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The Alternative Minimum Tax Takes A Rising Toll on the City

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SUMMARY

CONGRESS ADOPTED THE ALTERNATIVE MINIMUM TAX (AMT) in 1969 because some very wealthy Americans were paying no federal income tax. An analysis by IBO finds that an increasing number of New Yorkers, including some with much lower incomes than those the AMT originally targeted, are now becoming subject to it.

Taxpayers affected by the AMT cannot take many common deductions or an exemption that rises with family size. If current tax law does not change, IBO projects that the number of city taxpayers affected by AMT will grow dramatically. This will have important implications for local tax policy. Moreover, those who must pay the AMT lose future benefits from federal tax cuts. Among IBO's key findings:

- For 2004, about 136,000 city taxpayers are projected to be liable for the AMT, and the median amount of additional taxes owed by city taxpayers due to the AMT is $2,330. By 2010 the number will rise to 789,000—more than one-third of all city taxpayers.
- From 2004 to 2010 the share of taxpayers with children who must pay the AMT is projected to increase fivefold, to 64 percent.
- For 2004, about 56 percent of New York taxpayers with incomes between $125,000 and $500,000 will pay the AMT.
- Over time, increasing numbers of taxpayers with more moderate incomes—from $50,000 to $125,000 a year—will also have to pay the AMT. While roughly 4 percent of this income group is now liable for the AMT, over half this income group—479,000 taxpayers—will be subject to the AMT in 2010.
- Due to the AMT city taxpayers will send an estimated $700 million in additional tax payments to Washington for 2004, and $3.0 billion by 2010.

The tax has implications for New York policymakers because it takes disposable income out of the local economy, decreasing local spending and economic activity in the city below what might occur without the AMT. The AMT also makes it harder for the city to compete with other localities for residents and jobs because taxpayers subject to the AMT cannot deduct state and local taxes from their federal income tax. This means a growing number of New Yorkers will bear the full burden of this region's particularly high tax levels.

One reason for the growth in the number of taxpayers affected by the AMT is that it is not indexed for inflation, so as taxpayers' nominal incomes go up more people become subject to the tax. Recent federal income tax cuts also contribute substantially to the expansion in AMT liability because they have reduced the money owed by taxpayers under the "regular" tax system while pushing more taxpayers into owing the alternative minimum tax.

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AN OVERVIEW OF THE AMT

This brief begins with a look at the origin of the individual alternative minimum tax.[1] The next section uses an example of an actual tax return to show how the calculation of tax liability under AMT rules differs from that of the regular federal income tax liability; the section also examines the reasons why the number of AMT payers and their liability has grown and will continue to grow if current law is not changed. Next, IBO's simulation model and the data used for forecasting tax liabilities is described, followed by our forecast of the AMT's increasing impact on New Yorkers: the amount of AMT that will be paid by city residents in the coming years and the numbers and characteristics of those taxpayers. The conclusion explores the policy implications of the AMT and its projected growth, particularly with respect to further federal tax reforms.

History. In 1968, Congressional testimony that 155 Americans with incomes over $200,000—equivalent to roughly $1.2 million in today's dollars—paid no federal income taxes in 1966 generated a public outcry against what was seen as an unfair use of tax laws by some of nation's wealthiest citizens.[2] In response, as part of the Tax Reform Act of 1969, Congress enacted a minimum income tax, applied mainly to income from capital gains—a tax that taxpayers needed to pay in addition to their regular liability.

There were several reforms of the minimum tax in the following years, and by 1982 the tax had taken the form of the AMT as it exists today: an alternative method of calculating federal income tax liability which certain filers are required to do in addition to the regular (non-AMT) method. The filer's total income tax is determined by whichever calculation results in greater liability. The number of taxpayers incurring AMT liability grew steadily in the first few years of the tax's existence and then declined sharply after 1986, when many income tax loopholes were eliminated and regular liabilities increased substantially. The upward trend resumed in the 1990s, with the number of AMT taxpayers increasing tenfold, from 132,000 filers nationwide in 1990 to an estimated 1.3 million in 2000 according to IRS data.[3] For reasons discussed below, the tax cuts of the last four years have further fueled the numbers paying the AMT, and one recent projection estimates that by 2010 the AMT will affect 30 million taxpayers.[4]

The Parallel Tax. The AMT is often called the "parallel" tax because affected tax filers calculate their liability through the AMT system along side of their regular liability. A tax filer is

