

# AMT: Always More Tax

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## Summary

AMT is the quagmire that ensnares ever more unsuspecting taxpayers year after year. Beginning with a review of the legislative history, this course will examine the efficacy and the rationale behind the tax that everyone loves to hate and will attempt to predict its future viability. With an emphasis on the mechanics, topics covered will include tax preference items, tax deferrals and adjustments, exemptions and credits.

*The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.*

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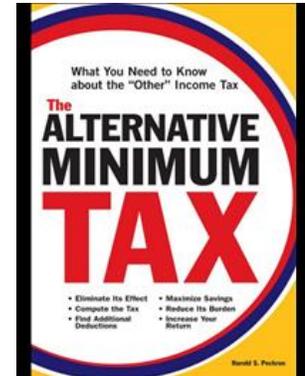
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## I. Introduction

The Alternative Minimum Tax (AMT) is a legislative quagmire that ensnares ever more unsuspecting taxpayers year after year. Introduced more than 40 years ago, AMT was intended to make the U.S. income tax system more equitable. Throughout the years, this tax has been heavily modified and has evolved into an overwhelmingly complex parallel system with which many taxpayers must struggle to comply.



While the average taxpayer knows of his filing responsibilities and files his returns with at least a minimal understanding of the Internal Revenue Code as applicable to his **Form 1040**, he is often unaware of his obligation to comply with the AMT. **Form 6251 Alternative Minimum Tax – Individuals** instructions as published by the Internal Revenue Service (IRS) require that all taxpayers complete this two-page puzzler, but only submit the completed form if in fact AMT is owed.

*Use **Form 6251** to figure the amount, if any, of your alternative minimum tax (AMT). The AMT applies to taxpayers who have certain types of income that receive favorable treatment, or who qualify for certain deductions, under the tax law...Attach **Form 6251** to your return if any of the following statements is true: **Form 6251**, line 31, is greater than line 34; You claim any general business credit, the qualified electric vehicle credit, the non-conventional source fuel credit, or the credit for prior year minimum tax; The total of **Form 6251**, lines 8 through 27, is negative and line 31 would be greater than line 34 if you did not take into account lines 8 through 27.<sup>1</sup>*

In the past, only select taxpayers have owed the tax and were required to file the AMT form. However, the Joint Committee on Taxation projects that nearly two million low-income taxpayers will soon have to prepare **Form 6251**, if only to prove that they do not owe AMT.<sup>2</sup> As a result, taxpayers—ignorant of and non-compliant with the AMT rules—dodge a bullet. Yet due to continuing modifications to the system and a lack of inflation-indexing, ever more taxpayers will become subject to the AMT, which in turn will impose increasingly complex filing requirements upon even some moderate-income earners. Hence, a tax once designed to establish a measure of equity between taxpayers of differing financial means, now applies to taxpayers of nearly every income strata. It has become a stealth tax that simply is not fair!

Public clamor for fairness may ultimately prevail and dictate further modifications or eventual elimination of the AMT. In fact, tax reform proposals currently under consideration in Congress include measures that will effectively raise the regular tax to offset revenues foregone under a disappearing AMT.

<sup>1</sup> As excerpted from the Department of Treasury, Internal Revenue Service *2005 Instructions for Form 6251, Alternative Minimum Tax—Individuals*.

<sup>2</sup> *National Taxpayer Advocate, 2003 Annual Report to Congress*, Department of Treasury, Pub. 2104 (Dec. 31, 2003)

## II. Legislative History

In 1969 Joseph Bar, Secretary of the U.S. Treasury reported to the Joint Economic Committee that 155 individual taxpayers with incomes in excess of \$200,000 did not pay federal income tax on their 1967 tax returns.<sup>3</sup> The public was outraged. Congress received more letters about this perceived unfairness than about the Vietnam War!<sup>4</sup> In response, the Tax Reform Act of 1969<sup>5</sup> created an add-on tax of 10% designed to trap these “evaders.” But by 1974, the U.S. Treasury reported that 244 high-income earners still had no tax liability.

