

# Executive's Tax & Management Report

Wealth-building strategies plus  
late-breaking tax news

## Issues Congress May Tackle by Year's End

With a minimum wage hike and small business tax incentives already approved, what's next for federal lawmakers in the tax realm? The legislative agenda for the remainder of the year could include discussing a permanent solution to the alternative minimum tax (AMT), the possible extension of tax cuts initially enacted in 2001 and revenue offsets, according to the most recent Congressional Research Service (CRS) Report for Congress.

### Alternative Minimum Tax

The AMT was originally implemented to ensure that high-income taxpayers could not reduce their tax liability below a certain threshold. However, because the AMT is not indexed for inflation, an increasing number of taxpayers are subject to the AMT. "Democratic leaders have indicated interest in legislation providing AMT relief," the CRS report states.

The CRS report explains how the AMT works and why more and more taxpayers may be subject to it. "The AMT functions like a parallel income tax, with lower rates than the regular tax but with a broader base—that is, with fewer deductions, exemptions, credits, and special tax preferences than are allowable under the regular tax. Each year, a taxpayer pays either his or her regular tax or the tentative AMT, whichever is higher. Taxpayers are permitted a flat exemption amount in calculat-

ing their AMT. However, the exemption is fixed at a flat dollar amount that is not indexed for inflation. And while the AMT only has two rate brackets (26% and 28%), the bracket dividing point is likewise not indexed. In contrast, the structural features of the regular income tax—personal exemptions, the standard deduction, and rate bracket thresholds—are indexed," the report stated. "Thus, as time passes and incomes grow in both real and nominal terms, the AMT exceeds the regular tax for more taxpayers."

Recent rate reductions and tax cuts for married couples, as well as other tax cuts, have magnified the problem, according to the report.

Congress approved temporary fixes by increasing the exemption amount every few years during the last several years. Most recently, the Tax Increase Prevention and Reconciliation Act of 2006 (P.L. 109-222) extended the increased exemption for one year to \$42,500 for single filers and \$62,550 for married couples filing jointly, the report states. "Absent further action, the exemption amounts will revert in 2007 to the pre-EGTRRA amounts of \$45,000 and \$33,750 for couples and singles, respectively." As a result, more taxpayers would be subject to the AMT.

In a recent Senate Committee in Finance hearing, ranking member Sen. Chuck Grassley (R-Iowa)

described the AMT as "a complete policy failure that was created with 155 taxpayers in mind, but could consume 23 million taxpayers this year."

Grassley supports S. 55, the Individual Alternative Minimum Tax Repeal Act of 2007, which would permanently repeal the AMT without any offsetting revenues. "Revenues projected to be collected by the Alternative Minimum Tax are revenues the tax was never meant to collect, and that would only be collected through error. To make offsetting a condition for repeal is to commit to reshape a problem without actually solving it."

A similar bill, H.R. 1366, was introduced in the House of Representatives and referred to the Committee on Ways and Means.

Grassley said he plans to introduce a Senate bill "that will provide taxpayers a safe harbor from being punished for the fact that Congress has failed to deal with the AMT. Right now millions of Americans don't know whether they should be paying an estimated tax because Congress hasn't passed AMT relief," he said during the hearing. "In other words, there are many taxpayers who will be facing a big tax bill if we don't pass AMT relief. By law, many of these taxpayers should be paying estimated tax right now based on the fact that as the law is today, they are subject to the AMT."

“Under my proposal, in computing tax for purposes of the penalties in the tax code 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,” he said. “So if you didn’t have to pay AMT last year we aren’t going to penalize you if you don’t file estimated taxes for AMT this year. Just because Congress can’t do its job, doesn’t mean the taxpayer should be punished.”

### **Extension of EGTRRA Cuts**

Tax cuts for married couples designed to alleviate the “marriage tax penalty” and repeal of the estate tax were among the provisions enacted under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16). Those and other EGTRRA tax cuts will expire at the end of 2010, due to a sunset provision in the law, unless Congress acts to extend them.

“The debate over extension of the tax cuts has centered on three broad issues: its likely impact on the federal budget deficit, its possible effect on long-term economic growth, and its results for the fairness of the tax system,” the CRS report states.

### **Revenue Offsets**

Recognizing the federal budget deficit and that reducing or repealing the AMT and/or extending the EGTRRA cuts could result in significant revenue losses, Congress may consider revenue offsets, according to the report.

Sources of revenue that could be targeted include the so-called tax gap (*i.e.*, the difference between what taxpayers owe and the amount they actually pay), tax shelters, and restricting tax benefits for U.S. firms that operate abroad, the report states.

*Tax gap.* Changes in tax law and IRS tax administration are among the suggestions for reducing the estimated \$345 billion tax gap. In 2005 and 2006 reports, the Joint Committee on Taxation (JCT) recommended restricting tax shelters, closing tax “loopholes,” and addressing noncompliance through other means (*e.g.*, simplification and/or clarification of tax laws, increased withholding, and increased information reporting), the CRS report states.

According to the CRS report, the Treasury’s Office of Tax Policy has identified the following suggestions for reducing the tax gap:

- Strengthening reporting requirements
- Making efforts to enhance access to data

- Enhancing examination and collection authority
- Revising penalties
- Issuing additional regulations and guidance for taxpayers
- Increasing research
- Improving information technology
- Establishing more efficient compliance activities
- Reducing tax-code complexity

*Tax shelters.* Tax shelters have gained considerable interest from lawmakers in recent years, and they have enacted certain restrictions into law, the CRS report states. “Like the tax gap, tax shelters not only reduce tax revenue directly, but rise questions about tax fairness among taxpayers not using shelters.”

*Tax treatment of U.S. foreign income.* “There are some indications that Congress may include the tax treatment of U.S. firms’ foreign income in any search for additional tax revenue,” according to the CRS report.

Under current law, U.S. firms can use a tax benefit, known as “deferral,” to invest overseas in countries that have relatively low tax rates and “to indefinitely postpone U.S. tax on their foreign income as long as that income is reinvested abroad in foreign subsidies,” the report states. ■