# PRESENT LAW AND ISSUES RELATING TO THE CORPORATE AND INDIVIDUAL ALTERNATIVE MINIMUM TAX (AMT)

Scheduled for a Hearing

Before the

SENATE COMMITTEE ON FINANCE

on May 3, 1995

Prepared by the Staff

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## INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on May 3, 1995, on issues relating to the alternative minimum tax ("AMT") on individuals and corporations and proposed changes to the AMT included in H.R. 1215 (the "Tax Fairness and Deficit Reduction Act of 1995") as passed by the House of Representatives on April 5, 1995. This document,[1] prepared by the staff of the Joint Committee on Taxation, describes present-law AMT rules and the provisions in H.R. 1215, and discusses issues relating to the present-law AMT.

Part I of the document is an overview of present-law AMT and the provisions in H.R. 1215. Part II describes the present-law AMT rules and the legislative background of the AMT. Part III is an analysis of the present-law AMT rules, including data on individual and corporate AMT taxpayers. Part IV is a description of the AMT provisions in H.R. 1215 as passed by the House.

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[1] This document may be cited as follows: Joint Committee on Taxation, Present Law and Issues Relating to the Corporate and Individual Alternative Minimum Tax (AMT) (JCX-22-95), May 2, 1995.

# I. OVERVIEW

## Present law and background

Present law imposes a minimum tax, known as the alternative minimum tax ("AMT"), on an individual or a corporation to the extent the taxpayer's minimum tax liability exceeds its regular tax liability. The individual AMT is imposed at rates of 26 and 28 percent on alternative minimum taxable income in excess of a phased-out exemption amount. The corporate AMT is imposed at a rate of 20 percent on alternative minimum taxable income in excess of a $40,000 exemption amount.

Alternative minimum taxable income is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items. In the case of a corporation, in addition to the regular set of adjustments and preferences, there is a second set of adjustments known as the "adjusted current earnings" adjustment. The adjusted current earnings adjustment replaced the "book income" adjustment for taxable years beginning after 1989. Thus, for many taxpayers, when compared to the regular tax, the AMT generally imposes a lower marginal rate of tax on a broader base of income.

If a corporation is subject to AMT in any year, such amount of tax is allowed as a credit in any subsequent taxable year to the extent the corporation's regular tax liability exceeds its tentative minimum tax in such subsequent year. For an individual, this credit is allowed to the extent the taxpayer's AMT liability is a result of adjustments that are timing in nature.

The corporate AMT was enacted as part of the Tax Reform Act of 1986. Prior to 1987, corporations were subject to an "add-on" minimum tax. The Tax Reform Act of 1986 also expanded the pre-existing individual alternative minimum tax. Various changes have been made to the AMT since 1986, including the repeal of certain preferences and adjustments and increases to the individual AMT rate.

## Analysis of issues

Relatively few individuals are subject to the AMT. Those that are so subject tend to be individuals with higher adjusted gross incomes. Similarly, relatively few corporations are subject to the AMT. However, large corporations are more likely to be subject to the AMT than are small corporations. This is generally true because large corporations tend to be more capital intensive and many of the preferences and adjustments of the corporate AMT relate to the cost recovery of capital items, such as depreciation.

As a separate system within the regular tax system, the AMT should be analyzed in terms of equity, efficiency, growth, and simplicity. The individual AMT may act to increase the progressivity of the income tax system. The effects of the AMT on the cost of capital and aggregate investment is uncertain. The AMT creates additional compliance burdens and is viewed as complex by taxpayers.

**H.R. 1215 as passed by the House**

H.R. 1215 (the "Tax Fairness and Deficit Reduction Act of 1995"), as passed by the U.S. House of Representatives on April 5, 1995, would repeal the corporate AMT for taxable years beginning after December 31, 2000. In addition, the bill generally would repeal the various adjustments and preferences that relate to business activities of individuals and corporations for transactions entered into after December 31, 1995. The depreciation adjustment would be repealed for property placed in service after March 13, 1995. The individual AMT, as amended by the bill, would remain in existence. For taxable years beginning after December 31, 1995, a taxpayer with AMT credit carryovers would be allowed to use these credits to offset 90 percent (rather than 100 percent) of its regular tax liability (determined after the application of other credits as under present law).

## II. PRESENT LAW AND LEGISLATIVE BACKGROUND

### A. Present-Law Rules

**In general**

Present law imposes a minimum tax (known as the alternative minimum tax ("AMT")) on an individual or a corporation to the extent the taxpayer's minimum tax liability exceeds its regular tax liability. The individual minimum tax is imposed at rates of 26 and 28 percent on alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount. The 26 percent rate is applied to the extent that an individual's AMTI in excess of an exemption amount does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return). The 28 percent rate is applied to the amount in excess of $175,000. The exemption amounts are: (1) $45,000 in the case of married individuals filing a joint return or a surviving spouse, (2) $33,750 in the case of a single individual; and (3) $22,500 in the case of a married individual filing a separate return or an estate or a trust. The exemption amounts are not indexed for inflation and are phased-out by an amount equal to 25 percent of the amount by which the taxpayer's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return or a surviving spouse, (2) $112,500 in the case of a single individual, and (3) $75,000 in the case of a married individual filing a separate return or an estate or a trust. The corporate AMT is imposed at a rate of 20 percent on AMTI in excess of a $40,000 exemption amount.[2] The corporate exemption amount is not indexed for inflation and is phased-out by an amount equal to 25 percent of the amount by which the corporation's AMTI exceeds $150,000.

Alternative minimum taxable income is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items. In the case of a corporation, in addition to the regular set of adjustments and preferences, there is a second set of adjustments known as the "adjusted current earnings" adjustment.

**Preference items in computing AMTI**

The minimum tax preference items are:

(1) The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. For taxable years beginning after 1992, this preference does not apply to percentage depletion allowed with respect to oil and gas properties.

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[2] In addition, in the case of a corporation, section 59A imposes an environmental tax at a rate of 0.12 percent on modified AMTI in excess of a $2,000,000 exemption amount. Environmental tax collections are dedicated to the Hazardous Substance Superfund. This tax is scheduled to expire for taxable years beginning after December 31, 1995.

(2) The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. "Excess intangible drilling costs" is the amount by which the regular tax deduction for intangible drilling costs exceeds the amount that would have been deducted had such costs been capitalized and amortized over a 120-month period. For taxable years beginning after 1992, this preference does not apply to independent producers to the extent the producer's AMTI is reduced by 40 percent (30 percent in 1993) or less by ignoring the preference.

(3) The amount that a financial institution's bad debt deduction determined under section 593 (the percentage of taxable income method generally available to savings and loan associations) exceeds the amount that would have determined based on the institution's actual experience.

(4) Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds) issued after August 7, 1986.

(5) Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

(6) One-half of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter farm or passive activities are denied.[3]

**Adjustments in computing AMTI**

The adjustments that all taxpayers must make are:

(1) Depreciation on property placed in service after 1986 must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property.[4]

(2) Mining exploration and development costs expensed under the regular tax must be capitalized and amortized over a 10-year period.

