An Introduction to the Alternative Minimum Tax

-- By International Comparisons

Vance Kuang-Ta Lo

Assistant Professor

Department of Public Finance

National Chengchi University

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1. Introduction

In order to develop domestic infrastructures, attract more foreign investments and channel the savings of citizens, Taiwan government amended some tax laws and enacted new special tax treatments to encourage economic growth during 1960s-1970s. The remarkable achievement of economic development in the past three decades in Taiwan has been recognized world-wide as an "economic miracle". Among all those tax amendments and treatments, the income tax has been used often as a significant vehicle to promote various social and economic goals during the period. This has been accomplished by according preferential tax treatments to certain items of income and expense. The net result; however, has been an erosion in the income tax base. By taking advantage of the preferences and incentives in the tax codes, some individuals and corporations can substantially reduce their income taxes. The consequences are now reflected in the insufficiency of tax revenues, low level of tax burden and income inequality.

In the past decade, although the main source of finance for government expenditure in Taiwan was still from tax revenues, the percentage of tax revenues to net expenditures of all levels of government has only averaged approximately 60%. The tax burden is usually measured by the proportions of total tax revenues in both the national income and the gross domestic product (GDP). Table 1 shows that, in the decade between 1996 and 2005, the percentage of total tax revenues to national income in Taiwan was 15.3% on average. There was a tendency since 1996 for the proportion to decrease, and it was reached at 15.8% in 2005. As for the ratio of total tax revenues to GDP for the same period, the average was 13.8%, with a similar tendency to decrease from 1996 to 2005. The overall tax burden in Taiwan is characterized by a relatively low level compared with other countries. For example, the ratios of total tax revenues to GDP in the U.S. and Japan were 25.5% and 26.4% in 2004, respectively, both higher than 12.9% in Taiwan for the same year (Figure 1).

In the meantime, the income inequality becomes worse in Taiwan. The proportion of households below the poverty line as a percentage of total number of households rose from 0.83% in 1995 to 1.16% in 2005. In addition, the ratio of disposable income of the highest 20% to that of the lowest 20% went up from 5.0 in 1991 to 6.0 in 2005. The Gini ratio also increased from 0.308 in 1991 to 0.348 in 2005. Not only for individuals, but the inequality of tax liabilities across different industrial companies also exists in Taiwan. According to the data in 2006, the amounts of taxes reduced or exempted for corporate in Taiwan was estimated about NT$120 billion, as a percentage of tax revenues of 7.5%[1]. Further, among all the corporations eligible for the tax exemption in 2003, the high-tech corporations accounted for 70%, the traditional industry companies only occupied 30%. Thus, the tax benefits tend to favor the high-tech industry in Taiwan significantly.

In order to modify the tax revenue loss and unfairness resulting from the use of tax incentives which benefited only a small minority of enterprises and individuals, Taiwan government advocated the adoption of a minimum income tax system by referring to the experiences of the USA, Canada, Korea and India so as to maintain equality in the bearing of the fiscal burden and to promote social justice. The Income Basic Tax Act (also called Alternative Minimum Tax Act) imposes a basic tax similar to an alternative minimum tax (AMT) and the implementation of this Act will enforce payment of a certain amount of basic taxes on high-income individuals and enterprises that have

[1] Source: Government Finance in the Republic of China 2006, Ministry of Finance, R.O.C.

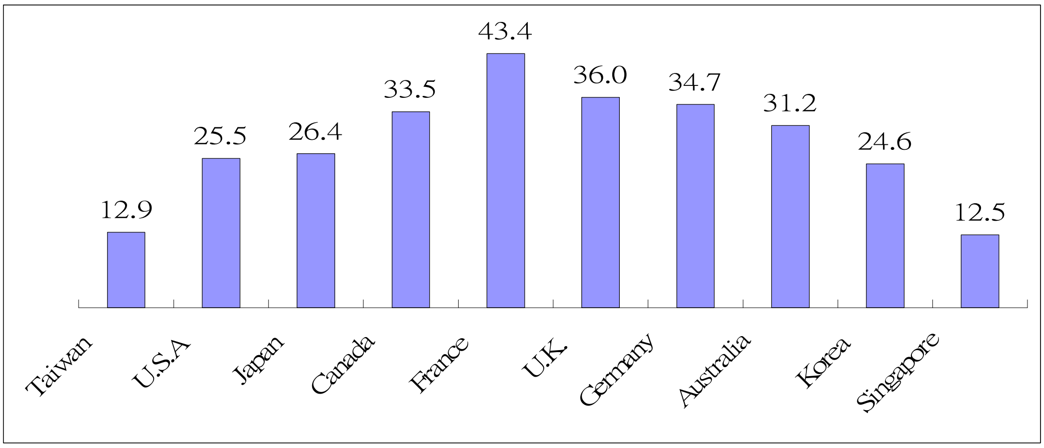
previously paid disproportionately low taxes or even none. The Act was passed by the legislature on 9th December, 2005, and took effect on 1st January, 2006.

