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Stargazing: The Alternative Minimum Tax for Individuals and Future Tax Reform

ALTHOUGH income tax philosophy often seems impenetrable, most tax reform proposals are meant to further a few straightforward principles. Thus, the basic premise of most tax reform efforts is that, whenever possible, our income tax laws should be both fair and simple.[1]

What constitutes fairness is controversial. At the very least, fairness requires that those with equivalent economic incomes pay the same amount of tax.[2] Reform efforts following this view seek a

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A technical discussion of the alternative minimum tax appears as a chapter in *Federal Income Taxation of Individuals* by Boris I. Bittker and Martin J. McMahon, Jr. (Warren, Gorham & Lamont 1988).

[1] D. BRADFORD & U.S. TREASURY TAX POLICY STAFF, BLUEPRINTS FOR BASIC TAX REFORM (2d ed. 1984) [hereinafter BRADFORD]; 1 DEPARTMENT OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH (Nov. 1984) [hereinafter TREASURY I]; Roberts, Friedman, Ginsburg, Louthan, Lubick, Young & Zeitlin, *A Report on Complexity and the Income Tax*, 27 TAX L. REV. 325 (1972); Special Committee on Simplification, Section of Taxation, American Bar Association, *Evaluation of the Proposed Model Comprehensive Income Tax*, 32 TAX LAW. 563 (1978); THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY (P-H, May 1985) [hereinafter TREASURY II].

[2] S. SURREY, PATHWAYS TO TAX REFORM (1973); TREASURY I, *supra* note 1, at 5; Surrey, *The Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted*, 70 HARV. L. REV. 1145, 1146 (1957); Thuronyi, *Tax Reform for 1989 and Beyond*, 42 TAX NOTES 981 (1989); TREASURY II, *supra* note 1.

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comprehensive tax base[3] and horizontal equity.[4] Other views of fairness hold that the rich should pay more tax on the dollar than the working and middle classes.[5] Proponents of this view call for progressivity.[6] Fairness also explains the search for universal tax liability[7] and the use of the tax system to further important social goals.

Throughout its history, the alternative minimum tax has promised to further each of these tax reform principles. Yet, a review of the alternative minimum tax is disconcerting because the tremendous complexity it creates is not offset by any increased equity. Hence, judged by the "normal" standards of tax policy, the alternative minimum tax is a miserable failure.

The defects in the alternative minimum tax are both obvious and well-known. In fact, years before its first adoption, strong criticism of early proposals relied on minimum tax concepts.[8] Given those early criticisms and the inherent problems created by even a single tax system, why did Congress embrace this second tax, and why does the tax continue to flourish after almost two decades?

This Article argues that some form of minimum tax has survived since 1969 not because of Congress' failure to test the concept against the basic goals of tax policy, but because a separate tax system serves a unique purpose within Congress' tax reform agenda. That purpose is to provide an "out-of-town try-out" for particular provisions to see if they can play the "Great White Way" of the regular tax system. In this sense, the alternative minimum tax is a crystal ball that reveals the future of tax reform.

Part I of this Article describes how the alternative minimum tax and its predecessors operate within the context of the regular tax

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[3] For a discussion of the comprehensive tax base, see *infra* notes 58-74 and accompanying text.

[4] For a discussion of horizontal equity, see *infra* notes 115-19 and accompanying text.

[5] For a discussion of vertical equity, see *infra* notes 89-114 and accompanying text.

[6] For a discussion of progressivity, see *id.*

[7] For a discussion of universal tax liability, see *infra* notes 127-34 and accompanying text.

[8] *See, e.g.*, Bittker, *An Optional Simplified Income Tax?*, 21 TAX L. REV. 1, 1-3 (1965), in which the author reviews a 1963 proposal by Sen. Russell B. Long (D-La.) for an optional tax with a base which would have contained many of the items presently excluded from the tax base (such as state and local taxes and tax exempt interest) in exchange for a lower tax rate. Professor Bittker concludes that the proposed optional simplified tax, which was presented as a means of achieving simplicity, would, in fact, increase complexity without creating a truly comprehensive tax base. *Id.* at 36-37. The optional simplified tax proposal is discussed further at *infra* notes 75-88 and accompanying text.

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system. The description is not comprehensive because, for the purposes of this Article, we only need to know what tax benefits these systems attack without analyzing the mechanics.[9] Similarly, the discussion is limited to those provisions that affect individuals (or individuals and corporations) but does not attempt to address provisions directed solely to corporations. Part I also includes a short history of the minimum tax movement, starting with the proposed optional simplified tax and moving through the minimum tax, maximum tax, and the alternative minimum tax. This history emphasizes tax benefits that are (or were) subject to the alternative minimum tax, and the creation in 1986 of a completely separate tax system similar to the regular tax, but which produces its own tax liability through the use of independent depreciation systems, credits, and basis and net operating loss rules.

Part II tests the alternative minimum tax against tax policy concerns of simplicity, equity, and a comprehensive tax base. Judged by each of these aspirations, the alternative minimum tax is found wanting.

Part III presents the question of why Congress created a tax system that contradicts standard views of tax policy. Part III's hypothesis is that political concerns make the alternative minimum tax an attractive legislative laboratory for testing how acceptable Code changes are to various constituencies. Thus, Part III postulates that, despite the failure of the alternative minimum tax to satisfy the basic goals of tax policy, Congress has retained the tax in order to provide a "halfway house" for particular provisions that it may want to eliminate or revise in the future.[10]

If Congress has retained the alternative minimum tax in order to serve this function, it should be possible to: (1) demonstrate that past versions of the alternative minimum tax foreshadow present provisions within the regular tax, and (2) replicate this result by using the present alternative minimum tax to predict future tax reform. To this end, Part III shows how past versions of the alterna-

[9] For a complete discussion of the mechanics of the alternative minimum tax (AMT) as it affects individuals, see B. BITTKER & M. MCMAHON, FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 41 (1988).

[10] When the AMT was first enacted, Professor Bittker suggested that the tax might serve as a legislative laboratory for testing future tax reform. B. BITTKER & L. STONE, FEDERAL INCOME ESTATE AND GIFT TAXATION 340 (4th ed. 1972). At the time, this premise could not rise above speculation because the AMT had been in effect for too short a time. Now that almost 20 years have passed, however, there is historical evidence that we can use to test Professor Bittker's theory.

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tive minimum, minimum, and maximum taxes seem to presage changes in the regular tax by highlighting past provisions which have now found their way into the regular tax system. Further, because legislation cannot be duplicated in a laboratory, Part III uses the present alternative minimum tax to predict future changes in tax reform, thus making the future a kind of ongoing experiment.

Finally, the Article concludes that the alternative minimum tax serves no useful function. Further, even if the alternative minimum tax allows Congress a kind of legislative laboratory, the cost, in terms of complexity alone, is too high to sustain its continued existence.

I

Operation of the Alternative Minimum Tax

In order to understand the alternative minimum tax, it is necessary to consider how the regular tax system determines tax liability, because the alternative minimum tax first imitates and then manipulates the results produced by the regular tax.[11] This imitation followed by manipulation is the key to understanding the alternative minimum tax.

A. Determining Tax Liability Under the Regular Tax

To understand how an individual's tax liability is computed, imagine that you are a contestant in a game show. On the game floor you are surrounded by figurines representing wonderful prizes such as seven-figure annual salaries, dividends, interest, rent-free apartments in the best part of town, free vacations, lavish expense accounts, and the like. In your hand is a shopping basket. The object of the game is to fill this basket with all the figurines you can possibly handle without going over the weight limit for the show. If you fill the basket without going over, all the prizes are yours and you walk out the door a happy contestant. If your basket is too heavy, however, you will end up leaving a sizable portion of your "win-

[11] W. Andrews, Basic Federal Income Taxation 766-68 (3d ed. 1985); B. Bittker & L. Stone, Federal Income Taxation 409-13 (5th ed. 1980); A. Gunn, Federal Income Taxation 748-53 (1981).

Although this Article highlights a variety of minimum tax systems as they have existed since their introduction in the 1960s, Part I is primarily limited to the AMT and the regular tax as they exist today. To be sure, each system had some minor variations. However, as is demonstrated more fully below, each minimum tax system followed basically the same method and interacted with the regular tax in essentially the same way.

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nings" at the gate, where the show's sponsors will take them to build a military base in some place you have never heard of.

The obstacle to all these riches is that the prizes' values do not correspond to the figurines' weight. For example, that $12,000 annual salary you earned as a janitor to get through school weighs a great deal, but $150,000 of municipal bond interest does not even register on the scale. This is because the bond interest has a tiny ring at its base to which you attach a balloon called "tax preference."[12] When the balloon fills with helium, it floats your prize out of the basket to meet you outside the gate.

This is essentially what happens when you compute the amount of taxes you owe each year. Although you start with a heavy basket filled with all of your income "from whatever source derived,"[13] the basket gets lighter and lighter as the tax preference balloons float part of your income past the gate to meet you at the tax-free haven outside. It is only what remains in the basket after the tax preference items have flown away that make up your taxable income (or tax base).[14] Your tax rate is multiplied against this tax base to pro-

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[12] For purposes of this Article, I define tax preferences as those deductions, exclusions, and credits that make taxable income different from economic income. For example, under this definition, accelerated depreciation in excess of economic depreciation is a tax preference. Further, the medical expense deduction is a tax preference because it represents a personal cost not related to the production of income. Others disagree with this definition. For another view of tax preferences which does not support my definition, see Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, arguing that tax expenditures should be defined as those sections that confer benefits through the Internal Revenue Code which could be provided more efficiently through other avenues.

[13] I.R.C. § 61 (1986). It will be shown that fruitful minds interpret "income" to embrace all manner of things, including the value of owner occupied housing and the services of a spouse-homemaker. *See, e.g.*, Pechman, *infra* note 58. This approach is based on Professor Henry C. Simons' definition of income as all increases in wealth plus all consumption over a particular period of time. H. SIMONS, PERSONAL INCOME TAXATION 50 (1938, reprinted by the University of Chicago Press 1970).

For example, under Professor Simons' theory, an individual whose net worth rose from $500 in the beginning of Year One to $600 at the end of Year One, and who had consumed an additional $25, would be taxed on income of $125.

Professor Simons' definition is often used by income tax theorists. *See, e.g.*, Halperin, *Interest in Disguise: Taxing the "Time Value of Money"*, 95 YALE L.J. 506, 508 (1986); Strnad, *Tax Timing and the Haig-Simons Ideal: A Rejoinder to Professor Popkin*, 62 IND. L.J. 73, 75 (Winter 1986-87); Strnad, *The Bankruptcy of Conventional Tax Timing Wisdom is Deeper than Semantics: A Rejoinder to Professors Kaplow and Warren*, 39 STAN. L. REV. 389, 391 (1987). However, Professor Simons' definition is not the basis for determining income under the Code.

[14] For example, consider the Solomons, a married couple filing a joint return for tax year 1989. In 1989, the Solomons earned $300,000 in dividends and $4,000 in tax-exempt interest from private activity bonds. However, they will pay tax on a much

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duce your tentative tax liability for the year.[15]

Consequently, if you want to reduce your tax liability under the regular tax, you must consciously seek out tax preferences. With these preferences, you can earn large amounts of economic income while paying very small amounts of tax. This is the game of taxation that the alternative minimum tax was meant to change.

B. Congress Creates a Shadow Tax System

The calculation of regular tax liability reveals a gap between what first appears in a taxpayer's basket (i.e., "all income from whatever source derived") and what finally ends up on the game show's scale (that is, the tax base that, when multiplied against the tax rate, produces the tentative tax owed). This gap between "all income," "taxable income," and the actual tax due, comes not from tiny balloons lifting prizes from the scale but from exclusions,[16] deductions,[17] ex-

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smaller amount than $304,000. This is because, by using the following deductions, exemptions, and exclusions, they will reduce their economic income of $304,000 down to a taxable income of $66,000 and their actual tax liability down from a potential effective rate of 28% to a mere 10.4%:

The Solomons and the Regular Tax System

1.	All income from whatever source derived		$304,000
2.	Exclusions		
	a.	Tax exempt interest income	(4,000)
3.	Deductions		
	a.	Accelerated depreciation	(50,000)
	b.	Mine exploration expenses	(40,000)
	c.	Home mortgage interest (mortgage not used to purchase the property)	(20,000)
	d.	Charitable contribution of capital gain property with a fair market value of $50,000 and a basis of $10,000	(50,000)
	e.	Investment expenses	(20,000)
4.	Exemptions		
	a.	One for each spouse	(4,000)
Taxable Income			$116,000
Actual Tax Liability (assuming no credits)			$ 30,514
Effective Rate (on the entire $304,000)			10.4%

The effective rate on the entire $304,000 is provided for reference only. In that the taxpayers have real expenses associated with the cost of producing the $304,000, their actual economic income would be something less than the full $304,000.

[15] Actual regular tax liability may be reduced by a variety of credits. For a discussion of tax credits affecting individuals' income tax returns, see B. BITTKER & M. MCMAHON, *supra* note 9, ¶ 16 (business credits) and ¶ 24 (personal credits).

[16] *See* I.R.C. § 61(a) which states: "*Except as otherwise provided in this subtitle*, gross income means all income from whatever source derived . . . ." (emphasis added).

Exclusions are items Congress prefers to leave tax-free, for example, the fair market value of gifts, *id.* § 102, state and local bond interest, *id.* § 103, and the value of employer provided health insurance, *id.* § 106.

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emptions,[18] and credits[19] provided for under the regular tax. If a person's basket is filled with enough exclusions, deductions, exemptions, and credits, she will have little or no regular tax liability.[20] If she neglects to add these preferences to her basket, her regular tax liability may be very large indeed. At first, this may not seem like a problem because taxpayers generally know what items reduce their tax before the game begins. Thus, we can suppose that they simply avoid the heavily taxed items and run straight for the tax preference items. That strategy is not always possible, however, because few of us have complete control over our sources of income. Further, Congress controls what items make our baskets heavier or lighter. As a result, Congress can prevent taxpayers from stuffing their income baskets so as to avoid tax completely. This is where the alternative minimum tax comes in; it takes items that are privileged

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[17] There are two types of deductions which are removed from a taxpayer's income: "above the line" deductions and itemized deductions.

In general, above the line deductions represent the cost of producing income, for example, salaries paid to employees or the cost of maintaining business equipment. *Id.* § 162. However, above the line deductions also include some personal expenses such as alimony payments. *Id.* § 215.