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[3] Given the full applicability of section 469 (relating to the deductibility of losses from passive activities) following a phase-in period after the passage of the Tax Reform Act of 1986, these provisions are largely deadwood.

[4] Generally, under the regular tax, the 200-percent declining balance method applies to tangible personal property with a class life of less than 20 years, the 150-percent declining balance method applies to tangible personal property with a class life between 20 and 25 years, and the straight-line method applies to all other property.

(3) Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.[5]

(4) The amortization deduction allowed for pollution control facilities (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax) must be calculated under the alternative depreciation system.

(5) Dealers in property (other than certain dealers of timeshares and residential lots) may not use the installment method of accounting.[6]

The adjustments applicable to individuals are:

(1) The miscellaneous itemized deductions (generally those that are allowable against the regular tax if they are in excess of two percent of the taxpayer's adjusted gross income) are not allowed.

(2) State, local, and foreign real property taxes; state and local personal property taxes; and state, local, and foreign income, war profits, and excess profits taxes are not allowed as itemized deductions.

(3) Medical expenses, except to the extent in excess of ten percent of the taxpayer's adjusted gross income, are not allowed as itemized deductions.

(4) Certain restrictions are placed on home mortgage interest that is otherwise deductible for regular tax purposes.

(5) Standard deductions and personal exemptions are not allowed.

(6) The amount allowed to be expensed and deducted under the regular tax for circulation expenditures must be capitalized and amortized over a three-year period.

(7) The amount allowed to be expensed and deducted under the regular tax for research and

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[5] Pursuant to a provision in the Omnibus Budget Reconciliation Act of 1989, most taxpayers producing property pursuant to a long-term contract must use the percentage of completion method for regular tax purposes. Under prior law, contractors could use the completed contract method to report income from a portion of the contract.

[6] Pursuant to a provision in the Revenue Act of 1987, most dealers in property are denied the use of the installment method. Under prior law, dealers were allowed to report income under the installment method.

experimental expenditures must be capitalized and amortized over a 10-year period;[7] and

(8) The special rules relating to incentive stock options do not apply.[8]

The adjustments applicable to corporations are:

(1) The special rules applicable to Merchant Marine capital construction funds do not apply.[9]

(2) The special deduction under section 833(b) (relating to Blue Cross and Blue Shield organizations) is not allowed; and

(3) The adjusted current earnings adjustment, as described below, applies.

**Adjusted current earnings and book income adjustments**

The adjusted current earnings adjustment increases a corporation's AMTI by an amount equal to 75 percent of the amount by which the adjusted current earnings ("ACE") of the corporation exceeds its AMTI (determined without the ACE adjustment and the alternative tax net operating loss deduction).[10] In determining ACE, the following rules apply:

(1) For property placed in service before 1994, depreciation generally is determined using the straight-line method and the class life determined under the alternative depreciation system.[11]

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[7] No adjustment is required if the taxpayer materially participates in the activity that relates to the research and experimental expenditures.

[8] Under the regular tax, no income results at the time of the qualified transfer of any share of stock pursuant to the exercise of an incentive stock option.

[9] Generally under the regular tax, amounts contributed to a Merchant Marine capital construction fund may be expensed, earnings on investments within the fund are not subject to tax, and withdrawals from the fund are not subject to tax to the extent the amount of the withdrawal is used to reduce the adjusted basis of a qualified vessel.

[10] If ACE is less than AMTI, the ACE adjustment may reduce AMTI to the extent of prior-year ACE inclusions.

[11] Pursuant to a provision in the Omnibus Budget Reconciliation Act of 1993, the ACE depreciation adjustments is not required for property placed in service after 1993. See the discussion in Part II.B. below, for changes made to the corporate depreciation adjustment.

(2) Any amount that is excluded from gross income under the regular tax, but is included for purposes of determining earnings and profits, is included in determining ACE.[12] Thus, for example, interest income on State and local bonds that is tax-exempt under section 103 is included in ACE.

(3) The inside build-up of a life insurance contract is includible in ACE (and the related premiums are deductible).[13]

(4) Intangible drilling costs (other than those incurred by an independent producer after 1992) must be capitalized and amortized over a 60-month period, rather than expensed and deducted.

(5) The regular tax rules of sections 173 (allowing circulation expenditures to be expensed) and 248 (allowing organizational expenditures to be amortized over a 60-month period) do not apply.

(6) Inventory must be calculated using the FIFO, rather than LIFO, method.

(7) The installment sales method generally may not be used.

(8) No loss may be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

(9) Depletion (other than oil and gas depletion claimed by an independent producer or a royalty owner after 1992) must be calculated using the cost, rather than the percentage, method; and

(10) In certain cases, the adjusted bases of the assets of a corporation that has undergone an ownership change must be stepped-down to their fair market values.[14]

The ACE adjustment applies to taxable years beginning after 1989. For taxable years beginning after 1986 and before 1990, the AMTI of a corporation was increased by the "book income adjustment," as described in detail in Part II.B. below.

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[12] Exceptions and special rules are provided for related expenses that are not deductible for regular tax purposes but reduce earnings and profits, the dividends received deduction relating to certain dividends, taxes on dividends from 936 companies, and certain dividends received by certain cooperatives.

[13] Under the regular tax, the inside build-up of a life insurance contract is not subject to tax and the related premiums are not deductible.

[14] Under the regular tax, the usage of built-in losses with respect to assets acquired after a corporate change of ownership may be limited by section 382. The effect of the ACE provision is to eliminate such losses for ACE purposes.

### Other rules

The combination of the taxpayer's net operating loss carryover and foreign tax credits generally cannot reduce the taxpayer's AMT by more than 90 percent of the amount determined without these items.

The various credits allowed under the regular tax generally are not allowed against the AMT.

If a taxpayer is subject to AMT in any year, such amount of tax is allowed as a credit in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax in such subsequent year. If the taxpayer is an individual, this credit is allowed to the extent the taxpayer's AMT liability is a result of adjustments that are timing in nature.

## B. Legislative Background

### Minimum taxes prior to the Tax Reform Act of 1986

Immediately prior to the Tax Reform Act of 1986 ("1986 Act"), corporations were subject to an "add-on" minimum tax (first introduced in 1969 and applied to both individuals and corporations) and individuals were subject to an alternative minimum tax similar to the AMT of present law. This individual alternative minimum tax was first introduced in 1978.

A corporation was subject to the "add-on" minimum tax in addition to its regular tax liability. The amount of the tax was 15 percent of the corporation's tax preferences, to the extent the aggregate amount of these preferences exceeded the greater of the regular income tax paid or $10,000. The corporate tax preferences were: (1) the excess of accelerated over straight-line depreciation in the case of real property; (2) the excess of 60-month amortization over the amount of depreciation otherwise allowable in the case of certified pollution control facilities; (3) the excess of bad debt deductions over the amount of those deductions computed on the basis of actual experience in the case of a financial institution; (4) percentage depletion to the extent in excess of the adjusted basis of the depletable property; and (5) 18/46 of the corporation's net capital gain.[15] Special rules also applied to corporations with net operating losses.[16]

Prior to the 1986 Act, individuals were subject to an alternative minimum tax that resembled the AMT of present law. The tax was payable in addition to all other tax liabilities to the extent it exceeded the individual's regular tax liability. The tax was imposed at flat rate of 20 percent on

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[15] Prior to the 1986 Act, corporations were subject to a maximum rate of tax of 28 percent on net capital gains and a maximum rate of tax of 46 percent on ordinary income.

