

NEW YORK
CITY BAR

COMMITTEE ON PERSONAL
INCOME TAXATION

BABCOCK MACLEAN
CHAIR
ROBINSON BROG LEINWAND GREENE
GENOVESE & GLUCK, P.C.
1345 AVENUE OF THE AMERICAS
NEW YORK, NY 10105
Phone: (212) 603-6315
Fax: (212) 956-2164
bml@robinsonbrog.com

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RE: 2007 Reform of Alternative Minimum Tax

FRAN OBEID
SECRETARY
KOSTELANETZ & FINK LLP
530 FIFTH AVENUE
NEW YORK, NY 10036
Phone: (212) 808-8100
Fax: (212) 808-8108
fobeid@kflaw.com

GILDA I. MARIANI
VICE CHAIR
CHIEF, MONEY LAUNDERING
& TAX CRIMES UNIT
NEW YORK COUNTY
DISTRICT ATTORNEY'S OFFICE
ONE HOGAN PLACE
NEW YORK, NY 10013
Phone: (212) 335-9143
Fax: (212) 335-4097
marianig@dany.nyc.gov

The Honorable Max S. Baucus
Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Charles E. Grassley
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington D.C. 20510

The Honorable Charles B. Rangel
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington D.C. 20515

The Honorable Jim McCrery
Ranking Member
House Committee on Ways and Means
1102 Longworth House Office Building
Washington DC 20515

Dear Chairman Baucus, Chairman Rangel, Senator Grassley and Representative McCrery:

The Personal Income Tax Committee of the Association of the Bar of the City of New York¹ would like to respectfully offer comments on the important subject of 2007 Reform of the Alternative Minimum Tax. In particular, the areas of main concern addressed by this letter are support of a continued increased AMT exemption amount in 2007 and support of a short term 2007 AMT Estimated Tax Relief provision of safe harbor from IRS interest and penalties (which is particularly relevant for those taxpayers whose estimated tax payments for 2007 have not taken into account an extension of the 2006 increased AMT exemption).

¹ The principal drafter of this letter was R. John Smith with substantial assistance from Elizabeth Zanet and Saleem Moghal. Helpful comments were received from other members of the Association of the Bar of the City of New York Personal Income Tax Committee.

A short term 2007 AMT increased exemption is consistent with the short term AMT relief enacted by Congress between 2003 and 2006. In so doing, Congress has held down the number of AMT taxpayers to less than there would have been under prior law. This patch expired at the end of 2006 and Congress has not yet enacted a patch for 2007. Without the proposed 2007 AMT short term reform, the number of Americans affected by the AMT for 2007 will increase from approximately four million to more than 23 million. The Joint Committee on Taxation projects that most of the 23 million taxpayers affected would earn between \$50,000 and \$200,000, that is middle income families.² The problem with the AMT goes beyond just those paying the tax.

The AMT affects a lot of other taxpayers, as well. The AMT forces many taxpayers to have to calculate their tax liability twice, first under the regular tax system, and then again under the AMT. The IRS estimates that the average taxpayer takes about 30 hours filling out a Form 1040.³ The AMT increases that burden.

Background

The first comprehensive AMT was enacted in 1982. The purpose of the AMT, as stated in the legislative history, was to ensure that no taxpayer with substantial economic income should be able to avoid all tax liability by using exclusions, deductions, and credits.⁴ Now, the AMT affects middle income families who are working hard and raising children. The Joint Committee on Taxation estimates that 4.2 million paid AMT in 2006. Among those taxpayers, 25,000 had adjusted gross income of less than \$20,000, hardly the category of taxpayer that should have to be subject to increased complexity and taxes due in computing and paying their federal income taxes.⁵

In 2006, approximately 200,000 taxpayers subject to AMT had adjusted gross income between \$75,000 and \$100,000. Approximately 1.3 million AMT taxpayers had adjusted gross income between \$100,000 and \$200,000. Only about 80,000 taxpayers had adjusted gross income of \$1 million and above. In summary, in 2006 more taxpayers earning less than \$100,000 were subject to the AMT than taxpayers earning more than \$1 million.⁶

The AMT has strayed from its original purpose. At its inception, the AMT was enacted to insure that upper-income taxpayers would pay some amount of income tax. Now, it is subjecting middle-income taxpayers to an additional tax.

