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Recommended Citation
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The Case for Repealing the Corporate Alternative Minimum Tax

Terrence R. Chorvat*
Michael S. Knoll**

The corporate alternative minimum tax ("AMT") was enacted in its current form in 1986 in response to claims that many large and financially profitable corporations were paying little or no federal income tax. The basis for that belief was a 1985 report issued by the Citizens for Tax Justice.1 That report, which has since been followed by similar reports,2 compared the taxes each corporation paid to the income it reported to its shareholders. The idea is that if a corporation’s actual tax payments are small relative to its financial statement ("book") income, then the corporation is avoiding taxes by artificially depressing its taxable income. The assumption that is implicit in this exercise is that book income is not as easily manipulated and thus is a more accurate measure of a firm’s true income than is taxable income.3 Recent events have undermined that assumption. The financial accounting abuses at Enron, WorldCom, Global Crossing and Qwest showed that book income can also be heavily manipulated4 and therefore is not necessarily a more

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3. An explicit assumption in the exercise is that each firm’s actual tax payments can be estimated with reasonable certainty. See discussion infra Part IV.

4. For WorldCom, see WorldCom’s Collapse, N.Y. TIMES, July 23, 2002, at C6; for Global Crossing, see Clinton, Other Democrats Named in Global Crossing Fraud Suit, BLOOMBERG NEWS, May 7, 2002; for Qwest, see Qwest, Directors Sued Over Stock Sales, Accounting, BLOOMBERG NEWS, Aug. 14, 2002.
accurate measure of performance than is taxable income. Thus, recent
events demonstrate the falsity of the assumption upon which Congress
justified the corporate AMT. Undercutting the original justification for
the corporate AMT does not by itself make the case for its repeal. It
does, however, justify a re-examination.

Based on such a re-examination, we argue that the corporate AMT
should be repealed. In this article, we argue that the corporate AMT does
not further any significant policy goal, that it imposes substantial addi-
tional compliance costs, and that it raises little and possibly no revenue.
Furthermore, it impedes important tax reforms dealing with corporate
tax shelters by obscuring the amount of tax actually paid by corpora-
tions. A better way to combat tax shelters would be to reduce tax prefer-
ences and to require more detailed tax disclosures by corporations.

Part I of this article examines the history and background of the corpo-
rate AMT. Part II examines the arguments made by defenders of the
minimum tax and finds them wanting. Part III discusses the effects of the
corporate AMT on corporations and the economy. It shows that the cor-
porate AMT has much to argue against it. Part IV discusses the issues
that will arise if we decide to eliminate the corporate AMT. In particular,
it addresses how we should deal with the current stock of AMT credits,
the issue that derailed the most recent attempt to repeal the corporate
AMT. It also discusses how the principal concern currently being raised
by the minimum tax's defenders—that repeal would unleash a new and
even greater wave of corporate tax shelter activity—could be more effec-
tively addressed by reducing tax preferences and requiring greater public
disclosure of public companies' tax information.

I. BACKGROUND AND HISTORY OF THE CORPORATE AMT

A. Background

In 1998, the most recent year for which official data are available, the

5. Gary A. McGill & Edmund Outslay, Did Enron Pay Taxes? Using Accounting In-
formation to Decipher Tax Status, 96 TAX NOTES 1125 (2002); Victor Fleischer, Enron's
Dirty Little Secret: Waiting for the Other Shoe to Drop, 94 TAX NOTES 1045 (2002) (arguing
that Enron's tax accounting showing roughly zero income was much more accurate than its
financial accounting showing large amounts of income).

6. For earlier proposals to eliminate the corporate AMT, see Hearings Before the
House Comm. on Ways & Means, 102d Cong. (1995) (statement of Mark A. Bloomfield
and Margo Thorning on Behalf of the American Council for Capital Formation). See also
ANDREW LYON, CRACKING THE CODE: MAKING SENSE OF THE CORPORATE ALTERNAT-
IVE MINIMUM TAX 129-37 (1997). For a more recent proposal, see STAFF OF J. COMM. ON
TAX'N, 107TH CONG., STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND
RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 8022(3)(B) OF THE IN-

7. McGill & Outslay, supra note 5. See also discussion infra note 50. The corporate
AMT has also confused and obscured the analysis of corporate tax shelters. See McGill &
Outslay, supra note 5.

8. See discussion infra Part IV.

289 (2002).
Treasury collected $3.3 billion in taxes from the corporate AMT. That figure, however, does not reflect the likely level of current and future collections for two reasons. First, significant changes to the minimum tax that were enacted in 1997 had not been fully implemented by 1998. These changes are expected to reduce corporate AMT collections sharply. Second, corporations are able to claim a credit against their regular income tax for AMT payments made in previous years. In some years, such as 1998, total credits claimed exceeded total collections. In those years, net corporate AMT receipts are negative. Taking these two factors into account, going forward, net corporate AMT collections are expected to average about $1 billion per year. That is to say, on average, annual corporate AMT collections are expected to exceed credits taken against the regular corporate tax by roughly $1 billion.

In comparison, the regular corporate income tax raises about $200 billion annually. Thus, the corporate AMT accounts for only about one-half of one percent of total federal corporate income tax collections. Although taxes raised by the corporate AMT have been and will continue to be small, that does not mean its consequences are minimal. That is because the minimum tax affects a large portion of the corporate sector.

In 1998, 18,360 firms paid the corporate AMT. A better and more useful gauge of the minimum tax’s economic impact is to look at the percentage of total assets held by affected firms. The Department of the Treasury recently reported that “[o]ver one-quarter of all corporate assets were held by companies paying higher taxes [in 1998] due to the AMT.” This latest data is in line with past years. According to a 1995 General Accounting Office study, during the first five years that the corporate AMT was in effect (from 1987 through 1991), 49 percent of corporations

11. The 1997 changes were fully implemented in 1999.
13. TREUBERT & JAUQUET, supra note 9, at 73. For 1998, the total AMT credit claimed was $3.4 billion, while the AMT collected was $3.3 billion. Id. For 1997, $4.1 billion was claimed in credits and $3.9 billion was collected. Id.
14. Id.
16. TREUBERT & JAUQUET, supra note 9, at 73.
17. Press Release, Dep’t of Treasury, Treasury Releases Data on the Corporate Alternative Minimum Tax (Nov. 6, 2001), available at http://www.treas.gov/press/releases/po762.htm (last visited Feb. 10, 2003). The Treasury report also noted that the manufacturing sector is particularly hard hit by the corporate AMT. “Over one-half of all manufacturing assets were held by companies paying higher taxes under the AMT.” Id.
with more than $50 million in assets had their tax payments increased in at least one year. These corporations accounted for 66.2 percent of all assets held in corporate form.\footnote{18}

\section*{B. The History of the Corporate AMT}

In 1969, Congress adopted a minimum tax for both individuals and corporations. The corporate minimum tax, which was known as an “add-on” minimum tax, was separate from the regular corporate income tax and was paid in addition to it. The base for this tax was so-called “tax preferences” enjoyed by the taxpayer rather than the taxpayer’s income. Selected tax preferences in excess of the $30,000 exemption amount were subject to a 10-percent tax.\footnote{19} Other than an increase in the tax rate to 15 percent in 1976, this early form of the minimum tax was largely unchanged until the Tax Reform Act of 1986 (“TRA 86”).

In 1986, Congress adopted the corporate AMT in its current form. According to the Senate Finance Committee’s report on TRA 86, the principal objective in enacting the corporate AMT was to ensure that profitable corporations would not “avoid significant tax liability by using various exclusions, deductions and credits,” to which they are entitled under the regular tax, but which are not viewed as accurately reflecting economic income.\footnote{20} Interestingly, other provisions of TRA 86 itself reduced the need for a corporate AMT by altering many of the preferences that corporations used to reduce their taxable income relative to their book income. Chief among these changes was the new tax depreciation rules. The Accelerated Cost Recovery System (“ACRS”), which existed between 1981 and 1986, greatly accelerated the depreciation deductions that firms could use on their tax returns as compared with the straight-line depreciation that they typically reported to their investors.

The new tax depreciation system introduced by TRA 86, which is often referred to as modified ACRS (“MACRS”), is still faster than straight-line depreciation, but it is significantly slower than the depreciation that was available under ACRS. Therefore, some of the perceived problem of financially profitable corporations paying too little tax was solved in 1986 by directly attacking the problem that the corporate AMT addressed only indirectly.