[16] In addition, section 291 provided a reduction in the use of certain preferences by corporations in computing taxable income. Section 291, as amended by the 1986 Act, remains in present law.

alternative minimum taxable income in excess of an exemption amount. A taxpayer's alternative minimum tax liability could be reduced by foreign tax credits and refundable credits. An individual's alternative minimum taxable income was his or her adjusted gross income, increased by certain preferences and reduced by alternative tax itemized deductions.

The tax preference items were: (1) dividends excluded from taxable income under prior-law section 116 (prior law allowed an individual to exclude up to $100 of dividends annually); (2) the excess of accelerated over straight-line depreciation in the case of real property; (3) the excess of accelerated over straight-line depreciation (the latter using lengthened recovery periods) in the case of leased personal property; (4) the excess of 60-month amortization over the amount of depreciation otherwise allowable in the case of certified pollution control facilities; (5) the excess of the deduction for expensed mining exploration and development costs over the amount that would be allowable if the costs were capitalized and amortized over a 10-year period; (6) the excess of the deduction for expensed circulation expenditures over the amount that would be allowable if the costs were capitalized and amortized over a 3-year period; (7) the excess of the deduction for expensed research and development expenditures over the amount that would be allowable if the costs were capitalized and amortized over a 10-year period; (8) percentage depletion to the extent in excess of the adjusted basis of the depletable property; (9) that portion of net capital gains that were deductible from gross income (unless the gain related to the sale or exchange of a principal residence);[17] (10) the excess of the fair market value received through the exercise of an incentive stock option over the exercise price; and (11) the amount by which excess intangible drilling costs deducted in the taxable year exceeded the net income from oil, gas, and geothermal properties. An individual could avoid some of the preferences listed above by electing to defer regular tax deductions for circulation expenditures, research and experimental expenditures, intangible drilling costs, mining exploration and developments costs, and depreciation. An individual may have had an incentive to make such an election even though it increased his or her regular taxable income in the year of the election in order to reduce his or her alternative minimum tax liability in future years. The election may have been attractive because the prior-law alternative minimum tax was, in many respects, an "add-on" system (i.e., minimum tax paid with respect to timing preferences did not give rise to a credit to be used in subsequent years).

The itemized deductions that an individual could deduct for minimum tax purposes were casualty or theft losses, gambling losses to the extent of gambling gains, charitable deductions, medical deductions to the extent in excess of 10 percent of the taxpayer's adjusted gross income, interest expense on qualified home indebtedness, other interest expense not in excess of qualified net investment income, and deductions for estate tax attributable to income in respect of a decedent.

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[17] Prior to the 1986 Act, individuals could deduct from income up to 60 percent of net capital gains.

**Changes made by the Tax Reform Act of 1986**

The 1986 Act replaced the corporate "add-on" minimum tax with the present-law corporate AMT. The 1986 Act also broadened the base of the pre-existing individual alternative minimum tax. In addition, the 1986 Act increased the individual AMT rate to 21 percent, phased-out the exemption amounts, provided the AMT credit, and changed the individual AMT from essentially an add-on system of preferences to a separate tax system of preferences and adjustments, the latter of which were deferral items that could "turn-around" (i.e., decrease AMTI) over the life of the related property.

The 1986 Act provided that the ACE adjustment described in Part II.A., above, was to apply to taxable years beginning after 1989 and the "book income adjustment" was to apply to taxable years beginning in 1987, 1988, and 1989. The book income adjustment was the amount equal to 50 percent of the amount by which the adjusted net book income of a corporation exceeded its AMTI (determined without the book income adjustment and the alternative tax net operating loss deduction). The "adjusted net book income" of a corporation meant the net income or loss of the corporation as set forth in the corporation's applicable financial statement, with the following adjustments:

(1) Adjusted net book income did not include any Federal income taxes, or income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States, unless such foreign taxes were deducted rather than claimed as a credit on the taxpayer's return. In addition, adjusted book earnings could be reduced by the corporation's environmental tax liability under section 59A.

(2) If the corporation filed a consolidated return with other corporations, adjusted net book income took into account items of the corporation's applicable financial statement that were properly allocable to the members of the group that were included in the return, with appropriate adjustments for dividends received from affiliated corporations that were not included in such return.

(3) Appropriate adjustments were required to the extent the applicable financial statement covered a period other than the corporation's taxable year.

(4) In the case of a cooperative to which section 1381 applies, adjusted net book income did not include patronage dividends and per-unit retain allocations to the extent such amounts were not otherwise taken into account in determining adjusted net book income.

(5) Subject to certain limitations, for purposes of determining the alternative minimum tax foreign tax credit, 50 percent of any taxes withheld or tax paid to any possession of the United States with respect to dividends received from a section 936 corporation were treated as a tax paid to a foreign government.

(6) In the case of an Alaskan Native Corporation, adjusted net book income would be appropriately adjusted to allow cost recovery and depletion deductions attributable to property

received pursuant to the Alaskan Native Claims Settlements Act and for certain payments made pursuant to such Act.

(7) In the case of a mutual life insurance company, adjusted net book income was reduced by policyholder dividends to the extent such payments exceeded the differential earnings amount determined under section 809.

(8) In the case of a corporation in title 11, or to the extent the corporation is insolvent, adjusted net book income did not include any income resulting from the transfer of stock of the corporation in the discharge of its indebtedness.

(9) The Secretary of the Treasury had the authority to properly adjust adjusted net book income to prevent the omission or duplication of any item.

For this purpose, the applicable financial statement of a corporation was an statement covering the taxable year which was (1) required to be filed with the Securities and Exchange Commission; (2) a certified audited income statement to be used for purposes of a statement or report for credit purposes, to shareholders, or for any other substantial nontax purposes; (3) an income statement for a substantial nontax purpose required to be provided to the Federal government, a State government, a political subdivision of a State, or any agency of any of the above; or (4) an income statement to be used for purposes of a statement or report for credit purposes, to shareholders, or for any other substantial nontax purposes. If a corporation did not have an applicable financial statement, the earnings and profits of the corporation was considered to be the net income or loss of the corporation as set forth in an applicable financial statement. In addition, if a corporation had only a statement described in (4) above, the corporation could elect to use its earnings and profits in lieu of net income or loss on such statement. If a corporation had more than one statement described above, the corporation generally was to take into account the first statement delineated above.

## Changes made since the Tax Reform Act of 1986

Certain amendments have been made to the individual and corporate AMT bases and rates since the 1986 Act. The principal changes are described below.