In this paper, we first explain how the AMT system works and briefly introduce the AMT system in different countries, such as U.S.A, Canada, Korea, India and Taiwan. We next will discuss the potential problems of AMT and give a preliminary investigation on AMT with regard to the issues of equity, economic efficiency and its complexity. This paper is organized as follows. We explain what the AMT system is and how it works in Section 2. We introduce the AMT system in different countries in Section 3. Section 4 discusses some issues regarding to the AMT system, and Section 5 concludes this paper.

Table 1: Ratios of Tax Revenues to Government Expenditure, National Income and GDP in Taiwan (Unit: %)

Year	Tax Revenues / Government Expenditure	Tax Revenues / National Income	Tax Revenues / GDP
1996	65.0	17.2	15.8
1997	67.7	16.8	15.4
1998	70.1	17.1	15.6
1999	66.1	15.8	14.3
2000	61.4	14.3	12.9
2001	55.4	14.3	12.8
2002	55.5	13.4	12
2003	55.3	13.5	12.1
2004	60.4	14.3	12.9
2005	65.8	15.8	14.1
Average	62.3	15.3	13.8

Source: Yearbook of Finance 2006, Ministry of Finance, R.O.C.



Source: Data of Singapore is derived from Statistics Yearbook of Singapore (2007 Edition).
Other countries are derived from "Revenue Statistics of OECD" (2007 Edition).

Note: Tax burden ratios in this chart include social security contributions with the exception of Taiwan and Singapore. The tax burden ratio of Taiwan including social security contributions was 18.2% in 2004. As defined by the Directorate General of Budget, Accounting and Statistics (DGBAS) of Executive Yuan, social security contribution in Taiwan indicates insurance expenses of enterprises and households, public service pension fund of civil servants, and the withdrawal amount of labor pension.

Figure 1: Tax Burdens of Select Countries

2. How Does the Minimum Tax Works

The purpose of minimum tax is to assure that no taxpayers with substantial economic income are able to avoid most or even all tax liabilities by using exclusions, deductions and credits. In order to let those high-income individuals and corporations pay at least some tax, two different types of minimum tax are used to achieve the goal. One is "Add-on Minimum Tax"; the other is "Alternative Minimum Tax".

The concept of the add-on minimum tax is simple. In addition to paying the regular income tax, taxpayers also have to pay a certain percentage of some specific tax preferences which are often used by high-income taxpayers to reduce their tax liabilities under the regular income tax. For example, the 1969 Tax Reform Act in the U.S. enacted an add-on minimum tax of 10% tax rate levied on the minimum tax base, which was the sum of specific tax preferences minus a $30,000 exemption amount. The specific tax preferences included, for instance, excess investment interest income, deductions of bad debts and capital gains, accelerated depreciation on property, and so on. The most significant tax preferences were the portion of capital gains income that was excluded from tax under the regular income tax. Essentially, the add-on minimum tax functioned much like an excise tax on specified tax preferences in excess of some fixed amount.

However, there are some problems in an add-on minimum tax. First, the tax base under the add-on minimum tax was the “tax preferences” that were not allowed in the AMT laws, rather than “income”. Thus, the relationship between tax liability and income was weak. Second, the add-on minimum tax was not designed to define a comprehensive income base. It still left out many important tax preferences or by narrowly defining existing preferences; thus taxpayers with substantial income were still permitted to report little or no taxable income. Third, although a flat rate was applied to the tax base, by allowing a deduction for regular taxes the tax on preferences became inversely proportional to the progressive tax paid under the regular schedule. Forth, no distinction was made between tax preferences that were deferrals and those that were complete exemptions. Last, the provisions of the add-on minimum tax were considered complex because it required an entirely new set of computations on the part of taxpayers.