Because of various problems\footnote{21} with the corporate AMT, Congress enacted some significant changes to the tax in 1997. As will be discussed in

\begin{footnotes}
\item[19] See id. at 20. Unlike the current corporate AMT, tax credits were not restricted. Id.
\item[20] Staff of J. Comm. on Tax’n, Summary of H.R. 3838 (Tax Reform Act of 1986) As Reported by the Senate Committee on Finance, JCS-12-86 (1986) [hereinafter Summary of H.R. 3838].
\item[21] Congress believed that the corporate AMT inhibited capital formation, so it altered depreciation schedules to conform more closely with those under the regular tax. See J. Comm. on Tax’n, 105th Cong., General Explanation of Tax Legislation Enacted in 1997, JCS-23-97 (Comm. Print 1997).
\end{footnotes}
more detail below, Congress altered the depreciation rules under the AMT in 1997 to bring them more in line with the depreciation rules for regular taxable income. This significantly reduced AMT collections. Prior to 1997, corporate AMT collections were approximately $4 billion per year. The Joint Committee on Taxation estimated that the 1997 changes would reduce AMT payments by approximately $2 billion per year, essentially cutting collections in half.

C. THE STRUCTURE OF THE CORPORATE AMT AND CALCULATION OF THE AMT LIABILITY

The corporate AMT operates as a separate corporate income tax parallel to the regular corporate income tax. Unlike the earlier add-on minimum tax that it replaced, the current corporate AMT requires affected corporations to calculate their tax liability under two parallel tax systems. First, a corporation calculates its income tax liability under the regular corporate income tax; then, it must calculate its tax liability under the corporate AMT. As the phrase “alternative minimum tax” implies, the corporation pays the greater of its regular tax liability or its liability under the AMT. Accordingly, if a corporation’s regular tax liability exceeds its liability under the AMT, it pays its regular tax liability. If, however, its liability under the AMT is greater than its liability under the regular tax, it must pay its regular tax and make an additional payment of the difference. The additional payment is referred to as the corporation’s AMT liability.

The corporate AMT differs from the regular corporate income tax in two principal ways. First, the corporate AMT rate of 20 percent is substantially below the regular corporate income tax rate of 35 percent that applies to most corporations. Second, the tax base for the corporate AMT, alternative minimum taxable income ("AMTI"), is broader than

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22. A taxpayer’s regular income tax liability after the foreign tax credit but before other tax credits is referred to as its regular tax liability.

23. For purposes of determining whether a corporation’s AMT liability or its regular tax liability is larger, the regular tax does not include the accumulated earnings tax, the personal holding company tax, the built-in gains tax, the tax on excess passive income of S corporations and additional taxes due to an investment credit recapture or low-income housing recapture.

24. This definition of a corporation’s AMT tax liability ensures that the additional revenue raised by the corporate AMT equals the corporate AMT liability.

25. Compare I.R.C. § 55 (2002) (corporate AMT), with I.R.C. § 11 (2002) (regular corporate tax rate). For large corporations, the regular corporate income tax is 35 percent. It is progressive at lower income levels and provides for recapture of the benefit of lower rates at higher incomes as described in the following table:
the tax base for the regular corporate income tax.\textsuperscript{26}

AMTI is calculated by adding certain preferences and adjustments to regular taxable income. Preferences and adjustments are items a corporation may claim to reduce regular taxable income, but which are disallowed under the AMT. The slower depreciation allowed under AMT rules is the primary adjustment in the expanded AMTI base. In addition, the AMT imposes restrictions on the use of net operating losses and the foreign tax credit and requires a so-called “adjustment for adjusted current earnings.”\textsuperscript{27}

The starting point for determining a taxpayer’s AMTI is its regular taxable income. In general, all rules that apply in determining a taxpayer’s regular taxable income apply in determining AMTI as well. To calculate AMTI, the taxpayer then adds back various “preferences” and adjustments. AMTI is then reduced by an exemption amount. The taxpayer’s tentative AMT liability (often called the tentative tax) is determined by applying the AMT tax rate to the taxpayer’s AMTI, less any exemption amount.

The AMT rules permit deductions for net operating losses (“NOLs”) from prior years. However, the amount of this deduction cannot exceed 90 percent of AMTI before the NOL is taken into account. Almost all credits against regular corporate tax, such as the research and development credit, are disallowed against the AMT. The only credit that is allowed against AMT is the foreign tax credit, which must be computed separately for regular and AMT tax purposes.\textsuperscript{28}

\begin{center}
\begin{tabular}{|c|c|}
\hline
Taxable Income & Tax Rate \\
\hline
$50,000 or less & 15\% \\
$50,000 to $75,000 & 25\% \\
$75,000 to $100,000 & 34\% \\
$100,000 to $335,000 & 39\% \\
$335,000 to $10,000,000 & 34\% \\
$10,000,000 to $15,000,000 & 35\% \\
$15,000,000 to $18,333,333 & 38\% \\
over $18,333,333 & 35\% \\
\hline
\end{tabular}
\end{center}

The extra 5-percent tax between $335,000 and $10 million and the extra 3-percent tax between $15 million and $18.33 million are to “catch up” on the lower rates applied under $75,000 and under $10 million. The net effect is that if a corporation’s taxable income is above $335,000 but less than $10 million, the average tax rate on all income is 34 percent; if corporate income is above $18.33 million, the average tax rate on all income is 35 percent.

26. The corporate AMT provides that tax is assessed on AMTI less an exemption amount. The maximum exemption amount for corporations is $40,000. It is phased out at the rate of 25 cents for every dollar of AMTI in excess of $150,000. Thus, the exemption amount is zero for corporations having AMTI of $310,000 or more. For most corporations, the exemption amount will be zero, so they are effectively taxed at a 20-percent flat rate.


28. The foreign tax credit is equal to the foreign income taxes paid, however it is subject to a limit equal to the amount of U.S. income tax owed (before taking the foreign tax credit into account) multiplied by the foreign source income of the taxpayer divided by the worldwide income of the taxpayer. This must be calculated separately for AMT purposes because both the amount of U.S. tax owed and the definition of income are different for AMT purposes than for regular tax purposes. I.R.C. §§ 56, 901 (2002).
Corporations are allowed a credit against their regular tax liability for prior years' minimum taxes paid. If a taxpayer starts paying the corporate AMT and never returns to paying the regular tax, then the AMT liabilities it pays over the years are permanent increases in its tax liability. Alternatively, if the taxpayer temporarily pays the AMT, but thereafter pays the regular tax in large enough amounts so that it exhausts its AMT credits, then the effect of the AMT is to accelerate the taxpayer's tax payments, not to permanently increase them. For those corporations that will eventually utilize all of their AMT credits, the direct cost to the taxpayer (and value to the government) of the corporate AMT is the time value of money associated with the prepayment of the regular tax. The calculation of a corporation's AMT liability is summarized in Table 1.

TABLE 1

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1</td>
<td>Compute taxable income (TI) as determined under the regular tax rules.</td>
<td></td>
</tr>
<tr>
<td>Step 2</td>
<td>Add to this amount any net operating loss (NOL) deduction carried forward from another tax year claimed in computing TI for the current year.</td>
<td></td>
</tr>
<tr>
<td>Step 3</td>
<td>Add or subtract the adjustments other than the alternative minimum tax NOL (AMT NOL) deduction and adjusted current earnings (ACE) adjustment.</td>
<td></td>
</tr>
<tr>
<td>Step 4</td>
<td>Add so-called &quot;preference items.&quot;</td>
<td>The result is Pre-adjustment AMTI</td>
</tr>
<tr>
<td>Step 5</td>
<td>Add or subtract the adjusted current earnings ACE adjustment.</td>
<td>The result is AMTI</td>
</tr>
<tr>
<td>Step 6</td>
<td>Subtract the AMT NOL deduction.</td>
<td>The result is the AMT tax base</td>
</tr>
<tr>
<td>Step 7</td>
<td>Subtract the exemption amount, if any.</td>
<td>The result is the AMT tax base</td>
</tr>
<tr>
<td>Step 8</td>
<td>Apply to this base the AMT rate of 20 percent.</td>
<td>The result is Pre-foreign tax credit tentative minimum tax</td>
</tr>
<tr>
<td>Step 9</td>
<td>Subtract from this the AMT foreign tax credit.</td>
<td>The result is the tentative minimum tax</td>
</tr>
<tr>
<td>Step 10</td>
<td>Compare the corporation's regular tax liability with its tentative minimum tax.*</td>
<td>If a corporation's regular tax liability is larger than its tentative minimum tax, then its AMT liability is zero. If the tentative minimum tax is larger, its AMT liability is the excess of its tentative minimum tax liability over its regular tax liability.</td>
</tr>
</tbody>
</table>

* For the purpose of this calculation, the regular tax liability is calculated without AMT credits.