### Tax rates

The individual AMT rate was raised from a flat 21 percent to a flat 24 percent by the Omnibus Budget Reconciliation Act of 1990 ("1990 Act"). The Omnibus Budget Reconciliation Act of 1993 ("1993 Act") instituted the two-tier individual rate system (at 26 and 28 percent) of present law and increased the individual exemption amounts. Both the 1990 and 1993 Acts increased the top marginal individual rates for purposes of the regular income tax. The corporate AMT rate has remained at 20 percent since the 1986 Act.

Depreciation

Several changes have been made to the corporate depreciation adjustment. For taxable years beginning in 1987, 1988, and 1989, corporations were subject to the book income adjustment. Thus, for AMT purposes, the allowable deduction for the cost of depreciable property placed in service in those years generally was effectively bifurcated--one-half of the deduction was determined using the 150-percent declining balance method over the alternative depreciation system class life for the property and the other half was determined pursuant to whatever method the taxpayer used for book purposes. For property placed in service prior to 1987, the deduction was also bifurcated--one-half of the deduction was determined using the regular tax allowance and the other half was determined under the taxpayer's book method.

The corporate ACE adjustment (applicable to taxable years beginning after 1989) generally required the cost of depreciable property to be recovered using the straight-line method over the alternative depreciation system life of the property. Thus, for AMT purposes, the allowable deduction for the cost of depreciable property placed in service after 1989 and before 1994 generally was bifurcated as follows--25 percent of the deduction was determined using the 150-percent declining balance method over the alternative depreciation system class life for the property (the AMT depreciation adjustment applicable to all taxpayers) and 75 percent was determined using the straight-line method over the same alternative depreciation system class life (the ACE depreciation adjustment). The combination of the two systems results in depreciation allowances that are roughly equivalent to the allowances that would have been obtained had the corporation used the 120-percent declining balance method over the alternative depreciation system class life for the applicable property. The ACE depreciation adjustment also had transition rules for property placed in service before 1990. For property placed in service prior to 1990, corporations were required to recover the remaining basis of property over the remaining class life under the alternative depreciation system and using the straight-line method for ACE purposes. For property placed in service prior to 1987, remaining basis means adjusted basis under the regular tax. For property placed in service prior after 1986 and before 1990, remaining basis means adjusted basis under the AMT depreciation adjustment applicable to all taxpayers (i.e., using the 150-percent declining balance method over the alternative deprecation system class life for personal property). In addition, as originally enacted, ACE contained a provision that provided that the ACE depreciation deduction could not exceed the depreciation expense the corporation claimed for book purposes. Similar rules applied with respect to intangible drilling costs, depletion and mining expenses. These "book-backstop" rules were repealed by the Omnibus Budget Reconciliation Act of 1989.

The ACE depreciation adjustment was repealed by the 1993 Act for property placed in service after December 31, 1993. The ACE depreciation adjustment remains applicable to property placed in service before that date.

Oil and gas provisions

The 1986 Act version of the AMT contained several provisions that related to oil and gas exploration and production.[18] Preferences included (1) the deduction for percentage depletion to the extent the deduction exceeded the adjusted basis of the property and (2) the amount by which excess intangible drilling costs ("IDCs" ) arising in the taxable year exceeded 65 percent of the net income from oil and gas properties. "Excess IDCs" was the amount by which the regular tax deduction for IDCs exceeded the amount that would have been deducted had such costs been capitalized and amortized over a 120-month period. In addition, under ACE, percentage depletion could not be used and the cost of IDCs had to be capitalized and amortized over a 60-month period.

The 1990 Act provided a special energy deduction for purposes of reducing AMTI. The deduction was based on a specific portion of the various oil and gas related preference and ACE adjustment items. Specifically, the special energy deduction was initially determined by determining the taxpayer's IDC preference and marginal production depletion preference. The amount of these preferences was the amount that the taxpayer's AMTI would have been reduced had the AMT rules relating to IDCs and percentage depletion on marginal properties not applied. The IDC preference was divided between qualified exploratory costs and other costs and each portion, and the marginal production depletion preference, were multiplied by specified percentages. These three products were added together to comprise the special energy deduction. The special energy deduction was not allowed to the extent it exceeded 40 percent of the taxpayer's AMTI (determined without this deduction and net operating losses). In addition, the special energy deduction was phased-out if the average price of crude oil exceeded $28 a barrel in the prior year.

The special energy deduction was repealed in the Energy Policy Act of 1992. The 1992 Act also repealed the preferences and ACE adjustments for the deductions of IDCs and percentage depletion of oil and gas producers other than integrated oil companies. The repeal of the IDC preference and ACE adjustment could not reduce a taxpayer's AMTI by more than 40 percent (30 percent in 1993) of the amount that the taxpayer's AMTI would have been had the preference and adjustment ACE not been repealed.

Charitable contributions of appreciated property

Under the regular tax, a taxpayer generally is allowed to deduct the fair market value of appreciated property contributed to a charity. The 1986 Act included a preference that limited a taxpayer's deduction for the charitable contribution of appreciated property to the taxpayer's adjusted basis in the property. The 1990 Act repealed this preference for tangible personal property contributed in taxable years beginning in 1991 and contributions made before July 1, 1992, in taxable years beginning in 1992. The 1993 Act repealed the preference for tangible personal property contributed after June 30, 1992, and other appreciated property contributed after December 31, 1992.

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[18] As discussed above, the corporate and individual minimum taxes in effect before the 1986 Act also contained preferences with respect to oil and gas exploration and production.

Miscellaneous changes

The Omnibus Budget Reconciliation Act of 1989 made miscellaneous changes to the AMT. These changes: (1) allowed additional dividends to qualify for the dividends-received deduction under ACE, (2) excluded discharge of indebtedness income from ACE to the extent the income was excluded under the regular tax, (3) repealed certain ACE capitalization rules, (4) conformed the effective date of the ACE change of ownership provision with the general effective date of ACE, (5) conformed certain ACE and regular tax rules with respect to IDCs, (6) repealed ACE rules with respect to annuities, (7) excepted small home construction contracts from the AMT long-term contract rule, (8) repealed the AMT adjustment for research and development expenditures for individuals who actively participate in the underlying business, (10) provided an exception to the 90-percent limitation on the use of foreign tax credits, (11) increased the minimum tax credit by the amount of the orphan drug credit not allowed solely by reason of the tentative minimum tax limitation, and (12) allowed corporations to use the entire amount of their AMT liability as a minimum tax credit (under prior law, corporations were only allowed the credit with respect to deferral items; this rule currently applies to individuals).

Moreover, certain changes have been made to the regular income tax to more closely conform its base to the AMT base. For example, many of the preferences contained in the pre-1986 individual alternative minimum tax were enacted, in part, because of a concern with individuals investing in tax shelter activities. The 1986 Act directly addressed this concern with the enactment of the passive activity rules of section 469. Similarly, the present-law AMT adjustments relating to installment sales by dealers and long-term contracts apply to relatively few taxpayers because since 1986, Congress has, with some exceptions, adopted the AMT treatment for these items for regular tax purposes. Finally, the depreciable recovery period for nonresidential real estate under the regular tax (39 years) now approximates the period used for AMT purposes (40 years).