Due to the problems discussed above, the add-on minimum tax is replaced by alternative minimum tax (AMT). Taxpayers who may be subject to the alternative minimum tax must calculate their tax liability twice: once under regular income tax rules and again under AMT rules. The AMT tax liability is then compared with the regular tax liability, and the higher of the two amounts becomes the effective tax liability, or the taxpayers directly pay the difference as a surcharge to the regular tax. Thus, the alternative minimum tax (AMT) is a second income tax that runs parallel to the regular individual income tax.

AMT tax liability is calculated by applying a tax rate to a tax base called alternative minimum taxable income (AMTI). AMTI is basically the regular taxable income plus some various items that are called “AMT preferences”. An AMT preference is an item identified as a potential tax saving in the regular income tax that is not permitted in the AMT. Technically, there are two different types of AMT preferences. Exemption preferences allow taxpayers a variety of deductions, exclusions or credits in the regular tax, but are not allowed in the AMT. These items include personal exemptions, the standard deduction, and itemized deductions for state taxes and miscellaneous expenses. Deferral preferences allow taxpayers to postpone regular income tax payments or shelter income by hastening deductions or delaying income recognition. Compared with exemption preferences, deferral preferences are more complex, have a greater tendency to affect high-income filers, and generate less AMT revenue.

Gujarathi and Barua (1998) argue that there are two important differences between the add-on minimum tax and the alternative minimum tax. First, the add-on minimum tax was no more than an excise tax on the excessive use of tax preferences. It reduced the value of the tax preferences without directly addressing the relationship between taxes and income. By coordinating the minimum tax with the regular tax, the AMT eliminates the problem of tax being imposed on preferences if the taxpayer was taxed at an effective rate higher than the minimum tax rate. Second, the AMT brought to bear several additional preferences and adjustments.

$$\{\underbrace{(\square+\square+\square)}_{\text{Sum of specific tax preferences}} - \text{Exemption}\}\times\square\% = \text{Add-on minimum tax}$$

Figure 2: Add-on Minimum Tax

$$\{\underbrace{[\text{Regular taxable income} + \overbrace{(\square+\square+\square)}^{\text{Sum of specific tax preferences}}}_{\text{AMT taxable income}}] - \text{Exemption}\}\times\square\% = \text{AMT tax (1)}$$

$$\Updownarrow$$

Regular income tax (2)

→ *Tax liability is the higher amount of (1) and (2)*

Figure 3: Alternative Minimum Tax

3. AMT System in Different Countries

America

The U.S. federal income tax currently has both the individual and corporate alternative minimum tax (AMT)[2]. The concept of a minimum tax was enacted as part of the Tax Reform Act of 1969. Under the provisions of add-on minimum tax, individuals as well as corporations had to total up some specific tax preference items[3], subtract an exemption of $30,000, and then apply a 10% to the remainder. Thus, the add-on minimum tax actually functioned much like an excise tax on specified tax preferences in excess of some fixed amount. The Tax Reform Act of 1976 increased the flat minimum tax rate from 10% to 15% and reduced the exemption from $30,000 to $10,000, or the full amount of regular income tax liability, whichever was greater.

The Revenue Act of 1978 (the 1978 Act") restructured the minimum tax into two taxes for individuals. The add-on minimum tax was retained for all tax preferences except with respect to the capital gains deduction and excess itemized deductions. A new alternative minimum tax (AMT) was established to adjust the taxpayer's income for these two items. The new AMT defined a tax base that included all the components of Adjusted Gross Income (AGI), the capital gains exclusion, and preferences. The full amount of regular income tax was allowed as a credit against the AMT. The alternative

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[2] For more details, please refer to Joint Committee on Taxation (2001), "Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Federal Tax System," JCS-03-01. Washington, DC: Joint Committee on Taxation.

[3] The items of tax preferences that were subjected to the 10 percent add-on minimum tax included: (1) excess investment interest income; (2) accelerated depreciation on personal property; (3) accelerated depreciation on real property; (4) amortizations of rehabilitation expenditures; (5) amortization of certified pollution control facilities; (6) amortization of railroad rolling stock; (7) tax benefits from stock options; (8) bad debt deductions of financial institutions; (9) depletion; and (10) the deduction for capital gains.

minimum tax applied a three-tier rate schedule (10, 20 and 25 percent) to alternative minimum taxable income in excess of $20,000. Refundable tax credits and foreign tax credits were the only tax credits allowed in computing the alternative minimum tax. If the taxpayer's alternative minimum tax exceeded the taxpayer's regular tax plus the add-on minimum tax, the greater alternative minimum tax would be payable.