When all income is reduced by exclusions and above the line deductions, it becomes adjusted gross income. *Id.* § 62. Adjusted gross income is then decreased further by itemized deductions. These deductions (which are only available to individuals) consist of medical and dental expenses, *id.* § 213, state and local taxes, *id.* § 164, home mortgage interest and a portion of consumer interest, *id.* § 163, gifts to charity, *id.* § 170, casualty and theft losses, *id.* § 165(c)(3), moving expenses made in connection with an income producing activity, *id.* § 217(a), and the miscellaneous deductions (which include such items as union dues and unreimbursed employee business expenses), *id.* § 67(b). If the taxpayer prefers, a standard deduction may be substituted for the itemized deductions. *Id.* § 63(b)-(c).

[18] Personal exemptions are amounts determined by statute that a taxpayer removes from income based on the number of dependents included on her return. *Id.* § 151.

[19] Credits reduce the tax owed rather than simply reducing taxable income. For example, assume a taxpayer has all income from whatever source derived of $200. That income includes exclusions of $30, above the line deductions of $20, below the line deductions of $1, a personal exemption of $3, and a potential standard deduction of $2. The taxpayer's taxable income is $145 because he will reduce his income by all of the items previously listed except the below the line deductions, having elected to use the higher standard deduction instead. If his income tax rates are 15% for the first $50 and 28% for the remaining income, his tentative tax will be $34.10 ((15% x 50 = 7.50) + (28% x 95 = 26.60)). If the taxpayer now has a tax credit of $4.10, his actual tax liability is only $30 rather than $34.10 because the credit reduces his tax dollar for dollar.

[20] Once all deductions, exemptions, and exclusions are eliminated, we are left with taxable income, which is also called the tax base. *Id.* § 63(a). Taxable income is multiplied by the tax rate to determine the tentative tax. *See id.* § 1 (various individual tax rates). The tentative tax is then decreased by the taxpayer's credits, if any, which results in the final tax liability under the regular tax.

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under the regular tax and strips them of their favored status. Although an item avoids the regular tax, it may still contribute to the public coffers if it is singled out under the alternative minimum tax.[21]

C. History of the Alternative Minimum Tax

The attempt to make up for overly generous provisions in the regular tax is the common characteristic of all the minimum tax systems. However, Congress did not always use the same technical devices from year to year. The first minimum tax, enacted in 1969, was an "add-on" tax, meaning that an individual was subject to two separate taxes rather than the combined regular and alternative minimum tax liabilities we use today. The regular tax continued unchanged, but the taxpayer was forced to make a separate calculation of her tax preference items and pay a second ten percent flat rate tax when those preferences exceeded a fairly large exemption amount.[22]

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[21] For example, what happens to the Solomons, *supra* note 14, when, having made their way through the regular tax, they are confronted with the alternative minimum tax?

The Solomons and the Alternative Minimum Tax System

1.	Taxable income under the regular tax	$116,000
2.	Items provided with generous treatment under the regular tax which are forced back into the alternative minimum tax base	
	a. Tax exempt interest income	4,000
	b. Excess of accelerated depreciation over AMT depreciation (assume $50,000 less $30,000)	20,000
	c. Mine development expenses (90% x $40,000)	36,000
	d. Home mortgage interest (assuming debt was not used to purchase the property)	20,000
	e. Charitable contribution of capital gain property with a fair market value of $50,000 and a basis of $10,000	40,000
	f. Investment expenses	20,000
	g. Two exemptions under the regular tax	4,000
Alternative Minimum Taxable Income		$260,000
	h. Less AMT exemption	(12,500)
Alternative Minimum Tax Base		$247,500
Tentative AMT liability (21% x 242,500)		$ 51,975
Effective Rate (on entire $304,000)		17%

Again, the effective rate is computed on $304,000 for comparison purposes only and is not meant to imply that this couple has no legitimate reductions from their gross receipts to produce their economic income.

[22] Tax Reform Act of 1969, Pub. L. No. 91-172, § 301(a), 83 Stat. 487, 1969 U.S. CODE CONG. & ADMIN. NEWS 509, 623-28 (codified at I.R.C. §§ 56-58) [hereinafter T.R.A. 1969].

At first, the exemption amount was the sum of $30,000 *plus* the full regular tax liabil-

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The minimum tax was joined by a maximum tax which was also enacted in 1969.[23] The maximum tax was supposed to help reduce the incentive to use tax shelters by ensuring that earned income (as opposed to investment and other types of unearned income) would never be taxed at more than a fifty percent rate.[24] The idea was to encourage the pursuit of earned income (rather than tax preferred items) through the maximum tax's lower rate while discouraging the use of tax preferences through the minimum tax.

By 1976, it was clear that high-income individuals were still using preferences to avoid tax liability.[25] In response, Congress strengthened the minimum tax by increasing its flat rate to fifteen percent and lowering its exemption amount to the greater of $10,000 or one-half of regular income taxes paid.[26] From the adoption of the mini-

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ity for the year *plus* any tax carryover from prior taxable years. I.R.C. § 56(a)(1)-(2) (1969).

The tax preference items which were subject to the first minimum tax were:

1. Investment interest deductions in excess of investment income
2. Rapid amortization of pollution control facilities in excess of accelerated depreciation
3. Rapid amortization of railroad rolling stock in excess of accelerated depreciation
4. The excess of the fair market value of qualified stock options over the option price of the shares
5. Bad debt deductions of financial institutions to the extent that they exceeded additions to bad debt reserves
6. The long-term capital gains exclusion
7. Any depreciation deductions in excess of straight line for real estate and personal property subject to a net lease
8. Excess percentage depletion deductions over basis. *Id.* § 57(a).

For a discussion of the constitutionality of the minimum tax, see Birkeland, *The Minimum Tax Concept: A Constitutional Analysis*, 52 TAXES 40 (1974).

[23] T.R.A. 1969, *supra* note 22, § 804(a), *reprinted in* 1969 U.S. CODE CONG. & ADMIN. NEWS 509, 752-53 (codified at I.R.C. § 1348 (1969)).

[24] H.R. REP. No. 413, 91st Cong., 1st Sess., pt. 1, at 208 (1969), *reprinted in* 1969 U.S. CODE CONG. & ADMIN. NEWS 1645.

At this time, the rates under the regular tax ran as high as 70%. I.R.C. § 1 (1969).

[25]
> The existing minimum tax on tax preferences was enacted in 1969 in order to ensure that high-income individuals and corporations pay at least a minimum rate of tax on their tax preferences . . . . The current minimum tax, however, has not achieved this goal . . . . Moreover, the existing minimum tax is largely a tax on only one type of preferred income—the excluded half of long-term capital gains, which constitutes about seven-eighths of the . . . minimum tax base.

S. REP. No. 938, 94th Cong., 2d Sess., pt.1, at 109, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 3439, 3544.

[26] Tax Reform Act of 1976, Pub. L. No. 94-455, § 301(a), 1976 U.S. CODE CONG. & ADMIN. NEWS (90 Stat.) 1520, 1549 (codified at I.R.C. § 56(a) (1976)) [hereinafter T.R.A. 1976].

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mum tax in 1969 through 1976, there were also several changes in the preferences that triggered the tax.[27]

In 1978, Congress enacted the first alternative minimum tax. Why add another tax to the already littered playing field? Congress thought the existing minimum tax "adversely affected capital formation" because a person could, conceivably, pay a large regular tax and still be subject to the minimum tax on capital gains as long as his total tax preferences exceeded his exemption amount.[28] To

[27] In 1971, the excess of investment interest over investment income was dropped as a tax preference. This was part of the original minimum tax which only applied the tax preference label to investment interest for years before 1972. I.R.C. § 57(a) ((1972) flush language).

In 1972, the excess of 60-month amortization over regular depreciation for on-the-job training and child care facilities was added, bringing the total number of tax preferences to 10. Revenue Act of 1971, Pub. L. No. 92-178, § 303(b), 85 Stat. 497, 1971 U.S. CODE CONG. & ADMIN. NEWS 579, 580 (codified at I.R.C. § 57(a)(10) (1971)) (effective for tax years ending after Dec. 31, 1971).

In 1976, Congress added two more tax preferences. The new preferences included itemized deductions (other than medical and casualty loss deductions) in excess of 60% of adjusted gross income and intangible drilling costs for oil and gas wells in excess of amortization over a 10-year period. T.R.A. 1976, *supra* note 26, § 301(c)(1)-(2), 90 Stat. 1520, 1550-51. The preference for accelerated depreciation on personal property was also expanded to include all leased property rather than simply property subject to a net lease. *Id.* § 301(c)(1), 90 Stat. 1520, 1550.

For a discussion of the changes in the minimum tax from 1969 to 1978, see Madeo & Madeo, *Some Evidence of the Equity Effects of the Minimum Tax on Individual Taxpayers*, 34 NAT'L TAX J. 457 (1981).

[28] H.R. REP. NO. 1445, 95th Cong., 2d Sess., pt. 4, at 203 (1978); *see also* H.R. CONF. REP. NO. 1800, 95th Cong., 2d Sess. 263-68, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 7198, 7259-65.

For example, let us consider a married taxpayer who, in 1978, earned $100,000 in salary and another $200,000 in capital gains. In 1978, capital gains were allowed a 60% exclusion under the regular tax. Revenue Act of 1978, Pub. L. No. 95-600, § 402(a), 1978 U.S. CODE CONG. & ADMIN. NEWS (92 Stat.) 2763, 2867 (codified at I.R.C. § 1202(a)) [hereinafter R.A. 1978]. Assuming that itemized deductions and personal exemptions reduced taxable income by another $10,000, the taxpayer's regular taxable income would be $170,000. This would result in a total tax due of $88,204, computed as follows: $83,580 + [68% x (170,000 − 163,200)]. *See* I.R.C. § 1(a) (1978).

Based on the minimum tax alone, this couple would be subject to an additional add-on tax because his tax preference (the $120,000 capital gains exclusion) would exceed their minimum tax exemption of $44,102 (one-half of the regular tax paid). Their preference amount would be $75,898 ($120,000 exclusion less his $44,102 exemption). Therefore, they would be responsible for an additional add-on minimum tax of $11,385 (15% of $75,898). This is why there was some fear the minimum tax alone would adversely affect capital formation.

However, under the first AMT the result is different. The alternative minimum taxable income would start with the full $300,000 because the capital gains exclusion would be added back into the tax base. This tax base would be reduced by the AMT exemption of $20,000 and then be subject to the modified progressive rates originally used in the AMT. *See infra* note 33. This would leave a total AMT liability of $62,000. Be-

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avoid this perceived problem, Congress switched the capital gains preference from the minimum tax to the alternative minimum tax which was triggered only when alternative minimum tax liability exceeded regular tax liability.[29]

The first alternative minimum tax worked alongside the minimum and maximum tax systems.[30] It was a fairly limited tax with only two preferences[31] and a $20,000 exemption.[32] Rather than the flat rate used by the minimum tax, the alternative minimum tax used a progressive rate which ran from ten to twenty-five percent.[33]

In 1981, the alternative minimum tax became even less progressive as the top rate dropped from twenty-five to twenty percent.[34] In 1983, even modest progressivity became a thing of the past as the alternative minimum tax went to a flat rate of twenty percent.[35]

By 1983, the minimum and maximum taxes disappeared, leaving the alternative minimum tax as the only game in town.[36] With this, the number of items favored under the regular tax, but tainted by

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cause this amount is less than the total regular tax liability of $88,204, there is no additional tax owed. This is how Congress hoped to use the AMT to attack tax preferences without adversely affecting capital formation.

[29] R.A. 1978, *supra* note 28, § 421(a), 1978 U.S. CODE CONG. & ADMIN. NEWS (92 Stat.) 2763, 2871-74 (codified at I.R.C. § 55 (1978)).

[30] For a description of the mechanics of the 1978 AMT, see Coven, *The Alternative Minimum Tax: Proving Again That Two Wrongs Do Not Make a Right*, 68 CALIF. L. REV. 1093 (1980).

[31] The two preferences were: (1) the capital gains exclusion, and (2) itemized deductions (other than state and local taxes, medical and dental expenses, and casualty losses) in excess of 60% of adjusted gross income. R.A. 1978, *supra* note 28, § 421(a)-(b), 92 Stat. 2872, 2874 (codified at I.R.C. § 55(b) and 57(a) (1979)). Both preferences previously appeared in the minimum tax. I.R.C. § 57 (1969).

[32] I.R.C. § 55 (1979).

[33] The rates for the alternative minimum tax in 1978 were:

$ 0 to $ 20,000	exemption
$ 20,000 to $ 60,000	10%
$ 60,000 to $100,000	20%
over $100,000	25%

At this time, the regular tax rates ran from 14% to 70%. I.R.C. § 1 (1978).

[34] Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, §§ 101(d)(1)(A)-(B), 102, 1981 U.S. CODE CONG. & ADMIN. NEWS (95 Stat.) 172, 183, 186 (amending I.R.C. § 55(a)(1) (1981)) [hereinafter ERTA].

[35] Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 201(a), 1982 U.S. CODE CONG. & ADMIN. NEWS (96 Stat.) 324, 411 (codified as amended at I.R.C. § 55(a) (1983)) [hereinafter TEFRA]. The rate remained at 20% until 1986 when it rose to 21%. I.R.C. § 55(a) (1987).

[36] The maximum tax was repealed in 1981 when the regular tax rates were lowered to a top rate of 50%. ERTA, *supra* note 34, § 101(c), 95 Stat. 183.

The minimum tax continued until 1982 before it too was eliminated. TEFRA, *supra* note 35, § 201(c), 96 Stat. 419 (amending I.R.C. § 56 (1982)).

the alternative minimum tax, increased from two to nine as the alternative minimum tax began attacking preferences previously subject to the minimum tax.[37] These alternative minimum tax preferences represented items that were not allowed as deductions or exclusions under the alternative minimum tax, although they reduced taxable income under the regular tax.

The structure of the alternative minimum tax also changed as it began to more closely resemble the regular tax. For example, the alternative minimum tax got its own set of itemized deductions (rather than simply adding back portions of deductions previously taken under the regular tax)[38] and the alternative minimum tax ex-

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[37] The preferences added between 1978 and 1983 included:

1. Accelerated depreciation on real property in excess of straight line
2. Accelerated depreciation on leased personal property in excess of straight line
3. Amortization of certified pollution control facilities in excess of depreciation otherwise allowable
4. The excess of fair market value of incentive stock options over the option price
5. Percentage depletion deductions in excess of adjusted basis. These five preferences previously appeared under the recently repealed minimum tax. *See supra* note 22.