# III. ANALYSIS OF ISSUES

## A. Data on AMT Taxpayers

**Individual AMT taxpayers**

Relatively few taxpayers, either individual or corporate, are subject to the AMT. In 1992, of the 86.7 million individual income tax returns with positive tax liability, approximately 287,000, or 0.33 percent, paid tax arising from an individual AMT liability.[19] Table 1 presents individual AMT data for the 1987-92 tax years.

**Table 1.--Individual Income Tax Returns With Tax Liability Under the Individual Alternative Minimum Tax, 1987-1992**

| Year | Number of returns (thousands) with positive tax liability | Number of returns (thousands) paying AMT | Percentage of returns paying AMT | Excess of AMT liability over regular liability $ (millions) |
|---|---|---|---|---|
| 1987 | 86,723 | 139.8 | 0.16 | 1,674.9 |
| 1988 | 87,135 | 113.6 | 0.13 | 1,027.9 |
| 1989 | 89,178 | 117.5 | 0.13 | 831.0 |
| 1990 | 89,862 | 132.1 | 0.15 | 830.3 |
| 1991 | 88,734 | 243.7 | 0.27 | 1,213.4 |
| 1992 | 86,731 | 287.2 | 0.33 | 1,357.1 |

Source: Internal Revenue Service, *Statistics of Income*, various years.

In 1992, the approximately 287,000 individual AMT taxpayers had a total tax liability of $1.36 billion arising from the excess of their AMT over their regular tax, or 0.28 percent of $476.2 billion in total individual income tax liabilities. Table 2 below reports how individual AMT taxpayers were distributed across various income classes in 1991 when those classes are demarcated by adjusted gross income ("AGI") as defined under the regular individual income tax.

[19] Joint Committee on Taxation tabulations from Internal Revenue Service, Statistics of Income, Individual Income Tax Returns, 1992.

**Table 2.-- Distribution of Individual AMT Taxpayers and Liabilities by Adjusted Gross Income, 1991**

| AGI | Number of Returns | Tax Liability (Thousands $) |
|---|---|---|
| No AGI | 4,261 | 53,720 |
| $1 to less than $5,000 | 14,164 | 3,501 |
| $5,000 to less than $10,000 | 8,431 | 4,941 |
| $10,000 to less than $25,000 | 3,402 | 7,607 |
| $25,000 to less than $50,000 | 18,537 | 37,246 |
| $50,000 to less than $75,000 | 39,955 | 84,250 |
| $75,000 to less than $100,000 | 35,783 | 87,982 |
| $100,000 to less than $200,000 | 69,309 | 249,880 |
| $200,000 to less than $500,000 | 39,344 | 322,047 |
| $500,000 to less than $1 million | 7,275 | 143,776 |
| $1 million and over | 3,211 | 218,475 |
| Total | 243,672 | 1,213,426 |

Source: Internal Revenue Service, *Statistics of Income*, 1991

Table 2 reveals two features that would be expected from the design of the AMT.[20] First, as explained in Part II.A. above, the AMT broadens the base of regular income tax by adding back into income some exclusions from income, tax preferences, the standard and certain itemized deductions, and personal exemptions. Hence, some taxpayers with low or no incomes under the regular tax may have relatively high AMTI. For example, in 1991, 4,261 returns that showed no adjusted gross income and thereby would have had no income tax liability under the regular tax paid over $53 million income taxes under the AMT.[21] Second, many of the AMT preferences and adjustments relate to investment and business income and itemized deductions. Investment and business income and itemizing deductions are more prevalent among taxpayers with higher income. Table 2 shows that almost 80 percent of all AMT taxpayers have adjusted gross incomes of $50,000 or greater. Only 20 percent of all individual taxpayers with positive tax liabilities in 1991 had adjusted gross incomes of $50,000 or greater.

[20] Also in 1991, 32,154 individual returns claimed $169.3 million in tax credits for AMT paid in prior years.

[21] There were 926,020 returns filed in 1991 reporting no adjusted gross income.

## Corporate AMT taxpayers

The corporate AMT is paid by relatively few corporations. For example, in 1990, approximately 32,000 of 2.1 million corporate income tax returns included an AMT liability. Table 3 reports corporate AMT taxpayers as a percentage of all corporate income tax returns between 1987 and 1992.

**Table 3.--Corporate AMT Taxpayers as a Percentage of All Corporate Returns, 1987-1992**

| Year | Percentage of Corporate AMT Taxpayers |
|---|---|
| 1987 | 0.7 |
| 1988 | 1.1 |
| 1989 | 1.1 |
| 1990 | 1.5 |
| 1991 | 1.5 |
| 1992 | 1.3 |

Source: U.S. General Accounting Office, *Experience With the Corporate Alternative Minimum Tax*, (GAO/GGD-95-88), April 1995, Table II.2, p. 34.

Tax payments under the corporate AMT constitute a larger percentage of all corporate income tax payments than is the case of the individual AMT. In 1992, total corporate income tax revenue was $96.8 billion. Of this amount, AMT payments contributed $4.9 billion, and $2.3 billion in credits for prior AMT paid were claimed. The net, $2.6 billion, comprised 2.6 percent of all corporate income tax payments.[22]

Larger corporations are more likely to be AMT taxpayers than are smaller corporations. A recent General Accounting Office (GAO) study calculates that less than half of one percent of corporations with less than $1 million in assets were paying AMT, while more than 20 percent of corporations with more than $1 billion in assets were paying AMT.[23] This outcome would be expected

[22] The Omnibus Budget Reconciliation Act of 1993 eliminated the ACE depreciation adjustment for property placed in service after 1993. Over time, this should reduce the number of corporate and individual AMT taxpayers and the AMT liabilities relative to the data reported here for 1992 and earlier.

[23] U.S. General Accounting Office, *Experience With the Corporate Alternative Minimum Tax*, (GAO/GGD-95-88), April 1995, p. 35.

by the design of the AMT. The AMT includes as an adjustment the difference between accelerated depreciation claimed under the regular tax system and depreciation calculated under the AMT's less generous allowance schedules. As described in Part II.A. of this document, other AMT preferences and adjustments defer the recovery of other capital costs that are deductible under the regular tax. Thus, the greater a corporation's capital assets, the greater its total value of accelerated depreciation and other capital-related preferences and adjustments, and the greater the likelihood the corporation will be an AMT taxpayer. For the same reason, a capital-intensive business is more likely to be subject to the AMT than would a less capital-intensive business with equal gross revenues. The GAO estimated 25 percent of all corporate assets are owned by corporations subject to the AMT.[24] Recognizing the importance of the treatment of depreciation and other capital costs under the AMT may also explain the apparent counter-cyclic pattern of Table 3, where the percentage of corporate AMT taxpayers increased as the economy experienced recession and declined with recovery. Fixed capital assets produce a schedule of depreciation deductions that is invariant to economic conditions. As the economy enters a recession, business receipts fall. Consequently, corporate income as measured under the regular tax declines, but depreciation deductions generally remain the same.[25] Because, in simple terms, a taxpayer becomes subject to the AMT when its AMT tax preferences and adjustments become large relative to its regular taxable income,[26] a recession increases the likelihood that a business will become an AMT taxpayer.[27]

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[24] GAO, *Experience With the Corporate Alternative Minimum Tax,* p. 36.