The Tax Equity and Fiscal Responsibility Act of 1982 (the "1982 Act") expanded the alternative minimum tax and repealed the add-on minimum tax for individuals[4]. The tax preferences that had been subject to the add-on minimum tax became tax preferences for computing the alternative minimum tax. The tax preference for excess itemized deductions was repealed, but only certain itemized deductions were allowed in computing the alternative minimum tax. The 1982 Act increased the exemption from $20,000 to $30,000 ($40,000 for married individuals filing a joint return).

The Tax Reform Act of 1986 (the "1986 Act") further modified the minimum tax provisions of the Code by expanding the base of the alternative minimum tax for individuals, replacing the 15-percent add-on minimum tax for corporations with a broad-based alternative minimum tax, and making various structural changes. For individuals, the three-tier rate schedule was replaced with a single rate of 21 percent. For corporations, the alternative minimum tax rate was set at 20 percent.

The alternative minimum tax rates for individuals were increased to 24 percent by the Omnibus Budget Reconciliation Act of 1990. A two-tier rate structure for individuals (with 26 percent and 28 percent rates) was enacted by the Omnibus Budget

[4] The add-on minimum tax continued to apply to corporations until 1987.

Reconciliation Act of 1993. The Taxpayer Relief Act of 1997 (the "1997 Act") repealed the alternative minimum tax for small corporations (generally with average annual gross receipts under $7.5 million) and cutback on the tax preference for depreciation.

Present law imposes an alternative minimum tax on an individual to the extent the taxpayer's tentative minimum tax liability exceeds his or her regular tax liability. The tentative minimum tax liability is computed for individuals at rates of (1) 26 % on the first $175,000 of alternative minimum taxable income in excess of a phased-out exemption amount and (2) 28 % on the amount in excess of $175,000. The exemption amounts are $45,000 in the case of married individuals filing a joint return and surviving spouses; $33,750 in the case of other unmarried individuals; and $22,500 in the case of married individuals filing a separate return, estates, and trusts. These exemption amounts are phased out by an amount equal to 25% of the amount that the individual's alternative minimum taxable income exceeds a threshold amount[5]. The exemption amounts, the threshold phase-out amounts, and the $175,000 rate bracket amount are not indexed for inflation. The lower capital gains rates applicable to the regular tax also apply for purposes of the alternative minimum tax.

Similar to the individual alternative minimum tax, the corporate alternative minimum tax (CAMT) is designed to prevent corporations that report large profits from paying little or no federal income tax. Under the CAMT, corporations are required to compute their tax liability under the normal corporate income tax and then again under the CAMT and pay the higher amount. The CAMT applies a lower tax rate to a broader definition of income with less generous allowances for deductions. Present law imposes

[5] $150,000 for married individuals filing a joint return and surviving spouses; $112,500 for unmarried individuals; and $75,000 for married individuals filing a separate return, estates, and trusts.

an alternative minimum tax on a corporation to the extent the corporation's minimum tax liability exceeds its regular tax liability. This alternative minimum tax is imposed on corporations at the rate of 20% on alternative minimum taxable income in excess of a $40,000 phased-out exemption amount. The exemption amount is phased-out by an amount equal to 25% of the amount that the corporation's alternative minimum taxable income exceeds $150,000.

In the U.S., if an individual or a corporation is subject to alternative minimum tax in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit[6] in any subsequent taxable years to the extent the taxpayer's regular tax liability exceeds his or her tentative minimum tax liability in such subsequent years. Therefore, the AMT is essentially a prepayment of regular tax in the U.S. However, for individuals, the credit is allowed only to the extent that the taxpayer's alternative minimum tax liability is the result of adjustments that are timing in nature[7].

Canada

Canada government noticed that some taxpayers with substantial income were able to avoid most tax liabilities by using deductions, exemptions, exclusions and credits in 1980s. Thus, the AMT system in Canada was enacted in 1986 to guarantee that high-income taxpayers paid at least a minimal amount of tax.