Regular Income Tax Liability and Tentative AMT Liability

	Regular Tax		Alternative Minimum Tax
		The Tax Base	
	Adjusted gross income		**Adjusted gross income**
minus	Deductions (standard or itemized)	*minus*	Itemized deductions
minus	Exemptions	*minus*	AMT exemption
equals	**Taxable income**	*plus*	AMT preference items
		minus	Refunds of state and local income taxes
		equals	**Alternative minimum taxable income**
		Tax Rates	
Income other than capital gains			
	Six brackets, marginal rates from 10% to 35%, through 2010		**26% and 28%**
Capital gains			
	Two brackets, marginal rates of 5% and 15%, through 2007; 0% and 15% in 2008; 10% and 20% from 2009 on		**Same as regular tax**
Qualified dividends			
	Same as capital gains through 2008; Same as most income from 2009 on		**Same as capital gains through 2008; Same as most income from 2009 on**
		Inflation Indexing	
	Tax brackets, standard deduction, and personal exemption		**None**

SOURCE: IBO.
NOTES: Regular exemptions vary with family size; AMT exemption is determined by filing status. ATM preferences include state and local taxes paid, miscellaneous deductions, and medical expenses deduction for filers with itemized deductions and, for all filers, other items less frequently used, such as interest from certain private activity bonds. Regular taxable income can be negative; alternative taxable income cannot be less than zero.

required to compute a second tax liability under AMT rules if a particular measure of income—gross income adjusted by a number of items such as specific deductions and credits, the foreign tax credit, and taxes on distributions from some types of employee benefit plans—is greater than certain AMT-specific thresholds.

But not all of those who must make the additional AMT calculations will end up owing more in taxes. The dollar amount that results from the AMT calculation is termed the "tentative AMT liability," and a taxpayer pays more in taxes only if his or her tentative AMT exceeds regular tax liability. How much more is paid is simply the excess of tentative AMT over regular liability; this additional tax is "AMT liability."

Comparison of AMT and Regular Income Tax. The computations of both tentative AMT liability and regular liability start with the tax filer's adjusted gross income (AGI) and take into account deductions and exemptions to calculate taxable income which is then subject to the applicable tax rates. But the schedule of tax rates and the definitions of taxable income, exemptions, and deductions are different in the two systems, as are the rates at which income is taxed. Figure 1 outlines the basic differences in calculating regular liability and tentative AMT liability.

Regular Income Tax Liability. The regular rules for determining income tax are probably familiar to most readers. Deductions and personal exemptions are subtracted from adjusted gross income to derive the amount of taxable income. Deductions are either the standard deduction (for example, $9,700 for 2004 for married couples filing joint returns) or the sum of itemized deductions, whichever is larger. Itemized deductions can include state and local taxes paid, a portion of medical expenses, mortgage and other interest payments, and miscellaneous job-related and other expenses. The number of personal exemptions taken varies with family size; for 2004, the amount was $3,100 per person.

The taxable income resulting after deductions and exemptions are taken is the base of the tax—the tax rates are applied to this base using the schedule of tax brackets and marginal tax rates. Currently, the marginal tax rates for most types of income range from 10 percent to 35 percent, and these rates will remain in effect though 2010. Current law includes a schedule of lower rates on income from capital gains and qualified dividends though 2008.[5]

After regular tax liability is determined, allowable credits can then be taken to offset some or all liability. Each year, the standard deduction, personal exemption, tax brackets, and many other elements used to calculate the regular income tax are adjusted (indexed) for inflation. This is one of the critical differences with the AMT, where there are no adjustments for inflation.

Tentative Alternative Minimum Tax Liability. The method of determining tentative AMT liability starts with the tax filer's adjusted gross income and then, for filers who itemize, deductions are subtracted. An exemption specific to the AMT is also subtracted. The AMT exemption varies only by filing status; unlike the personal exemption under the regular income tax, it does not increase with family size.[6] The exemption amounts for 2004—$58,000 for joint filers, $40,250 for singles and heads of households—reflect temporary increases introduced as partial, short-term fixes to slow the increase in AMT incidence resulting from the 2001, 2003, and 2004 tax cuts. Under current law, the exemptions will revert to their historical levels, $45,000 for couples and $33,750 for others, in 2006.

The most significant difference between computation of taxable income under the AMT and the regular tax is that AMT requires various items to be added back to income. These items are termed "preference items."[7] For filers who itemize, preferences include what are usually some of the largest deductions taken: medical and dental expenses, job-related and other miscellaneous deductions, and state and local taxes paid. For all filers, there are a large number of other preference items, such as interest from certain private activity bonds and income from the exercise of incentive stock options, but these affect only a very limited number of taxpayers with relatively high incomes.[8] In contrast to these preference items that are added back to income, income from state and local tax refunds is subtracted in calculating AMT taxable income.