[25] A business may reduce its purchases of capital equipment during a recession, thereby reducing deductions for depreciation over time.

[26] A taxpayer pays the AMT if its AMT tax liability exceeds its regular tax liability. Let Y represent a corporation's regular taxable income. Let P represent AMT preferences. Then alternative minimum taxable income is (Y+P), and ignoring graduated marginal tax rates under the regular tax, a taxpayer is subject to the AMT when:

$$(.20)(Y+P) > (.35)Y.$$

Simplifying, this is equivalent to:

$$(.20)P > (.15)Y$$

or

$$P/Y > .75.$$

As preferences become large relative to income, the taxpayer is more likely to be subject to the AMT.

[27] The counter-cyclical nature of the corporate AMT is increased by the rules relating to the AMT credit. Under present law, a corporation that pays AMT in one year may carry forward such amount of AMT as a credit to reduce the corporation's regular, but not AMT, tax liability in a subsequent year. As discussed above, a corporation is more likely to be subject to the regular

The preponderance of firms being subject to the AMT being large firms may be explained by other factors as well. First, the corporate AMT contains an $40,000 exemption amount that phases-out as AMTI increases. Second, many smaller firms are closely-held and a closely-held firm has greater control of its corporate income tax liability by entering into transactions with owner-operators of the firm. Finally, it may be expected that because larger firms are more likely to be audited by the Internal Revenue Service than are smaller firms, larger firms are more likely to comply with the AMT rules.

## B. Issues

### Overview

In general, the AMT applies a lower marginal rate of tax to a broader tax base. Thus, the AMT may simultaneously lower the taxpayer's marginal tax rate (the amount of tax liability arising from an additional, or marginal, dollar of income) while increasing the taxpayer's average rate of tax (total tax divided by total income). In the case of income from capital investment, the AMT may increase or decrease the effective marginal tax rate because the tax rate on the income from investment depends upon the capital recovery permitted, for which the AMT generally lengthens recovery period, as well as the statutory rate of tax applied to that income.

Some maintain that the base of the AMT provides a better measure of economic income than does the base of the regular income taxes.[28] Although it is generally true that the base of the corporate AMT more closely adheres to economic income principles than does the regular tax, there are some deficiencies in income measurement in the individual AMT. First, the individual AMT does not contain all the business-related adjustments and preferences contained in the corporate AMT. Second, miscellaneous itemized deductions are preferences under the individual AMT, even though some of these deductions, such as employee business expenses and investment expenses, relate to the production of income and should be deductible in determining economic income.

Strictly speaking, the corporate AMT (and to some extent the individual AMT) is not a separate tax but is a calculation that assesses a larger income tax liability today in return for a reduced income tax liability in the future. Each dollar of AMT paid today generates credits that may be applied against future regular income tax liabilities.[29] However, because AMT credits accrue in nominal dollars, the time value of money erodes the future value of such credits. As a consequence, the AMT increases the

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tax when its gross income rises.

[28] See, for example, Senate Finance Committee, *Report on H.R. 3838, the "Tax Reform Act of 1986,"* at p. 518: "The committee believes that the minimum tax should serve one overriding objective: to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits."

[29] Under the individual AMT, only that portion of the taxpayer's AMT liability that relates to adjustments and preferences that are timing in nature give rise to an AMT credit.

real tax liability of AMT taxpayers.

As a pre-payment of tax rather than a separate tax, the AMT should be assessed as part of the individual and corporate income taxes. Analysts usually evaluate taxes in terms of: (1) equity--the fairness of the tax; (2) efficiency--the extent to which the tax distorts economic decisions; (3) growth--the extent to which the tax system encourages or discourages economic growth; and (4) simplicity--the ease of compliance and administration by affected taxpayers and the IRS.

**Equity**

In practice, the AMT has the effect of requiring more taxpayers to pay over some funds to the Federal Treasury every year, than would be the case if only the regular income taxes applied (see the discussion relating to Table 2 above). To the extent that taxpayers who outwardly appear to have the ability to pay taxes indeed do pay taxes, some observers conclude that the AMT increases the perceived fairness of the income tax system. The Senate Finance Committee noted that this was one of the rationales for the enactment of the corporate AMT.

> In particular, both the perception and the reality of fairness have been harmed by instances in which major companies have no taxes in years in which they reported substantial earnings, and may even have paid substantial dividends to shareholders. Even to the extent that theses instances may reflect deferral, rather than permanent avoidance, of corporate tax liability, the committee believes that they demonstrated a need for change.[30]

To assess whether the AMT promotes the overall equity of the individual and corporate income tax systems, it is necessary to look beyond who remits tax payments to the Federal Treasury to who bears the burden of the individual and corporate income taxes. Regarding the corporate income taxes, economists argue that corporations do not bear the burden of the corporate income tax, but rather individuals bear the burden of the corporate income tax and all other taxes. There is disagreement, however, over which individuals bear the burden of corporate income tax, whether it is customers in the form of higher prices, workers in the form of reduced wages, owners of all capital in the form of lower after-tax returns on investment, or some combination of these individuals.[31] Regarding the individual income tax, while economists generally believe that income taxes on wages are borne by taxpayers who supply labor, there is disagreement concerning the incidence of taxes that affect the returns earned by capital such as the taxation of interest, dividends, capital gains, and business income from pass-through entities.

[30] Senate Finance Committee, *Report on H.R. 3838, the "Tax Reform Act of 1986,"* at p. 519.

[31] For a discussion of incidence of the corporate income tax and taxes on the return to capital, see, Joint Committee on Taxation, *Methodology and Issues in Measuring Changes in the Distribution of Tax Burdens* (JCS-7-93), June 14, 1993, pp. 44-51.

The uncertainty regarding the incidence of income taxes on the returns to capital make it difficult to assess the effect the AMT has on the equity of the burden of the income tax system. As noted above, the AMT raises effective average tax rates for affected taxpayers. At the individual level, the data above suggested that higher-income taxpayers are more likely to be AMT taxpayers than are lower-income taxpayers. If the burden of the taxes were to rest with the affected taxpayers, the individual AMT might increase the overall progressivity of the income tax system.

Some analysts argue that the AMT promotes horizontal equity by taxing more equally taxpayers who have the same economic capacity but choose to engage in different patterns of tax-favored activities. Other analysts note that in a market economy, investment by individuals and corporations would be expected to equilibrate risk-adjusted, after-tax returns. As a consequence, the prices of tax-favored investments would be bid up (or their quantity increase) and the prices of tax-disfavored investments would fall (or their quantity decrease). In equilibrium, the pre-tax returns of tax-favored and tax-disfavored investments would differ, but their after-tax returns would be the same.[32] For example, tax-exempt bonds trade at interest rates lower than otherwise comparable taxable bonds. This is because the tax-exempt borrower does not have to offer as great an interest rate to the lender to provide the lender with a competitive after-tax return. If after-tax returns equilibrate, analysts may questions whether a horizontal inequity existed prior to the enactment of the AMT.