The Tax Reform Act of 1976<sup>6</sup> sought to correct the inequity by reducing the applicable exemption. Initially set at \$30,000, only taxpayers with AMT-taxable income above the exemption amount were subject to a tax rate of 10%. With the new rules in place, income in excess of \$10,000 was subject to a rate of 15%.

Further changes mandated by the Revenue Act of 1978<sup>7</sup> and the Economic Recovery Tax Act of 1981<sup>8</sup> added taxpayers to the AMT tax rolls. While exemption amounts for regular tax purposes were indexed for inflation, AMT exemptions remained constant. The Tax Equity and Fiscal Responsibility Act of 1982<sup>9</sup> set those exemption amounts at \$30,000 for Single (S) and \$40,000 for Married-Filing-Jointly (MFJ) taxpayers. The AMT rate was set at a flat 20%.

Soon tax preference items were added. Identified as sources of potentially excessive tax savings under the regular system, preference items are those which are disallowed for AMT computation purposes. The introduction of these preferences quadrupled both the number of affected taxpayers as well as the revenue raised.<sup>10</sup>

Having found such a lucrative method by which to bolster government coffers, the Tax Reform Act of 1986<sup>11</sup> added yet more preference items, raised the tax rate to 21%, and

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<sup>3</sup> “In inflation-adjusted terms, those 1967 incomes would be roughly \$1.17 million in today’s dollars.” Andrew Chamberlain and Patrick Fleenor, *Background on the Individual Alternative Minimum Tax* (May 24, 2005). Citing: Graetz, Michael, *The U.S. Income Tax: What It Is, How It Got That Way, and Where We Go From Here*, New York: W. W. Norton and Company (1999).

<sup>4</sup> Jim Saxton, Chairman Joint Economic Committee United States Congress, *The Alternative Minimum Tax For Individuals: A Growing Burden* (May 2001).

<sup>5</sup> Pub. L. No. 91-172, 83 Stat. 487(1969).

<sup>6</sup> Pub. L. No. 94-455, 90 Stat. 1520 (1976).

<sup>7</sup> Pub. L. No. 95-600, 92 Stat. 2763 (1978).

<sup>8</sup> Pub. L. No. 97-34, 95 Stat. 172 (1981).

<sup>9</sup> Pub. L. No. 97-248, 96 Stat. 324 (1982).

<sup>10</sup> James Maroney, Timothy Rupert, and Carol Fischer, *Alternative Minimum Tax: Bane of Middle-Income Taxpayers*, *The CPA Journal*, 2000 (last accessed Dec. 21, 2005).

<sup>11</sup> Pub. L. No. 99-514, 100 Stat. 2085 (1986).

created an exemption phase-out. Where moderate-income filers were previously unaffected, they were now more likely to become subject to the AMT.

Raised to 24% in 1990<sup>12</sup>, the AMT rate was increased yet again three years later and now is no longer a truly flat tax with a single rate applicable to all taxpayers. Indeed, the rate was bifurcated, effectively creating a graduated tax system wherein lesser taxable incomes were—and still are—taxed at 26%, while higher taxable incomes (over \$175,000) were—and are—taxed at 28%.<sup>13</sup>

The 1993 Act also raised the AMT exemption to \$33,750 (S) and \$45,000 (MFJ). Despite temporary legislation<sup>14</sup> which increased these exemptions amounts during tax years 2003 through 2012, they have otherwise remained unchanged for more than a decade and will once again become effective in 2013, barring further amendments or extensions of the temporary provisions.

As more taxpayers were affected by the AMT, public outcry demanded its repeal. Unwilling to forego the tax in its entirety, some relief was granted in 1998<sup>15</sup> with the introduction of reduced capital gains rates which were applicable to both regular and AMT tax computations. In 1999<sup>16</sup>, taxpayers could apply non-refundable personal credits to their regular tax liability, even if they owed AMT.<sup>17</sup> Thus, while these credits could not reduce the tax liability below zero and generate a tax refund; the credits could now be employed where previous AMT rules prohibited such application. Similarly, the Economic Growth and Tax Relief Reconciliation Act of 2001<sup>18</sup> allowed Adoption, Child, Earned Income, and Individual Retirement Account Credits to be claimed regardless of AMT liability.