The corporate AMT applies to all corporations, other than:
1) those in their first year of existence (i.e., the tentative minimum tax of a corporation in its first year of existence is zero), and

2) corporations that are considered small (i.e., if the corporation has annual gross receipts of $7.5 million or less for all consecutive three-year periods beginning after 1993 and ending before the tax year in question).

The most important "preference" items and other differences between the regular income tax and the AMT definition of income are the following:

1. **Depreciation.** The largest difference between AMTI and regular taxable income results from the different depreciation methods under the two systems. Under the AMT, property (other than real property) is depreciated using the 150-percent declining balance method. Under the regular tax system, taxpayers will generally use the 200-percent (double) declining balance method.

2. **Net Operating Losses ("NOL").** AMTI is computed using the AMT NOL deduction rather than the regular tax NOL deduction. The AMT NOL cannot exceed 90 percent of AMTI before the AMT NOL is taken into account. Under the regular tax, if a corporation has NOLs from prior years and profits in the current year, it can reduce its taxable income for the current year by any NOLs it has down to zero. Thus a firm with a large stock of NOLs and positive AMTI (before taking account of NOLs) will have to pay minimum tax even if its regular tax liability is zero.

3. **Foreign Tax Credits.** The AMT foreign tax credit is calculated in much the same way as the foreign tax credit allowed under the regular

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29. Regulated investment companies ("RICs") and real estate investment trusts ("REITs"), which are exempt from the regular tax, are not subject to corporate AMT. I.R.C. § 59(d) (2002). Organizations that operate in these forms have to apportion items among their shareholders who will include them in their own individual AMT calculations. The character as preference items is determined at the entity level, which is then passed through to shareholders. The corporate AMT applies on a consolidated basis and the minimum tax liability must be computed on a consolidated basis. Foreign corporations are also subject to the AMT, but only on their income and deductions that are effectively connected with the conduct of a U.S. trade or business.

30. Before 1999, the AMT used longer depreciable lives than did the regular tax rules. Beginning in 1999, depreciable lives under the corporate AMT and the regular tax rules are the same. Conforming the depreciable lives cut AMT tax collections almost in half.


32. Property with a class life of 10 years or less is depreciated using 200-percent declining balance method; property with a class life of 15 or 20 years is depreciated using 150-percent declining balance method. I.R.C. § 168(b) (2002). With both the 150- and 200-percent declining balance methods, the taxpayer switches to the straight-line method for the first tax year for which the straight-line method (using the adjusted basis as of the beginning of the year) yields a higher allowance. Id. If, however, the taxpayer uses the straight-line depreciation for regular tax purposes, it will also use that method for AMT purposes. Id. For purposes of both the AMT and the regular tax, real property is depreciated on a straight-line basis. Id.

33. See I.R.C. § 56 (2002). The rationale for carrying over NOLs without limitation is that it allows the corporation to average out taxable income over several years, which is viewed as more accurately reflecting the company's total taxable income.
tax, except that the foreign tax credit limit is calculated using AMTI instead of taxable income. The foreign tax credit limit is equal to the total U.S. tax (calculated before the foreign tax credit) multiplied by a fraction of foreign source income in the numerator and total worldwide income in the denominator. For purposes of determining the foreign tax credit limit for AMT purposes, worldwide income and foreign source income are calculated using AMT rules. Further, U.S. tax is calculated using AMT liability. When calculating the foreign tax credit limit for AMT purposes, the credit cannot exceed 90 percent of the AMT liability (calculated without taking into account the credit and AMT NOLs).

4. Adjusted Current Earnings ("ACE"). One of the most burdensome of the differences between the two taxes results from dealing with "adjusted current earnings." A corporation's AMTI for any tax year is increased by 75 percent of the excess of the corporation's ACE over its AMTI determined without regard to the ACE adjustment and the AMT NOL. ACE is determined using the statutory rules for calculating "earnings and profits." "Earnings and profits" is separate and distinct from either AMTI or regular taxable income, although it, like AMTI, starts with regular taxable income and then makes various adjustments. Specifically, in calculating "earnings and profits," tax-exempt interest is included; the last-in, first-out method of accounting cannot be fully used; the installment sale method is disallowed; and the 70-percent dividends received deduction is disallowed. The ACE adjustment means that a corporation must keep at least three sets of books to calculate its taxes (one for regular tax, one for "normal" AMTI, and a third for the ACE adjustments).

5. Completion methods. AMTI is computed using the percentage-of-completion method of accounting for long-term contracts other than home-construction contracts. This method requires corporations to "book" income associated with work in progress rather than waiting until the contract has been completed. In contrast, the completed contract method, which is sometimes allowed for regular tax purposes, allows the taxpayer to defer income until a contract is complete rather than having to include portions in gross income as the work proceeds.

6. Excess of depletion. The excess of any percentage depletion deductions over the year-end adjusted AMT basis of the property on which the deduction is claimed is considered a preference and so must be added back to AMTI.

35. See generally I.R.C. § 56 (2002). Likewise, a corporation's AMTI is reduced by 75 percent of the excess of the corporation's pre-adjustment AMTI over its ACE. The reduction cannot exceed the excess of the total positive adjustments for all prior years over the total negative adjustments for all prior years. Id.
36. It is also separate and distinct from financial reporting or book income.
38. I.R.C. § 460(e) allows the completed contract method for Home Construction contracts and other contracts that have a duration of less than two years, and result in less than $10,000,000 in gross receipts to the taxpayer.
II. HOW THE CORPORATE AMT HAS FAILED TO LIVE UP TO ITS BILLING

Although Congress originally justified the corporate AMT on the simple premise that firms reporting large amounts of book income to shareholders should be required to pay some substantial amount of tax,39 the current defenders of the minimum tax have developed additional and more sophisticated arguments. In this Part, we examine these more recent justifications for the minimum tax. The most common arguments now being advanced in defense of the corporate AMT are that it improves the fairness of the tax system; that it discourages investment in tax preferred assets; that it is necessary to prevent corporations from using tax shelters to eliminate their income tax liability; and that it discourages firms from inflating their book income. This Part demonstrates how the corporate AMT fails to accomplish any of these goals in a systematic manner.

A. THE CORPORATE AMT AND "FAIRNESS"

The most frequently made argument in defense of the corporate AMT takes the broad form that a minimum tax will make the tax system fairer. In its simplest form, this fairness argument can be summarized by the often-cited quotation of Robert S. McIntyre, the director of Citizens for Tax Justice, that “[i]t’s a scandal when members of the Fortune 500 pay less in taxes than the people who wipe their floors or type their letters.”40 At some level, McIntyre’s observation has an obvious appeal. The financial statements of many corporations show large cash flows and assets, including sometimes large amounts of cash on hand. It seems obvious that these corporations have the resources to pay at least a minimal amount of tax. There are, however, several problems with this line of argument.

First, the corporate AMT is a very inefficient way to collect taxes from corporations.41 Thus, assuming that corporations should pay more in federal income taxes, the corporate AMT is an especially poor way of forcing them to do so.42 As we argue in this article, the corporate AMT imposes high compliance costs, raises little (if any) revenue, and misallocates resources.43 Far more effective would be to eliminate the corporate

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41. Some economists advocate replacing the corporate income tax with a value-added tax ("VAT") on the grounds that the corporate income tax is a particularly inefficient tax. See Harvey Rosen, Public Finance 449 (5th ed. 1999).
42. Of course, if the low rate of tax results from corporations literally cheating—that is, committing fraud by making false statements on their tax returns—it seems unlikely that additional rules will get them to comply. Since these firms have already demonstrated a propensity to cheat to reduce their taxable income, it seems unlikely that adding more self-reported rules will change things much.
43. See discussion infra Part III.
AMT and either raise the corporate tax rate or reduce tax preferences.\textsuperscript{44} Indeed, either a small increase in tax rates (less than one percent) or a reduction in tax preferences (such as depreciation) could easily replace the taxes collected by the corporate AMT while at the same time practically eliminating the full cost of complying with the minimum tax.\textsuperscript{45}

Second, it is important to remember that corporations do not pay taxes, only people pay taxes. Ultimately, the economic burden of the corporate income tax, including the AMT, must be borne by individual workers, customers, and investors.\textsuperscript{46} While the specific incidence of the corporate income tax has been a particularly contentious issue,\textsuperscript{47} the fact remains that people pay taxes and the fairness of the corporate AMT should be evaluated based on its consequences for individuals.