Other tax preferences added to the AMT which were new to both the alternative and minimum taxes included:

6. Interest and dividend income excluded under the $100 regular tax exclusion, the all-saver exclusion, and the 15% net interest exclusion
7. Intangible drilling costs on oil, gas, and geothermal wells in excess of net income from production
8. Circulation, research, and experimental expenditures to the extent they exceeded the amount that would have been allowed as a deduction if amortized over a 10-year period.

The capital gains exclusion also continued as a tax preference, although itemized deductions in excess of 60% of adjusted gross income were eliminated as a tax preference in favor of a special set of AMT itemized deductions. *See infra* note 38.

Thus, from 1978 to 1982, the items of tax preference under the AMT rose from two to nine.

[38] In 1983, the AMT itemized deductions were:

1. Casualty and wagering loss deductions to the extent allowed under the regular tax
2. Charitable contribution deductions to the extent allowed in calculating the regular tax
3. Medical expenses in excess of 10% of adjusted gross income
4. The pro-rata portion of the estate tax which was allocable to income in respect of a decedent
5. The amount of investment interest that did not exceed the qualified net investment income
6. For estates and trusts only, amounts distributed to beneficiaries and amounts permanently set aside for charitable purposes.

I.R.C. § 55(e)(1) and (6) (1983).

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emption changed to reflect filing status, something that had been part of the regular tax for some time.[39] Further, a taxable income calculation was added requiring the taxpayer to start with adjusted gross income, add back targeted tax preferences, and subtract out alternative minimum tax approved itemized deductions and net operating losses.[40] This was different from the earlier alternative minimum tax which did not require a separate tax base calculation or use of different (or modified) deductions.

The alternative minimum tax changed slightly in 1984,[41] but major developments occurred in 1986.[42] Under the Tax Reform Act of 1986,[43] the alternative minimum tax became a fully developed tax system. For example, the new alternative minimum tax has its own depreciation rules, unlike the old alternative minimum tax which merely added a portion of regular tax depreciation back into the alternative minimum tax base.[44] This change required separate ba-

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[39] *Id.* § 55(f)(1). The exemption amounts continue to this day. They are $40,000 for a joint return, $30,000 for a single person, and $20,000 for married people filing separately. I.R.C. § 55(f)(1) (1986).

[40] I.R.C. § 55(b)(1) (1983).

[41] The changes made in 1984 were:

1. The investment tax credit recapture was taken out of the AMT tax base;
2. For intangible drilling costs, the election to take accelerated cost recovery deductions and the investment tax credit in lieu of expensing was eliminated for wells located outside the United States;
3. The amount attributable to the alcohol fuel credit was not included in the AMT tax base;
4. The circulation expense preference was amended to provide a three-year amortization period rather than the prior ten-year period;
5. In computing net investment income for purposes of the investment interest deduction, income and deductions from a limited business interest were taken into account.

Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 711(a), 1984 U.S. CODE CONG. & ADMIN. NEWS (98 Stat.) 494, 942-43 (codified as amended at I.R.C. §§ 55-58 (1984)).

[42] For a more complete discussion of the mechanics of the AMT from 1986 to the present, see B. BITTKER & M. MCMAHON, *supra* note 9, ¶ 41 (a complete description of 1989 AMT mechanics); Monroe, *The Alternative Minimum Tax as Everyone's Tax: Important Structural Changes Made by the Tax Reform Act of 1986*, 1986 COLUM. BUS. L. REV. 177 (a comparison of how items are treated under the AMT and the regular tax after 1986); and Nolan, *An Analysis of the New Alternative Minimum Tax*, 33 TAX NOTES 280 (1986) (a summary of the 1986 AMT).

[43] Tax Reform Act of 1986, Pub. L. No. 99-514, 1986 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2085 [hereinafter T.R.A. 1986].

[44] Rather than making an adjustment for each item of property in the amount (if any) by which the regular tax deduction exceeds the alternative depreciation deduction, "the alternative depreciation deduction is substituted for the regular tax [accelerated cost recovery system (ACRS)] deduction. The principal effect of this system is that it permits 'netting' " so that there is potential for a negative adjustment to taxable income when an alternative deduction exceeds the regular tax deduction for the year. JOINT

sis rules as well, although, under the pre-1986 alternative minimum tax, property kept its regular tax basis even when the alternative minimum tax limited the regular tax depreciation deduction.[45] The new alternative minimum tax has its own net operating loss deductions[46] and credits.[47] To a limited extent, it uses different account-

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COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986 (CIS J862-15) 439 (May 1987) [hereinafter JOINT COMMITTEE ON TAXATION].

For example, compare the results under the old AMT where there was no separate depreciation schedule and the post-1986 version in which there is a separate depreciation schedule.

Assume the taxpayer has two pieces of property. In Year Three, Property A has a regular depreciation deduction of $70 although the most depreciation allowed under the AMT is $50. Property B has a regular depreciation deduction of $8 but under the AMT the maximum deduction runs as high as $30.

Under the pre-1986 AMT, the excess of the regular depreciation deduction of $70 over the alternative minimum tax deduction of $50 is a tax preference which is added back to the taxpayer's alternative minimum tax base. The fact that the AMT system would allow Property B an extra $22 of depreciation is irrelevant to this $20 increase in the alternative minimum tax base.

After 1986, however, the taxpayer is not required to increase his AMT base for the $20 excess depreciation on Property A because the $22 excess AMT depreciation on Property B is netted against the depreciation on Property A. Further, both Property A and Property B now have two basis calculations, one for their regular tax depreciation and the second for their AMT depreciation.

For an explanation of the mechanics of the AMT depreciation system created in 1986, see B. BITTKER & M. MCMAHON, *supra* note 9, ¶ 41; Middleton & Newcomb, *How the TRA of 1986 Alters the Scope of and Planning for the AMT*, 67 J. TAX'N 44 (1987).

[45] Many of the adjustments required by § 56 result in a deferral, rather than an elimination, of deductions. Recognizing this fact, § 56(a)(7) provides that certain property will have one basis for regular taxable income and a second for alternative minimum taxable income.

For example, AMT depreciation will usually require lower deductions than ACRS in early years but, because a taxpayer is generally allowed to write off his entire basis in property, there will be higher deductions in later years. In order to reflect this change in the timing of depreciation and other deductions, the basis of property for alternative minimum taxable income must be higher in those early years.

The properties affected by the alternative basis concept of I.R.C. § 56(a)(7) are: (1) depreciable property subject to § 56(a)(1), (2) pollution control facilities subject to § 56(a)(5), (3) property eligible for mining exploration and development write-offs under § 56(a)(2), and (4) circulation, research, and experimental expenditure deductions under § 56(b)(2).

[46] Instead of the net operating loss (NOL) deduction normally allowed under § 172, § 56(a)(4) requires the use of the alternative tax NOL deduction of § 56(d). Essentially, the alternative tax NOL deduction is the ordinary NOL deduction modified to eliminate the effect of tax preference items. Separate computations are required for AMT net operating losses and for loss carryovers.

A NOL for purposes of the AMT is a normal net operating loss with two exceptions: first, under § 56(d)(2)(A), items of tax preference are either added back to taxable income or modified as provided in §§ 56-58; second, only itemized deductions as modi-

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ing rules.[48] Itemized deductions are radically altered,[49] and the

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fied under § 172(d) and allowed in computing alternative minimum taxable income, are taken into account. JOINT COMMITTEE ON TAXATION, *supra* note 44, at 469.

The alternative tax NOL deduction in a carryover year is limited to 90% of alternative minimum taxable income computed without the deduction. I.R.C. § 56(d)(1)(A). Accordingly, the alternative tax NOL deduction can never offset more than 90% of alternative minimum taxable income.

As a result of these modifications to the ordinary NOL deduction, a taxpayer who avoids regular tax liability in a profitable year because of loss carryovers under § 172 must usually pay some alternative minimum tax even if, apart from the net operating loss, he has not made use of any item that requires adjustment or increase under the alternative minimum tax rules. *See, e.g.*, DuPont v. United States, 483 F. Supp. 588 (D. Del. 1980) (taxpayer's liability for minimum tax increased because net operating loss carryback completely eliminated regular tax liability).

[47] For a good working explanation of the AMT credit, see B. BITTKER & M. MCMAHON, *supra* note 9, ¶ 41; Middleton & Newcomb, *supra* note 44; Stern, *Planning With the New Minimum Tax Credit*, 12 REV. TAX'N INDIV. 129 (1988). *See also* TAX NOTES TODAY, Aug. 10, 1988 (letter from Neil Kimmelfield to the Department of the Treasury discussing the relationship of the minimum tax credit against regular tax liability to the AMT foreign tax credit).

[48] Profits reported using the completed contract method under the regular tax must use the percentage of completion method for the AMT except for certain small construction contracts which are allowed to use simplified procedures. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 1007(b)(1), 1988 U.S. CODE CONG. & ADMIN. NEWS (102 Stat.) 3342, 3428 (codified as amended at I.R.C. § 56(a)(3) (1988)) [hereinafter T.M.R.A. 1988].

[49] In computing AMT income, § 56(b)(1) makes several adjustments to the use of itemized deductions. First, miscellaneous itemized deductions are completely eliminated from alternative minimum taxable income. These are defined by § 67(b) to include *all* deductions *other than* business expenses (which are not employee business expenses) and other costs allowable in computing adjusted gross income, and deductions for interest, taxes, casualty losses, charitable gifts, medical expenses, and a few other items. The most common examples of miscellaneous itemized deductions are employee business expenses (such as union dues, malpractice insurance, and uniforms) and investment expenses. Next, medical expenses, which are allowed in computing regular tax liability to the extent that they exceed 7.5% of adjusted gross income, must exceed 10% of adjusted gross income for the alternative minimum taxable income calculation. Finally, the standard deduction provided under § 63(c) is completely eliminated from alternative minimum taxable income as are all itemized deductions for state or local property and income taxes.

In order to avoid double counting, § 56(b)(1)(D) provides that state and local tax refunds are not included in alternative minimum taxable income although these amounts are normally included in a regular taxable income calculation.

Itemized interest deductions allowed in computing regular tax liability are also affected by the AMT adjustments. The items affected are:

1. Personal interest deductions. While the regular tax allows limited deductions for interest on consumer loans under the phase-in rules of § 163, consumer interest is not allowed as a deduction to any extent in computing alternative minimum taxable income.

2. Interest on private activity bonds. In computing regular taxable income, § 163(d) limits the taxpayer's investment interest deductions to his net investment income. For purposes of computing this limitation, tax exempt interest is not treated as investment income because it never enters the tax base. However, under § 56(b)(1)(C), normally tax exempt interest (and amounts treated as interest) on private activity bonds

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number of tax preferences is dramatically increased.[50]

D. *How the Alternative Minimum Tax Manipulates the Regular Tax*

Over the last twenty years, Congress has used a variety of shadow taxes to manipulate the results achieved under the regular tax. Under the present alternative minimum tax, the tampering began when Congress cut the string on some, but far from all, of the regular tax preference balloons. As a result, a small group of tax preferences, removed from income under the regular tax, fell back into

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issued after Aug. 7, 1986 are treated as investment income for purposes of the § 163(d) limitation. At the same time, the cost of earning this interest income is treated as deductible under § 163 despite the restriction of § 265(a)(2).

3. Home mortgage interest. Under § 163(h)(2)(D) of the regular tax, a taxpayer may deduct up to $100,000 of interest on home mortgage loans which are used for non-housing related personal expenses so long as the debt is secured by the taxpayer's principal residence. Under § 56(b)(1)(C) however, the deduction for interest generated by loans for non-housing related personal costs is denied.

[50] The tax preferences affecting individuals added by the Tax Reform Act of 1986 included:

1. Income from long-term contracts entered into after Mar. 1, 1986, which have to be recomputed using the percentage of completion method
2. The full sale price from the sale of dealer property, when reported under the regular tax by using the installment method of accounting
3. Interest from private activity bonds, which is tax exempt under the regular tax
4. Deductions for charitable contributions of appreciated property which are limited to the donor's basis, rather than the property's fair market value as provided for under the regular tax
5. Losses on tax shelter farm activities, which are completely disallowed
6. Passive losses, which are completely disallowed, rather than a portion being allowed under the phase out rules of the regular tax as provided for by § 469
7. The foreign tax credit, which is modified so that it cannot offset more than 90% of tentative alternative minimum taxable income. T.R.A. 1986, *supra* note 43.

There were some slight changes made to the AMT preferences as a result of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10243(a), 1987 U.S. CODE CONG. & ADMIN. NEWS (101 Stat.) 1330, 1330-423 (amending I.R.C. § 56(f)(2)), and the T.M.R.A. 1988, *supra* note 48. In 1987, the installment method was allowed for all non-dealer dispositions of property, and in 1988 all taxpayers were required to use the percentage completion method of accounting (rather than the long-term contract method), except that small construction contracts were allowed to use a new simplified procedure for cost allocations. The incentive stock option preference was also changed so that a taxpayer must now report excess of fair market value over option price only when his rights in the stock are freely transferable or not subject to a substantial risk of forfeiture. For a discussion of this provision, see Ferrante, *Incentive Stock Options and the Alternative Minimum Tax*, 42 TAX NOTES 499 (1989).

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the tax base.[51] Because of these additions, the alternative minimum tax base is larger than the regular tax base. This higher base is then decreased by a larger personal exemption than that provided for under the regular tax.[52] The net result, called alternative minimum taxable income,[53] is subject to a flat tax rate of twenty-one percent, which produces a tentative alternative minimum tax.[54] The tentative alternative minimum tax is then reduced by those credits allowed under the alternative minimum tax.[55] When these calculations are completed, the two tax liabilities (alternative minimum and regular) are compared to determine which is larger. The taxpayer pays the larger amount.[56]

Thus, the alternative minimum tax makes the game both more costly and more complicated. A taxpayer cannot simply fill her basket with preferences secure in the knowledge that there will be no tax due. Instead, the taxpayer must attempt to reduce the regular tax liability while at the same time avoiding imposition of the alternative minimum tax. To do this effectively, tax preferences and their amounts must be carefully chosen.[57] But, aside from making

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[51] The items included in the tax base under the AMT are listed in I.R.C. §§ 56-58 (1989). The items which affect an individual's return under these sections include: accelerated depreciation, *id.* § 56(a)(1); mining exploration and development costs, *id.* § 56(a)(2)(A); certain deductions under the long-term contract method of accounting, *id.* § 56(a)(3); NOL deductions, *id.* § 56(a)(4); amortization of pollution control facilities, *id.* § 56(a)(5); installment sales of certain property by dealers, *id.* § 56(a)(6); certain itemized deductions, *id.* § 56(b)(1); circulation expenses, *id.* § 56(b)(2); research and experimental expenditures, *id.* § 56(b)(2); losses from certain farming activities, *id.* § 58(a); certain passive losses, *id.* § 58(b); excess percentage depletion deductions, *id.* § 57(a)(1); excess intangible drilling costs, *id.* § 57(a)(2); tax-exempt interest from private activity bonds, *id.* § 57(a)(5); and charitable contributions of appreciated property, *id.* § 57(a)(6). Many of these items are discussed in more detail throughout this Article.