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<sup>12</sup> Pub. L. No. 101-508, 104 Stat. 1388 (1990). *Omnibus Budget Reconciliation Act of 1990*.

<sup>13</sup> Pub. L. No. 103-66, 107 Stat. 312 (1993). *Omnibus Reconciliation Act of 1993*.

<sup>14</sup> Introduced by Pub. L. No. 108-27, 117 Stat. 752 (2003). *Jobs and Growth Tax Relief Reconciliation Act of 2003*. Extended by PL 108-311, 118 Stat. 1166 (2004). *Working Families Tax Relief Act of 2004*.

<sup>15</sup> Pub. L. No. 105-206, 112 Stat. 685 (1998). *Tax Technical Corrections Act of 1998*.

<sup>16</sup> Pub. L. No. 106-170, 113 Stat. 1860 (1999). *Tax Relief Extension Act of 1999*.

<sup>17</sup> *Kappus v. Commissioner*, 337 F.3d 1053 (D.C. Cir.2003). Taxpayers claimed a foreign tax credit for taxes they paid to Canada on their Canadian-source income, reducing their regular U.S. tax liability to zero. But the IRS limited the allowable foreign tax credit to 90% of the taxpayers' AMT liability, arguing that this preference rule superseded any preexisting treaty obligation with which it conflicted.

<sup>18</sup> Pub. L. No. 107-16, 115 Stat. 38 (2001). *Economic Growth And Tax Relief Reconciliation Act of 2001*.

# THE ORIGINS OF THE ALTERNATIVE MINIMUM TAX

**1970**

## THE MILLIONAIRE'S TAX:

AMT was introduced by the Tax Reform Act of 1969. It was originally intended to target 155 high-income households that had been eligible for many loopholes and ended up paying little to no income tax.

REVENUE



\$120 MILLION

.14% of income tax



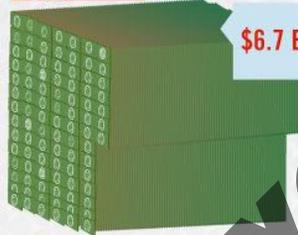
REVENUE

1979



\$870 MILLION

1986



\$6.7 BILLION

**1979**

## REPEALED ADD-ON TAX

Congress enacted the modern ATM in 1979 to operate alongside the "Millionaire's Tax". In 1983, Congress repealed the add-on tax.

The "AMT creep" into middle class taxpayers is due to the fact that AMT was not indexed for inflation.

**1986**

REVENUE

## THE TAX REFORM ACT

This act eliminated much sheltering activity and eliminated the partial exclusion of capital gains which accounted for almost 85% of AMT preferences in 1985. AMT revenue initially dropped but continued to rise steadily since it was not indexed by inflation.

1985

\$6.7 BILLION

## AFTER TAX REFORM ACT

1987

\$1.7 BILLION

## 2001-2006 TAX CUTS

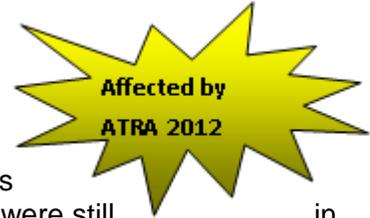
These taxes temporarily increased the ATM exemption and allowed certain nonrefundable credits to be used regardless of ATM liability.

**2001**

SOURCES: NYTIMES | TAX POLICY CENTER  
OFFICE OF TAX ANALYSIS DOT



These rules were first scheduled to expire in 2010; later extended and scheduled to expire at the end of 2012. With the passage of the American Taxpayer Relief Act of 2012 (ATRA),<sup>19</sup> enacted with bipartisan support, an era of one- to two-year exemption fixes came to an end. Tax analysts believe that legislators have long sought to introduce a permanent fix but could not do so in good conscience knowing that the high cost<sup>20</sup> of removing – or, at least, keeping new taxpayers from joining – the existing AMT tax rolls could not be justified while tax cuts enacted in 2001 and 2003 were still in effect. With the expiration of most of these provisions, ATRA could now be used to set the AMT exemption at \$50,600 (S) and \$78,750 (MFJ) for 2012 and then index it, along with exemption phase-out thresholds and tax brackets, to inflation beginning in 2013.