Unlike the complexity in determining AMT taxable income, the schedule of tax rates under the AMT is simple. Filers with taxable incomes under $175,000 (half of that for married filing separately) are taxed at 26 percent; those with incomes above these amounts are taxed at 28 percent less $3,500. Because the brackets for single filers are the same as those for married couples filing jointly and for heads of households, the structure of the AMT penalizes both filers with children and married couples.[9] Recent reforms to eliminate marriage penalties in the regular system have not been extended to the AMT. As with the regular tax, the AMT calculations on returns with income from capital gains and (for the next few years) dividends are more complicated because the AMT applies the same preferential (lower) tax rates for those types of income as in of the regular tax system. In any case, the result of the calculations—tentative AMT liability—is compared with regular tax liability to determine if any alternative minimum tax is owed.[10]

An Example. To illustrate the calculations just described and examine the situation of a New York City resident who pays the alternative minimum tax, a tax return of an anonymous family has been selected from the sample of 2002 tax returns used for this study. (The sample is described in greater detail below.) In order to project what this return would look like in 2004, IBO has adjusted all the elements of the return for inflation, changes in tax law, and income growth.

Our sample tax return has been filed by a married couple with three dependent children whom we'll name the "Briscoe" family. The family has an adjusted gross income of $108,623, with most all of the income from wages. The Briscoes offset almost a third of AGI with itemized deductions totaling $34,044; the largest component was job-related and other miscellaneous deductions ($13,958). The sum of state and local income and property taxes taken as deductions is just over $10,000. The Briscoes are generous, making $7,308 in charitable contributions, which they also deduct. The final item they deduct is interest payments, probably mortgage payments or perhaps interest on home equity loans since the family also pays the property tax.

When all these itemized deductions and the $15,500 personal exemption (5 x $3,100) are subtracted from AGI, the Briscoes' taxable income becomes $59,079, which puts them in the third tax bracket. The marginal rate in this bracket is 25 percent, and the regular tax liability amounts to $8,244. The effective tax rate with respect to AGI is 7.6 percent ($8,244 divided by $108,623). This is much lower than the marginal rate because taxable income equals only a portion (54 percent) of AGI and because most of the taxable income falls in the two lowest tax brackets where marginal rates are 10 percent and 15 percent.

Example of AMT-Paying City Residents:

A married couple with three children filing a joint return (The Briscoes)

2004 Values	
Wage income	$110,689
Interest	$20
Taxable state and local tax refunds	$1,062
Federal adjustments to income	($3,150)
Adjusted Gross Income	**$108,623**
Mortgage and other interest payments	$2,756
Charitable contributions	$7,308
Job-related and miscellaneous expenses	$13,958
NYC property tax	$2,413
NYS personal income tax	$4,967
NYC personal income tax	$2,642
Itemized Deductions	**$34,044**
Job-related and miscellaneous expenses	$13,958
NYC property tax	$2,413
NYS personal income tax	$4,967
NYC personal income tax	$2,642
Taxable state and local tax refunds	($1,062)
AMT Preference Items	**$22,918**

Calculation of Taxable Income

	Regular Tax	**Alternative Minimum Tax**
Adjusted Gross Income	108,623	108,623
Deductions	(34,044)	(34,044)
Exemptions	(15,500)	(58,000)
AMT Preference Items	n.a.	22,918
Taxable Income	**59,079**	**39,497**

Tax Liability

	Regular Tax Liability	**Tentative AMT Liability**
	$8,244	**$10,269**
Marginal Tax Rate	25.0%	26.0%
Effective Tax Rate	7.6%	9.5%

AMT Liability = $2,025
(Tentative AMT liability minus regular tax liability)

Total Tax Liability (before credits) = $10,269
(Regular tax liability plus AMT liability)

SOURCES: IBO, based on 2002 PIT Sample File, Office of Tax Policy Analysis, NYS Department of Taxation and Finance.

The 2004 federal income taxes that the Briscoes owe, however, is not limited to the regular tax. Their AMT calculations start with AGI, subtract itemized deductions, and also subtract the AMT exemption, which at $58,000 is much higher than the regular exemption. But roughly 70 percent of their itemized deductions—including state and local taxes paid and job-related expenses—are AMT preference items added back to taxable income. In contrast, $1,062 of income from state and local tax refunds is subtracted from taxable income. As a result, the Briscoes' taxable income for AMT purposes is $39,497, almost $20,000 less than regular taxable income.

The tentative AMT is simply 26 percent of the Briscoes' taxable income, or $10,269. So, in addition to their regular tax of $8,244, the Briscoes pay AMT of $2,025—the difference between the AMT and the regular tax. This raises the family's effective tax rate to 9.5 percent, and the Briscoes' AMT accounts for almost a fifth (19.7 percent) of their total tax burden. In this example, the AMT calculation yields a higher tax liability than does the regular tax even though AMT taxable income is substantially lower than regular taxable income. This results from the 26 percent tax rate being applied to all of the Briscoe's AMT taxable income, as opposed to the regular tax in which a portion of income is taxed at lower rates.