Some defenders of the corporate AMT are willing to take up the challenge of justifying the corporate minimum tax based on its incidence by arguing that it improves vertical equity.\textsuperscript{48} Their argument is usually cast as an argument that the corporate AMT increases tax progressivity.\textsuperscript{49} There is a long-standing and extensive debate over whether the tax system should be progressive and, if so, how progressive.\textsuperscript{50} We do not intend to join in that debate in this article. What can be said here is that elimination of the corporate AMT would have little, if any, effect on the overall progressivity brought about through the corporate income tax.

\textsuperscript{44} The argument supporting so-called preference items, which are deviations in the definition of taxable income from economic income, is that there is some well-grounded policy reason for it. See Stephen Utz, \textit{TAX POLICY: AN INTRODUCTION AND SURVEY OF THE PRINCIPAL DEBATES} 234 (1993). An example would be that the taxpayer is providing a valuable social service that is not adequately compensated by the market and so the taxpayer should be compensated by the government. For example, charitable contributions are deductible, because of a belief that the social benefits of charity are not fully compensated. \textit{Id.} Another example would be income on which it is simply too expensive to collect tax. For example, de minimis fringe benefits, which are excluded from income under I.R.C. § 132, are excluded because it would be too costly to tax them. See William Klein \textit{et al.}, \textit{FEDERAL INCOME TAXATION} 63-5 (7th ed. 2000). If a corporation is providing many socially beneficial services, then it is not necessarily a bad thing that it pays little or no tax. If, on the other hand, there is no external social benefit, Congress could save considerably more money by drafting the rules more carefully.

\textsuperscript{45} \textit{See} discussion \textit{infra} Part IV.B.1. The federal corporate tax, with its close to flat 35-percent tax rate, raises roughly $200 billion a year. See Barry, supra note 14, at 2. Thus, a 1-percent increase—to 36 percent—will raise roughly $6 billion, which is three to six times larger than estimated gross annual revenue from the minimum tax.

\textsuperscript{46} Michael L. Marlow, \textit{A PRIMER ON THE CORPORATE INCOME TAX: INCIDENCE, EFFICIENCY, AND EQUITY ISSUES} (Tax Foundation, Background Paper No. 38, 2001).


\textsuperscript{48} McIntyre \& Nyguen, supra note 2, at 10.

\textsuperscript{49} A tax system is progressive if the ratio of the tax paid to income tends to increase with individual income. That is to say, a progressive tax system is one in which the average tax rate is an increasing function of income. Utz, supra note 44.

While it is true that the corporate AMT increases taxes more on investors who invest in corporations that pay little in corporate taxes, there is probably no difference in the wealth of shareholders in firms that are affected by the AMT and those that are not. It is thus unlikely that the corporate AMT increases progressivity by raising taxes more on corporations with wealthier investors than on corporations with less wealthy investors.

Alternatively, the argument that the corporate AMT increases progressivity can be framed as the following: the minimum tax increases taxes on capital, which fall more heavily on the wealthy. This argument has some merit because higher-income individuals tend to earn a higher portion of income from capital. However, any increase in corporate taxes would have the same effect. Accordingly, if a general increase in corporate taxes is desirable, Congress should increase corporate tax collections directly either by raising tax rates or by cutting back on preferential tax treatments, such as accelerated depreciation. As stated above, either change would raise corporate taxes without incurring the compliance and other inefficiency costs associated with the corporate AMT.

B. The Corporate AMT and Investment in Tax Preferred Assets

Another argument that some defenders of the corporate AMT make is that the minimum tax discourages investment in tax-preferred assets, which can increase efficiency by shifting investment to projects with a higher total return. This is an example of the general theory of the second best—the idea that a policy that would reduce efficiency in an otherwise distortion-free environment might increase efficiency because it offsets other distortions. It thus might be true that the corporate AMT increases efficiency because it reduces the distorting effects of tax preferences. However, if true, it does so in a manner that is far more costly than simply reducing preferences. If there is too much investment in tax preferred items, a simpler and more effective policy would be to reduce tax preferences for all firms. For example, if lawmakers think depreciation is too rapid or depletion allowances too high, they should scale them back directly. More generally, if the tax system provides too much encouragement for a particular type of investment, the law should be changed. Conversely, if the tax system provides the appropriate level of encouragement, the benefits should not be limited arbitrarily by corporate AMT.

The current compromise—large preferences and a corporate AMT—is a poor solution. It is the worst of both alternatives. It does not generally

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52. As discussed infra Part III, much of the impact of the AMT is to change the form of the investment rather than to prevent it. Of course, to some extent the corporate AMT does discourage investment in tax-preferred assets.
53. ROSEN, supra note 41, at 300-02.
discourage firms from making tax-favored investments. It only discourages those firms that are subject to the AMT from doing so. As described below, the result frequently will be that the same investments will be made, but that they will be made by firms that are not as efficient, or they will be made at a different time, or they will be financed in a different way.\textsuperscript{54}

The argument that the corporate AMT is a good policy because it discourages excessive investment in tax-preferred assets is sometimes cast using the language of political economy. Defenders argue that the minimum tax is an economically desirable political compromise because it restrains Congress from providing larger and more distorting preferences. We have two observations. First, this argument (at least if it stands by itself) is a concession on the merits. It recognizes that the corporate AMT is a bad policy and that it should be eliminated if another method of restraining Congress's largesse can be found. Second, we are skeptical of such a political argument in this context. The corporate AMT is among the most complex parts of the corporate tax.\textsuperscript{55} It seems unlikely that politics would require a complicated and opaque provision to tax large and sophisticated parties such as corporations. Relative to individual taxpayers, corporations are likely to have a comparative advantage in understanding and lobbying to amend a complicated tax provision.

C. THE CORPORATE AMT AND CORPORATIONS' USE OF TAX SHELTERS

Another argument that defenders of the corporate AMT frequently make is that the minimum tax is necessary to restrain corporations' use of abusive tax shelters.\textsuperscript{56} In the last five years or so, the media has focused a bright light on corporate tax shelters, and some of the transactions brought to light are highly abusive.\textsuperscript{57} There is also a concern that corporations are making widespread use of abusive tax shelters.\textsuperscript{58} As a result, the minimum tax's defenders are concerned that its repeal would unleash

\textsuperscript{54} See discussion infra Part III.


\textsuperscript{58} See Bankman, supra note 57; Mihir Desai, \textit{Tax Dodging: Enron Isn't Alone}, BusinessWeek Online (Mar. 4, 2002), at http://www.businessweek.com/magazine/content/02_09/b3772051.htm (“[Mihir A.] Desai figures that more than half the difference between tax and book income is generated by shelters, the careful shifting of earnings from one year to another, and outright fraud.”).
an even larger wave of tax shelters.\textsuperscript{59}

This claim is dubious for several reasons. First, there are legal and non-legal constraints on tax shelter activity.\textsuperscript{60} Admittedly these constraints are imperfect, but they do operate. Second, and more to the point, the corporate AMT does little to constrain tax shelter activity. Many tax shelters are unlikely to be restrained until the corporate taxpayer has already sheltered much of its income. For example, tax shelters using foreign tax credits or net operating losses can eliminate 90 percent of AMTI before the AMT's limits on the use of foreign tax credits or net operating losses are triggered. Also, many tax shelters rely on tax preferences that are not directly reduced by the AMT. Instead, because AMT firms have their incomes increased, the affected firms are required to use larger shelters to receive the same amount of tax benefit. The cost of this additional sheltering activity is probably minimal (because the documents are already drawn up and shelters are often priced as a percentage of the tax saved). Moreover, it is reasonable to expect tax shelter promoters to develop and market shelters that are not defeated by the minimum tax.

Although the corporate AMT does little to aid the government in its battle against tax shelters, it arguably makes it more difficult for Congress to address the problem. That is because the claim made by some defenders of the corporate AMT—that the minimum tax restrains abusive corporate tax shelters—could also be used by tax shelter promoters to argue that additional rules are not needed to restrain corporate tax shelters.\textsuperscript{61} In Part IV, we discuss some reforms that have greater potential to discourage tax sheltering.