[52] Under I.R.C. § 55(d), married individuals filing joint returns and surviving spouses are allowed a $40,000 exemption; single individuals who are not surviving spouses receive a $30,000 exemption; and married individuals who file separate returns are limited to a $20,000 exemption. These exemptions are phased out at certain AMT income levels. *Id.* § 55(d)(3).

Compare this to the $2,000 per person exemption for the filer and each of her dependents provided under the regular tax system by virtue of I.R.C. § 151(d)(1).

[53] *Id.* § 55(b)(2).

[54] *Id.* § 55(b)(1)(A).

[55] For the AMT credit, see I.R.C. § 53. For other credits allowed under the AMT, see I.R.C. § 59.

[56] Under the statute, the taxpayer actually pays either his regular tax standing alone, or his regular tax *plus* the portion of his AMT which exceeds his regular tax. *Id.* § 55(a).

[57] To give one simple example of how the AMT may come into play, assume we have three single taxpayers one of whom, *A*, earns $100,000 of salary, one of whom, *B*, earns $100,000 of interest income from bonds which produce tax exempt income under I.R.C.

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some people's lives more difficult by forcing them to engage in ever more careful tax planning, what does the alternative minimum tax do for the Code as a whole? Does it make it more fair or comprehensive? Does it actually prevent tax avoidance? The balance of this Article addresses these questions.

II

THE ALTERNATIVE MINIMUM TAX AND TAX POLICY

This Article looks at one section of the Internal Revenue Code and asks how it fits into the universe of income taxation. To that end, this Article tests the alternative minimum tax against the standard explanations driving income taxation as a whole. If the alternative minimum tax moves the entire tax structure towards legitimate policy goals, then no further explanation is required. If instead, the alternative minimum tax fails to support recognized tax policies, we should ask what other policy goals it might serve. With that perspective in mind, this Part reviews the basic concerns underlying income tax policy against the backdrop of the alternative minimum tax.

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§ 103, and a third, *C*, who earns $100,000 of income from private activity bonds, as defined by I.R.C. § 141.

In 1988, Taxpayer *A* has taxable income of $95,050. This consists of Taxpayer *A*'s gross income of $100,000 reduced by her standard deduction of $3,000 and her personal exemption of $1,950.

Under I.R.C. § 1(c) and (g) the tax due from Taxpayer *A* is $29,291.50, which is computed as:

15% of $17,850	=	2,677.50
28% of $25,300	=	9,761.50
33% of $46,410	=	15,315.30
28% of $ 5,490	=	1,537.20

The tax owned by Taxpayer *B* is $0 because his income is all exempt from taxes by virtue of I.R.C. § 103.

Like Taxpayer *B*, Taxpayer *C* will owe no regular tax. *Id.* § 141. Taxpayer *C*'s interest income from private activity bonds is an item of tax preference under I.R.C. § 57(a)(5), thus Taxpayer *C* has a $14,700 AMT to pay. *Id.* § 55(d).

Taxpayer *C*'s AMT computation starts with the $100,000 tax preference (assuming no costs associated with earning the private activity bond interest income), which is reduced by the alternative personal exemption of $30,000 provided for by I.R.C. § 55(d)(1). The $70,000 of alternative minimum taxable income is subject to a 21% flat rate for a total tax liability of $14,700. *Id.* § 55(b)(1)(A). This is still $14,591.50 less than Taxpayer *A*'s regular tax liability.

What happens when AMT liability exceeds the regular tax liability? If, for some reason, taxpayer *A*'s AMT liability was $35,291.50 instead of $14,700, then that liability would exceed regular tax liability by $6,000. In this situation, taxpayer *A* pays his entire regular tax liability of $29,291.50, plus an additional alternative minimum tax of $6,000.

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A. The Alternative Minimum Tax and the Comprehensive Income Tax Movement

The idea of the alternative minimum tax first began to take hold in the 1950s, more than a decade before any minimum tax provision was added to the Code. It was during this time that the comprehensive income tax movement caught fire as tax analysts began asserting that Congress should rid the Code of special provisions which kept the tax base from matching economic income.[58] By 1956, the National Tax Association's annual conference was devoted to the question of "tax mitigation" (what we now call "tax avoidance"). A number of papers focused on the lack of a comprehensive tax base as the cause of inequities in the Code.[59] By the 1960s, the comprehensive income tax base had earned its place among the important goals of tax reform.[60]

The comprehensive income tax base is an attempt to achieve fairness by forcing taxable income to match economic income. The

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[58] For example, in 1951, Walter Heller of the University of Minnesota presented a paper before the American Finance Association in which he criticized the Internal Revenue Code for containing exclusions and overgenerous deductions that kept the tax base from matching economic income. The items that Heller seemed most concerned with were percentage depletion, imputed income, state and local bond interest, undistributed corporate profits, accrued capital gains at the time of death, the taxpayer's use of a personal exemption while her parents also list her as a dependent, the rollover of gains on a personal residence, and the exclusion for military pay allowances. Very few of these items are addressed by the AMT. Heller, *Practical Limitations on the Federal Net Income Tax,* 7 J. FIN. 185 (1952).

In 1956, Joseph Pechman joined the fray by asserting that the adoption of a comprehensive income tax base could substantially lower rates, which at that time were as high as 91%, I.R.C. § 1 (1956), and raise revenue. The proposed income tax base would, for example, eliminate deductions targeted at particular individuals and industries and do away with itemized deductions for state and local taxes. The exclusion of certain transfer payments, such as old age survivor's benefits and unemployment compensation, would be eliminated, along with exclusions for imputed rents and a portion of capital gains, state and local bond interest, imputed income from the consumption of home-produced food and stock in trade, and savings earned from insurance contracts. Pechman, *Erosion of the Individual Income Tax,* 10 NAT'L TAX J. 1 (1957).

[59] Ture, *The Costs of Income Tax Mitigation,* 1956 NAT'L TAX ANN. 51 (49th Annual Conference on Taxation).

[60] Blum, *Federal Income Tax Reform—Twenty Questions,* 41 TAXES 672 (1963).

Following publication of Professor Blum's article, Professor Galvin reported on the work of the American Bar Association Committee on Taxation, charged with studying the income tax with a view to the creation of a comprehensive tax base. Galvin, *Progress in Substantive Tax Reform; Work of the American Bar Association; Treasury Studies; What Tax Practitioners Can Do,* 1965 MAJOR TAX PLAN. 1. Apparently, there were those who were not happy with the committee's work and much of Professor Galvin's report is an attempt to address those critics who felt the committee had gone too far.

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purposes of this equivalence are: (1) to compel universal tax liability, and (2) to ensure that those who earn the same amount of income pay the same amount of tax. Universal tax liability results from a broad definition of taxable income. For example, if taxable income matched economic income dollar for dollar, then everyone, including infants and the very poor, would pay some tax based on the economic income they receive in the form of food and shelter.[61] When this broad definition of income is adopted, it becomes clear that universal tax liability is stymied each time Congress overlooks certain types of economic income in constructing a tax base.

The road from economic income to taxable income leads us past an assortment of exclusions, deductions, and credits. These serve a variety of functions in the income tax agenda. Sometimes a provision serves tax administration. For example, in theory, the value of owner-occupied housing should be taxed.[62] Yet, when we face the reality of actual valuation problems and potential citizen resentment, this income is ignored. Sometimes a provision is based on moral concerns, as in the past when disability insurance payments were not taxed. Often, provisions are justified as furthering some economic or social goal. An example of this is the exclusion for interest paid on state or local bonds which decreases the cost to states of borrowing money[63] and credits which encourage the construction of low-income housing.[64] This dilution of economic income for the sake of social policy lead the comprehensive income tax movement to the tax expenditure budget.

The tax expenditure budget is one way of attacking tax preferences and achieving a comprehensive tax base.[65] The point of the budget is to educate policy makers to the cost of special provisions by equating tax preferences to direct government grants for particular groups and industries.[66] To advocates of the tax expenditure budget, the only difference between direct government expenditures and tax preferences is that the latter allows Congress to indirectly

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[61] H. SIMONS, *supra* note 13, at 50-52.

[62] S. SURREY, *supra* note 2, at 285 n.5.

[63] The idea is that the average investor who can receive 10% before tax and 8% after tax from a corporate bond will be willing to receive 8% tax free from a municipal bond. By making the municipal interest tax-exempt, the federal government helps states reduce their borrowing costs.

[64] For example, the low-income housing credit provided by I.R.C. § 42 is meant to increase investments in low-income housing by increasing the after-tax return such investments can produce.

[65] *See* S. SURREY, *supra* note 2, at 30-31; Surrey, *supra* note 2.

[66] Surrey, *supra* note 2.

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dispense benefits it would never dare furnish directly.[67] The tax expenditure concept has had some effect. For example, Congress now publishes a tax expenditure budget which lists the yearly cost in lost revenue of various tax preferences.[68]

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67 One example Surrey uses to illustrate this point is the deduction for home mortgage interest. Based on the rates at the time he devised the argument, Surrey showed that the deduction was worth 70 cents on the dollar to the wealthy and absolutely nothing to the poor. Surrey then asked whether any politician would vote for a direct expenditure program in which the Treasury actively gave wealthy people 70% of their mortgage interest payments while providing little to the working class and nothing to the poor. S. SURREY, *supra* note 2, at 232-36.

68 OFFICE OF MANAGEMENT AND BUDGET, SPECIAL ANALYSES BUDGET OF THE UNITED STATES GOVERNMENT G-1, G-1 to G-59 (Fiscal Year 1990) [hereinafter TAX EXPENDITURE BUDGET].

Although many have championed the cause of the comprehensive tax base, others have disagreed. For example, Professor Bittker asserted early on that the comprehensive tax base movement missed the point when it condemned all tax preferences as unseemly. For example, he questioned why so many preferences never make the comprehensive tax movement's hit list. He opined that the reason for these omissions was that all preferences serve some constituency whose normative values make the preference good. Yet, once we allow some exceptions to the comprehensive tax base's "nuke 'em" philosophy, we are bound to allow others because restricting tax advantages to only a few taxpayers is even more unfair than the present system. Further, we cannot even lean over backwards against tax preferences because we do not always agree on what is a preference and what follows the rule. Instead of grasping for distinctions that can never be made, Bittker's approach calls for periodic review of preferences to make sure they are still serving their purposes rather than wholesale slaughter in the name of a comprehensive tax base. *See, e.g.*, Bittker, *Comprehensive Income Taxation: A Response*, 81 HARV. L. REV. 1032 (1968); Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967); Bittker, *An Optional Simplified Income Tax?*, 21 TAX L. REV. 1 (1965). *But see* Galvin, *More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA's CSTR*, 81 HARV. L. REV. 1016 (1968); Musgrave, *In Defense of an Income Concept*, 81 HARV. L. REV. 44 (1967).

Professor Zelinsky, another critic of the comprehensive income tax base, points out that tax incentives can be an economically efficient means of achieving desired results that often cost less than other means. When government intervention is appropriate, the Internal Revenue Code may be the cheapest way of achieving policy goals. Zelinsky, *Efficiency and Income Taxes: The Rehabilitation of Tax Incentives*, 64 TEX. L. REV. 973 (1986). *Contra* Johnson, *Why Have Anti-Tax Shelter Legislation? A Response to Professor Zelenak*, 67 TEX. L. REV. 591 (1989).

Professors Bankman and Griffith echo this view when they point out that tax preferences are one way that our society encourages particular activities. Bankman & Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905 (1987).

Professor Thuronyi changes the discussion completely by challenging Professor Surrey's definition of preferences to such an extent that he would preserve such comprehensive tax base bugaboos as accelerated depreciation. In Professor Thuronyi's view, favored tax treatment is not a tax preference when Congress wishes to confer a benefit that cannot be provided more efficiently outside the Internal Revenue Code. Thuronyi, *supra* note 12.

Where does this leave us with the alternative minimum tax? As noted earlier, I define tax preferences as those deductions, exclusions, exemptions, and credits that move taxable income away from economic income.[69] Using this definition, literally hundreds of tax preferences lurk in the Code. Yet, the minimum tax systems have never attacked more than twenty of these preferences at any given time.[70] Even limiting ourselves to the less inclusive tax expenditure budget, that budget contains at least ninety-nine tax preferences that escape the alternative minimum tax.[71] Thus, whether we use a broad definition of tax preferences or the narrower tax expenditure budget, the alternative minimum tax does little to promote a comprehensive tax base, especially in terms of the number of preferences attacked.

Further, suppose we look at the amount of revenues lost through preferences rather than the number of items thrown back into the tax base. After all, the alternative minimum tax may still contribute to a comprehensive tax base if it catches major offenders in an effective way. This analysis, however, reveals that many large revenue losers also escape the alternative minimum tax. For example, the alternative minimum tax fails to eliminate such offenders as the step-up in basis at death, the general exclusion of state and local bond interest, and tax deferred annuities and pensions.[72]

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[69] For a further discussion of my definition of tax preferences, see *supra* note 12.

[70] For a list of the various preferences attacked under the minimum tax systems, see *supra* notes 22-50 and accompanying text.

[71] Monroe, *The Alternative Minimum Tax From a Practical Perspective: Its Role in the Income Tax Structure Under Current Law, and Its Possible Role in Future Deficit Reduction Legislation,* 1988 COLUM. BUS. L. REV. 341, 353-55.