To calculate the AMT, individuals begin with the regular taxable income for the year,

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[6] Namely, this credit is defined as the minimum tax credit.
[7] For example, the individual alternative minimum tax adjustments relating to itemized deductions and personal exemptions are not timing in nature, and no minimum tax credit is allowed with respect to these items.

including all available deductions and exemptions. Next, individuals add back the deductions and exemptions which comprise the so-called tax preferences items, then minus a basic exemption of $40,000. This results in "adjusted taxable income" for AMT purposes. The AMT is then computed on this amount at the flat rate of 16%. Most tax credits are deducted from this tax other than the pension tax credit, the disability credit transferred from a dependant, tuition and education credits transferred from a dependant, and certain credits transferred from spouse. If the AMT liability exceeds the regular income tax, the AMT is required; otherwise, individuals only simply pay the regular income tax. In addition, if the AMT applies, the difference between the AMT and regular tax payable may be carried forward for up to seven years and deducted when the regular income tax is in excess of AMT.

The tax preferences added back to regular taxable income to arrive at adjusted taxable income for the AMT include, for example, net losses due to claiming capital cost allowance, net losses from tax shelter investments, carrying charges on investments in films or rental or leasing property, one-quarter of net capital gains, and so on.

In addition to the individual AMT, Ontario province also imposes AMT on corporations. Ontario levies a Corporate Minimum Tax (CMT) on adjusted book income allocated to Ontario. The CMT applies to all corporations that are subject to Ontario corporate tax, other than those eligible for the CMT small-business exemption. In general, a corporation is required to pay CMT only to the extent that CMT exceeds corporate income tax payable.

Korea

In Korea, there are many advantageous tax treatments which are offered to companies and individuals to encourage economic growth. Most of the tax incentives are enacted in "The Special Tax Treatment Control Law (STTCL). However, in order to improve neutrality and universality in taxation and to raise fiscal revenue, STTCL also requires that taxpayers eligible for the tax incentive codes should pay a minimum tax. The essence of the minimum tax system is quite simple in Korea. Taxpayers are required to calculate their tax liabilities twice: Once using the rules of the regular tax system, and a second time using the rules of the minimum tax system. Many advantageous deductions and tax credits available to corporations under the regular tax system are not allowed under the minimum tax system[8].

Under the regular income tax system, the Korean corporation tax is 13% on taxable income under KRW 100 billion after taking into account the deductions and exemptions, and 25% for income exceeding KRW 100 billion. Corporations (both domestic and foreign) are also subject to a resident surtax at the rate of 10% of the corporate income tax liability, which makes the current effective tax rate 27.5% for income in the higher tax bracket. However, corporate taxpayers are also liable for the minimum tax, which is defined as the greater of 15% (13% on the first KRW 100 billion) of the taxable income before various deductions and exemptions (defined as "adjusted taxable income", ATI) or actual tax after various deductions and exemptions. For small-and-medium-sized (SME) companies, minimum tax is the greater of 10% of ATI or actual tax liability.

As for individuals, the minimum tax, with exceptions, will be calculated at the

[8] For more details, please refer to Dalsgaard (2000), "The Tax System in Korea: More Fairness and Less Complexity Required", and Hong (2002), "An Overview of Korean Taxation".

greater of 35% of income tax liability before exemptions or actual tax after exemptions. The minimum tax is applied to business income of a resident individual and Korean-source business income of a nonresident individual, but it is not applied to employment (earned) income.

India

The Indian Income Tax Act contains large number of exemptions from total income. Besides exemptions, there are several deductions permitted from gross total income. Further, depreciation allowable under the Income Tax Act is not the same as required under the Companies Act. The result of such exemptions, deductions, and other incentives under the Income tax Act in the form of liberal rates of depreciation is the emergence of zero tax companies which in spite of having high book profit are able to reduce their taxable income to zero.

In reaction to companies that reported significant book profits but paid zero taxes, the MAT (Minimum Alternative Tax) was introduced in the 1996-1997. The MAT rule stipulates that if a corporation’s taxable income is less than 30% of its book profits, then 30% of the book income is deemed taxable. Two features of MAT in India. First, India only imposes MAT on corporations not on individuals. Second, the tax base of corporation MAT is simply the 30% of book profits. Unlike the AMT in the U.S., Indian companies do not need to compute the MAT tax base through a complicated calculation. All companies are subject to the MAT provisions, with the exception of FTZ (free trade zone) companies, EOUs (export-oriented undertakings) and companies in the power and infrastructure sector.

