Alternative minimum tax, corporate
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A complex tax (either federal or state) designed to increase the income tax on businesses that the legislature believes pay too little relative to “standard” rules of taxation.

Overview
Minimum taxes are intended to increase tax payments from taxpayers who, under the rules of the regular tax system, are believed to pay too little tax relative to a more standard measure of their income. The U.S. federal income tax has both a personal and a corporate alternative minimum tax (AMT). Standard rules of business income taxation call for the recognition of income as it accrues, that is, at its receipt or when all events have occurred that fix the right to receive the income, whichever comes first. Deductions are permitted only when definite liabilities have been incurred. These standard rules are strongly influenced by (but differ somewhat from) both financial accounting practices and economic principles of income measurement. (Note that both standard rules and regular tax rules depart from economic measures of income by not allowing a deduction for the opportunity cost of equity-financed capital. The standard rules, as embodied in the AMT, additionally depart from economic principles by making little or no attempt to adjust measured income for the effects of inflation. The regular tax system gives some consideration for inflation through accelerated depreciation for equipment and valuation rules for inventory.)

Rules of the regular tax system make many departures from the standard rules, in a manner that generally results in a lower measure of income. The motives for these departures—or tax preferences—may may include an aim for simplicity, an incentive for certain activities, political influence, or better accounting for other economic factors such as inflation.

Corporate and individual minimum taxes were first put into the U.S. tax code in 1969. Initially, the minimum tax functioned much like an excise tax on specified tax preferences in excess of some fixed amount. As part of the Tax Reform Act of 1986, the corporate minimum tax was significantly modified to cover a much broader range of preferences and is now called the alternative minimum tax. It is an alternative tax because the rules for this minimum tax constitute a complete, alternative set of rules to the regular tax system. It is a minimum tax because a corporation must pay the larger of its AMT or its regular tax liabilities.

AMT calculation
The AMT has its own rules for the measurement of income and deductions, and it has separate tax rates. While closely following the rules of the regular system, the AMT has a broader definition of income and a less generous set of deductions. Further, most business tax credits, such as the credit for research and experimentation, cannot be used to reduce tax payments under the AMT.

Given the larger measure of taxable net income under the AMT, practically all corporations would pay AMT were it not for the fact that the tax rate under the AMT is lower than the maximum tax rate under the regular tax system. The tax rate under the AMT is 20 percent, while the average tax rate under the regular tax system is about 34 percent for firms with more than $100,000 of income. Because the regular tax rate is 70 percent higher than the AMT rate, a firm’s income must be at least 70 percent greater under the AMT before it must make payments under this system. It might at first appear that such a significant percentage change in net income would require that the AMT use tremendously different measures of includable income or allowable deductions relative to the regular tax system. But for the typical manufacturing firm, gross receipts and deductions are 10 to 20 times larger than its net income. A 5 to 10 percent change in includable receipts or allowable deductions is sufficient to create an AMT liability.

The starting point for the determination of income for AMT purposes is the corporation’s regular taxable income. Regular taxable income is modified by a series of additional computations, termed adjustments and preferences. Adjustments can either increase or decrease taxable income, whereas preferences are calculated on a property-by-property basis and only enter to the extent that they are positive. Adjustments include a portion of accelerated depreciation on buildings and equipment, amortization of pollution control facilities, mining exploration and development expenses, income reported under the completed contract method of accounting, and installment sales income.

Preferences include percentage depletion, intangible drilling costs, bad debt deductions of financial institutions, and interest on certain bonds that would otherwise be tax-exempt. Between 1987 and 1989, an additional preference was one-half the amount by which a corporation’s book income (with certain modifications) exceeded its taxable income for
AMT purposes. This preference was enacted as an explicitly temporary measure and was replaced in 1990 with an alternative measure of income, adjusted current earnings. Since 1990, 75 percent of the difference between adjusted current earnings and the firm’s taxable income for AMT purposes is included in income.

