exemption amounts after 2006.
(b) Baseline extends all individual income and estate tax provisions scheduled to sunset in 2010.

Appendix Table 2
Percentage Change in Number of AMT Taxpayers under Incremental AMT Reform Plans, 2007

Plan	Cash Income Class (thousands of 2006 dollars)											
	All	< 10	10-20	20-30	30-40	40-50	50-75	75 - 100	100 - 200	200 - 500	500 - 1,000	> 1,000
Plan 1: Extend expiring AMT relief[a]	-81.4	*	*	*	-99.8	-99.2	-97.4	-97.6	-91.1	-34.7	-10.6	-6.5
Plan 2: + Index AMT at 2006 levels	-84.8	*	*	*	-99.8	-99.2	-98.0	-98.3	-93.8	-45.1	-12.4	-7.5
Plan 3: + Allow dependent exemptions	-88.2	*	*	*	-99.8	-99.8	-99.0	-99.0	-96.5	-55.3	-17.9	-9.1
Plan 4: + Allow standard and state and local tax deductions	-97.1	*	*	*	-99.8	-99.8	-99.3	-99.5	-98.9	-92.8	-67.5	-50.9
Plan 5: + Allow misc. and medical deductions	-98.2	*	*	*	-99.8	-99.8	-99.8	-99.9	-99.6	-95.4	-72.3	-58.8
Plan 6: + Repeal AMT exemption phase out	-99.2	*	*	*	-99.8	-99.8	-99.8	-99.9	-99.6	-98.0	-94.2	-84.8
Plan 7: Repeal AMT	-100.0	*	*	*	-100.0	-100.0	-100.0	-100.0	-100.0	-100.0	-100.0	-100.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).
Notes:
Calendar year.
* Less than .05 percent of taxpayers in the income class pay the AMT under current law.
(a) Expiring provisions limit the use of personal nonrefundable credits after 2006, limit the use of the EITC and the child credit after 2010, and eliminate the increased AMT exemption amounts after 2006.

Appendix Table 3

Number of Tax Units and Taxpayers, Selected Years

Tax Units in Millions

Cash Income Class ($ thousands)	Current Law 2007	2010	2011	2016
Less than 100	126.4	128.8	129.7	134.0
100 - 200	16.7	18.8	19.4	22.9
200 - 1,000	5.2	6.1	6.4	7.8
More than 1,000	0.4	0.4	0.4	0.5
All	149.3	154.7	156.5	165.7

Taxpayers in Millions [a]

Cash Income Class ($ thousands)	Current Law 2007	2010	2011	2016
Less than 100	68.2	71.4	77.7	80.2
100 - 200	16.5	18.6	19.2	22.7
200 - 1,000	5.2	6.1	6.4	7.7
More than 1,000	0.4	0.4	0.4	0.5
All	90.3	96.5	103.8	111.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1)
Notes:
Calendar years. Tax units (and taxpayers) that are dependents of other tax units are excluded from the analysis.
(a) Taxpayers are defined as those with positive individual income tax liability net of refundable credits.