In 1997, the tax liability of the MAT was the 30% of the book profits (tax base) times the corporation income tax rate of 40%. Therefore, the tax rate of MAT in 1997 was 12% (30%*40%). However, India modified the MAT regulations in 2001 where the MAT tax liability was the whole book profits (tax base) times the separate MAT tax rate of 7.5%, which was not related to the corporation income tax rate.

***Taiwan*[9]**

In order to modify the tax revenue loss and unfairness resulting from the use of tax incentives which benefited only a small minority of enterprises and individuals, the Taiwan government advocated the adoption of a minimum income tax system by referring to the experiences of the USA, Canada, and Korea so as to maintain equality in the bearing of the fiscal burden and to promote social justice. The Income Basic Tax Act[10] (hereinafter referred to as the IBTA) imposes a basic tax similar to an alternative minimum tax and the implementation of this Act will enforce payment of a certain amount of basic taxes on high-income individuals and enterprises that have previously paid disproportionately low taxes or even none.

Under the IBTA, individuals and enterprises are required to calculate both their regular tax under the Income Tax Act and their basic tax amount (BTA) under the AMT system. If the amount of regular income tax is less than the amount of basic tax, the amount of income tax payable shall also include the balance of the amount of basic tax and regular income tax, in addition to the amount as calculated in accordance with the Income Tax Act and other relevant laws. In other words, AMT is an alternative to

[9] For more details, please refer to “Guide to ROC Taxes 2007”, Ministry of Finance, ROC.
[10] The Act was passed by the legislature on 9th December, 2005, and announced by the President on 28th December, 2005. The new law took effect on 1st January, 2006.

regular income tax: taxpayers must pay the higher of the two, but not both.

The basic income amount (BIA) for individuals and enterprises is the sum of regular taxable income and added-back items listed in the IBTA statue. For example, the added-back items for individuals are offshore income[11], some specific insurance proceeds, non-cash donations, income derived from unlisted stock transactions, the difference between fair market value and par value of employee bonus stocks. As for enterprises, the added-back items includes, for instance, exemption income from security and futures transactions, exemption income of offshore banking units (OBUs), and some specific exemption income under five-year tax holidays regulations.

The basic tax amount (BTA) of an individual is the amount of basic income amount (BIA) with a deduction of NT$ 6 million and then multiplied by the tax rate of 20%. A profit-seeking enterprise is allowed to deduct NT$ 2 million with the tax rate of 10%. In addition, the deduction amount is indexed by inflation.

4. Issues of AMT

Equity

The alternative minimum tax was originally motivated by the notion of vertical equity — that high-income people should pay at least some income tax each year. Burman *et al.* (2005) argue that roughly 1,600 tax filers with incomes above $1 million will pay no federal income tax, but at least 7,600 high-income tax filers would owe no income tax without the AMT in 2005. If the existence of the AMT also discourages

[11] These rules will take effect on 01/012009 but the effective date can be extended to 01/01 2010.

taxpayers from attempting to shelter income, the number paying no income taxes without an AMT could be much higher. The AMT results in a higher tax liability for certain taxpayers than would be the case if only the regular income tax applied. This occurs if: (1) the taxpayer's tentative minimum tax exceeds his or her regular tax liability; or (2) the use of tax credits allowed under the regular tax is limited by the taxpayer's tentative minimum tax. To the extent that taxpayers who appear to have the ability to pay taxes do pay taxes as a result of the AMT, some observers conclude that the AMT increases the perceived fairness of the income tax system.

To assess whether the AMT promotes the overall equity of the tax system, it is necessary to look who remits tax payments, and who bears the burden of the AMT. The AMT raises average tax rates for affected taxpayers. That is, the AMT increases the amount of the affected taxpayer’s tax liability as a percentage of his or her income. At the individual level, higher-income taxpayers are more likely to be AMT taxpayers than are lower income taxpayers. If the burden of the taxes were to rest with the affected taxpayers, the individual AMT might increase the overall progressivity of the income tax system.