The IRS has recently announced the following inflation-adjusted amounts for the 2013 tax year:<sup>21</sup>

AMT Exemptions	\$51,900 (S) & \$80,800 (MFJ)
Exemption Phase-outs	\$115,400 (S) & \$153,900 (MFJ)
AMT Tax Brackets	26% ≤ \$179,500 & 28% > \$179,500

Created in response to the ire of disgruntled taxpayers who thought it was unfair that a select few did not pay their fair share of tax, the AMT has evolved from a “class tax” to a “mass tax.”<sup>22</sup> For a while, new rules were continuously introduced to capture more taxpayers, but when too many became affected, the rules were amended to lessen the pervasive impact of the AMT. Nevertheless, it was estimated that the AMT would affect 33% of all taxpayers by 2010.<sup>23</sup> Ninety-five percent of all taxpayers with Adjusted Gross Income (AGI) between \$100,000 and \$500,000 would likely pay AMT.

The AMT never successfully addressed the protested unfairness that a select few did not pay an equitable portion of the income tax, but has instead become a tax that secretly affects all but the lowest income earners. As a parallel tax system that only recently has become the focus of editorials in the mass media, the public remains blissfully unaware of the AMT’s cost until presented with a surprise bill on April 15<sup>th</sup> each year. As such, it is a stealth tax that is becoming all pervasive. And yet, about 100 taxpayers with incomes above \$1 million still did not pay *any* income tax in 2001.<sup>24</sup>

<sup>19</sup> Pub. L No. 112-240, 126 Stat. 2313 (January 2, 2013). *American Taxpayer Relief Act of 2012*.

<sup>20</sup> The Joint Tax Committee on Taxation has estimated that this permanent AMT patch will cost the federal government \$1.8 trillion over the next 10 years. Kroh, *A New Era for the AMT*, Tax Notes, January 14, 2013.

<sup>21</sup> Rev. Proc. 2013-15.

<sup>22</sup> Leonard Burman, William Gale, Mathew Hall, Jeffrey Rohaly, and Mohammed Adeel Saleem, *The Individual Alternative Minimum Tax: A Data Update*, (Urban-Brookings Institute 2004).

<sup>23</sup> Matthew Bailey, *The Individual Alternative Minimum Tax: No Alternative But Repeal*, NTU Policy Paper 114 (Apr. 22, 2004) at [http://www.ntu.org/main/press\\_papers.php?PressID=577&org\\_name=NTU](http://www.ntu.org/main/press_papers.php?PressID=577&org_name=NTU) (last accessed Dec. 21, 2005). Citing: Gregg Esenwein, *The Alternative Minimum Tax for Individuals*.

<sup>24</sup> Leonard Burman, William Gale, Jeff Rohaly, Benjamin Harris, *The AMT: Out of Control*, Tax Policy Center (Sep. 18, 2002) at <http://www.taxpolicycenter.org/publications/template.cfm?PubID=310565> (last accessed Dec. 21,



## HISTORY OF AMT LEGISLATION

- Tax Reform Act (1969): Introduced 10% add-on tax to ensnare tax “evaders”
- Tax Reform Act (1976): Reduced exemptions, raised rate to 15%, added certain itemized deductions as tax preferences
- Economic Recovery Tax Act (1981): Reduced top AMT rate from 25 to 20%; left AMT exemptions, deductions & brackets un-indexed for inflation
- Tax Equity and Fiscal Responsibility Act (1982): Added AMT preference items, raised exemption to \$30K (Single) & \$40K (MFJ), set rate at a flat 20%
- Tax Reform Act (1986): More preferences, exemption phase-out, upped rate to 21%
- 1990: AMT tax rate raised to 24%
- 1993: AMT rates, brackets & exemptions raised to current levels
- Taxpayer Relief Act (1997): Reduced Regular & AMT capital gains rates
- Economic Growth and Tax Relief Reconciliation Act (2001): Temporarily increased AMT exemptions; allowed adoption, child, earned income & IRA credits to be used
- Tax Hike Prevention Act (2010): Extended temporary AMT exemptions for 2 years
- American Taxpayer Relief Act (2012): AMT exemptions, phase-out thresholds and tax brackets permanently indexed to inflation