\section*{D. The Corporate AMT and Financial Accounting}

Another argument made by defenders of the corporate AMT is that the corporate AMT helps to restrain companies from inflating their financial statements.\textsuperscript{62} The argument is that because the corporate AMT more closely tracks book income it discourages aggressive accounting.\textsuperscript{63} Although it is true that book income generally exceeds regular taxable income and that AMTI is generally between book and taxable income, it

\begin{itemize}
\item \textsuperscript{60} See Pearlman, \textit{supra} note 9; see also David M. Schizer, \textit{Frictions as a Constraint on Tax Planning}, 101 COLUM. L. REV. 1312 (2001).
\item \textsuperscript{61} Reuven S. Avi-Yonah, \textit{Why the Corporate AMT Should be Retained}, 93 TAX NOTES 988 (2001); McIntyre, \textit{supra} note 59.
\item \textsuperscript{62} McGill and Outslay argue that the AMT also complicates the analysis of the tax payments of corporations. See McGill & Outslay, \textit{supra} note 5; see also infra text accompanying notes 63-65.
\item \textsuperscript{64} Id. For analysis of how the AMT more closely tracks book income, see Robert McIntyre, \textit{Why We Have a Corporate AMT} (2001).
\end{itemize}
is not clear how the corporate minimum tax restrains companies from inflating book income. Financial and tax books are separate and largely independent from one another. Most important, neither regular taxable income nor AMTI includes book income as part of the tax base. There is, thus, no tax penalty that firms must pay for reporting higher book income. It follows, therefore, that there is no reason to expect that the minimum tax discourages firms from inflating reported earnings.

Some commentators go even further. McGill and Outslay suggest that the minimum tax can make it easier for some firms to inflate their reported earnings. They show that Enron worked hard to make it appear that it was paying more tax than it actually was. Why would a company want to appear as if it was paying more tax than it was? If it was obvious that Enron was paying little or no U.S. federal income tax, then investors might have begun to wonder if Enron really had much income. Even though Enron was apparently making no profit, the management of Enron was able to use the complexities of both the financial accounting rules and the corporate AMT rules to make it appear that it was paying federal income tax. Therefore, rather than improving the information available to outside analysts and shareholders, the AMT obscured the ability of outsiders to understand Enron's actual financial situation by making Enron appear more profitable than it was.

We argue below that a more efficacious tax-based response to aggressive accounting is to require more extensive disclosures of tax liabilities. Increased transparency might discourage both tax sheltering and earnings inflation.

III. COSTS IMPOSED BY THE CORPORATE AMT

According to its defenders, the corporate AMT plays an important function by restraining corporate tax sheltering and financial accounting manipulation, yet it has few, if any, negative consequences because it raises little revenue. We paint a different picture. In our view, the corporate AMT does not systematically advance any legitimate policies, but it does have substantial negative consequences across a large segment of the economy. In Part I, we showed that the minimum tax's impact is widespread even though gross collections are small. In Part II, we argued that the minimum tax does not promote any of its goals. In this Part, we

67. Fleischer, supra note 5.
68. McGill & Outslay, supra note 5, at 1126-27, 1132.
69. Because the tax system measures income in a different manner than the financial accounting system does, shareholders are better informed if they know the results of both systems, rather than the results of only the financial accounting rules. To the extent that both tax and financial statement income are based on similar calculations neither would operate as a check on the other. See infra Part IV.
argue that the corporate AMT has large and important negative consequences.

Corporations that pay the AMT have their depreciation schedules stretched out, their depletion allowances reduced, and their use of NOLs and foreign tax credits curtailed. These changes, which increase their tax bills, are at least partially offset by the AMT credits they receive for the additional tax they pay. These credits can be used in future years to offset their regular tax liability. However, because these credits cannot be used to reduce taxes below what they would be with the corporate AMT, many companies carry AMT credits on their books for years. Companies with excess credits have their taxes increased by the AMT and have their incentives altered by it as do corporations that currently pay the AMT. This is why the corporate AMT's effects are disproportionate to its revenue.

Commentators who have studied the corporate AMT have recognized that it is extremely difficult to trace out the minimum tax's affect on investment incentives. That affect depends among other things, upon the type of asset, the firm's financial structure, and the firm's past and expected future income tax situations. Nonetheless, commentators have recognized four types of largely negative consequences from the corporate AMT. First, it discourages investment. Second, it misallocates resources. Third, it is administratively burdensome. Fourth, it makes for poor fiscal policy.

A. THE CORPORATE AMT DISCOURAGES INVESTMENT

The corporate AMT discourages affected firms from investing in plant, equipment and other productive activities. There are two reasons for this. First, and most obviously, the "loopholes" that the corporate AMT curtails are the same incentives that Congress bestowed to encourage such investment. The minimum tax's preferences and adjustments reduce the value of these incentives, thereby discouraging affected firms from making such investments.

Second, and less obviously, the reduced corporate AMT tax rate, coupled with credits that the corporation can use against its regular tax liability in the future, reduces the effective marginal tax rates for affected firms. Such a reduction in a firm's effective marginal tax rate will make tax-advantaged investments less attractive. Thus, not only are AMT

71. This is an application of the well-known phenomenon that competition for tax-preferred assets drives up their return and reduces their yield. Such a reduction in yield is called an implicit tax. Assets that bear large amounts of implicit tax are favored by high-bracket investors because they prefer to pay implicit tax (at the market determined rate) over explicit tax (at their own tax rate). See, e.g., Calvin H. Johnson, Inefficiency Does Not Drive Out Inequity: Market Equilibrium & Tax Shelters, 71 Tax Notes 377, 382 (1996). In contrast, low-bracket taxpayers avoid assets that bear large amounts of implicit tax because they prefer to pay explicit tax (at their own rate) over implicit tax (at the market determined rate).
firms discouraged from investing in plant and equipment, they are also discouraged from investing in advertising and research because these expenditures can be immediately expensed.\textsuperscript{72} On the other hand, the reduction in tax rate experienced by firms subject to the AMT will encourage them to invest in activities that are not tax advantaged, such as increasing cash reserves.

As described above, the welfare consequences of discouraging investment in tax-preferred investments are ambiguous.\textsuperscript{73} The rationale for providing targeted investment incentives is that they have beneficial effects that go beyond the private return earned by the investor. If the existence of so-called positive externalities can justify the special tax benefits, then the corporate minimum tax reduces welfare by discouraging welfare-enhancing investment. Alternatively, if the tax code's investment incentives cannot be justified, they should not be provided by the tax code at all. Either way, it makes no sense to provide investment incentives through one provision of the tax code (the regular corporate income tax) and to take them away with another (the corporate AMT).

B. **THE CORPORATE AMT MISALLOCATES RESOURCES**

The corporate AMT not only discourages some investments; it also misallocates resources. That is, it changes who makes specific investments, the legal form these investments take, how they are financed, and when they occur. These changes are all economically wasteful.

One of the keys to understanding the consequences of the corporate AMT comes from recognizing that it does not affect all firms. It only affects those firms whose tax liability is increased or would be increased by the corporate AMT.\textsuperscript{74} The investment incentives of firms that have not had their tax liabilities affected by the corporate AMT are not changed. The corporate AMT thus introduces an unlevel playing field between AMT and regular firms because the tax paid on the same investment varies depending upon whether a firm is paying the regular tax or the AMT. The impact of this unlevel playing field is that an economically less efficient firm will sometimes make an investment because the corporate AMT prevented a more efficient firm from doing so. That is inefficient.

\textsuperscript{72} Expenditures on advertising and research are tax-advantaged because they produce benefits beyond the current year, but can be deducted immediately.

\textsuperscript{73} See discussion supra Part II.B.

\textsuperscript{74} A corporation's tax liability is increased by the corporate AMT if it pays the tax, has AMT credits that it cannot currently use because that would drive its AMT liability below its regular liability, or is paying the regular tax and has declined to make investments that would have put it into the corporate AMT. At the margin, such firms are all under the AMT. The Department of the Treasury recently reported that in 1998, 30,226 companies had increased tax liabilities due to the corporate AMT. Eighteen thousand three hundred fifty-two companies actually paid the AMT and 11,874 companies "had their use of tax credits limited by AMT rules." See Dep't of Treasury, supra note 17. There is no data on how many firms changed their investment plans to avoid falling into the AMT. See id.
Moreover, it is not surprising that firms in specific industries (such as manufacturing, mining and public utilities) are more likely to be affected by the corporate AMT than those in other industries. This is because the AMT decreases the expected value of any deductions taken in years in which the corporation will generate a loss by reducing the amount of deductions and restricting the use of NOLs. This reduces the incentive to invest in depreciable property, engage in research and development, or incur other deductible expenses, including paying the salaries of new hires. This change in investment incentives is not tied in any rational way to any legitimate governmental purpose (e.g., improving the efficiency of the economy or the provision of public goods).