[72] To illustrate this failure, let us call to mind the Jones-Street family. Grandfather Jones and Grandfather Street met in 1931 when they were young Wall Street tycoons. Although the market looked bad, they managed to acquire 500,000 shares of Good Luck Company at 10 cents per share (total investment $50,000). Over the years, the shares split ten to one and the value per share rose to $45. Thus, when they died, the grandpas left 5 million shares with a total value of $225 million. Had they sold these shares before dying, their taxable incomes would show at least $224,950,000, representing the now realized profit in their investment ($225 million less $50,000). But they were too smart for that. Instead they left the shares to their married children, the Jones-Streets, who immediately sold 20,000 shares for $900,000. Did the children pay a tax on the sale? We would think so, given that the sale let them realize a substantial profit. However, because under I.R.C. § 1014 their basis in the shares was increased to the share's fair market value on the date of the grandpas' death, the Jones-Streets were treated as if the sale produced no profit. In other words, they took the profit tax-free. The story continues. The children wanted to provide for their children, the twins, so they invested the $900,000 in municipal bonds which generated $90,000 a year in interest. With this money, the twins bought Jaguar convertibles and spent four happy years at Princeton. Did anyone pay tax on this windfall? Again, we would think so because

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This comparison shows that the alternative minimum tax leaves massive gaps in the comprehensive income tax base. Some taxpayers will get caught, but most will escape the tax completely. This is true even though these taypayers use deductions and credits to completely eliminate large portions of otherwise taxable income. Further, even if we believe that the alternative minimum tax could, in the abstract, move us toward a comprehensive tax base, it seems that the actual tax is simply too easy to avoid.[73] Thus, it cannot be claimed that the alternative minimum tax is the patron saint of the comprehensive income tax movement.[74]

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each of us would pay tax if we were lucky enough to work 100 hours a week for the same $90,000. Yet, because interest from municipal bonds is exempt from taxes under I.R.C. § 103, this income escaped tax as well.

Compare the Jones-Streets with the Smithfield family which earns $225 million by selling land and then tries to wipe out its regular tax liability through accelerated depreciation deductions of like amount. The Smithfields will escape the regular tax with ease because their depreciation deductions will offset their gains from dealings in property and so their regular taxable income becomes zero. The AMT, however, will most likely reduce their depreciation deductions, making some alternative minimum taxable income appear. That income will be subject to the flat 21% alternative minimum tax rate.

The tax expenditure budget estimates that, for 1990 alone, such tax benefits as the step-up in basis at death and the exclusion for municipal bond interest will cost the Treasury $13.460 billion (carryover basis of capital gains at death) and $10.730 billion (exclusion of municipal bond interest) in lost revenues, for a total loss to the Treasury of $24.19 billion. TAX EXPENDITURE BUDGET, *supra* note 68, at G-41, G-44.

[73] Practitioner-oriented literature shows a variety of ways to avoid alternative minimum tax liability. *See, e.g.*, Garlock, *An Analysis of the Alternative Minimum Tax and the Planning Opportunities It Offers*, 52 J. TAX'N 206 (1980); Hoyt, *How to Avoid the Alternative Minimum Tax When Making Charitable Gifts of Appreciated Property*, 37 TAX NOTES 633 (1987); Poreba, *Alternative Minimum Tax: Income Shifting is Only One Way to Lessen its Impact*, 36 TAX'N FOR ACCT. 242 (1986); Stern, *supra* note 47; Streer & Holland, *Working with the Revised Alternative Minimum Tax for Individuals*, 18 TAX ADVISOR 150 (1987).

[74] In 1982, Professor Graetz disagreed with this conclusion. Graetz, *The 1982 Minimum Tax Amendments as a First Step in the Transition to a "Flat-Rate" Tax*, 56 S. CAL. L. REV. 527 (1983). At that time, Graetz believed that the country was ready for a transition from a preference-ridden progressive tax to a flat tax imposed on a comprehensive base. The objections Graetz anticipated to that transition were fairness to those who had invested based on expectation of continued favorable tax treatment, and the use of a flat tax as a smoke screen for shifting the tax burden from the upper-class to the middle-class. *Id.* at 555-66. Graetz saw the AMT as a good transition to a broad based flat tax because of its elimination of the capital gains preference. However, he suggested that several changes be made in the AMT in order to strengthen its contribution to the comprehensive tax base. These changes included the complete elimination of the exclusion for state and local bond interest, *id.* at 555-56, interest earned on life insurance, *id.* at 556, the step-up in basis to fair market value on the date of death, *id.* at 556-57, and the exclusion for employer-provided health insurance, *id.* at 557-58. As we have seen, Professor Graetz's suggestions have not been followed. Thus, whatever the potential for encouraging a comprehensive tax base, the AMT has not lived up to its promise.

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B. *The Alternative Minimum Tax and Code Complexity*

The comprehensive income tax movement promised many things, including simplicity.[75] For comprehensive tax base disciples, Code complexity was a function of the taxpayers' search for favored income combined with Congress' struggle to separate worthy beneficiaries from their less deserving companions.[76] If those concerns were replaced by a comprehensive tax base, Code complexity would diminish because no one type of income would be favored over another. Hence, both the taxpayer and Congress would be free to pursue more important matters. In this atmosphere, Senator Long introduced his Simplified Tax Method, a system that, although never passed, served as the basis for the first enacted minimum tax.[77]

The Simplified Tax Method presaged future minimum tax systems in that it eliminated various tax preferences in exchange for lower rates.[78] In application, the Simplified Tax Method was different from our present experience in at least two respects. First, under the Simplified Method the taxpayer received a choice. She could elect to compute her liability using either the regular tax or the Simplified Method. Second, the Simplified Method's purpose differed from later minimum tax systems because Senator Long's major concern was simplicity rather than revenue raising, equity, or a comprehensive tax base.[79] Nevertheless, Senator Long took the same route to simplicity as the comprehensive income tax movement, namely, a reduction in tax preferences so that the tax base

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[75] Blum, *supra* note 60, at 681-82; Pechman, *supra* note 58; Roberts, Friedman, Ginsburg, Louthan, Lubick, Young & Zeitlin, *supra* note 1; Ture, *supra* note 59.

[76] Ture, *supra* note 59, at 56-57, 61; *see* Pechman, *supra* note 58.

[77] Senator Russell B. Long (D-La.) introduced the Simplified Tax Method (S. 3250, 88th Cong., 2d Sess. (1963)) on Oct. 2, 1964 as an amendment to H.R. 8363 (which later became the Revenue Act of 1964). The bill was not passed. For Senator Long's speech to the Senate, see 110 CONG. REC. S23,653-65 (daily ed. Oct. 2, 1964).

[78] Some of the items that were included back into the tax base were percentage depletion, intangible drilling costs, local, state and foreign taxes, the capital gain exclusion, tax exempt interest, contributions to qualified employee and self-employed pension plans, employee death benefits, and sick pay. Of these items, those now covered by the present AMT include percentage depletion, intangible drilling costs, and local, state and foreign taxes. Tax exempt interest is also partially covered by the AMT but only to the extent that it is generated by private activity bonds. Incentive stock options are also covered under the present AMT, but not the types of pension plans suggested by Senator Long.

[79] For a discussion of why Senator Long's proposal would not have aided Code simplicity or helped create a truly comprehensive income tax base, see Bittker, *supra* note 8, at 12-19.

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more nearly resembled economic income.[80]

Senator Long believed that his Simplified Tax Method would reduce Code complexity by allowing taxpayers to elect a lower tax rate in exchange for giving up a preference-ridden tax base.[81] He believed his system would eliminate the need for high-priced tax specialists because the appeal of simplicity would outweigh the urge for a smaller tax bill. Thus, taxpayers would elect his system without regard for higher tax bills.[82]

As enacted, the minimum and alternative minimum taxes were never elective. Thus, whatever her view of simplicity versus wealth, a taxpayer who uses alternative minimum tax targeted preferences cannot avoid two separate calculations: one for regular tax liability and a second for the alternative minimum tax. This alone is enough to put the alternative minimum tax on the wrong side of the simplicity column. The two separate calculations are just the beginning of the story, however, because the alternative minimum tax has become more complicated both internally and in relation to the regular tax as well.

When it was first enacted, the alternative minimum tax was criticized for increasing Code complexity, despite the fact that it contained only two preferences and no special accounting, basis, or depreciation rules.[83] More than a decade later, the number of preferences has increased dramatically and the alternative minimum tax contains its own depreciation system, net operating loss deductions, and credits.[84] These changes mean that record keeping alone is now a major task for those who use tax preferences.[85] For example, a person who uses accelerated depreciation may have to keep track of up to ten different depreciation methods in order to comply with the

[80] For a discussion of those tax preferences which were included back into the tax base under the Simplified Optional Tax, see *supra* note 78 and accompanying text.

[81] *Id.*

[82] This belief in the willingness of Americans to give up money in exchange for simplicity was rejected by Professor Bittker. Bittker asserts that taxpayers would probably spend more time and money on advisers in an attempt to figure out which system saved the most money. Rather than making the income tax simpler, adding in another system could only make everything more complicated. *See* Bittker, *supra* note 8.

[83] For a discussion of the mechanics of the first AMT, see *supra* notes 22-50 and accompanying text. For criticisms of the complexity of the first alternative minimum tax, see Coven, *supra* note 30; Note, *Alternative Minimum Tax: The 1978 Revenue Act's "Catch-All" Provision,* 11 RUT.-CAM. L.J. 101 (1979).

[84] *See supra* notes 43-50 and accompanying text.

[85] Monroe, *supra* note 71.

alternative minimum tax.[86] The result is a major increase in Code complexity, even for those who may actually avoid alternative minimum tax liability.[87] Thus, the entire idea of an alternative minimum tax is antithetical to Code simplicity.[88]

C. *Does the Alternative Minimum Tax Increase Code Equity?*

When we speak of Code equity we are talking about at least two things: horizontal equity, that is, that people earning the same amount of economic income should pay the same amount of tax, and vertical equity, that is, that people who earn more should pay a greater portion of their income in taxes than those who earn less. We are also talking about a more elusive quality—perceived fairness.

1. *Vertical Equity and the Alternative Minimum Tax*

On the surface, the regular tax employs progressive rates: the more income in a person's tax base, the higher the person's rate.[89] Progressive rates have been part of the income tax since its inception.[90] Although many support progressivity, the attempt to tax the rich at a higher rate than the working and middle classes has met with periodic resistance.[91]

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[86] Lipsey & Withers, *Applying the New Alternative Minimum Tax to Real Estate,* 15 J. REAL EST. TAX'N 124 (1980).

[87] Monroe, *supra* note 71; Monroe, *supra* note 42; Comment, *The Alternative Minimum Tax for Individuals: Present Problems and Future Possibilities,* 63 WASH. L. REV. 103 (1988) (the alternative minimum tax increases code complexity for everyone).

[88] Thuronyi, *supra* note 12.

[89] For example, under I.R.C. § 1(c) (tax imposed on unmarried individuals) a taxpayer pays 15 cents on the dollar for her first $17,850 of income but pays 28 cents of tax on the next dollar in her tax base.

The reader should be careful to note, however, that income in the tax base is not the same as economic income. As the text points out *supra* at notes 14 and 57, a person can have a great deal of economic income and little or nothing in her tax base.

[90] The Income Tax Act of 1913, ch. 16, 38 Stat. 114, 166-67, had rates running from one percent on incomes above $20,000 to as high as six percent for incomes of more than $500,000. Randolph Paul asserts that progressive income taxation originated in the colonies when New Plymouth began to tax its members according to their ability to pay. R. PAUL, TAXATION IN THE UNITED STATES 3 (1954). Professors Blum and Kalven claim that the constitutionality of the progressive income tax has not been challenged since 1916 and that, both before and after that year, the policy behind the progressive income tax was left to the gut reaction that progressivity was the right thing to do. W. BLUM & H. KALVEN, THE UNEASY CASE FOR PROGRESSIVE TAXATION (1953).

[91] W. BLUM & H. KALVEN, *supra* note 90, set out a series of arguments for and against progressive rates. This work is still a classic in the field. Other early works on progressive taxation include C. GALVIN & B. BITTKER, THE INCOME TAX: HOW PRO-

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Despite objections, the majority view supports progressivity.[92] Supporters of progressive rates argue that progressive taxation allocates taxes to those who benefit most from government. Under this theory, the rich are thought to get more and better government services than others, particularly in the form of government protection of their wealth.[93]

For those who hypothesize a decreasing utility of money, the argument in favor of progressivity asserts that the rich do not suffer more from higher rates than others do from relatively lower ones. For those who accept this view, the loss of even ninety cents on the dollar may not be a problem to a taxpayer who is worth billions.[94] This supposition is often supported by a related proposition, namely, that the rich have a greater ability to pay and therefore should pay more.[95] Moreover, a variety of economic theories reveal that society's overall welfare increases through the use of progressive rates.[96]

Progressive rates are also supported on moral and ethical

GRESSIVE SHOULD IT BE? (1969), and Cohen, *Reflections on the U.S. Progressive Income Tax: Its Past and Present*, 62 VA. L. REV. 1317 (1976). Recent works also support progressive taxation. *See, e.g.*, Bankman & Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905 (1987) (proponents of a flat rate tax have failed to give a normative underpinning to their theories); Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 MICH. L. REV. 465 (1987) (author dissects the classic arguments in favor of a flat rate tax and then provides a series of justifications, including a feminist analysis, for the progressive tax).

A number of recent works support a flat rate tax, including: Doernberg, *A Workable Flat Rate Consumption Tax*, 70 IOWA L. REV. 425 (1985); Graetz, *The 1982 Minimum Tax Amendments as a First Step in the Transition to a "Flat-Rate" Tax*, 56 S. CAL. L. REV. 527 (1983); O'Kelley, *Tax Policy for Post-Liberal Society: A Flat-Tax-Inspired Redefinition of the Purpose and Ideal Structure of a Progressive Income Tax*, 58 S. CAL. L. REV. 727 (1985). Some supporters of a flat rate tax see it as a way of increasing progressivity. For a discussion of this perspective, see *infra* notes 98-110 and accompanying text.

[92] TREASURY I, *supra* note 1; DeWind, *Law and the Future: Federal Taxation*, 51 NW. U.L. REV. 227 (1956); Surrey, *supra* note 2 (professional learning and public opinion support the progressive income tax); TREASURY II, *supra* note 1.

[93] Blum, *supra* note 60, at 686-88; Kornhauser, *supra* note 91. *See generally* J. BUENKER, THE INCOME TAX AND THE PROGRESSIVE ERA 42-49 (1985).

[94] W. BLUM & H. KALVEN, *supra* note 90, at 56-63; Bankman & Griffith, *supra* note 91, at 1958; Feld, *Fairness in Rate Cuts in the Individual Income Tax*, 68 CORNELL L. REV. 429, 458 & n.122 (1983); Griffith, *Theories of Personal Deductions in the Income Tax*, 40 HASTINGS L.J. 343, 373 (1989); Kelman, *Time Preference and Tax Equity*, 35 STAN. L. REV. 649, 667-68 n.45 (1983).