In general, taxpayers with large families and those who live in high-tax areas are much more likely to pay the AMT. Taxpayers with children, particularly large families, are also much more likely to pay the AMT because the loss of the regular personal exemption under AMT rules is more costly to them. Taxpayers who live in areas with high tax burdens, such as New York City, are also more likely to pay the AMT because adding back state and local taxes will boost their AMT taxable incomes to a greater extent. The Briscoes, for example, would not have paid the AMT if their state and local tax payments did not have to be included among their AMT preference items.

AMT Growth in New York City and Elsewhere. Increasing numbers of city families like the Briscoes are becoming AMT payers. One reason is that in contrast to the regular income tax, the AMT is not adjusted for inflation. For taxpayers whose inflation-adjusted (real) incomes remain constant over time, the indexing of income brackets, exemptions, and other elements of the regular tax for inflation limits the growth of their tax burdens. But with no inflation indexing, tentative AMT liability will rise by more than regular tax liability over time, resulting in a growing number of taxpayers paying the AMT. The problem resulting from only one of the parallel tax systems being adjusted for inflation began in 1982, when inflation-indexing in the regular tax system was initiated. But it has become more widely acknowledged only in recent years, as more moderate-income taxpayers have begun to incur AMT liability.

Another factor contributing greatly to the expansion of the AMT are the federal income tax cuts enacted in the last four years. The cuts have reduced taxpayer liabilities under the regular system, much more so than the short-term adjustments in the AMT exemption which have yielded only a temporary reduction in AMT liability. The result of the tax cuts has been to reduce many taxpayers' regular liability to levels below tentative AMT, increasing the number of AMT taxpayers. But without reforms that greatly reduce the AMT burden, those filers currently paying the AMT will not benefit from future federal tax cuts because the reduction in taxes under the regular system will be offset by an increase in AMT liability. It has been estimated that 12 percent of the value to New Yorkers of the 2001 and 2003 federal tax cuts was lost due to the AMT.[11] By preventing a growing number of taxpayers from benefiting from cuts under the regular income tax, the AMT will play an increasing role in reducing the fiscal cost of the tax cuts.

In New York City the percent of taxpayers subject to the AMT has grown and is projected to continue growing in the coming years, a trend evident in other areas of the country as well. What distinguishes the city is the greater likelihood that its taxpayers will incur AMT liability. Two factors make New Yorkers more likely to pay the AMT. One is our high state and local taxes, a burden made even higher in the last few years by temporary increases in the city's real property tax and in state and city personal income taxes. Also, with wages and salaries generally higher in New York than in most other parts of the country, many city taxpayers have incomes in the middle- and upper-middle ranges that increasingly account for those who must pay the AMT.

PROJECTED AMT GROWTH IN NEW YORK CITY

Data and Methodology. IBO's projections of the numbers and characteristics of city residents paying the AMT are based on an annual sample of New York State tax returns compiled by the Office of Tax Policy Analysis of the New York State Department of Taxation and Finance. The latest available sample is for tax year 2002. The sample contains over 113,000 returns, but only returns filed by full-year city residents—about 31,400—were used to generate the findings reported here. For 2004, this subset of returns represents 3.1 million city tax filers, of which an estimated 2.0 million had positive amounts of federal income tax liability.[12]

IBO's micro-simulation model takes the information reported on each tax return in the sample—such as family size, wages, other forms of income, deductions, and tax credits—and uses forecasts of inflation and income growth to determine future values for each of the data items. The model calculates federal, state, and city tax liabilities using the projected values and takes into account any tax policy changes since 2002. The policy changes incorporated into the model are only those enacted since 2002 or those scheduled to happen under current law, such as the expiration of the three-year increases in state and city personal income taxes scheduled for the end of 2005. Thus, the model's projections are based on the assumption that there will be no changes in the law in the future.

Not all of the information reported on federal income tax returns is also on New York returns, so in calculating federal tax liabilities some simplifying assumptions are made. For estimating the AMT, the most notable limitation of the state tax return is the lack of information on many AMT preference items. But the sample returns do report the largest and most widely reported preference items: state and local taxes paid, miscellaneous deductions, and medical expenses. Moreover, working with the state returns has the advantage of generating precise estimates of tax filers' New York State and New York City personal income taxes, which is particularly useful in estimating the AMT because these taxes account for the bulk of AMT preference items.[13] On balance, however, using state tax returns to project AMT liability generates relatively conservative estimates of total AMT liability and its incidence among city taxpayers.