### III. Statistical Analysis

In 2001, fewer than 2% of all taxpayers—whose income accounted for only 7% of AGI—paid AMT which amounted to only 1% of the total tax revenue collected. By 2010, it was estimated that the AMT would raise nearly 10% of total tax revenues.<sup>25</sup>

Not only will AMT collections increase relative to total tax revenues, but ever more taxpayers of moderate means will be forced to foot the bill. Under laws in effect until recently, which effectively lowered the regular income tax while simultaneously failing to

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2005). The authors point out that while 100 taxpayers owed no tax at all, at least 700 did not owe tax under the regular tax system but were forced to pay under the AMT system.

<sup>25</sup> Leonard Burman, William Gale, Mathew Hall, Jeffrey Rohaly, and Mohammed Adeel Saleem, *The Individual Alternative Minimum Tax: A Data Update*, (Urban-Brookings Institute 2004).

index the AMT, the number of AMT-affected taxpayers began a sudden and marked escalation in 2004. The results were scary; by 2017, AMT would affect 53 million people, equal to roughly 35% of all taxpayers.<sup>26</sup> With the enactment of ATRA, the numbers have become significantly more taxpayer-friendly: More than 30 million taxpayers who would have owed AMT for 2012 have been sheltered from the tax by the higher exemption now in effect; those who are still subject will nevertheless save roughly \$85 billion. The combination of a larger AMT exemption, higher thresholds for the exemption phase-out, and the increased top AMT tax bracket will further reduce the number of AMT-affected taxpayers to just 3.4 million in 2013.<sup>27</sup>

#### “MASS” NOT “CLASS” TAX

- 2001: < 2% of taxpayers paid AMT which amounted to 1% of total tax revenue
- 2006: AMT generated \$23.9B in revenue (up from \$1.6B in 1990)
- 2007: 23.4M taxpayers will be subject to AMT (up from 3.5M in 2006 but far less than the 53M anticipated for 2017!)
- 2012: If ATRA had not been made retroactive to year-start, AMT would have applied to 34 million taxpayers and many more in future years.

#### IV. Failed Rationale

Designed to rectify perceived inequities, the add-on tax of 1969 was intended to make everyone pay his fair share of tax as well as ensure that everyone paid at least some amount for the support of government. Thus, the add-on tax as originally enacted was structured in a relatively simple manner as a surtax imposed atop the regular income and was not subject to separate rules for computing taxable income. However, during the course of its evolution, the AMT has become a tax with its own distinct set of rules for income inclusion and expense deduction. While initial minimum tax legislation comprised merely “19 pages of average-sized type in the statute book,” by 1999 “AMT legislation took up 56 pages of small type.”<sup>28</sup> The resulting complexity has led even the IRS to estimate that it would take more than six hours, on average, to prepare **Form 6251**.<sup>29</sup>

<sup>26</sup> Shidler, *AMT expected to snare many more in middle class*, InvestmentNews.com, January 8, 2007.

<sup>27</sup> Williams, *How the New Tax Act Affects the Alternative Minimum Tax*, Forbes, January 18, 2013 [available at <http://www.forbes.com/sites/beltway/2013/01/18/how-the-new-tax-act-affects-the-alternative-minimum-tax/>, last accessed May 21, 2013].

<sup>28</sup> Jim Saxton, Chairman Joint Economic Committee U.S. Congress, *The Alternative Minimum Tax For Individuals: A Growing Burden* (May 2001).

<sup>29</sup> *Id.* Citing: Internal Revenue Service, *Statistics of Income Bulletin*, V. 20, No. 2, Fall 2000.