[95] W. BLUM & H. KALVEN, *supra* note 90, at 64-68; Kornhauser, *supra* note 91, at 465 n.3. *See generally* J. BUENKER, *supra* note 93, at 42-49.

[96] Bankman & Griffith, *supra* note 91.

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grounds. For example, feminism has been used to support the assertion that humankind's basic survival depends on self-interested concern for the general welfare. This concern for others over individual advantage is reflected in our progressive rate structure.[97]

Although vertical equity is often thought to require progressive rates, some theorists advocate a flat rate as a means of increasing progressivity. This notion is not as far-fetched as it initially appears. First, consider that our present rate structure (when combined with our preference-ridden tax base) can lead to the rich paying at lower rates than those with lesser incomes. Next, note that a large exemption produces progressivity even with a flat rate. Thus, progressivity might well be served by a flat tax combined with a large exemption.[98]

Although progressivity is widely accepted, arguments against it are plentiful. For example, Code complexity is often cited as a fault of progressivity. This is because much tax planning revolves around obtaining lower rates either by deferring income to periods when rates are expected to be lower, or attempting to obtain favorable rates within the present system (such as attempts to obtain capital gains treatment during the many years when the capital gains exclusion was still available).[99] According to those who oppose progressive rates, this planning then forces Congress to develop more and more provisions that limit the taxpayers' ability to manipulate the system.[100]

Political irresponsibility is also offered as a reason for flattening rates. This is based on the view that the rich are an electoral minor-

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97 Kornhauser, *supra* note 91.

98 *See, e.g.,* Graetz, *supra* note 74; O'Kelley, *supra* note 91. To understand how we can have progressivity with a flat rate and a large exemption amount, compare the effective rates paid by three taxpayers in the following hypothetical situation. Assume that we have a completely comprehensive tax base, a flat rate of 20%, and a single $20,000 exemption for each return.

Smith has an economic income of $30,000. After taking his $20,000 exemption, his taxable income is $10,000. His tax on that $10,000 is $2,000 based on the 20% flat rate. Thus, the amount of his overall income that is paid in tax is approximately 7%. Jones has economic income of $50,000. After taking his $20,000 exemption, his taxable income is $30,000. His tax on that $30,000 is $6,000 based on the 20% flat rate. Thus, he pays 12% of his overall income in tax. Jackson has an income of $100,000. After taking his $20,000 exemption, his taxable income is $80,000. His tax is $16,000, which is 16% of his overall income. Therefore, even with a flat rate, a large exemption supports progressivity.

99 W. BLUM & H. KALVEN, *supra* note 90.

100 This view is rejected by the other side in this debate which sees the solution in lower rates for everyone because lower rates reduce the incentive to manipulate the system. *See, e.g.,* Kornhauser, *supra* note 91.

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ity who are unable to protect themselves from the irresponsible majority. This jealous majority, so the argument goes, use progressivity as a way to gouge the vulnerable rich by forcing them to pay higher taxes.[101] Another common objection to progressivity is the view that higher marginal and effective rates adversely affect economic productivity. After-tax rewards diminish as income and, therefore, the tax rate rises.[102] Consequently, this inhibition adversely affects society as a whole, or so anti-progressivity advocates assert.

The regular tax's progressive rates have never been matched in the minimum, maximum, or alternative minimum taxes.[103] Instead, those tax systems have employed flat or modified progressive rates that were never as steep as the rates found in the corresponding regular tax. Thus, we might expect that minimum tax proponents would also support flat rates. However, this is not the case. Lack of support for a flat rate tax from minimum tax adherents is not as strange as it first appears because, despite attempts to link them, the elimination of tax preferences really has little to do with lowering rates.[104] The reason for this is that, if we believe that a preference is undeserved, the taxpayer should pay tax on the item regardless of what rates apply. The elimination of an undesirable preference does not require any corresponding "give back" in the form of lower rates.[105]

Although progressive taxation has numerous enemies, they rarely, if ever, go so far as to advocate a regressive tax system in which the rich pay less tax than other classes. Yet, because of the many preferences contained within the regular tax system, it is possible for some very wealthy people to avoid tax altogether or to substantially reduce their rates when compared to others. What does the alternative minimum tax do to avoid this situation?

Scholars addressing this issue indicate that the alternative minimum tax is not a great force for progressive taxation. Stanley Surrey first made this observation in the late 1960s when the minimum

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101 W. BLUM & H. KALVEN, *supra* note 90, at 19-21.

102 *Id.* at 21-28; *see* Kornhauser, *supra* note 91, at 472.

103 *See supra* notes 22-50 and accompanying text.

104 In TREASURY I and TREASURY II, *supra* note 1, arguments in favor of a broader tax base were sweetened with the promise of lower rates. *See* TREASURY I, *supra* note 1, at 1-11; TREASURY II, *supra* note 1, at 1-8. This linking of preferences and rates was also part of the Tax Reform Act of 1986. JOINT COMMITTEE ON TAXATION, *supra* note 44, at 6-11.

105 *See* Zelenak, *When Good Preferences Go Bad: A Critical Analysis of the Anti-Tax Shelter Provisions of the Tax Reform Act of 1986*, 67 TEX. L. REV. 499 (1989).

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tax system was still in the planning stage.[106] As Surrey pointed out, a flat tax whose rate drops below regular tax rates cannot support a progressive rate structure. At most, it can make the tax less regressive, but it can never cross the line to true progressivity.[107] Although the alternative minimum tax has changed considerably since Surrey's first review, in 1985 Professor Cooper demonstrated that the alternative minimum tax liability on $100,000 produced an effective rate no higher than twelve percent.[108] As to the capital gains exclusion, which was the original minimum tax preference and a major cause of regressive taxation, Professors Graetz, Coven, and Garlock have shown that the alternative minimum tax in its various forms never did much to eliminate the rate reduction caused by the capital gains exclusion.[109] Thus, although a few commentators believe that the alternative minimum tax supports vertical equity,[110] the majority view is that it does little, if anything, for progressivity.[111]

Although academics have toyed with the flat rate tax concept, politicians rarely advocate a single rate, although they have sometimes offered lower rates in exchange for a broader tax base.[112] These lower rates are meant to support progressivity, because a lower rate applied to a larger base results in the wealthy paying a

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[106] S. SURREY, *supra* note 2, at 247-82.

[107] This point was also made during the same era by Professors Davenport and Goldman. Davenport & Goldman, *The Minimum Tax For Tax Preferences and the Interest Deduction Limitation under the Tax Reform Act of 1969*, 16 WAYNE L. REV. 1223 (1970).

[108] Cooper, *The Taming of the Shrewd: Identifying and Controlling Income Tax Avoidance*, 85 COLUM. L. REV. 657 (1985).

[109] M. GRAETZ, FEDERAL INCOME TAXATION PRINCIPLES AND POLICIES (Successor ed. 1985); Coven, *supra* note 30; Garlock, *supra* note 73. To make matters worse, Rabinowitz asserted that the minimum tax bypassed the rich who relied on investment income and went straight for the middle-class taxpayer who relied on salary income. Rabinowitz, *Some Reflections on the Social and Economic Impact of the Tax Reform Act of 1976—The Very Rich Get Richer and the Middle Class Gets Soaked*, 31 TAX LAW. 163 (1977).

[110] *See, e.g.*, Madeo & Madeo, *supra* note 27.

[111] In addition to the articles already cited, *see, e.g.*, Note, *The Minimum Tax for Items of Tax Preference . . . Movement Toward a Comprehensive Tax Base?*, 41 U. CIN. L. REV. 365 (1972) (1969 minimum tax failed to increase either horizontal or vertical equity); Comment, *supra* note 87 (minimum tax did not support horizontal or vertical equity).

[112] JOINT COMMITTEE ON TAXATION, *supra* note 44, at 6-11.

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higher percentage of their income in tax.[113]

It is true that the alternative minimum tax forces some people to pay higher taxes. However, given the nature of the alternative minimum tax, it cannot be viewed as a force in support of vertical equity simply because too few returns are affected to make much of an impact on the overall system.[114] To say that the alternative minimum tax supports progressivity is like saying that emptying a glass of water into the ocean increases its volume. The statement is true but insignificant.

2. Horizontal Equity and the Alternative Minimum Tax

Horizontal equity is achieved when people with the same economic income pay the same amount of tax.[115] In this sense, the alternative minimum tax may be viewed as supporting horizontal equity. After all, in 1987 some 114,000 people paid an average of $10,000 more under the alternative minimum tax than they would have paid if only the regular tax applied.[116] These 114,000 people would say that their taxable income more closely resembles their economic income because of the alternative minimum tax. However, would they reject the alternative minimum tax in favor of a truly comprehensive tax system? The answer is clearly no, because a truly comprehensive tax system would grab large amounts of sheltered income rather than toying with a few preferences and charging a small additional tax.[117] Furthermore, a comprehensive tax system is harder to avoid than the alternative minimum tax which hits so few taxpayers and preferences.

A few people infrequently paying an occasional extra thousand dollars cannot cure the malfunctions of an entire system. In order to be a real force for horizontal equity, the alternative minimum tax would have to do more than catch a meager number of returns. Unfortunately, that is all the alternative minimum tax does—catch a smattering of returns.[118] Thus, although a bald definition of hori-

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[113] In fact, this was one of the justifications for lowering tax rates as part of the Tax Reform Act of 1986. JOINT COMMITTEE ON TAXATION, *supra* note 44, at 7-9.

For a mathematical explanation of how lowered rates could result in greater progressivity, see *supra* note 98.

[114] Wall St. J., Aug. 9, 1989, at A1, col. 5.

[115] *See supra* notes 92-111 and accompanying text.

[116] According to the Internal Revenue Service, 114,330 returns were subject to the alternative minimum tax in 1987. Wall St. J., *supra* note 114.

[117] For a discussion of the comprehensive tax, see *supra* notes 58-74 and accompanying text.

[118] *See supra* note 116.

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zontal equity may embrace the alternative minimum tax, true horizontal equity for all taxpayers requires something more. It requires some assurance that most, if not all, people with the same economic income will pay the same amount of tax.

The Code cannot achieve horizontal equity so long as it is riddled with tax preferences. Preferences distinguish taxable income from economic income, which results in the janitor paying tax on his $12,000 salary, while the retired executive pays nothing on his $150,000 municipal bond interest. Thus, the problem of horizontal equity is actually part of the controversy surrounding a comprehensive tax base. Yet, the alternative minimum tax does not bring the system significantly closer to a comprehensive tax base. Furthermore, even within its limited parameters, it does not attack enough preferences or affect enough people to support horizontal equity.[119]

3. *Taxpayer Morale and the Minimum Tax System*

The comprehensive income tax movement was a theoretical justification for eliminating tax preferences; but it was concern for taxpayer morale that finally got a minimum tax passed. In 1969, Congress shook when Joseph Barr testified that 155 people earning over $200,000 a year paid no taxes at all.[120] Much activity followed this revelation. The United States Treasury Department published a previously repressed report which offered solutions to the problem of tax avoidance by high-income individuals;[121] the Nixon administration jumped in with its own limit on tax preferences;[122] and, finally, the Senate Finance Committee took the lead by drafting the

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119 There are those who will say that the AMT provides as much horizontal equity as we can expect given the political realities of American taxation. Considering the tremendous complexity caused by the tax and the minuscule results it provides, the politics might better be served by eliminating the tax altogether.

120 *Hearings on the 1969 Economic Report of the President Before the Joint Economic Committee,* 91st Cong., 1st Sess. 8-44 (1969) (statement of Joseph W. Barr, Secretary of the Treasury).

121 UNITED STATES TREASURY DEPARTMENT, TAX REFORM STUDIES AND PROPOSALS (House Committee on Ways and Means and Senate Committee on Finance (1969)) [hereinafter TREASURY STUDIES].

122 For a complete discussion of the legislative history of this period, see Davenport & Goldman, *supra* note 107. *See also* Caplin, *Minimum Tax for Tax Preferences and Related Reforms Affecting High Income Individuals,* 4 IND. LEGAL F. 71 (1970-71) (discussion of the studies that were conducted prior to the passage of the first minimum tax). A more limited discussion of the legislative history is contained in Note, *supra* note 111.

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first enacted minimum tax.[123] Senate concern for taxpayer morale is clear from the legislative history which states:

> The fact that present law permits a small minority of high-income individuals to escape tax on a large proportion of their income has seriously undermined the belief of taxpayers that others are paying their fair share of the tax burden. It is essential that tax reform be obtained not only as a matter of justice but also as a matter of taxpayer morale. Our individual and corporate income taxes, which are the mainstays of our tax system, depend upon self-assessment and the cooperation of taxpayers. The loss of confidence on their part in the fairness of the tax system could result in a breakdown of taxpayer morale and make it far more difficult to collect the necessary revenues.[124]

Today, taxpayer morale remains at least one justification for the alternative minimum tax. As recently as 1986, Congress continued to view the tax as a way of letting the public know it cared.[125]

Taxpayer morale is an essential aspect of any self-assessment system and its importance to our income tax remains almost legendary. Yet, it seems odd that concern for taxpayer morale drove enactment of the minimum and alternative minimum taxes when we consider that very few members of the public have ever heard of this tax or understand its effects.[126] If the point is to make people believe that no one can escape tax, then the only route to success is to promulgate information about that alternative tax system. Moreover, getting the word out about the alternative minimum tax could be disastrous once the public discovers that it does not achieve its purpose. That is the risk of creating a system in which public relations are more important than substantive change. In any event, because the public knows little or nothing about the alternative minimum tax, it seems fair to say that the alternative minimum tax is a pathetic failure as an attempt to manipulate our perceptions of Code fairness.

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[123] Tax Reform Act of 1969, Pub. L. No. 91-172, § 301(a), 83 Stat. 487, 1969 U.S. CODE CONG. & ADMIN. NEWS 509, 623-28 (codified at I.R.C. §§ 56-58 (1970)).

[124] S. REP. No. 552, 91st Cong., 1st Sess. 13-14, *reprinted in* 1969 U.S. CODE CONG. & ADMIN. NEWS 2027, 2040.

[125] The ability of high-income individuals and highly profitable corporations to pay little or no tax undermines respect for the entire tax system and, thus, for the incentive provisions themselves.