The AMT also influences the form certain investments take. One of the largest and most important differences between the corporate AMT and the regular corporate income tax is the treatment of depreciation. For tax purposes, the lessor of leased property is generally considered the owner and therefore is permitted to depreciate the leased property. The lessee cannot depreciate the property, but it can deduct lease payments from its regular taxable income. Because lease expenses are not an adjustment or preference item, an AMT firm that leases property does not suffer the same disadvantage as one that owns property. Moreover, many of the benefits of accelerated depreciation can be passed through to the lessee in the form of reduced lease payments. Thus, to the extent that the AMT causes firms to lease instead of own property, the effect is to impose additional costs of writing leases as well as the agency costs from separating the user from the residual claimant.

The AMT also discourages firms from using debt relative to equity to finance capital investments. Because interest payments are deductible but dividends and retained earnings are not, a corporation with more debt in its capital structure will (other things being equal) report smaller taxable income and pay a smaller tax liability. This smaller tax liability makes it more likely that the debt-financed firm will have to pay the minimum tax than an otherwise-equivalent equity-financed corporation. Thus, the corporate AMT encourages firms to use less debt than they otherwise would.

The AMT also can influence the timing of investment. Because AMT firms have higher hurdle rates for investment in depreciable property.

75. Lyon, supra note 6, at 108.
76. Id. at 131.
77. Id.
79. This is another example where the corporate AMT counters a questionable tax policy. Here, the questionable policy is the preferential treatment of debt, which tends to increase bankruptcies and discourage investments that cannot support much debt. See Michael S. Knoll, Taxing Prometheus: How the Corporate Interest Deduction Discourages Innovation and Risk-Taking, 38 Vill. L. Rev. 1461 (1993). Once again, a better policy would be to eliminate the differential treatment of corporate debt and equity directly.
than other firms, they have a greater incentive to invest before they are subject to the AMT or after they come out of it.\textsuperscript{80} This encourages firms to change the timing of their investments. As described below, this time shifting is especially undesirable because of the cyclical effects of the corporate AMT.

Finally, because AMT liability is calculated on a consolidated basis, firms that expect to find themselves subject to the AMT have an incentive to merge with other firms. If the combined entity would not be subject to the AMT, but one of the two entities individually would, then the corporations have reduced their joint tax liability through the merger.\textsuperscript{81} This incentive is likely to be stronger in the case of conglomerate mergers because the incomes of the various businesses are likely to be uncorrelated. As a result, the constituent firms of a conglomerate can probably offset one another's tentative AMT liability. The investigation of the many tax-planning costs associated with mergers and their preparation is outside the scope of this paper. The important point here is that this cost and all of the other costs described in this Part arise because of the corporate AMT and not for an economically beneficial reason.

C. The Corporate AMT Increases Tax Compliance Costs

The corporate AMT complicates the tax system and makes compliance more costly. According to a 1995 survey of large corporations conducted by Joel Slemrod and Marsha Blumenthal, the tax compliance costs of firms subject to the corporate AMT are 18 to 26 percent higher than those of firms that are not subject to the tax.\textsuperscript{82} Most of the additional cost is derived from supplementary planning, record keeping, and form completion required by the minimum tax. For example, instead of calculating the amount of tax owed once, the corporate AMT requires each corporation that might potentially have to pay the tax to keep at least three sets of tax records: one for regular tax purposes, one for 'normal' AMTI calculations, and a third for the ACE adjustment. Within these three sets of tax books, each firm must keep as many as five sets of depreciation records.\textsuperscript{83}

The Slemrod and Blumenthal measure of the additional compliance costs of AMT firms does not precisely measure the cost of complying with the corporate AMT. There are two principal reasons for this.\textsuperscript{84} First, firms that are subject to the corporate AMT are likely to have more

\textsuperscript{80} Lyon, supra note 6, at 67-68.
\textsuperscript{81} This benefit exists whether the AMT firm eventually uses its credits or not, but the benefit of a merger is greater if the AMT firm would not have exhausted the credits because then there is a permanent reduction in tax from the merger. Alternatively, if the AMT firm would have eventually used the credits, then there is only a timing benefit from the merger.
\textsuperscript{82} See Slemrod & Blumenthal, supra note 55.
\textsuperscript{83} See Lyon, supra note 6; See also, Slemrod & Blumenthal, supra note 55, at 415.
\textsuperscript{84} Another reason is that the sample is not representative of firms subject to the corporate AMT.
complex tax situations and thus to have more complicated tax returns than those that are not. The former, for example, are likely to use more depreciable property in their businesses and to incur the additional cost of dealing with those rules. Even without a corporate AMT, such firms would likely have higher tax compliance costs than other firms. That would suggest that the Slemrod and Blumenthal measure overestimates the increased cost of complying with the corporate AMT.

Second, many companies that are not currently paying the corporate AMT still must make the required calculations and maintain the necessary records. In the Slemrod and Blumenthal survey, of the 365 respondents, 167 were currently subject to the AMT and 115 were not. Of the 115 firms that were not currently subject to the corporate AMT, 101 kept the necessary records and made the relevant corporate minimum tax calculations. That non-AMT firms must keep the records necessary to calculate the corporate AMT suggests that Slemrod and Blumenthal's estimate of the additional compliance costs incurred by AMT firms underestimates the total cost of complying with the corporate AMT.

Moreover, the underestimate might be very large. That is because the AMT-related compliance costs of firms that are not currently paying the AMT are not simply ignored. Indeed, when the Slemrod and Blumenthal number is used as an estimate of the cost of complying with the corporate AMT, then the AMT-related compliance costs of non-AMT firms reduces the estimated cost. That is because these costs are implicitly being treated as part of the cost of calculating the non-AMT firm's regular tax liability (and thus reducing the difference) when they are really part of the cost of complying with the AMT.85

However, given these caveats, if we use the Slemrod and Blumenthal numbers in connection with estimates of total corporate compliance costs, we can derive an estimate for the total compliance costs for the corporate AMT. The Tax Foundation estimates that the total annual cost to U.S. corporations of complying with the federal income tax is $40.3 billion.86 Multiplying the Tax Foundation's estimate of the total cost to U.S. corporations of complying with the federal income tax ($40.3 billion) and the estimate of the percentage of total corporate tax compliance costs that are due to the corporate AMT (18 to 26 percent) implies an estimated cost for complying with the corporate AMT of between $7.2 billion and $10.4 billion.87 This admittedly rough estimate of the cost of

85. An example might help to make this clearer. Assume the total tax compliance costs of a typical AMT firm are 100 and of a typical non-AMT firm are 70. This implies an estimated cost of complying with the corporate AMT of 30 (100 - 70). If, however, the AMT-related compliance costs of a typical non-AMT firm are 10, then the total cost of complying with the AMT is not 30, but 60 (100 + 10 - 60).
86. Barry, supra note 15, at 8. The estimate is for 1998.
87. A report by the Joint Committee on Taxation estimated that 16.9 percent of the total compliance cost of corporations was due to the corporate AMT. STAFF OF J. COMM. ON TAX’N, 106TH CONG., PRESENT LAW AND BACKGROUND RELATING TO THE MARRIAGE TAX PENALTY, EDUCATION TAX INCENTIVES, THE ALTERNATIVE MINIMUM TAX, AND EX-
complying with the corporate AMT is several times the revenue raised by the tax.

Indeed, since compliance costs are generally deductible, the net revenue raised by the corporate AMT might be very small and possibly negative. If compliance costs are as low as $6 billion annually and are deductible at a tax rate as low as the 20-percent statutory corporate AMT rate, the cost to the government in foregone tax revenue is $1.2 billion. That is, the corporate AMT would in fact not raise any revenue, but it would cause a revenue loss of approximately $200 million dollars a year.\(^8\)

Moreover, unlike the revenue raised by the corporate AMT, where there is an offsetting tax credit that will later disgorge much of the revenue raised, this is a permanent cost. Of course, this calculation is subject to the caveats described above, and therefore it could be significantly off the mark.