Comparing AMT Payers with Other Taxpayers. In comparison to city residents who pay the regular tax, AMT payers have higher incomes, more children, and are more likely to itemize deductions; these differences persist over time. But in the coming years, the number of AMT payers is expected to swell and the typical income levels of AMT payers declines significantly.

A larger percentage of New York City taxpayers pay the AMT than taxpayers nationwide. For 2004, 6.8 percent of city taxpayers paid the AMT, a much higher share than the recent projections of the percent of Americans who will soon pay the AMT.[14] Among New York taxpayers with children, the incidence of the tax is almost twice as high 12.2 percent.

AMT payers have higher incomes than other city taxpayers, whether measured as average AGI ($297,761 v. $68,389 for all taxpayers) or median AGI ($196,602 v. $42,317).[15] The AMT accounts for 8.9 percent of AMT payers' federal income tax liability on average.

The Briscoes have two of the most significant attributes of AMT payers: they itemize deductions and they have children. Along with 98.5 percent of city AMT payers, the Briscoes itemize their federal tax deductions, In contrast, only 29.6 percent of other city taxpayers itemize. Almost a fifth (19.5 percent) of all city taxpayers who itemize deductions on their 2004 federal returns will incur AMT liability, though in large part this simply results from itemizers having higher incomes. Even controlling for income, however, AMT payers

A Comparison of AMT Payers with Other New York City Taxpayers, 2004 and 2010

	2004		2010	
	AMT Payers	Other Taxpayers	AMT Payers	Other Taxpayers
Number of taxpayers	136,473	1,876,309	788,508	1,500,474
Percent of all taxpayers	*6.8%*	*93.2%*	*34.4%*	*65.6%*
Percent of all taxpayers with children	*12.2%*	*87.8%*	*64.0%*	*36.0%*
Median federal adjusted gross income	$196,602	$42,317	$95,666	$36,245
Average federal adjusted gross income	$297,761	$68,389	$137,154	$71,911
Median federal income tax (including AMT)	$37,506	$3,201	$13,519	$2,579
Median alternative minimum tax	$2,330	$0	$1,894	$0
AMT as percent of federal income tax	*8.9%*	-	*13.5%*	-
Percent of group with itemized deductions (federal)	98.5%	29.6%	62.1%	24.3%
Percent with children	49.4%	25.9%	57.7%	17.1%
Percent with more than one child	30.3%	9.2%	31.0%	4.1%

SOURCES: IBO, based on 2002 PIT Sample File, Office of Tax Policy Analysis, NYS Department of Taxation and Finance.
NOTES: Average and median amounts for 2010 are adjusted for inflation ($ 2004).

are more likely to itemize than those who incur no AMT liability. This is particularly true for filers with annual incomes under $125,000. As is highlighted below, the number of filers in this income group who will become AMT payers is expected to grow rapidly in coming years.

AMT payers are more likely to have children—49.4 percent of them compared to 25.9 percent of other taxpayers. The difference between AMT payers and others is relatively greater when the number of children is considered: families with more than one child comprise 30.3 percent of AMT payers, compared to 9.2 percent of other taxpayers. About 7 percent of AMT payers are families with three children, like the Briscoes; only 2 percent of other taxpayers are. Looked at another way, almost a quarter of all tax-paying families (23.2 percent) with three children pay the AMT. For even larger families paying taxes, over half (52.6 percent) pay AMT.

IBO projects a sharp increase in the number of New Yorkers who will be affected by the AMT—particularly taxpayers at lower income levels—if the current tax law remains unchanged. The number of AMT payers in the city will increase annually from 2004 to 2010, with a particularly large jump—a tripling—of the number in 2006, when the AMT exemptions revert to prior levels. While the total number of city taxpayers is projected to grow by 13.7 percent from 2004 to 2010, the number of AMT payers is expected to increase almost fivefold—478 percent—so that by 2010 over a third of all city taxpayers will incur AMT liability. This compares to estimates that about 30 percent of all U.S. taxpayers will pay the AMT in that year.[16]

The number of city taxpayers with AMT liability will swell from over 136,000 for 2004 to 789,000 for 2010. Almost two-thirds of city taxpayers with children will pay the AMT by the next decade, including nearly 80 percent of all families with more than one child.

As taxpayers at lower and lower income levels become ensnared by the AMT over time, the median incomes for both AMT payers and regular taxpayers decline from 2004 to 2010.[17]

Income Distribution of AMT Payers. The AMT will boost the tax burdens of increasing numbers of less affluent New Yorkers over time, greatly expanding the number of AMT payers and the amounts of their AMT liability.