S. REP. No. 313, 99th Cong., 2d Sess. 518-19 (1986).

[126] Anyone who doubts this statement can perform their own simple empirical test. Stand on a convenient street corner and ask the first hundred people you meet about the AMT. Should you find 15 people who have the foggiest idea about it, I will gladly buy you dinner.

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4. *Universal Tax Liability as Fairness*

When it created the minimum tax, Congress' major concern was taxpayer morale.[127] But, it expressed another interest as well—that, in fairness, everyone should pay some tax.[128] These two concerns differ because Congress could achieve fairness, in the sense of everyone paying some federal income tax, without boosting taxpayer morale. Fairness without public relations would occur, for example, if everyone actually paid some tax but the public believed that certain people could escape liability.

That the significant concern was fairness rather than revenue-raising is expressed by the fact that the preferences attacked by the alternative minimum tax cost the Treasury billions of dollars each year. Yet in 1987, the alternative minimum tax raised only $1.23 billion in additional revenues.[129] Further, the alternative minimum tax affects very few taxpayers, who end up paying an average additional tax of a few thousand dollars.[130] Thus, in this view of fairness, the important point is to keep taxpayers from getting too much of a good thing, in this case the use of perfectly legal and, in other circumstances, approved tax preferences. Does this strategy make sense? If so, is the alternative minimum tax the proper route for achieving that purpose?

Examples of Congress giving candy with one hand and snatching it back with another continue to grow.[131] This approach has lead one commentator to ask, albeit in a different context, "When do good preferences go bad?"[132] Why are some preferences good in

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[127] For a discussion of the minimum tax, see *supra* notes 16-50 and accompanying text.

[128] *See supra* note 25 and accompanying text.

[129] Wall St. J., *supra* note 114.

To give one example of the cost in lost revenues of some tax preferences subject to the alternative minimum tax consider that, in 1987, the lost revenues from accelerated depreciation for individuals alone reached $12.630 billion. These figures do not approach the total cost of all alternative minimum tax preferences or the overall cost of the tax expenditure budget for individuals which is estimated at $237.785 billion. OFFICE OF MANAGEMENT AND BUDGET, SPECIAL ANALYSES BUDGET OF THE UNITED STATES GOVERNMENT, G-1, G-41 to G-45 (Fiscal Year 1989).

[130] B. BITTKER & L. STONE, *supra* note 10, 409-13. According to the Wall Street Journal, the average increase in taxes paid on 1987 returns due to the AMT was $10,758.33. Wall St. J., *supra* note 114.

[131] The most common areas for individual taxation concern denial of losses because they violate a series of rules such as: (1) transactions between related parties under § 267; (2) amount at risk rules under § 465; (3) passive activity loss rules under § 469; or (4) investment interest rules under § 163.

[132] Zelenak, *supra* note 105, at 501.

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small portions but bad in large ones? If Congress finds a particular preference pleasing, why not freely encourage as much use as possible rather than limiting taxpayers to just enough? The alternative minimum tax restrictions are not focused on revenue drains. The total cost of preferences to the Treasury is not an alternative minimum tax issue. Thus, the alternative minimum tax is not troubled when one million people each take ten dollars of accelerated depreciation deductions. Yet, even though the cost to the public fisc is the same, the alternative minimum tax snaps into action when one person takes $10 million of the same deductions.

The argument that limiting preferences is fair because everyone should pay some tax focuses on what preferences do for individual taxpayers. Yet, favored provisions should not be enacted for individual benefit. Instead, preferences should work to benefit the economy or society rather than individuals.[133] If the preference serves society, then those employing it are justly rewarded.[134]

Of course, the response to this argument is that limiting preferences supports fairness because everyone should pay some tax. This value is important in order to create a cohesive society. The problem with the alternative minimum tax is that it does not force universal tax liability. Furthermore, it does not help people believe that everyone is paying tax even if that belief is false. Thus, whether universal tax liability is a real aspiration or merely a public relations gimmick, the alternative minimum tax flunks this test along with all the others.

III

EXPLAINING THE ALTERNATIVE MINIMUM TAX WITHIN THE CONTEXT OF THE REGULAR TAX SYSTEM

Standard tax policy cannot explain the alternative minimum tax.

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[133] *See* Bankman & Griffith, *supra* note 91; Zelenak, *supra* note 105; Zelinsky, *supra* note 68.

[134] Others have made similar points in reference to other Code provisions. *See, e.g.*, Bankman & Griffith, *supra* note 91 (preferences should not be attacked because Congress has made a decision that they provide an overall benefit); Cooper, *supra* note 108 (investments that can only turn a profit after tax should not be eliminated because Congress wants people to use the preference for the overall good of society); Rosenberg, *Tax Avoidance and Income Measurement*, 87 MICH. L. REV. 365 (1988) (courts should only attack preferences which reduce taxable income in a way that Congress did not intend); Thuronyi, *supra* note 12 (the definition of tax preferences should not include items such as accelerated depreciation that are meant to specifically reduce taxable income). *Contra* Johnson, *supra* note 68.

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It does not help forge a comprehensive tax base; its contributions to vertical and horizontal equity are minor. As a tool for increasing taxpayer morale it lacks focus. It undercuts the use of preferences as a means of social engineering[135] and it makes the Code incredibly complex.[136] When generally accepted theories cannot explain an

[135] There is one theory that, although not part of the general explanations in the field, seems to explain the AMT. This theory is sometimes known as the public choice theory and at other times as the extortion doctrine.

Have you ever wondered why tax provisions change so much? Does Congress really keep getting things so wrong that it has to clean up its mistakes year after year? Professors Doernberg and McChesney explain these mutations by following the money trail. Doernberg & McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913 (1987); Doernberg & McChesney, *Doing Good or Doing Well?: Congress and the Tax Reform Act of 1986*, 62 N.Y.U. L. REV. 891 (1987). According to Doernberg and McChesney, tax reform is one way that members of Congress earn cash for their political campaigns. Through careful research, the authors show that representatives who sit on tax committees do very well in comparison to their colleagues when it comes to fundraising. Why? Doernberg and McChesney say it is because various interest groups are willing to sink large amounts of money into campaign war chests in order to influence legislation. This leverage may be used in a variety of ways. First, it may be used to get favorable legislation passed. Second, it may be used to get unfavorable legislation passed (unfavorable for your competition, that is). Lastly, it may be used to keep legislation from being passed at all. This is where extortion comes in. The more the Code changes, the more nervous interest groups are bound to get because change portends potential destruction of their purchased benefits. The more nervous they get, the more generous their contributions in support of the status quo. Thus, Congress need never actually take a benefit away. Congressmen need only threaten with talk of tax reform.

At first blush, the AMT works well with the extortion theory. A tax that only affects heavy users of tax preferences is perfect for scaring deep pockets without annoying the general public who do not even know the tax exists. Congress can make all sorts of threats to include things in the alternative minimum tax base and follow through or not as donations dictate. Unfortunately, as Doernberg and McChesney point out, we can never really know if this is what actually happens. However, it seems more plausible than some of the other theories used to justify the AMT.

Whatever its application to the regular tax, however, the extortion theory gives poor results when applied to the AMT. If the theory did apply, we would expect wide fluctuations in the types of preferences contained by the AMT. Those fluctuations would result from an active market in which various groups buy provisions only to be ousted by more generous constituents. Instead of these fluctuations, however, the AMT follows a more consistent path.

The AMT strikes out at the same group of benefits over and over again. Its hit list consists of accelerated deductions, excessive personal and investment (but not business) deductions, and the capital gains exclusion. As the tax gets older it also gets more stringent, but always within the context of a selected group of preferences. If the extortion theory worked for the alternative minimum tax, this harmony would not exist. After all, heavy users of accelerated deductions, itemized deductions, and capital gains have money. So why can't they ever get a Congressman on their side? Are they more moral than everyone else who uses tax benefits?

[136] For a discussion of the AMT and Code complexity, see *supra* notes 75-88 and accompanying text.

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event, it is time to develop and test a new hypothesis. Based on the available data, that is what we turn to now.

A. What We Observe in the Alternative Minimum Tax

Although correlation should not be confused with causality, associations may sometimes lead to insights. As we observe the alternative minimum tax over time, one affinity that begins to emerge is a relationship between preferences which were first attacked by the alternative minimum tax and the later elimination or restriction of these benefits under the regular tax system. In order to make this relationship clear, what follows is a review of regular tax restrictions placed on alternative minimum tax-targeted preferences.

1. Business Deductions

For many years, all investment interest was deductible under the regular tax.[137] This was a great advantage to taxpayers because they could borrow money to invest in assets, deduct the interest on the borrowed money, and then reap the gain from their investment at capital gains rates, thereby obtaining a double advantage. Perhaps because of this double benefit, Congress placed investment interest within the minimum tax systems.[138] After the deduction was targeted in this way, restrictions began to develop in the regular tax system. First, investment interest deductions were limited to investment expenses plus no more than $25,000 of other income.[139] Second, the restriction tightened so that the deduction was limited to investment income and no more than $10,000.[140] Finally, in 1986, investment interest deductions were limited to investment income so that no other income could be sheltered.[141]

The deduction for a financial institution's bad debts in excess of its bad debt reserve also has a regular and alternative minimum tax connection. First, in 1969, the deduction was made a minimum tax preference.[142] This made the bad debt reserve system less attractive

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[137] *See* I.R.C. § 163 (1969) (prior to amendment by T.R.A. 1986, *supra* note 43, § 511(a)).

[138] *See supra* note 22.

[139] Originally, investment interest deductions were limited to investment income plus $25,000. T.R.A. 1969, *supra* note 22, § 221(a) (enacting new I.R.C. § 163(d) effective for tax years beginning after Dec. 31, 1971).

[140] Prior to T.R.A. 1986, *supra* note 43, § 511(a) (amending I.R.C. § 163(d)), the investment interest deduction was limited to $10,000 plus the amount of investment income.

[141] *See* I.R.C. § 163(d) (1986).

[142] *See supra* note 22.

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for some taxpayers. In 1986, the bad debt reserve method was repealed under the regular tax for all but a few taxpayers.[143] Although financial institutions were spared from that portion of tax reform, their deductions in excess of bad debt reserves remained subject to the alternative minimum tax.[144]

The $100 dividend exclusion was also attacked by the alternative minimum tax before it was completely removed from the regular tax.[145]

2. *Personal Deductions*

Historically, the alternative minimum tax has limited access to the itemized deductions.[146] For example, medical expense deductions were limited to costs exceeding ten percent of adjusted gross income when the limit under the regular tax was still at three percent.[147] These limits were later reflected in the regular tax as the floor for medical expense deductions rose to a high of 7.5% of adjusted gross income.[148]

Charitable contributions of appreciated property have also caused a problem under the regular tax. The general rule of section 170 allows a full deduction of the fair market value of contributed property despite the fact that the taxpayer has never included the appreciation in her tax base.[149] The alternative minimum tax, however, eliminates the deduction for this untaxed appreciation. This restriction has crept into the regular tax as well, where the ability to deduct the contributed property's full fair market value is limited by adjusted gross income floors of thirty percent.[150]

Other itemized deductions moved from the alternative minimum tax to the regular tax include various miscellaneous deductions, which were completely eliminated from the alternative minimum

143 I.R.C. § 166(f) (1985) (repealed by T.R.A. 1986, *supra* note 43, § 805).

144 I.R.C. § 57(a)(4) (1989).

145 T.R.A. 1986, *supra* note 43, § 701(a) (amending I.R.C. § 57(a)).

146 Medical expenses must exceed adjusted gross income by 10% before they can be deducted in the alternative minimum tax, while the regular tax threshold climbed from 3% to 5% to 7.5%. TEFRA, *supra* note 35. The AMT was also the first place we saw a limitation on the amount of charitable contribution deductions so that only basis, and not fair market value, was deductible. *See supra* note 38. The limitation on investment interest deductions (so that they cannot exceed the amount of net investment income) first appeared in the AMT as well. *See supra* note 38.

147 *See supra* note 38. For a review of the AMT itemized deductions, see *supra* note 49.

148 *See* I.R.C. § 213(a) (1989).

149 *Id.* § 170.

150 *See id.*

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tax at the same time their deductibility under the regular tax was limited to a two percent of adjusted gross income floor.[151] A similar fate has come to the deduction for state sales taxes, which was removed from the regular tax at the same time all state and local taxes were taken out of the alternative minimum tax.[152] The all-saver exclusion was also attacked by the alternative minimum tax before it was completely removed from the regular tax.[153]

3. *Capital Gains Exclusion*

The capital gains preference was the first item salvaged by the minimum tax.[154] However, despite its natural activist constituency, the capital gains exclusion finally fell with the Tax Reform Act of 1986.[155] Recent political attempts to revive the capital gains exclusion point to how deeply it is entrenched in the Code. Yet, despite these political and moral pressures, recent attempts to revive the exclusion are based on anemic substitutions.[156] Furthermore, the controversy surrounding the exclusion demonstrates Congressional ambivalence about this tax benefit.

4. *Progressive Rates*

Progressivity, another provision with a great deal of support, never significantly influenced the minimum tax.[157] It is also losing favor in the regular tax. Rates are compressing, while actual progressivity, as measured by effective and marginal rates, de-

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[151] T.R.A. 1986, *supra* note 43, § 132(a) (adding I.R.C. § 67).

[152] *Id.* § 143(a)(1) (repealing I.R.C. § 164(a)(4) (1985)).

[153] *See supra* note 53 and accompanying text.

[154] For a discussion of the minimum tax, see *supra* notes 22-50 and accompanying text.

[155] T.R.A. 1986, *supra* note 43, § 301(a) (repealing I.R.C. § 1202 (1985)). For a complete discussion of the arguments for and against the capital gains exclusion, see Blum, *supra* note 60; Blum, *A Handy Summary of the Capital Gains Arguments*, 44 TAX NOTES 1145 (1989); and Blum, *A Handy Summary of the Capital Gains Arguments*, 35 TAXES 247 (1957).

[156] At this writing, capital gains proposals are coming fast and furious. The most recent proposal calls for rates as low as 19% (1% lower than the lowest rate available in 1986) but only when property is held for at least three years as opposed to the six-month holding period provided in 1986. *Tax Legislation: Packwood Predicts Passage of Capital Gains Tax by September*, 9 Tax Mgmt. Weekly Rep. 283, 284 (1990). At the same time, opposition to the capital gains exclusions continues to mount. *See, e.g.*, Jones, *Two of Three Americans Oppose Capital Gains Cut, Harris Poll Finds*, 46 TAX NOTES 1209 (1990); *Darman Backpedals on Duck Test; Democrats See Tide Turning on Bush's Capital Gains Cut*, 46 TAX NOTES 1353 (1990); *Tax Bill May Not Get Off the Ground, Hill Aids Say*, 46 TAX NOTES 1208 (1990).