The Slemrod and Blumenthal survey provides further support for the claim that costs of complying with the corporate AMT are very high.\(^8\) Three hundred and fifteen of the 365 tax officers who responded to the survey provided a response to the question “what aspect of the current federal tax code was most responsible for the cost of complying with the tax system?” The two most frequently mentioned provisions were depreciation (118 responses) and the corporate AMT (115 responses).\(^9\) The third most frequently mentioned provision was the uniform capitalization (“UNICAP”) rules (85 responses) and the fourth was compliance with international or foreign taxes (44 responses).\(^9\)

The survey also asked “what features of the Tax Reform Act of 1986 most contributed to complexity?” The answer most often given was the corporate AMT, which was mentioned by more than half of the respondents.\(^9\) Specifically, of the 311 firms responding to the question, 189 mentioned the corporate AMT. The next most common response, with 138 mentions, were the UNICAP rules, which were also introduced by TRA 86.\(^9\)

Slemrod and Blumenthal also asked respondents to suggest reforms that would simplify compliance. Of the 256 respondents answering this question, 75 recommended greater uniformity between federal and state tax systems and 42 recommended greater uniformity between taxable income and financial accounting income.\(^9\) However, the current tax provision that drew the most criticism was the corporate AMT. Sixty-two respondents singled it out: 38 called for its elimination, 11 recommended

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\(^8\) The calculation in the text assumes that the corporate AMT actually will raise $1 billion a year. See supra text accompanying notes 11-14.

\(^9\) See Slemrod & Blumenthal, supra note 55.
it be simplified, and 13 proposed that the ACE adjustment be eliminated. In contrast, only 19 surveys mentioned the UNICAP rules and only 13 surveys mentioned the foreign tax credit.

Another indication of the high compliance costs associated with the corporate AMT is the amount of money that corporations spend each year filling out IRS paperwork. A Tax Foundation report based on IRS paperwork calculations, found that corporations spend 17.3 million hours filling out AMT-related tax forms. At a very conservative cost of $34.66 per hour, the Tax Foundation report estimated the cost of completing IRS-mandated AMT-related paperwork to be $600.1 million per year. This cost is roughly half of the tax revenue that the corporate AMT is expected to raise. Moreover, this calculation does not include a very large portion of the total cost of complying with the corporate AMT in that it does not include costs related to tax planning, record keeping, and establishing and maintaining separate accounting systems.

Recent studies of corporate minimum tax regimes in other countries yield similar results. India also imposes a corporate alternative minimum tax, and the literature on its effects indicates that, much like the U.S. tax, it raises little revenue, is very expensive, and severely distorts investment.

D. THE CORPORATE AMT IS POOR FISCAL POLICY

As a matter of fiscal policy, policy makers frequently desire to reduce taxes when the economy is in a slump and to increase taxes when the economy is in danger of overheating. The idea is that, by putting money into private hands during an economic downturn, the government can stimulate spending that will bring the economy out of a recession or possibly prevent one from occurring. Similarly, by removing money from the private sector when the economy is in danger of overheating, the government can help stave off an inflationary spiral. As economists generally recognize, the problem with using taxes as an instrument of fiscal policy is that it takes time to enact new tax policies and additional time for those policies to have their intended economic impact. Because of the delays in observing a problem, formulating a responsive tax policy, and

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95. Id.
96. Id.
97. See Hearings Before the House Comm. on Ways & Means, 107th Cong. (2001) (statement of Scott Moody on behalf of the Tax Foundation), available at http://waysandmeans.house.gov/legacy/oversite/107cong/7-17-01/107-40final.htm#moody (last visited Feb. 10, 2003). Actually this cost is more than half of the net revenue raised because the costs themselves are deductible from income. The effect of this deduction is not included in most revenue estimates and hence the amount of revenue raised is even less.
98. Id.
100. See id. at 436.
then waiting for that policy to have an impact, many economists are skeptical of the use of targeted tax policy as an instrument of fiscal policy.\textsuperscript{102} In contrast, many economists view tax polices that automatically decrease revenues when the economy slows and increase collections as it grows as tending to stabilize the economy. Thus, flat or progressive taxes as opposed to head taxes are often viewed as fiscally prudent because collections decrease during recessions and increase during booms. The corporate AMT, however, works in exactly the opposite direction. Because more firms are subject to the AMT (and fewer firms are utilizing their credits) during economic downturns than during periods of growth, the corporate AMT increases collections during recessions and decreases them during booms. That reduces the stabilizing effect of the corporate tax, artificially accentuating natural market cycles and thereby tending to destabilize the economy.\textsuperscript{103}

As an instrument of fiscal policy, the corporate AMT does more than take money out of private hands during recessions. It also tends to discourage corporations from investing in new plant and equipment.\textsuperscript{104} Corporations are pushed into the AMT during recessions because their incomes fall. Because firms subject to the AMT have higher hurdle rates for many kinds of investment than firms subject to the regular income tax, the AMT discourages firms from investing during recessions.\textsuperscript{105} Because increased investment is one road out of recession, the corporate AMT has the undesirable effect of making such increased investment and economic recovery less likely.

IV. ALTERNATIVES TO THE CORPORATE AMT AND TRANSITIONAL ISSUES

In this article, we have argued that the corporate AMT distorts investment; that it raises little, if any, revenue; that it imposes large compliance costs; and that it does not advance any legitimate policy goals. In short, it is a bad policy. Therefore, the most logical response is that the corporate AMT should be repealed. There are, however, two hurdles to repeal of the tax. The first is determining how the existing stock of corporate AMT credits should be treated. The second is determining how the abuses that defenders of the corporate AMT believe it can discourage should be addressed.

A. THE TREATMENT OF EXISTING STOCK OF AMT CREDITS

In the seventeen years since its enactment, there have been many calls

\textsuperscript{102} See id. at 553.
\textsuperscript{103} Although the corporate AMT tends to accentuate market cycles, the magnitude of this effect is likely small because the corporate AMT raises little revenue. See supra text accompanying note 13.
\textsuperscript{104} Lyon, supra note 6.
\textsuperscript{105} See discussion supra Part III.B; see also Lyon, supra note 6, at 118-19.
for repeal of the corporate AMT. 106 Until 2001, none of those calls ever resulted in legislation that passed either house of Congress. In October 2001, the House of Representatives passed, as part of a broad economic stimulus package, a provision that would have repealed the corporate AMT. 107 The Senate, however, did not follow suit when it considered its own version of the stimulus bill. 108 Unfortunately, debate over repeal of the AMT was derailed over the issue of what should be done with the outstanding stock of AMT credits. This Part looks at alternative ways of treating the outstanding AMT credits if the minimum tax is repealed.

1. Cash Out Corporate AMT Credits at Full Value

The solution favored by House Republicans as well as corporations with unused AMT credits was that those credits should be cashed out at the time of repeal at full value. According to the Congressional Budget Office, that would have cost the Treasury $25.4 billion, all in fiscal year 2002. 109 House Republicans defended their proposal as an important part of an economic stimulus package needed to restart the economy after the September 11 attacks. However, even their allies conceded that the plan was politically untenable in the face of a barrage of attacks as a corporate give-away. In addition, even among those who favored tax cuts as a stimulus, it was never clear why AMT corporations should be the direct recipients of such a large portion of any stimulus package.

There were, however, other arguments for cashing out the credits. The minimum tax is intended not to increase corporate tax collections permanently, but merely to accelerate them. That is why firms are granted credits for the excess minimum tax they paid. Thus, even with a lump-sum payback, the federal government still had the benefit of a $25.4 billion interest-free loan from AMT companies. Viewed from this perspective, cashing out the credits immediately and at full value is not a corporate give-away, but merely the return of funds that companies were forced to loan to the government at zero interest.

2. Eliminate AMT Credits Without Compensation

At the other end of the spectrum, the federal government can eliminate the credits without making any payments. The government can take the position that the credits should expire with the tax. There are several problems with this solution. It changes past AMT payments from tax accelerations into permanent tax increases. It would also make some

106. See supra note 1.
108. In December 2001, the President removed repeal of the corporate AMT from the agenda in an ultimately unsuccessful attempt to get other provisions of the bill through Congress. Id.
109. The largest benefactors would have been Ford Motor ($2.3 billion), IBM ($1.4 billion), General Motors ($832 Million), and General Electric ($671 Million). Congressional Research Service, Memorandum to the House Ways and Means Committee, October 16, 2001, reprinted in 2001 TAX NOTES TODAY 206-19 (2001).
firms worse off with repeal. Nonetheless, proponents of this position could argue that these costs are one-time costs and so there would be no efficiency loss from their elimination. Proponents of that view could also point out that there are frequently winners and losers from changes in government tax policy. Nonetheless, such a blatant elimination of the value of the existing stock of tax credits raises the possibility of future government retroactive increases. That is widely thought to be a bad idea.