Other analysts note that because, as explained above, the business cycle may move taxpayers onto and off the AMT that the AMT may create its own horizontal inequities by taxing different businesses differently based on the variability of their profits during the course of a business cycle.[33]

**Efficiency and growth**

A tax system is efficient if it does not distort the choices that would be made in the absence of the tax system. No tax system can be fully efficient. Whether the AMT contributes to the efficiency of the United States tax system depends on the extent to which it reduces other inefficiencies in the tax system and the extent to which it creates new inefficiencies. By discouraging some individuals and corporations from undertaking what are otherwise tax-favored investments, efficiency may be increased. However, the AMT generally does not eliminate tax-favored treatment of certain activities or investments, but rather limits which taxpayers may take full advantage of the tax-favored treatment provided by the regular income tax. Some analysts have noted that on efficiency grounds, "no one should care if ten companies each invest a little in a tax-preferred activity or one company invests a lot"

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[32] Andrew B. Lyon, "The Alternative Minimum Tax: Equity, Efficiency, and Incentive Effects," in *Economic Effects of the Corporate Alternative Minimum Tax*, (Washington, D.C.: American Council for Capital Formation Center for Policy Research), 1991, pp. 51-82.

[33] Charles R. Hulten, "Commentary," in *Economic Effects of the Corporate Alternative Minimum Tax*, (Washington, D.C.: American Council for Capital Formation Center for Policy Research), 1991, pp. 84-88.

in such an activity.[34] However, under present law, the ten firms described above could each avoid the AMT while the one firm with the aggregated investment could be subject to the AMT. In addition, limiting which individuals or corporations can profitably undertake tax-favored activities could lead to more efficient investors finding the activity unprofitable, while less efficient investors find the activity profitable. Moreover, some tax-favored activities may be permitted as part of the regular income tax as a way reduce some other inefficiency in the economy. These arguments might suggest that efficiency could be better improved by changes in the regular income taxes.[35]

The effect of the corporate AMT also may lead to increased merger and acquisition activity. As discussed above, a capital-intensive firm (such as a leasing company) is more likely to be subject to the AMT than is a labor-intensive firm (such as a service provider). This may lead to the merger of capital-intensive and less capital-intensive firms so that their combine taxable incomes is not subject to the AMT.

In the mid-1980s there was concern that the regular income tax system created different effective tax rates on capital investment depending upon the source of finance and type of equipment being purchased by the investor. It has been argued that such differentials in effective tax rates reduce the efficiency of investment in the United States. For example, the regular income tax has been criticized as favoring debt-financed investments at the expense of equity-financed investments. One analyst calculated that the AMT would lower the cost of capital for equity-financed investment and increase the cost of capital for debt-financed investment, thereby reducing the regular tax's preference for debt finance.[36] The benefit of debt finance derives from the deductibility of interest expense. An AMT taxpayer deducts such expenses at a 20-percent tax rate rather than a 35-percent tax rate. This increases the after-tax cost of borrowing. At the same time, the returns to equity under the AMT are taxed at a 20-percent marginal tax rate rather than a 35-percent marginal tax rate, increasing the after-tax return to equity. The increased returns to equity investments are mitigated to the extent that, by lengthening depreciation lives and the lowering of the marginal tax rate, the AMT reduces the value of depreciation deductions. If the effect of a lower rate of tax on returns offsets the smaller value of depreciation deductions, equity-financed investments face a lower cost of capital under the AMT. More generally,, that study concluded that "the AMT compresses the range of effective tax rates on alternative classes of investments and sources of financing, thereby reducing the distortionary impact of taxation on

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[34] Michael J. Graetz and Emil M. Sunley, "Minimum Taxes and Comprehensive Tax Reform," in Henry J. Aaron, Harvey Galper, and Joseph A. Pechman (eds.) *Uneasy Compromise: Problems of a Hybrid Income-Consumption Tax*, (Washington, D.C.: The Brookings Institution), 1988, p. 406.

[35] As described in Part II.B. above, Congress has, in certain instances, conformed the regular tax base to the AMT base.

[36] B. Douglas Bernheim, "Incentive Effects of the Corporate Alternative Minimum Tax," in Lawrence H. Summers (ed.), *Tax Policy and the Economy, 3*, (Cambridge: The MIT Press), 1989.

decisions taken by individual firms. ... Furthermore, the AMT tends to move effective tax rates for atypical firms toward the mean, thereby reducing the distortionary impact of taxation on the allocation of capital across firms."[37] Subsequent research has questioned the extent of such efficiency gains, noting that the effective tax rates of firms temporarily on the AMT may show greater variance than those of firms that are routinely, or permanently, AMT taxpayers, or of firms that are regular income tax taxpayers.[38]

In addition, the AMT may affect the level of investment in the United States and thereby affect economic growth. By increasing average tax rates (the total tax paid by certain taxpayers), the AMT may reduce the cash flow of potential investors. If as some analysts believe, investors' cash flows are important to the investment decision, the AMT may reduce aggregate investment.

Finally, the effect of the AMT on effective tax rates, and thereby on the cost of capital, may change the incentive to undertake marginal investment projects and thereby affect the level of aggregate investment. As noted above, one cannot generalize about the effects of the AMT on the cost of capital because the effect varies with the type of investment, the means of finance, and the extent to which the investor is subject to the AMT both currently and in the future. The cost of capital may increase or decrease.[39] Understanding the potential incentive effects also is complicated by the lack of understanding of the magnitude that any such incentive effects may have on aggregate investment.[40] Others note that the uncertainty of knowing whether one will be subject to the AMT increases the uncertainty of investment decisions and may work to reduce investment.

**Simplicity and compliance**

The AMT requires a calculation of a second income tax base[41] and computation of a tax on that base, so the present tax system, with an AMT, is not as simple to administer or comply with as would the same system without an AMT. As detailed above, relatively few individual or corporate taxpayers are subject to the AMT. However, that observation understates the extent to which the AMT imposes a compliance burden on taxpayers. Many taxpayers must undertake the AMT calculation to determine whether, in fact, they are liable. For example, the GAO reported that while only 28,000 corporations

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[37] Bernheim, "Incentive Effects of the Corporate Alternative Minimum Tax," p. 91.

[38] Andrew B. Lyon, "Investment Incentives under the Alternative Minimum Tax," *National Tax Journal*, 43, December 1990, pp. 451-465.

[39] Lyon, "The Alternative Minimum Tax: Equity, Efficiency, and Incentive Effects."

[40] See, GAO, *Experience With the Corporate Alternative Minimum Tax*, for a more detailed review of some of the literature relating to the AMT's possible effects on aggregate investment.

[41] The ACE adjustment causes corporations to have three tax bases.

actually paid corporate AMT in 1992, 400,000 corporations filed the AMT form.[42] The 400,000 figure would understate the number of corporations that did the necessary calculations to determine whether they had an AMT liability.

