

Commentary on “OPTIONS TO FIX THE AMT”

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The AMT & broader instability

Adam Smith: “an old tax is a good tax.”

Sometimes change is desirable, e.g., due to new information or preferences.

But to have built-in instability, creating uncertainty for no good purpose, due to the lack of potentially sustainable rules on the books is, well ... moronic.

Causes of built-in instability

The current U.S. tax law has 3 gratuitous sources of gratuitous built-in instability:

- the overall U.S. fiscal gap;
- the post-2010 tax law sunsets;
- the AMT, with its projected growth path.

At least we are discussing one of these today, although each makes the other two harder to solve.

The Burman et al paper

This is a really useful exercise.

- The fiscal gap makes simple repeal wildly irresponsible (and ditto even for unfinanced short-term patches).
- We need to know what the tradeoffs actually look like.
- Plenty of time later for behavioral estimates.

We're not going to pick an option today (and if we did, who would listen). So the question is how to think about moving forward.

Two different time perspectives

Short-term: what might be a feasible scenario for a permanent, fiscally responsible AMT fix?

Long-term: where do we really (albeit realistically) want to go?

A fully financed AMT fix would be a major change with significant effects on the subsequent structure of the tax system.

But it may be unrealistic to hope for fundamental tax reform.

Realistic long-term tax policy goals

1) We need to address the fiscal gap.

--Rates WILL rise at some point (like it or not), but it's better to broaden the base.

2) A greatly scaled back AMT might be tolerable (if we were confident it would remain small), but no AMT would be better.

For reasons of political economy, this was not completely obvious in 1986, but it seems to be now.

The best argument for an AMT

Actual motivation (prevent “too much” use of otherwise OK preferences by a given taxpayer) was nonsensical.

But there was a reasonable political economy argument at the time that one could have more overall base-broadening with the AMT than without it.

I.e., indirect base-broadening via the AMT couldn't be fully traded in for regular tax base-broadening.

This could support a decent, though not overwhelming, case for having an AMT.

The “best argument’s” sorry fate

The underlying mechanism (e.g., new preferences are kept out of the AMT & not scaled up by reason of it) does not appear to be operating today.

Instead, the AMT is a zombie staggering forward through the force of inertia, and mattering mainly due to 3 items that entered it in 1986 largely through inertia.

2 of these 3 - personal exemptions and miscellaneous itemized deductions) are not even preferences.

For state & local taxes, inertia offers a one-time trade-in opportunity.

But if we have to keep the AMT ...

... it's important to keep it from growing again.

Desirable structural features might include:

- higher exemption amount, indexed for inflation.
- lower rates.
- no phase-outs.

Also, it would be nice to have it actually focused on meritorious base-broadening that isn't as feasible in the regular tax.

Back to the long-term goals

The only meritorious base-broadening that would naturally accompany AMT "trade-in" pertains to state & local tax deductions. (Less than 100% repeal to grease the wheels?)

But lots of other base-broadening would be desirable.

Perhaps the two other biggest items to address are home mortgage interest deductions and the exclusion for employer-provided health insurance.

Generally convert preferential items into (refundable) percentage credits?

Capital gains and dividends

In an alternative political economy universe, these might have been expressly put in the AMT (for better or worse) in 2003.

Assuming income taxation, interest deductibility, etc., is a 15% capital gains rate too low?

Should corporate integration be more thoroughgoing and avoid distinguishing between debt and equity?

But these would only be on the table in the event of a fairly global reform effort.

Short-term agenda for a fiscally responsible AMT fix

How would this happen, if it happened?

Some similar questions:

--What if Queen Victoria could fly?

--What do atheists think God would be like?

The problem: It requires politically painful regular tax base-broadening & raising some people's taxes.

This requires Reagan-era-style bipartisanship.

It takes two to tango, and we may not even have one.

The prognosis

Things have to get worse before they get better.

But this is not to say they will get better.

Is responsible problem-solving still feasible in the U.S. political system?

I am not wildly optimistic - and the AMT is not even the biggest or hardest test.