[157] *See supra* notes 33-35 and accompanying text.

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creases.[158] In fact, the 1986 Tax Reform Act followed a classic alternative minimum tax pattern by eliminating the capital gains exclusion and adopting compressed rates.

5. *Accelerated Cost Recovery Systems*

Accelerated depreciation is a trickier provision because its star seems to rise and fall. The best days for accelerated depreciation came early in the Reagan administration with the advent of an accelerated depreciation system (ACRS) that, in its heyday, allowed taxpayers to deduct the cost of real estate over as little as fifteen years (with equally generous provisions for other business and investment properties).[159] However, since the advent of ACRS, the alternative minimum tax has consistently cut back on its benefits. The alternative minimum tax rules are now so complex that taxpayers are forced to use alternative minimum tax depreciation (which more closely approximates economic depreciation) even when they are not subject to the alternative minimum tax.[160] The alternative minimum tax changes took place as regular depreciation simultaneously became less generous. This is an interesting way to destroy a provision: Keep a limited version in the regular tax but reduce its attraction by making it too costly to use.

Percentage depletion, another accelerated cost recovery system, was targeted by the minimum tax as early as 1969. This was followed in 1975 by the substantial repeal of percentage depletion under the regular tax for all properties except domestic gas wells and small independent producers. Even for those lucky survivors, the depletion rate dropped from 27.5% to 22% or 10%, depending on the type of gas produced.[161] Soon after, in 1976, oil and gas properties were further restricted as they became subject to the Amount at Risk Rules. Finally, in 1986, all depletion deductions were abolished for foreign properties.[162]

These results are also reflected in the treatment of intangible drilling and development costs, another early target of the alterna-

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158 Thuronyi, *supra* note 2, at 981-96.

159 ERTA, *supra* note 34, § 201, 95 Stat. at 203-19 (codified at I.R.C. § 168). ERTA had assigned 15 years for real property placed in service before Mar. 16, 1984, and after 1980. I.R.C. § 168(b)(2) (1981).

160 *See supra* notes 43-45 and accompanying text; *see also* Lipsey & Withers, *supra* note 86.

161 I.R.C. § 613(b)(1)(A) (amended by Tax Reduction Act of 1975, Pub. L. No. 94-12, § 501(b)(2)(4), 89 Stat. 29, 53 (1975)).

162 T.R.A. 1986, *supra* note 43, § 411, at 2225-26 (codified at I.R.C. § 263(i) (1988)).

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tive minimum tax. Until 1986, individuals had a five-year amortization period to recover intangible drilling costs. That period has been raised to ten years under the regular tax.[163]

In 1971, Congress amended the regular tax to provide for the rapid amortization of child care and on the job training facilities.[164] In 1977, this rapid amortization was added as a preference item within the minimum tax system. In that same year, Congress allowed the rapid amortization provision for job training facilities to expire, although it extended the treatment for child care facilities.[165] However, by 1982, Congress had allowed the child care provision to expire as well.[166]

Thus, based on observation of the minimum tax system over time, it seems that at least a crude relationship exists between the designation of a favored regular tax provision as a preference under the alternative minimum tax and the later elimination or restriction of the benefit under the regular tax. This relationship combines with other factors, such as the fact that the alternative minimum tax serves no regularly accepted tax policy, and instead results in Congress giving a benefit under the regular tax system and then taking it back under the alternative minimum tax. Can these data be explained by a single theory?

B. Possible Explanations for the Alternative Minimum Tax

The "give with one hand and take with the other" operation of the alternative minimum tax seems to show that Congress is uneasy about particular preferences. Perhaps these preferences appear too generous for some legislators' consciences. The alternative minimum tax then becomes a way of curbing Congressional beneficence. When Congress is unsure about a preference, the alternative minimum tax allows it to give the benefit in the regular tax and take it away under the alternative minimum tax.

This uneasiness may also explain why some items are first attacked under the alternative minimum tax and then eliminated as benefits under the regular tax. If Congress uses the alternative minimum tax when it is dubious about a particular preference, then inclusion in the alternative minimum tax base is a bad sign for a

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[163] T.R.A. 1986, *supra* note 43, § 701, at 2337.

[164] Revenue Act of 1971, Pub. L. No. 92-178, § 303(c)(4), 85 Stat. 497 (1971) (codified as amended I.R.C. § 642(f) (1988)).

[165] Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, § 402(a)(2), 91 Stat. 126, 155 (1977) (codified as amended I.R.C. § 188(b) (1988)).

[166] *Id.* § 402(a)(1), 91 Stat. 126, 155 (codified as amended I.R.C. § 188(c) (1988)).

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preference under the regular tax as well. After all, if Congress is apprehensive enough to mark the provision in the alternative minimum tax, it may soon consider abolishing it altogether. In this regard, the alternative minimum tax may serve a useful function by providing a political thermometer that checks the body politic, eliminating a preference for a few before eradicating it completely for the many. True, the test group is small and atypical in terms of absolute numbers; nevertheless, that test group embodies habitual preference users who are most likely to provide feedback on change.

Thus, the alternative minimum tax may serve two separate but related purposes. First, it allows some legislators to assuage whatever guilt they have about overly generous provisions. Second, it allows Congress a legislative laboratory for testing the possible elimination or restriction of a provision under the regular tax.

Of course, the relationship between placement in the alternative minimum tax and the later restriction or elimination of a provision is not perfect. Thus, for example, we see that the regular tax rules for amortization of certified pollution control facilities are actually becoming more generous despite the fact that the benefit is attacked by the alternative minimum tax.[167] The same is true for amortization of circulation expenditures.[168] This lack of complete correlation should be expected.[169] Thus, the fact that the model does not address every contingency does not argue against its description of

[167] In 1969, § 169 was enacted to allow for the rapid amortization of pollution control facilities. Tax Reform Act of 1969, Pub. L. No. 91-172, § 704, 83 Stat. 487 (1969) (codified at I.R.C. § 169 (1970)). In 1976, an investment tax credit was allowed in addition to rapid amortization, but the amount of the credit was calculated using only fifty percent of the value of the facility. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2112(a), 90 Stat. 1525, 1905 (1976) (codified at I.R.C. §§ 48(a)(8) & 46(c)(5) (1976)). In 1978, the investment tax credit was increased through calculating the amount allowed by using the full value of the facility. Revenue Act of 1978, Pub. L. No. 95-600, § 313(a), 92 Stat. 2763, 2826 (1978) (codified at I.R.C. § 46(c)(5) (1982)).

[168] Prior to 1984, circulation expenditures were amortized over a ten-year period. In 1984, the time period was reduced to three years. Deficit Reduction Act of 1984, Pub. L. 98-369, § 711(a)(3)(C), 98 Stat. 494, 942 (1984) (codified at I.R.C. § 173(b) (Supp. V 1987)). Further, for tax years 1987 and beyond, the election to amortize is no longer limited to individuals. T.R.A. 1986, *supra* note 43, § 701(a), at 2335-36 (codified at I.R.C. § 58 (1988)).

[169] In any empirical study, evidence often does not fit within the general pattern. It is impossible to generate 100% correlation, except when dealing with the obvious and sometimes not even then. For example, it is impossible to get a 100% correlation for such propositions as "All males have a X and a Y chromosome" because there will be males who have two X and one Y chromosome. It is impossible to get 100% correlation for the proposition that "All women with children are mothers" because some women with children are caretakers for relatives' children. If we say "All women who have carried a child to term were mothers at least for a moment," we can get perfect

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reality. The major provisions affected by the minimum tax systems follow the predicted pattern. This is also true of the majority of provisions. From the perspective of an empirical study, the finding that both the major provisions and the majority of provisions function as predicted is enough.

Further, nothing says that Congress must eliminate or restrict every preference that enters the alternative minimum tax. One of the points of testing a provision is to see if it works well. There is no reason to assert that Congress must be displeased with all of its creations, even when it is skeptical at some point during the provision's life. After testing a provision, Congress may find that all that is required is fine-tuning. Congress may even determine that the provision is helpful and should be expanded. Conversely, political pressure may grow to keep the preference protected. That is another reason for placing a provision within the alternative minimum tax in the first place—to test whether there is sufficient interest in the preference to justify its continued existence. If placement within the alternative minimum tax galvanizes a constituent group, then Congress is alerted that it must move more carefully.

C. *The Future as a Laboratory*

The alternative minimum tax cannot be explained using standard theories of income tax policy. Thus, a substitute explanation is called for. This Article's hypothesis is that the alternative minimum tax serves as an "out-of-town try-out" to see whether a provision can play the "Great White Way" of the regular tax system. A hypothesis standing alone is not enough, however. It must be tested as well as stated. But how to test this theory?

If legislation were a laboratory, we could set up an experiment in which we tried to replicate the conditions that might drive a preference into the alternative minimum tax. Then we would see whether the provision later became restricted under the regular tax as well. If the pattern of relationship we suspected emerged, we could conclude that the theory explained the result although, in fact, hidden or unconsidered aspects to the problem may explain the result more precisely or accurately. Legislation is not made in a laboratory, however, and so we must find a way to test the theory in the natural world of the legislative process. The experiment I have chosen projects what changes we can expect in the regular tax of the future

correlation because we have not actually said anything more than that the definition of mother is a woman who has borne a child.

based on what we know about the alternative minimum tax of today. The point of the experiment is to show that the initial appearance of a preference in the alternative minimum tax gives some indication of its future treatment under the regular tax. This is not as broad as asserting that an item must first appear in the alternative minimum tax before it can face restrictions under the regular tax or that the alternative minimum tax has some magical hold over the regular tax system as a whole. Thus, what follows are some predictions of what we might see in the regular tax of the future based on what is presently occurring in the alternative minimum tax of today.

1. A move to even more compressed rates

In the past, regular tax rates ran as high as ninety percent.[170] Even prior to the Tax Reform Act of 1986, rates climbed to as high as fifty percent. These rates contrasted with the alternative minimum and minimum taxes which never imposed a rate of more than twenty-five percent. Since 1986, the gap between the regular tax rates (fifteen, twenty-eight and thirty-three percent) and the alternative minimum rate (twenty-one percent) has closed. This trend indicates further compression in regular tax rates in the future. This compression will most likely fuse with a larger personal exemption thus following the trends begun by past and present minimum systems.

2. The complete elimination of the exclusion for interest from industrial revenue bonds

Industrial revenue bonds (also called private activity bonds) were created as a way for local governments to provide low-interest rate financing to private businesses.[171] This benefit is possible because state and local bond interest is exempt from federal taxes under section 103 of the Code. When states issue these bonds they trigger the tax-exempt status, although the funds are used by private individuals who are also responsible for repayment. The bond interest's tax-exempt status allows the bond to be sold at a lower interest rate with the savings passed on to the businessperson who supposedly provides jobs to the community in exchange. The alternative minimum tax, however, includes this interest in its base, thus potentially

[170] The marginal tax rates went as high as 91% in 1954. I.R.C. § 1 (1954).
[171] *See* I.R.C. § 103(b)(2) (Supp. V 1987).

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eliminating the tax-exempt benefit for some bond purchasers.[172] Now that constitutional objections to a federal tax on local bond interest are over,[173] the alternative minimum tax treatment of this benefit portends an end to the regular tax exclusion for this once-favored income.

3. A movement towards economic depreciation as the basis for all depreciation deductions

As discussed above, the alternative minimum tax has created such complex depreciation rules that those looking for simplicity have opted to use less accelerated methods rather than keep multiple sets of books. In this sense, the alternative minimum tax has already changed the regular tax system's depreciation methods. Further, the regular tax has also moved toward more economic depreciation. When these trends are combined, they indicate that we may expect further tightening of the depreciation deduction in the future.

4. The decline in the use of itemized deductions

From the first minimum tax to the present, itemized deductions have been severely limited under the minimum tax systems.[174] At the same time, the regular tax has also chipped away at itemized deductions.[175] This trend should continue under the regular tax with increased adjusted gross income floors for various itemized deductions and the possible elimination of others. This seems particularly true of the deduction for charitable contributions of appreciated property. As noted above, the restriction on the deduction continues to grow both in the alternative minimum tax and in the regular tax system as well.

CONCLUSION

The alternative minimum tax is but one aspect of the larger world of income taxation. Yet when placed against that larger landscape, the alternative minimum tax seems to thwart generally accepted tax policy. Given that legislation is meant to further some purpose, what purpose does the alternative minimum tax serve? Based on

[172] I.R.C. § 57 (a)(5) (1988). The alternative minimum tax credit against regular tax liability does not help with this limitation. Stern, *supra* note 47.

[173] South Carolina v. Baker, 485 U.S. 505 (1988).

[174] *See supra* notes 28-50 and accompanying text.

[175] *See supra* notes 146-53 and accompanying text.

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the evidence supplied by an empirical analysis, this Article suggests that the alternative minimum tax operates as a sort of legislative laboratory in which Congress manipulates certain tax preference benefits with a view to their possible restriction, elimination, or reform.

What if the assessment made here, that the alternative minimum tax is Congress' way of double-checking itself as to particular tax preferences, proves correct? Is this explanation by itself sufficient to justify a second tax in light of that tax's failure to satisfy other policy concerns? At least three groups of people must answer that question.

From a legislator's point of view, the answer, apparently, is yes. Otherwise, why continue to expand and develop a system that does not perform as expected? The benefit of double checking seems great enough to justify the alternative minimum tax's continued existence.

For those who pay for the tax directly, either through higher tax bills or through higher accounting costs, the answer is clearly no. For those who actually pay the tax and for those who merely plan to avoid it, the alternative minimum tax adds significantly to Code complexity and to transaction costs.

For those who are not directly affected by the tax, the answer is also no. This is because the problems of the regular tax are structural and thus are not solved by the imposition of the alternative minimum tax. Yet, the alternative minimum tax gives Congress the sense that it is doing something about Code defects when, in fact, the tax does little or nothing to correct Code shortcomings. As a result, this group is denied the fairness it seeks from the regular tax system. Thus, the failure to further tax policy combined with the addition of so much complexity outweighs the possible benefits to taxpayers of Congress' legislative laboratory.

However, lobbyists, practitioners, and others interested in the future of tax reform may want to remember the alternative minimum tax when trying to predict Code changes. As long as the alternative minimum tax continues, we have a small window into the future of tax reform.

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