For 2004, well over half of city taxpayers (55.6 percent) with incomes from $125,000 to $500,000 are projected to incur AMT liability, accounting for over two-thirds of all New Yorkers bearing the AMT's burden. These projections support the notion that the AMT today has become a tax affecting for the most part upper-middle-income filers, at least by New York City standards. And by 2010, 96.2 percent of these taxpayers are expected projected to incur AMT liability, making them more likely to pay the AMT than groups of taxpayers with higher or lower incomes.

But less affluent taxpayers in the $50,000 to $125,000 income range account for over two-thirds of the projected growth from 2004 to 2010 in the numbers of New Yorkers affected by the AMT—68.9 percent of 652,000 taxpayers. Only 4.4 percent of this group is expected to pay the AMT for 2004, but by 2010, over half will (53.7 percent). By 2010, this group of taxpayers will be more likely to pay the AMT than those with incomes above $500,000, only a third (36.5 percent) of whom will have to pay the AMT.

Number of NYC Resident Taxpayers and AMT Payers, by Income Groups

Federal AGI (2004 $)	2004 All Taxpayers	2004 AMT Payers	2004 Rate of AMT Incidence	2010 All Taxpayers	2010 AMT Payers	2010 Rate of AMT Incidence	2004 - 2010 Growth All Taxpayers	2004 - 2010 Growth AMT Payers
Under $20,000	306,010	0	0.0%	308,117	0	0.0%	0.7%	0.0%
$20,001 to $50,000	824,560	781	0.1%	796,764	48,729	6.1%	-3.4%	6139.3%
$50,001 to $75,000	392,403	6,581	1.7%	495,814	199,657	40.3%	26.4%	2933.8%
$75,001 to $100,000	190,969	11,506	6.0%	256,841	167,599	65.3%	34.5%	1356.6%
$100,001 to $125,000	99,689	11,798	11.8%	139,267	112,076	80.5%	39.7%	850.0%
$125,001 to $250,000	133,653	60,981	45.6%	201,832	194,481	96.4%	51.0%	218.9%
$250,001 to $500,000	39,183	35,054	89.5%	55,767	53,335	95.6%	42.3%	52.1%
$500,001 to $1,000,000	15,156	7,380	48.7%	20,342	10,371	51.0%	34.2%	40.5%
Over $1,000,000	11,159	2,392	21.4%	14,237	2,259	15.9%	27.6%	-5.6%
TOTAL	**2,012,782**	**136,473**	**6.8%**	**2,288,982**	**788,508**	**34.4%**	**13.7%**	**477.8%**
Total number of tax filers			**3,118,389**			**3,271,467**		
Growth from 2004 to 2010						**4.9%**		

SOURCES: IBO, based on 2002 PIT Sample File, Office of Tax Policy Analysis, New York State Dept. of Taxation and Finance.

Federal Income Tax Liability and AMT Liability, by Income Groups
Dollars in millions

	2004			2010		
Federal AGI (2004 $)	Total liability	AMT liability	AMT as % of Total	Total liability	AMT liability	AMT as % of Total
Under $20,000	$167.7	$0.0	0.0%	$189.2	$0.0	0.0%
$20,001 to $50,000	2,193.6	0.7	0.0%	2,331.2	30.9	1.3%
$50,001 to $75,000	2,510.6	7.1	0.3%	3,907.5	245.7	6.3%
$75,001 to $100,000	2,016.6	12.1	0.6%	3,548.7	345.8	9.7%
$100,001 to $125,000	1,553.3	19.0	1.2%	2,847.0	309.7	10.9%
$125,001 to $250,000	3,894.9	151.5	3.9%	7,712.2	1,195.3	15.5%
$250,001 to $500,000	3,087.8	224.2	7.3%	5,241.3	593.3	11.3%
$500,001 to $1,000,000	2,602.5	83.8	3.2%	4,051.4	105.0	2.6%
Over $1,000,000	9,137.1	201.8	2.2%	14,018.1	163.6	1.2%
TOTAL	**$27,164.0**	**$700.1**	**2.6%**	**$43,846.5**	**$2,989.4**	**6.8%**
Growth from 2004 to 2010:				**61.4%**	**327.0%**	

SOURCES: IBO, based on 2002 PIT Sample File, Office of Tax Policy Analysis, New York State Dept. of Taxation and Finance.

Even for 2004, the most prosperous New Yorkers were not the group most likely to be affected by the AMT: 48.7 percent of those earning $500,000 to $1 million, and 21.4 percent of millionaires, compared with 55.6 percent with incomes from $125,000 to $500,000. The AMT is less likely to affect those with high incomes because under the regular tax, so much of the taxpayer's income is taxed in the top two brackets where the marginal tax rates—30 percent and 35 percent—exceed the highest AMT tax rate of 28 percent.