Survey evidence has suggested that the compliance cost to taxpayers required by the AMT may be large. One recent analysis of tax compliance costs of large businesses finds that being subject to the AMT adds 16.9 percent to the personnel and nonpersonnel compliance costs of complying with Federal income taxes.[43] The average total income tax compliance cost reported in the survey was approximately $1 million, implying that complying with the corporate AMT may require additional expenditures of $160,000 annually by large businesses. While a large number, compliance costs generally are larger for larger businesses which often have more complex business arrangements. The AMT is not the mostly costly aspect of tax compliance. The same study identifies approximately 40 percent of total compliance costs as arising from foreign-source income and that having an ongoing appeal or tax litigation increases compliance costs by 18 to 28 percent.

At the individual level, taxpayers subject to the individual AMT due to business-related activities will experience compliance costs similar to those experienced by corporations subject to the corporate AMT. There are no studies that specifically measure compliance costs arising from the individual AMT. Indirect evidence of the complexity imposed by the individual AMT may be the increased utilization of the services of paid tax preparers by individual taxpayers subject to the individual AMT. In 1988, 14 percent of taxpayers with AGI of $100,000 or more and no significant farming or self-employment income prepared their own tax returns. Of taxpayers with AGI of $100,000 or more and significant income from self employment or farming, nine percent and four percent of taxpayers prepared their own returns. By contrast, only one percent of all taxpayers subject to the individual AMT prepared their own returns.[44] If taxpayers subject to the AMT are more likely to have complicated financial affairs, they might use paid tax preparers in the absence of the AMT.

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[42] GAO, *Experience With the Corporate Alternative Minimum Tax*, p. 3.

[43] Joel Slemrod and Marsha Blumenthal, "The Income Tax Compliance Cost of Big Business," Working Paper No. 93-11, The Office of Tax Policy Research, The School of Business Administration, The University of Michigan, July 1993, p .11.

[44] Based on tabulations of the staff of the Joint Committee on Taxation of the 1988 IRS, Taxpayer Compliance Measurement Program (TCMP).

## IV. DESCRIPTION OF AMT PROVISIONS IN H.R. 1215

**Repeal of the corporate alternative minimum tax**

H.R. 1215 (the "Tax Fairness and Deficit Reduction Act of 1995"), as passed by the U.S. House of Representatives on April 5, 1995, would repeal the corporate AMT for taxable years beginning after December 31, 2000. In addition, as described below, the bill would make certain changes to the individual AMT, and to the corporate AMT for taxable years beginning before January 1, 2001.[45] The individual AMT, as amended by the bill, would remain in existence.

**Preference items in computing AMTI**

The bill would make the following changes to the minimum tax preference items:

(1) The preference relating to depletion is repealed for depletion claimed in taxable years beginning after December 31, 1995.

(2) The preference relating to excess intangible drilling costs is repealed for costs incurred in taxable years beginning after December 31, 1995.

(3) The preference relating to bad debt losses of financial institutions is repealed for taxable years beginning after December 31, 1995.

(4) In the case of a corporation (other than an S corporation, regulated investment company, real estate investment trust, or REMIC), the preference relating to tax-exempt interest on private activity bonds is repealed for interest accruing after December 31, 1995.

In addition, Code section 58 (relating to tax shelter farm activity and passive losses) would be repealed for taxable years beginning after December 31, 1995. An individual that has a loss from a tax shelter farm activity arising in a taxable year beginning after December 31, 1995, (or arising in prior year and being carried forward) may use such loss in computing the individual's AMTI for a taxable year beginning after December 31, 1995 (to the extent such loss is otherwise allowable after taking into account such limitations as the passive activity and at-risk rules). The bill moves the passive activity rules of present-law section 58 to section 59(h).

**Adjustments in computing AMTI**

The bill would make the following changes to the adjustments used in computing AMTI:

(1) The adjustment relating to depreciation is repealed for property placed in service after March

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[45] These changes made to the corporate AMT would also apply for purposes of section 59A.

13, 1995. Under another provision of the bill, property to which the proposed neutral cost recovery system applies is not subject to the AMT depreciation adjustment. The neutral cost recovery system generally applies to qualified property placed in service after December 31, 1994, unless the taxpayer irrevocably elects, on a property-by-property basis, to not have the system apply.

(2) The adjustment relating to mining exploration and development costs is repealed for costs paid or incurred after December 31, 1995.

(3) The adjustment relating to long-term contracts is repealed for contracts entered into after December 31, 1995.

(4) The adjustment relating to pollution control facilities is repealed for property placed in service after December 31, 1995.

(5) The adjustment relating to installment sales is repealed for dispositions after December 31, 1995.

(6) The adjustments relating to circulation and research and experimental expenditures of individuals is repealed for costs paid or incurred after December 31, 1995.

(7) The adjustment relating to Merchant Marine capital construction funds of corporations is repealed for deposits made to a fund after December 31, 1995, and to earnings received or accrued after December 31, 1995, on amounts in such funds. Withdrawals of deposits and earnings from a fund after December 31, 1995, will be treated as allocable: (a) first to deposits (and earnings received or accrued) before January 1, 1987; (b) then, to deposits (and earnings received or accrued) after December 31, 1986, and before January 1, 1996; and (c) then, to deposits (and earnings received or accrued) after December 31, 1995.

(8) The denial of the special deduction allowed under section 833(b) is repealed for taxable years beginning after December 31, 1995.

<u>Adjusted current earnings (ACE) adjustment</u>

The bill would make the following changes to the ACE adjustment of the corporate AMT:

(1) The ACE rules relating to the inclusion (or deduction) of items included (or excluded) from the calculation of earnings and profits are repealed for taxable years beginning after December 31, 1995.

(2) The ACE adjustment relating to intangible drilling costs is repealed for amounts paid or incurred after December 31, 1995.

(3) The ACE adjustments relating to section 173 and section 248 costs are repealed for amounts paid or incurred after December 31, 1995.

(4) The ACE adjustment relating to LIFO inventory is repealed for LIFO adjustments arising in taxable years beginning after December 31, 1995.

(5) The ACE adjustment relating to installment sales is repealed for sales after December 31, 1995.

(6) The ACE adjustment relating to the exchange of debt pools is repealed for exchanges after December 31, 1995.

(7) The ACE adjustment relating to built-in losses with respect to certain changes of ownership is repealed for ownership changes after December 31, 1995.

(8) The ACE adjustment relating to depletion is repealed for depletion allowed in taxable years beginning after December 31, 1995.

**Use of credits**

The special rules relating to the use of net operating losses and foreign tax credits would be repealed for net operating losses and foreign tax credits used in taxable years beginning after December 31, 1995. Carrybacks of losses and credits to taxable years beginning before January 1, 1996, would continue to be subject to the 90-percent limitations.

The bill would not change the rules regarding the availability of other credits against the AMT.

For taxable years beginning after December 31, 1995, a taxpayer with alternative minimum tax credit carryovers would be allowed to use these credits to offset 90 percent of its regular tax liability (determined after the application of other credits as under present law). As under present law, in no event may alternative minimum tax credit carryovers be used to reduce the taxpayer's tax liability below its tentative minimum tax, if any.