Constrained by mandates to keep tax code changes revenue neutral, Congress has often elected to institute new AMT rules rather than alter flawed tax policies under the regular tax system. As a result, taxpayers must compute the tax basis of depreciable property differently under regular and AMT tax rules. Exemptions and phase-out amounts differ as well, as do allowable deductions and credits, forcing taxpayers who want to plan proactively for potential tax liabilities to evaluate their exposure under separate systems.

Often, a tax minimization strategy under one system may in fact cause increased liability under another. For example, taxpayers have often elected to pre-pay the fourth quarter estimated tax voucher for state income tax liabilities prior to the January 15<sup>th</sup> due date. If paid during the previous year (before December 31<sup>st</sup>), taxpayers may include the payment as an itemized deduction on Schedule A, thereby reducing the federal taxable income and the attendant federal tax liability. However, because state taxes are considered a tax preference item, the accelerated payment will be disallowed under the AMT computation. As a result, taxpayers may no longer rely upon long-accepted strategies and must now analyze the potential tax consequence of every decision under two systems rather than one.

While this may be a boon for tax advisors, taxpayers will incur not only the added cost of the AMT tax itself, but must also carry the financial burden of expert consultation, professional preparation, and bureaucratic administration. Even though more and more taxpayers will actually be required to file AMT tax forms, there will be many who need not do so but will be too confused by the rules to know that they are exempt from filing. In fact, out of 4 million AMT returns filed in 1998, 3.4 million did not result in an AMT liability and therefore need not have been submitted.<sup>30</sup>

#### PURPOSE OF AMT

- Make everyone pay a fair share & combat perceived inequities
- Everyone should pay something & eliminate abusive tax shelters
- It is easy to alter flawed policies in the Regular Tax by hiding corrections in AMT

#### SHORTCOMINGS

- Added complexity: **Form 6251** & basis computations
- Increased administrative costs: Professional preparation & IRS processing
- Reduced efficiency
- Convoluted planning opportunities
- Unnecessary filings
- AMT is not a flat tax due to its many adjustments & preference items

<sup>30</sup> Griffin, R. Jason, *The Individual Alternative Minimum Tax: Is It Touching People That It Shouldn't Be?*, Houston Business And Tax Law Journal (2004). Citing Nat'l Taxpayer Advoc., FY 2001 Ann. Rep. To Congress, I.R.S. Pub. 2104, 175 (Dec. 2001) at <http://Www.Irs.Gov/Pub/Irs-Pdf/P2104.Pdf>.

## V. Calculating AMT

To determine the amount of AMT owed, if any, taxpayers must begin by calculating their “regular” taxable income—in other words, the process begins by completing **Form 1040** to determine Gross Income less Adjustments and Deductions (Standard or Itemized) based upon familiar rules for income inclusion and expense deduction. The resulting Taxable Income is then transferred to **Form 6251** and provides the starting point for the four-step AMT calculation, summarized below:

### Step 1: Calculate AMT tax base

- Regular taxable income
- + AMT preferences
- + AMT adjustments
- = AMT taxable income
- Allowable AMT exemption
- = AMT tax base

### Step 2: Calculate tentative AMT liability

- AMT tax base
- x AMT tax rate (26; 28% if > \$175,000)
- = Pre-credit tentative AMT liability
- Allowable AMT foreign tax credit
- = Tentative AMT Liability

### Step 3: Calculate regular tax liability for AMT purposes

- Regular tax before credits
- Taxes due to lump sum distributions
- Allowable regular tax foreign tax credits
- = Regular tax liability for AMT purposes

### Step 4: Calculate AMT tax due

- Tentative AMT liability [from Step 2]
- Regular tax liability for AMT purposes [from Step 3]
- = AMT tax due (in addition to regular tax due)
- = Tentative AMT Liability

It should be noted that the AMT remains an add-on tax of sorts in that it is due only when the Tentative AMT Liability exceeds the Regular Tax computed on **Form 1040**. While taxpayers are in effect liable for the greater of the AMT or Regular Tax, IRS instructions specify that the Regular Tax is always paid and that the AMT liability in excess of the regular liability is *added on* to the Regular Tax due. The resulting sum is then submitted to the IRS.

