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BOOK REVIEW

Cracking the Code: Making Sense of the Corporate Alternative Minimum Tax. By ANDREW B. LYON. Washington, D.C.: The Brookings Institution, 1997. Pp. 156.

It is rare that an entire book can be devoted to a narrow aspect of the tax code, but such an investment is important to understand the political and legislative history of the corporate Alternative Minimum Tax (AMT), the changes in the current AMT since its enactment in 1986, and the various effects of this provision. The AMT was born out of compromise and exists to satisfy a political notion of fairness that has persisted for more than a decade: that corporations, for whatever reason, should generally not go untaxed in any particular year. For such a narrowly stated objective, there is little foundation that this alone should be an important criterion in the design of an efficient tax system, yet there remains broad public support for such a tax, based at least in part on a lack of understanding of tax incidence and the sometime purposeful exploitation of that lack of knowledge for political gain. In a world of better understanding of the economics of taxation, there would be no need for an AMT, but there would also be a much different regular tax code in effect—one which would not contain many of the best arguments used to support the existence of a minimum tax.

The AMT is unlike many other parts of the tax code in that it is not as easily isolated from all other provisions affecting corporations. To fully understand the AMT, its structure, and its effects requires one to begin with at least a general understanding of corporate taxation, be sensitive to the interactions between provisions that are often buried beneath the surface, and have some familiarity with financial accounting. It is no wonder that the AMT has attracted the attention of a broad array of researchers from a number of different disciplines—economics, accounting, finance, and law—who have found within its structure and intent a large number of policy and behavioral issues to examine.

Success in explaining what has often been characterized as one of the most complicated aspects of the tax code in a manner that might be accessible to an educated lay reader is by no means easily attained. Lyon's approach is direct and sufficiently comprehensive for this goal: present and analyze the reasons given for the existence of the tax, explain its structure (in a chapter and appendix not for the faint of heart or to

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be left for casual reading), identify the significance of the AMT and some of the specific economic effects of concern (along with new empirical results), and then make recommendations for improvement.

Lyon uses the traditional benchmarks of equity, efficiency, and administrability to frame the debate over the AMT, and devotes chapters or discussions to each of these issues. He is neither a new nor a neutral observer: this book is a clear outgrowth of much thought over a period of time. In addition to his legislative experience during the Tax Reform Act of 1986, and his subsequent research on the AMT, Lyon brings an extensive use of (proprietary) corporate tax return data to this book and to the discussions. Such data have not been widely used in academic research (especially in the corporate area where there is nothing comparable to the public-use individual tax return files). While being able to employ better data is always desirable, in this case, it is absolutely essential given the lack of useful tax information regarding the effects of the AMT on firms' financial statements.

Lyon is clearly not a supporter of the AMT, but his basis for criticism and suggestions for reform come from his understanding of the tax and his extensive research in the area. This is an academic approach to policy research that recognizes the importance of non-economic objectives in tax policy. Lyon's conclusion, that the fairness objectives of the AMT are not large enough to outweigh the economic costs it imposes and that other approaches to these concerns (primarily through the regular tax) would be more effective, is based upon careful study and persuasively argued.

The contributions of the book are Lyon's discussion of the AMT and its role in the tax system, the significance of the AMT among corporate taxpayers, and the effects of the AMT on investment. The data presented on AMT firms are extensive and informative, with numerous tables showing how many firms pay the AMT over time, by industry, by tax status, and a number of other groupings. At this point, some disclosure is in order: I had commented on a draft of this book prior to its publication, and lightly reread the book when it was released. Yet, even the third time through this material I found Chapter Six's tables interesting—a result, no doubt, of this being the only place one will ever be able to see such tabulations of nonpublic tax returns.

At the heart of Lyon's concern over the AMT are its effects on investment incentives and the potential negative effects this may have on the economy. This, of course, is an empirical issue, and handled as such in the book in two ways: first, through simulations of the effects of the AMT on hypothetical firms' cost of capital, and then through estimation of an investment model. The ability to estimate such a model is dependent on the data available to him, and Lyon is able to bridge the gap between investment theory and its usual empirical application by merging tax return data with that of the firms' financial statements. Only through such a match can firm-specific tax information be properly and separately measured and then included in a regression with financial and market-based information (such as is necessary to compute Tobin's *q*).

The arguments against an AMT, while including the potential effects on the country's capital stock, are in no way dependent upon there being proof of a decline in investment. However, given all of this attention to data and modeling,

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especially the detailed simulations of the effect of the AMT on firms' cost of capital in chapter 5, the empirical results, while statistically significant, are less than overwhelming. Lyon's conclusion that the AMT has reduced manufacturing firms' investment is based upon a dummy variable in a panel regression of whether firms were on the AMT in the prior period. His estimate that the AMT may have reduced investment by five percent is plausible when compared to his previous calculations of the effect of the AMT on firms' cost of capital and elasticities drawn from the literature.

Other aspects of inquiry are not pursued. For example, the extent to which firms were on the AMT or the reasons a firm may find itself on the AMT are lost in such a specification and are certainly worthy of more detailed analysis. A manufacturing firm on the AMT due to the book income preference would likely act differently than one affected by other adjustments and preferences. Further, while the AMT is portrayed as targeting specific kinds of investment, or particular types of industries, results of more disaggregated models are not presented. Such empirical analysis may well be defined as beyond the scope of this book (and will be a welcome addition to the literature in the future), but an opportunity to explore and discuss these issues has been lost.

In addition to further empirical tests, some additional discussion could have been provided to place the debate over the role of a minimum tax in better context. The United States is not alone in the world in imposing a minimum tax, and it would have been interesting to read about those systems and Lyon's opinion on their relative merits. One such approach, in stark contrast to the U.S. AMT, would be those countries that levy their minimum taxes on an asset base.

While the AMT is arguably unique in its structure and role, after reading this book, one is left to wonder if any provision of the tax code could survive similar scrutiny. As a result, this book, like many other studies, adds to the arguments in favor of a comprehensive reexamination and restructuring of the U.S. corporate tax system. Lyon suggests a number of opportunities for improvement, not only regarding the AMT, but also of the regular tax system and the provisions which give rise to it.

Given the changes to the AMT from the 1997 tax bill, and the continued calls for its outright repeal by many members of Congress, legislative actions may well require this book to be reclassified as economic history. Such actions would not affect the relevance of this book. The AMT has served as a focal point for both sides of the political spectrum on tax policy issues, with the advantages identified by one side labeled as vices by the other. This book may not change the views of anyone with a strong opinion regarding the AMT, but it can serve to raise the level of debate and remove a number of arguments that cloud the discussion. While this book should obviously be read by anyone with an interest in the AMT, its usefulness goes well beyond that provision. This is a book that deserves to be read and on the shelf of anyone with an interest in tax policy or who wants a better understanding of how policy develops.

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