Some analysts argue that the AMT promotes horizontal equity by taxing more equally taxpayers who have the same economic capacity but choose to engage in different patterns of tax-favored activities. Burman *et al.* (2005) demonstrated that by reining in tax shelters, the AMT significantly reduces the variance of average effective tax rates among taxpayers with similar incomes. Besides, other analysts note that in a market economy, investment by taxpayers would be expected to equalize risk-adjusted, after-tax returns. As a consequence, the prices of tax-favored investments would be bid up (or their quantity increase) and the prices of tax disfavored investments would fall (or their quantity decrease). In equilibrium, the pre-tax returns of tax-favored and tax-disfavored investments would differ, but their after-tax returns would be the same. For example, tax-exempt bonds trade at interest rates lower than otherwise comparable taxable bonds. This is because the tax-exempt borrower does not have to offer as great an interest rate to the lender to provide the lender with a competitive after-tax return. If after-tax returns equilibrate, analysts may question whether a horizontal inequity existed prior to the enactment of the AMT.

The AMT also raises equity issues with respect to preference items that are personal in nature. For example, some believe that it is fair that families with multiple dependents pay less tax than families with fewer dependents and support the regular-tax allowance of personal exemptions and child credits to further this goal. The AMT, in disallowing these exemptions and credits, may frustrate this view of fairness.

Under current law, about 31 million people will be paying the AMT in the U.S. by 2010, almost 9 times as many as in 2005. By 2015, 51.3 million taxpayers will be affected by the AMT, roughly 45% of all taxpayers with income tax[12]. Thus, the AMT originally designed for a few high-income taxpayers (class tax) will affect most taxpayers (mass tax). The primary reason the AMT grows more rapidly over time than the regular tax in the U.S. is that the AMT exemptions and other AMT parameters are not indexed for inflation, whereas the regular income tax parameters are indexed. Additionally, as income grows, state and local tax deductions under the regular income tax generally increase. However, there is no similar increase under the AMT because such deductions are not allowed under the AMT. Thus, because the AMT starts moving

[12] See Joint Committee on Taxation (2005), "Present Law and Background Relating to the Individual Alternative Minimum Tax," JCS-37-05. Washington, DC: Joint Committee on Taxation.

from the class tax to the mass class, the effectiveness of equity by imposing the AMT might lessen.

Efficiency

A tax system is efficient if it does not distort the choices that would be made in the absence of the tax system. However, no tax system can be fully efficient. Whether the AMT contributes to the efficiency depends on the extent to which it reduces other inefficiencies in the tax system and the extent to which it creates new inefficiencies. As an income tax, the AMT reduces the after-tax compensation from working (labor income is taxed) and saving (investment income is taxed). Thus, the AMT may distort decisions to supply labor and capital. The size of the marginal tax rate is one of the primary determinants of the size of any distortion created. However, the degree of additional distortion, if any, created by the AMT depends upon the tax rates of the AMT compared to those of the regular income tax.

If labor income is measured identically under the regular income tax and the AMT, then any distortions in labor supply are altered if a taxpayer subject to the AMT has a different marginal tax rate under the AMT than he or she would have under the regular tax. To the extent if this is true, the AMT is not likely to have a significant impact on labor supply distortions relative to the regular income tax. However, if labor income is measured differently under the regular income tax and the AMT, the AMT may increase the rate of tax on such forms of labor income, thereby seemingly increasing distortions in labor supply. However, by discouraging taxpayers from structuring their compensation to receive tax-favored remuneration, efficiency may be increased.

The same general analysis of comparing the possible distorting effects of the difference in marginal tax rates under the regular income tax and the AMT applies to taxpayer's decisions to save (to supply capital) in response to tax rates on investment income. There are several more cases where investment income is measured differently under the AMT than under the regular income tax than was the case with the measurement of labor income. By discouraging some taxpayers from undertaking what are otherwise tax-favored investments, efficiency may be increased to the extent that the tax-favored investments are inefficient. However, the AMT generally does not eliminate tax-favored treatment of certain activities or investments, but rather limits which taxpayers may take full advantage of the tax-favored treatment provided by the regular income tax. In addition, limiting which taxpayers can profitably undertake tax-favored activities could lead to more efficient investors finding the activity unprofitable, while less efficient investors find the activity profitable. Moreover, some tax-favored activities may be permitted as part of the regular income tax as a way to reduce some other inefficiency in the economy. These arguments might suggest that efficiency could be better improved by changes in the regular income taxes. The aggregate effect of the AMT on the efficient allocation of capital across various investment opportunities may be modest.