AMT Liability by Income Groups. The AMT liability of New Yorkers is expected to rise in the coming years, but at a slower pace than the number of AMT taxpayers. For 2004, city taxpayers will pay an estimated $700 million in AMT—about 2.6 percent of New Yorker's total federal income tax liability. IBO projects that by 2010, AMT liability for city taxpayers will increase to $3.0 billion in nominal terms—a rise of 327 percent. The growth of AMT liability is expected to far outpace total federal income tax growth, so by 2010 the AMT will account for a larger share of income taxes (6.8 percent) than for 2004. But AMT liability growth is dwarfed by the rapid increase in the number of AMT payers that will occur for the most part among taxpayers with lower incomes than those already paying the AMT. As a result, both the average and median AMT liabilities of individual taxpayers are expected to decrease significantly.[18]

Over time, AMT liability also becomes more concentrated in the middle of the income distribution. The share of the AMT paid by taxpayers with incomes over $500,000 falls from 40.8 percent for 2004 to 9.0 percent in 2010, but for taxpayers in the $75,000 to $250,000 range the share more than doubles, to 62.0 percent in 2010. For these taxpayers, the AMT will account for a relatively large portion of their federal income tax liability: 9.7 percent of liability for those earning $75,000 to $100,000 in 2010; 10.9 percent for those earning $100,000 to $125,000; and 15.5 percent for those earning $125,000 to $250,000. Like the projections of the number of people who will pay the AMT, the projections by income group of the actual amounts of AMT that taxpayers will owe by 2010 supports the view that the AMT is becoming a tax paid increasingly by upper-middle and even middle-income taxpayers.

ECONOMIC AND POLICY IMPLICATIONS

There have been many calls for radically reforming the AMT or eliminating it entirely because it increasingly is a burden not on the most affluent citizens but on those with upper-middle and middle incomes. The expansion of the AMT among these taxpayers in New York and elsewhere, is a consequence of the AMT not being indexed for inflation and of the several rounds of federal tax cuts since 2001—cuts that reduced many taxpayers' regular liabilities below tentative AMT liability. The Tax Policy Center has estimated that the 2001 and 2003 tax cuts have roughly doubled the number of taxpayers nationwide who must pay the AMT.[19] It also reports that had there been no tax cuts and had the AMT been indexed for inflation when the regular tax cuts were, there would be 300,000 AMT payers nationwide each year—roughly one-tenth the projected number for 2004 and one-hundredth the number in 2010.

Another consequence of the AMT is that it has a disproportionate impact on taxpayers with children, on married couples, and on taxpayers in high-tax states and cities, like New York City. Not surprisingly, IBO's projections of the percent of New Yorkers currently paying the AMT exceeds the comparable nationwide estimates, as do our estimates of average AMT liability.[20]

Beyond increasing the tax burden on citizens who are not its original intended targets, the AMT has several economic and policy implications for New York City. The first is that the cost of the AMT borne by New York City taxpayers is also a loss of disposable income in the local economy. IBO estimates that from 2004 to 2010 the loss will total $12.9 billion, decreasing local spending and economic activity below what it would have been if the AMT had not existed.

Another implication is that increasing numbers of city residents do not benefit from federal income tax cuts. Because AMT payers' regular income tax is already below their tentative AMT liability, for these taxpayers any reduction in the regular tax (in the absence of any cut in the AMT burden) will be offset by an equivalent increase in the AMT. The recent tax cuts have had paradoxical effects: by reducing regular federal income liabilities, the cuts shift many taxpayers into the ranks of those whose liabilities are determined by the AMT and thus neither enjoy the full benefit of the tax cuts nor receive the benefits of any possible future tax cuts. Given that a third of city taxpayers are projected to be AMT payers by 2010, making permanent the current tax cuts that are scheduled to expire in 2011 as proposed will not benefit large numbers of New Yorkers. Roughly 70 percent of taxpayers with incomes between $75,000 and $125,000 (in 2004 dollars) would receive no tax cut, as would almost all of those earning $125,000 to $500,000.