The AMT liability will only exceed the Regular Tax if sufficient Tax Preference Items and AMT Adjustments are added back to the Regular Taxable Income. Identified as potential sources of tax savings that may unfairly benefit some taxpayers, preference items include those which are commonly exploited to maximize allowable deductions and minimize the eventual tax due.

*Example: Under the regular tax system taxpayers may deduct medical expenses subject to a 7½ % AGI limitation<sup>31</sup>, but under AMT medical expenses must exceed 10% of AGI. Thus, if a taxpayer had an AGI of \$100,000 and incurred \$10,000 of medical expenses, he could deduct \$2,500 (= \$10,000 - 7½ % of \$100,000) of these expenses on his Schedule A as an itemized deduction, but would effectively have to add back the entire deduction when calculating AMT since none of the medical expenses would exceed the AMT limitation (= \$10,000 – 10% of \$100,000).*

Similarly, other items that must be considered for AMT but not regular income tax purposes include interest earned on certain private activity bonds; state income and real property taxes; and miscellaneous deductions such as unreimbursed employee business expenses and tax preparation fees. Where amounts for these items are deductible

<sup>31</sup> Increased to 10% beginning in 2013; therefore, most taxpayers will no longer be required to make AMT adjustments for medical expenses after 2013.

when calculating Regular Taxable Income, they must be added back as preference items when computing AMT.

The list of adjustments is long and in many cases involves complex calculations of differing depreciation allowances or basis adjustments, and recognition of otherwise non-taxable income such as Incentive Stock Options (ISOs). Merely scratching the surface with this non-inclusive list, it becomes clear that taxpayers must calculate their tax liability under two sets of rules in parallel systems, thereby complicating tax preparation and planning immensely.

#### Private Activity Bonds

Under regular tax calculations, interest received on all municipal bonds is federally tax exempt. However, interest earned on bonds issued to finance certain private activities (as classified by the Tax Reform Act of 1986)—including sports and convention facilities and other industrial development projects—are subject to AMT taxation.

#### Punitive Damage Awards

Taxpayers excluded the portion of their punitive damages award retained by their attorney as fees from gross income. The Tax Court disagreed and ruled that the entire award was includible in gross income, while the contingent fees paid to the attorney were deemed Miscellaneous Itemized Deductions. As such, they were disallowed under the AMT.<sup>32</sup>

Since AMT does not apply until the AMT Taxable Income exceeds the AMT Exemption, single taxpayers with incomes below \$50,600 and married taxpayers with incomes below \$78,750<sup>33</sup> need not concern themselves with AMT rules unless a taxable event occurs that suddenly raises their income level above the exemption amount.

*Example: Recognition of a large capital gain might trigger the unpleasantness of AMT. Long-term capital gains resulting from disposition of assets held for more than one year are currently taxed at reduced rates with a maximum marginal rate of 15%. But because these capital gains are then included in AMT Taxable Income, other preference items become subject to a minimum rate of 26%, thereby—for practical purposes—taxing the capital gains at a much higher effective rate*

#### Capital Gains

Taxpayers argued that the imposition of tax on an once-in-a-lifetime transaction was harsh and oppressive on folks of modest means, but the Court held that they should have anticipated the AMT because it was in existence at the time they had entered into the sales transaction.<sup>34</sup>

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<sup>32</sup> *Benci-Woodward v. Commissioner*, 219 F.3d 941 (9th Circ., cert. denied, 2000).

<sup>33</sup> Exemption amounts applicable to 2012 tax year.

<sup>34</sup> *Buttke v. Commissioner*, 625 F.2d 202 (8th Circ. 1980).

