

PRESIDENT'S ADVISORY

PANEL
ON FEDERAL TAX REFORM

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The Alternative Minimum Tax

Chairman Connie Mack III
The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue N.W.
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Washington, D.C. 20220

Dear Chairman Connie Mack:

As a tax professional whose career spans more than three decades, including U. S. Treasury and Tax Court service, and a nationally recognized Alternative Minimum Tax expert (see the enclosed AMT Book) who has spoken on National Public Radio and other media on the AMT, I respectfully offer the following comments.

I realize that there is very little likelihood that the AMT will be repealed given its significant tax revenue source. I am not suggesting that it be totally repealed. However, I do believe that the following AMT reforms will make it far more equitable and both vertically and horizontally fair to the American individual taxpayer. I am not addressing the corporate AMT.

Here are the specific proposals for AMT revision:

1. First and foremost, index the AMT (as espoused by various studies and groups, including the Congressional Joint Economic Committee Study, chaired by Jim Saxton in May, 2001). Since inflation erodes the value of the individual AMT exemption, the number of taxpayers subject to it would be significantly less than predicted by the Tax Policy Center.
2. Make permanent the AMT exemption. While indexing the AMT will initially reduce the number of persons subject to it, the AMT exemptions (\$58,000 for married couples filing jointly and \$40,250 for unmarried filers) that are scheduled

to expire will still present a problem if they revert to pre-2001 levels (\$45,000 and \$33,750, respectively). Making the AMT individual exemptions permanent would significantly reduce the number of taxpayers subject to it from 29 million to 5 million in 2010 based on Congressional Budget Office estimates in 2004.

3. Simplify the AMT. Albert Einstein once said “the hardest thing in the world to understand is the income tax”. More so with the AMT. Complexity in computing a crossover point (where the tentative minimum tax equals the regular tax), load up factors (loading up the AMTI with any adjustments or items), the tax credits (refundable, nonrefundable and the minimum tax credit) all drive an overly complex system. As one who has lectured on the AMT to practicing CPAs and tax lawyers in continuing professional education conferences, it is frightening to discover how few thoroughly understand its nuances.

It is also fallacious to assume that tax software – written by software specialists who are advised by tax professionals – will save the day. Witness the many AMT software changes to existing popular application programs.

How to simplify? I propose the following for the AMT:

- a) Allow the standard deduction. Those taxpayers who choose not to itemize are largely economically disproportionate in our society. Non home owners, retirees whose home is fully paid, and struggling hybrid and traditional families all opt for the standard deduction (which is indexed for inflation). Allowing it ensures uniformity and enhanced fairness.

- b) Allow personal and dependent exemptions. The AMT is not tax neutral at present. It disproportionately impacts taxpayers who choose a larger family by denying the personal and dependent exemptions.

Consider the case of Klaassen v. Commissioner, T.C. Memo 1998-241. Therein the taxpayers opposed birth control and abortion and were blessed with 13 children. On their Form 1040 they legitimately claimed their personal and dependent exemptions – all of which were denied for AMT purposes resulting in an increased tax liability. While the Klaassens may be an extreme case, nevertheless, their situation illustrates the disproportionate and overly complex treatment in the present AMT.

- c) Allow state and local income and property taxes. Once again, the present AMT impacts taxpayers in high tax states disproportionately. In numerous radio interviews across this great country, I am asked one question consistently: why is a taxpayer not allowed to deduct for the AMT his state and local income and real property taxes? Also, with many jurisdictions experiencing rising real estate values, the real property taxes tend to rise. Such a result produces an AMT problem for millions of taxpayers based largely on their situs.
- d) Allow medical expenses as under the regular tax. Since taxpayers may deduct unreimbursed medical expenses to the extent they exceed 7.5 percent of AGI (but only to the extent they exceed 10 percent of AGI for AMT purposes), an additional computational burden, ensuring added complexity, is evident.

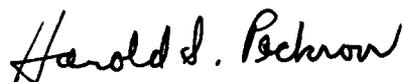
But of greater concern is fairness, particularly for the elderly.

Taxpayers who are unable to participate in tax-advantaged health savings plans (e.g. health savings account plans) are penalized by the current AMT.

Those taxpayers who do participate – the salaried employees – are reimbursed for medical expenses on a tax-free basis. Thus, these taxpayers avoid the medical expense deduction limitations and they further reduce their AGI which reduces the regular and AMT tax bases. The AMT floor then only applies to those taxpayers who cannot avail themselves of these plans and is, again, an overly complex and inequitable treatment.

Conclusion: In conclusion, the preceding proposals, while reducing the federal tax revenues, will provide the American taxpayer with greater equity, simplicity and confidence in an alternative tax system that is more reflective of reality in the 21st century.

Respectfully submitted,

A handwritten signature in cursive script that reads "Harold S. Peckron".

Dr. Harold S. Peckron