Present Law

Present law imposes an alternative minimum tax. The alternative minimum tax is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed \$175,000 (\$87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. Alternative minimum taxable income is the individual's regular taxable income increased by certain adjustments and preference items.⁷

The exemption amounts are: (1) \$62,550 for taxable years beginning in 2006, and \$45,000 for taxable years beginning after 2006, for married individuals filing jointly and surviving spouses; (2) \$42,500 for taxable years beginning in 2006, and \$33,750 for taxable years beginning after 2006, for other unmarried

² See Joint Committee on Taxation Report "Present Law and Background Relating to the Individual Alternative Minimum Tax", (JCX-38-07), June 25, 2007 (hereafter, "Joint Committee Report"), page 10, Figure 2, and page 14, Table 2.

³ Internal Revenue Service Publication "2006 Instruction Form 1040" page 81.

⁴ Tax Equity and Fiscal Responsibility Act of 1982, S. Rpt. No. 97-494 Vol. 1, at 108 (July 12, 1982).

⁵ Joint Committee Report, page 14, Table 2.

⁶ Joint Committee Report, page 14, Table 2.

⁷ Joint Committee Report, page 2.

individuals; (3) \$31,275 for taxable years beginning in 2006, and \$22,500 for taxable years beginning after 2006, for married individuals filing separately; and (4) \$22,500 in the case of estates and trusts.

The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) \$150,000 in the case of married individuals filing a joint return and surviving spouses, (2) \$112,500 in the case of other unmarried individuals, and (3) \$75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.⁸ The AMT has statutory marginal tax rates of 26 and 28 percent. However, those with alternative minimum taxable income in the phaseout range of the exemption level (\$150,000 to \$400,200 for married taxpayers filing jointly and \$112,500 to \$282,500 for unmarried individuals, in 2006) will have an effective marginal tax rate of 32.5 and 35 percent, respectively.⁹

Proposed 2007 AMT reform

It is our view that Congress should enact an AMT patch for 2007. The exemption amounts in effect for 2006 should be put into effect for 2007, adjusted for inflation. Taxpayers should be provided safe harbor from IRS penalties and interest for failure to include estimated tax payments in 2007 that take into account an extension of the increased AMT exemption provided in 2006. In computing tax for purposes of the penalties dealing with estimated tax, a taxpayer would be permitted to disregard the alternative minimum tax if the individual was not liable for the alternative minimum tax for the preceding tax year.

The amendments proposed herein should apply to taxable years beginning after December 31, 2006.

A 2007 AMT short term reform with an increased AMT exemption would prevent expansion of the AMT, reduce taxpayers' compliance costs and make routine tax planning simpler. In addition, the short term reform proposed here will enable Congress to address issues related to substantial changes in our income tax system given the large number of important provisions that are currently scheduled to terminate in the next few years.

Respectfully submitted,



Babcock MacLean
Chair

Cc:

Russell Sullivan
Staff Director
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington DC 20510

Kolan L. Davis
Republican Staff Director
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington DC 20510

Patrick G. Heck
Chief Tax Counsel
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington D.C 20510

Mark Prater
Republican Chief Tax Counsel
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510

John Buckley
Democratic Chief Tax Counsel
House Ways and Means Committee
Washington D.C. 20515

Jon Traub
Republican Chief Tax Counsel
House Ways and Means Committee
Washington DC 20515

Edward Kleinbard

Bernard A. Schmitt

⁸ Joint Committee Report, page 2.

⁹ Joint Committee Report, page 21.

**Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington DC 20515**

**Deputy Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington DC, 20515**