AMT income may effectively be reduced by up to 90 percent through net operating losses and foreign tax credits, both of which are recalculated using AMT principles. The 20 percent tax rate is applied to this measure of income, yielding tentative minimum tax, and this amount is compared to the firm’s regular tax liability before all credits except the foreign tax credit. If the tentative minimum tax is larger, the firm pays the excess as AMT, in addition to its regular tax liability. If the firm’s regular tax liability exceeds its tentative minimum tax, it may further reduce its regular tax by allowable business credits, but generally not below its tentative minimum tax. For firms with large amounts of business credits, such as the credit for research and experimentation, the AMT may serve to increase the firm’s tax liability by delaying the use of these credits even if the firm pays no AMT.

A major element of the increase in tax liability under the AMT involves differences in the timing of deductions. Because firms may switch between the AMT and the regular tax, a system of credits for taxes paid under the AMT and adjustments to the basis of depreciated property is needed to prevent the AMT from collecting taxes in excess of the value of the timing preference. The tax credit for AMT payments can only be used to offset future regular tax liability. Further, it may not be used to reduce regular tax payments below the tentative minimum tax (the same floor that limits the use of most business tax credits). A firm that pays AMT and eventually claims all of its AMT credits will have the same total tax liability over this period as it would have had in the absence of the AMT. Because the AMT credits are taken after the firm’s AMT payments, however, the AMT has resulted in an acceleration of tax payments. The cost to the firm of this acceleration is the forgone earnings on these funds. If a firm must wait a long time before claiming its AMT credits, this cost may be a sizable fraction of the AMT payment. Calculations indicate that firms undertaking investment in equipment while temporarily subject to the AMT generally face a higher cost of capital than firms on the regular tax (Lyon 1990). Interestingly, firms that are presently on the regular tax and are anticipating a short period of AMT liability in the future may face increased investment incentives as a result of the tax.

### AMT revenues

Between 1987 and 1992, AMT revenues were between $2.7 billion and $8.6 billion (1992 dollars), or between 3 and 9 percent of the regular tax revenues collected in those years. AMT credits claimed over this period were about one-fifth of the AMT paid (U.S. General Accounting Office 1995).

In each year between 1987 and 1992, firms paying AMT represented only 1 to 2 percent of all corporations. AMT incidence was much more likely, however, for larger firms. Approximately 20 to 30 percent of firms with assets in excess of $250 million paid AMT each year between 1987 and 1992. The General Accounting Office (GAO) has estimated that, among a sample of corporations with assets in excess of $50 million, 49 percent paid AMT in at least one year between 1987 and 1991. Firms paying AMT in at least one year accounted for nearly two-thirds of the corporate assets in the GAO sample.

A 1993 legislative modification to the calculation of the AMT is expected to reduce the future incidence of the AMT to some degree. A much more significant change was enacted in 1997, which substantially narrowed the differences between regular and AMT depreciation by equating recovery periods.

### Why an AMT?

The existence of the minimum tax appears to be an inconsistency in the formulation of tax law. One part of the tax system gives special deductions, exclusions, and incentives, and another part of the tax system takes them away (Graetz and Sunley 1988). Why, then, a minimum tax?

Some analysts believe the minimum tax is an appropriate “second-best” method to reduce the magnitude of deviations from economic measures of income if political constraints prevent their direct elimination. Corporations for which income measured under the minimum tax differs greatly from income measured under the regular tax are likely to pay minimum tax. Taxable income under the minimum tax, however, is not the same as economic income. Further, because a firm undertaking a tax-preferred activity can still avoid the minimum tax if the firm additionally undertakes other activities without such preferences, tax-preferred activities will still attract investment. If one desires, for reasons of efficiency, to limit the amount of the economy’s resources devoted to a given tax-preferred activity, the minimum tax will not be as effective as a direct reduction in the tax preference for that activity.
Others argue that the minimum tax does just what it is supposed to do. It allows tax policy to meet two social objectives: providing tax incentives to encourage particular activities and ensuring, for reasons of fairness, that corporations with positive incomes pay at least some tax. Of course, ultimately corporate taxes are borne by people, and the fact that a given corporation pays a low rate of tax may not have implications for equity among individuals. If the fairness concern is that individuals who earn income from certain corporate activities pay too little tax on this income, this directly conflicts with the assumed objective of encouraging the activity through a tax preference.

Additional readings

Cross references: adjusted current earnings; alternative minimum tax, personal; capital cost recovery; cost of capital; income tax, corporate, federal; taxable income, corporate.