It is generally conceded that in measuring economic income, deductions should be allowed for expenses incurred in the production of income. However, the AMT disallows the deduction of miscellaneous itemized deductions–including un-reimbursed employee business expenses and investment expenses that relate to the production of income. The disallowance of such deductions may lead to inefficiencies as taxpayers may be discouraged from certain otherwise profitable investments or activities or encouraged to rearrange their affairs to secure AMT deductions for such costs.

In addition, AMT also may distort taxpayers' incentive decisions other than work and saving decisions. For example, because the AMT does not allow exemptions for dependents or deductions for state taxes, it will impose particularly high burdens on taxpayers with children and those in high-tax states, which may influence taxpayers' fertility and location decisions. Moreover, because the AMT exemption for couples is less than double the exemption for singles and because the tax brackets are not adjusted for marital status, the AMT imposes significant marriage penalties.

Complexity and Compliance

The AMT is a second income tax that runs parallel to the regular income tax; therefore, it requires taxpayers to comply with two different income tax codes, which makes complex and burdensome. The National Taxpayer Advocate (2001) and the Internal Revenue Service (2000) have argues that the AMT is one of the most difficult and complex areas of tax laws in the states. Compared to the U.S., Canada, Korea, India and Taiwan have relatively simple AMT regulations to taxpayers. Canada only enacts individual AMT while India only has corporate AMT. Moreover, the corporate AMT tax base in India is simply 30% of the book income; therefore, companies do not need to compute AMT taxable income from a complicated calculation. Currently, Taiwan does not define as many tax preferences as the U.S government does under the AMT system. The most difficult and complicated added-back tax preference is the offshore income. Because it demands more complicated designs and needs interaction with other countries to include the offshore income in the individual AMT tax base, this rule will be effective in 2009 but can be extended to 2010.

5. Conclusions

In the past three decades, Taiwan government has offered many tax benefits to individuals and corporations to develop economic growth. However, some of them are no longer suitable in the recent economic environment. In addition, these tax benefits not only reduce tax revenues but hurt the fairness and efficiency as well. In order to alleviate the problem, Taiwan government has enacted the “Income Basic Tax Act” in 2006, which imposes a basic tax similar to an alternative minimum tax in the U.S. so as to enforce a certain tax liability on the high-income taxpayers who may pay a little or even no tax under the regular income tax system due to tax deductions, exclusions and exemptions.

The AMT is in fact an additional tax that some taxpayers have to pay in additional to their regular income tax liability. The AMT is a separate tax income with its own set of rules for determining tax deductions and with its own tax rates. The AMT rules for tax deductions are generally less generous than are the regular tax rules, but it usually applies a lower tax rate. Thus, the tax scope of the AMT can be described by the idea of “a broader tax base with a lower tax rate”. By including more income in the tax base regardless of its source and taxpayers’ demographic characteristics, horizontal equity can be achieved. Besides, vertical equity also can be improved because high-income taxpayers are more likely to subject to the AMT. Further, the economic distortions could be mitigated since AMT applies a lower tax rate. However, the AMT also has limitations. First, the AMT asks taxpayers to compute their income tax twice; one under the regular tax system, one under the AMT system; thus the compliance cost to taxpayers and administrations could be high and inevitable. Second, the AMT still allows certain deductions and tax credits; namely, it only partially reduces rather than completely eliminates the tax evasion. In this sense, the AMT is only a second best choice. Besides, which tax preferences should be added back to the AMT taxable income is sometimes subject to political considerations. Third, the original intent of the AMT is to prevent certain “high-income” taxpayers from using special tax benefits from paying little tax. The target group is a few high-income taxpayers. Thus, the AMT is selective fiscal reform plan, not a comprehensive design. Due to its selectiveness, the new economic distortion may arise.

According to the preliminary fiscal statistic data in 2006, the total amount of AMT revenues collected in Taiwan was estimated to NT$ 16 billion, where NT$ 4 billion come from the individual AMT and NT$ 12 billion were from the corporate AMT. The amount accounted for only 1.3% of total tax revenue in Taiwan in 2006. Although the AMT does not play a significant role in collecting revenues, it has its own important policy insight in which Taiwan start planning to regulate a much more reasonable taxation structure by broadening the tax base so as to establish a fair taxation system. However, whether and to what extent the AMT can effectively improve the equity and efficiency of the taxation in Taiwan, the empirical studies are needed for the future research.

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