3. Continue AMT Credits on Same Terms

For many firms, their credits were likely worth less than their face value. That is because they could not have used them all immediately. And for firms that would have never be able to use their credits, they were worthless. The federal government would have therefore provided a windfall to many companies by cashing out their credits immediately and at full value. It is also true that canceling the credits without any compensation would produce a windfall to the federal government at the expense of firms with AMT credits.

One possible compromise between the two polar positions would be for firms with unused AMT credits to continue calculating their AMT liabilities, but only for the purpose of determining the amount of AMT credits they can take. If their AMT liability exceeds their regular tax liability, they cannot use any credits. If their regular tax liability exceeds their AMT liability, they can use their credits, but only to bring their liability down to what it would have been with the minimum tax. Such a compromise eliminates the corporate AMT for the future, but it allows credits to be retired only as fast as they would have been retired with the AMT. Furthermore, the high compliance costs of the corporate AMT, described above, would not be entirely eliminated. They would continue for firms with AMT credits until all the credits have been used up.

4. Cash Out AMT Credits at Reduced Value

The previous alternative would have maintained the current law’s tax treatment with respect to the outstanding stock of AMT credits, thereby avoiding windfall gains or losses. It is possible to maintain the value of outstanding credits at roughly their current value without forcing AMT firms to go through the trouble and expense of maintaining the necessary records and calculating their AMTI. Instead, the law could provide one or more simple formulae for using the credits that in aggregate would be

111. Id. at 27-32 (arguing that there is no such thing as a one-time tax because taxpayers know the government can again impose a one-time tax).
112. That windfall was probably not close to the $25.4 billion price tag because many of the credits would have been used eventually.
designed to maintain the credits at their current value. There are several reasonable alternatives possible.

Congress could choose a set number of years that corresponds to how the credits were likely to be used (e.g. credits cashed in ratably over three, five, or ten years) or they could allow the credits to be used up to a fixed percentage of each corporation's tax liability (e.g., use the credits to offset up to 10, 25 or 50 percent of corporate income tax) or they could have cashed out the credits at a given fraction of their face value (e.g., 20, 40, or 75 percent).\textsuperscript{113} All of these compromises would allow the corporate AMT to be eliminated without providing a windfall to either taxpayers (as a group) or the federal government from the existing stock of credits.

B. Addressing the Concerns that are Preserving the Corporate AMT

We have argued in this article that the corporate AMT is bad policy and should be repealed. We believe that it should be eliminated even if there are no other changes to the tax law. We recognize, however, that in the current environment that might be politically infeasible. Accordingly, in this Part, we briefly discuss two proposals that would do a better job of raising taxes on corporate income and restraining tax sheltering (and perhaps also discouraging firms from inflating their book income) than does the minimum tax.

1. Reduce Tax Preferences

As discussed earlier, some defenders of the corporate AMT argue that the minimum tax should be preserved because it increases taxes on corporations and discourages investment in tax preferred assets.\textsuperscript{114} As shown earlier, the corporate AMT is a very costly way to raise revenue (which it might not even do) or to discourage inefficient investment.\textsuperscript{115} A simple way to raise taxes on corporations without imposing additional compliance costs or causing new distortions is to raise tax rates. The $1 billion that the corporate AMT raises annually (ignoring the deductions corporations take for the cost of complying with the tax) could be replaced by a small increase in the tax rate. The federal corporate income tax, with a top bracket of 35%, raises roughly $200 billion a year.\textsuperscript{116} Thus, an increase in corporate tax rates of 0.2%, with a top bracket of 35.2%, will increase corporate tax revenues by roughly $1 billion.

An even better response would be to reduce tax preferences.\textsuperscript{117} That

\begin{itemize}
  \item \textsuperscript{113} We have made no attempt to estimate actual revenue neutral formulae.
  \item \textsuperscript{114} See supra Part II.
  \item \textsuperscript{115} See supra Part III.
  \item \textsuperscript{116} See supra text accompanying note 14.
  \item \textsuperscript{117} If the tax rules provide too much encouragement for a particular type of investment, the simplest and most logical way to address the problem is to reduce the tax benefit directly by amending the law. For example, if Congress believes that the depreciation rules are too favorable, they should flatten out depreciation or lengthen depreciable lives. Con-
would not only raise revenue without increasing compliance costs. It would also reduce distortions.\textsuperscript{118} This can be illustrated using accelerated depreciation as an example. The most recent tax expenditure budget estimates that accelerated depreciation (depreciation in excess of straight-line) costs the Treasury over $31.62 billion a year.\textsuperscript{119} To pay for the repeal of the corporate AMT, Congress could reduce the excess of currently allowable depreciation over straight-line depreciation by about 3%. This small change would not only fund repeal of the corporate AMT, but it is generally thought that it would also improve investment allocation by reducing inefficient investment.\textsuperscript{120}

2. \textit{Better Disclosure of Tax Information}

Currently, public companies are required to reveal their provisions for taxes.\textsuperscript{121} From the information disclosed in public financial statements, it can be quite difficult to determine the actual amount of taxes paid.\textsuperscript{122} The numbers derived from financial statements by Citizens for Tax Justice and similar groups are to some extent guesswork; this allows corporations to say those numbers are inaccurate (which even if they are close, are still not exact).\textsuperscript{123} Whereas if the corporations themselves report these numbers, such a response would no longer be possible. If public corporations were forced to reveal the total amount of U.S. tax paid, and what their taxable income was, they would very likely in many cases decide to arrange their affairs so as to pay some substantial tax liability, in order to avoid a potential public relations disaster.\textsuperscript{124} Alternatively, if they feel they have good reasons for the small amount of tax paid, they can provide explanatory notes in their annual reports to explain why their tax income was so low, and why it was so much lower than their book in-


\textsuperscript{121} McGill & Outslay, \textit{supra} note 5.

\textsuperscript{122} Id. at 1130-31 (describing why the current portion of the income tax provision is not equivalent to taxes actually paid in the current year).

\textsuperscript{123} McINTYRE \& NGUYEN, \textit{supra} note 2. These numbers are questionable for another reason. Comparing an estimate of the firm’s actual tax payments and its book income for the year misrepresents its tax burden for two reasons. First, it ignores implicit taxes—reductions in the firm’s income from investing in tax-preferred assets (e.g., municipal bonds) rather than fully taxable assets (e.g., corporate bonds). Second, it ignores deferral taxes—taxes that the firm will pay in the future on income that is reported today on the financial statements, but is reported in the future on the firm’s tax returns. Because financial statements generally use straight-line depreciation, whereas the tax returns generally use accelerated depreciation, these temporary differences can be substantial for growing firms.

\textsuperscript{124} See Pearlman, \textit{supra} note 9.
come. It is quite possible that more transparent tax disclosures would raise more revenue than the corporate AMT.

Moreover, given the efforts to which the managements of Enron and WorldCom went to convince shareholders that they were paying substantial amounts of tax, this information clearly has some value to shareholders. More comprehensive and understandable tax disclosures might have given the shareholders of Enron and WorldCom a “heads-up” that something was amiss in the financial statements. Requiring such disclosures might have prevented the scandals by leading the responsible parties to believe that they would not have escaped detection long enough to profit.

Of course, care would have to be taken not to require disclosure of strategically important items such as transfer pricing strategies and other internal corporate matters. But better disclosure of aggregate tax numbers, such as total U.S. tax paid (rather than simply the reserves for tax, etc.) and the taxable income of public corporations, would give investors a better idea of what is going on in the corporation. Furthermore, this information would give policy analysts more information with which to base their analyses and conclusions.

V. CONCLUSION

Congress should repeal the corporate AMT. The corporate AMT does not advance any legitimate purpose—it does not increase efficiency or improve fairness in any meaningful way nor does it restrain tax sheltering or aggressive accounting. It raises little, if any, money for the government—net collections are roughly $1 billion a year going forward, but these collections are offset by the deductibility of tax compliance and planning costs. It imposes heavy compliance costs (likely several times its collections) and it distorts investment, encouraging firms to cut back or shift their investments.

125. McGill & Outslay, supra note 5.
126. In Corporate Income Taxes In the 1990s, McIntyre and Nguyen argued that corporations should also report such information as tax before credits, the effects of carrybacks and carryforwards, and the differences between book income and income for tax purposes. See McIntyre & Nguyen, supra note 2.