To the extent that New York City residents are more likely to be paying the AMT, the city receives a disproportionately smaller share of the benefits of nationwide tax cuts. And because AMT payers do not receive tax cuts, the cost to the federal government of providing tax cuts is reduced. In this way, the AMT can be viewed as a tax which in large part finances the tax cuts received by those not subject to the AMT, leading one journalist to dub the AMT "the stealth tax."[21]

Finally, the AMT will increasingly constrain the tax policies of New York City and other high-tax jurisdictions. Because state and local taxes are included among itemized deductions for regular income tax purposes, a portion of state and local taxes is offset in part by a reduction in federal income taxes. In this way, the federal government effectively finances some of the tax burden facing New Yorkers, as well as any increases in that burden to the extent that tax increases are borne by affluent taxpayers more likely to itemize deductions.[22]

But under the rules of the AMT, state and local taxes are not deductible. So as more and more taxpayers pay the AMT, a growing number of New Yorkers will not be able to mitigate the burden of the state's and city's already high tax levels, making it more difficult for the city to attract and retain residents and jobs. And because the federal government will bear less and less of the New York's tax burden over time, the increase in the number of city residents paying the AMT will only add to these difficulties.

Written by Michael Jacobs.

END NOTES

[1] In this brief, AMT refers to the individual alternative minimum tax. There also is an alternative minimum tax on corporate incomes, with features similar to the individual AMT.

[2] This draws on and summarizes the historical accounts in the following papers: Leonard E. Burman, William G. Gale, Jeffrey Rohaly and Benjamin Harris, "The Individual AMT: Problems and Potential Solutions," Discussion Paper No. 5, The Tax Policy Center (www.taxpolicycenter.org), Washington, DC (September 2002); and Robert Rebelein and Jerry Templanski, "Who Pays the Individual AMT?," OTA Paper 87, Office of Tax Analysis, U.S. Treasury Department, Washington, DC (June 2000).

[3] Historical data is from the various issues of the Internal Revenue Service's *Statistics of Income Bulletin*, and estimates for 2000 were made by Rebelein and Templanski, (2000), as presented in Joint Economic Committee, U.S. Congress, "The Alternative Minimum Tax for Individuals: A Growing Burden," (May 2001).

[4] Leonard E. Burman, testimony to the President's Advisory Panel on Federal Tax Reform, March 3, 2005.

[5] The President's Executive Budget for 2005-2006 proposes making the lower capital gains and dividend rates permanent.

[6] Under both the AMT and the regular tax, the exemption is reduced for filers with high incomes.

[7] The term "preference items" refers to the preferential treatment they receive under the regular tax system. But the term may seem odd to a taxpayer calculating potential AMT liability because preference items generally add to the AMT tax base.

[8] Burman, et al. (2002), p. 7.

[9] In the regular income tax, most of the brackets for joint filers are twice as wide as the brackets used by single filers.

[10] Specifically, what is compared is tax liability before credits. After regular liability and any possible additions of AMT liability are made, taxpayers may take a number of credits, such as the child tax credit or the dependent care credit, to offset liabilities. Under current law, AMT payers are generally allowed to take non-refundable personal credits through 2005.

[11] Karen Schlain, "New York City and the Federal Alternative Minimum Income Tax: The Future Is Now," *State Tax Notes*, February 23, 2004, Table III.

[12] Many filers can take credits against their liability. For some tax filers, credits exceed the value of pre-credit liability, effectively eliminating any income tax liability. Some federal tax credits, like the earned income tax credit, are refundable, meaning that taxpayers receive the full value of the credit even it exceeds the amount of pre-credit tax liability. In such instances, the taxpayer receives a check or "refund" for the amount of the excess credit.

[13] In his March 2005 testimony to the President's Advisory Panel on Federal Income Tax Reform, Leonard Burman reported that state and local taxes account for 51 percent of AMT preference items, miscellaneous expense deductions account for 20 percent, and the regular personal exemption, if it is included as a preference item, accounts for 22 percent of the total.

[14] Burman testified that in 2005, about 4 percent of taxpayers nationwide will pay the AMT.

[15] The median is the income level at which half the group has incomes above and half has incomes below, and it is often seen as a more representative measure of the typical incomes than the average, which is greatly boosted by the high incomes of the wealthiest.

[16] Burman testimony to the President's Advisory Panel on Federal Income Tax Reform.

[17] The median dollar amounts shown in the table have been adjusted for inflation, so that they are directly comparable with the 2004 amounts. For taxpayers as a whole, the median is projected to increase 15.2 percent, to $51,471 in 2010 (2004 dollars).

[18] Adjusting for inflation, median AMT falls from $2,330 for 2004 to $1,894 for 2010, equivalent to $2,135 in nominal terms.

[19] Leonard E. Burman, William G. Gale, and Jeffrey Rohaly, "The AMT: Projections and Problems," *Tax Notes*, July 7, 2003, pp. 105-6.

[20] Burman et al., "The Individual Alternative Minimum Tax: A Data Update," (August 2004).

[21] David Cay Johnston, *Perfectly Legal*, New York, NY: Portfolio, 2003.

[22] Presumably, the federal tax burden is higher (or service levels lower) than they would be without the federal revenue loss to the state and local tax deduction.