### Income Averaging

Intended to ease the burden of a progressive tax-rate schedule on a taxpayer with widely fluctuating income, income averaging did not alter the amount of includible income but merely reduced the rate at which it was to be taxed. While AMT rules, when applied, effectively eliminated this tax advantage, the Court held that the result was not contrary to Congressional intent and ruled that income averaging could not be used to determine the AMT Liability.<sup>35</sup>

Where taxpayers might have previously wrestled with the decision to do some year-end portfolio cleaning to offset realized gains and losses or to accelerate discretionary deductions, they must now also consider the potential AMT consequences of their actions. Something as simple as Personal Exemptions (PE) may suddenly become onerous. Historically, taxpayers sought to claim as many dependents as legally allowable to minimize their ultimate tax liability. However, because AMT computations do not consider personal exemptions, large families able to reduce their regular tax with PE will find that no such benefit exists under AMT.<sup>36</sup> In fact, it was estimated that PE would account for as much as 46% of all preference items claimed under AMT by 2010.<sup>37</sup>

### Personal Exemptions

While the parents of eight children claimed that their rights to free exercise of religion had been violated, the Court upheld AMT rules denying PE deductions on the grounds that a generally applicable but neutral law was not unconstitutional merely because it had the effect of making the observance of religious beliefs prohibiting birth control more expensive.

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<sup>35</sup> *Okin v. Commissioner*, 808 F.2d 1338 (9th Circ., 1987).

<sup>36</sup> *Klaassen v. Commissioner*, 1999 U.S. App. LEXIS 6320 (10th Circ., 1999).

<sup>37</sup> Robert Rebelein and Jerry Tempalski, *Who Pays The Individual Amt?*, Office of Tax Analysis Paper 87 (June 2000).

## A. A More Detailed Look at the AMT Computation

### Regular Tax Computation

- START with... Adjusted Gross Income (AGI)  
= Income before Adjustments, Deductions and Exemptions
  
- SUBTRACT... Adjustments
  - IRA contributions
  - Early withdrawal penalties
  - Self-employment Tax
  - Alimony paid
  - Moving Expenses
  
- SUBTRACT... Deductions
  - Medical expenses
  - Mortgage interest
  - State, real estate, and personal property taxes paid
  - Charitable contributions
  - Unreimbursed employee business expenses
  - Legal fees and investments expenses
  
- SUBTRACT... Personal Exemptions
  
- Credit for Prior Year Minimum Tax (refundable)
  - *Some or all* of the AMT tax liability may be used to offset future regular tax liabilities (**Form 8801 Credit for Prior Year Minimum Tax – Individuals, Estates, and Trusts**)
  - Credit can only be used in a year where AMT is not currently due
  - Credit is limited to the amount of AMT previously paid that was not attributable to timing items (such as ISOs and capital gains)
  - Credit can be used to reduce current Regular Tax liability
  - Any unused credit may be carried forward

### AMT Tax Preference Items [See Appendix A.]

= items identified as potential sources of inordinate tax savings under Regular Tax; not permitted under AMT

1. Personal Exemptions—none are allowed; must be added back to regular taxable income.

STRATEGY: Since a taxpayer subject to AMT does not derive any tax benefit from personal exemptions, he may wish to “donate” exemptions to another taxpayer if eligible under a multiple support agreement.

2. Standard Deduction—is disallowed; must be added back<sup>38</sup>

STRATEGY: An AMT-affected taxpayer may prefer to itemize deductions since some of the itemized deductions remain deductible for AMT purposes. However, it is crucial that the return be prepared *twice* (claiming both standard and itemized deductions) to determine the resulting effect on the state income tax return since many states require that the federally elected method is also used on the state return – the goal should be to minimize the taxpayer’s total tax liability, not just his AMT exposure.

3. Medical—must exceed 10% (versus only 7.5% of Regular AGI; 10% in 2013 and beyond).

STRATEGY: The AMT-subject taxpayer should be sure to maximize his use of all available pre-tax medical plans (HSAs, MSAs, FSAs and medical reimbursement plans) since expenses paid through these plans are deductible for regular and AMT purposes.

**NOTE:** The AGI limitation applicable to medical deductions under the regular tax system has been increased to 10% for most taxpayers.<sup>39</sup> Therefore, beginning in 2013 and beyond, no further AMT adjustments will be required for this deduction.

4. Taxes—NO deduction allowed for state/estimated taxes & DMV registration

STRATEGY: The AMT-affected taxpayer should not pre-pay his fourth quarter state estimated tax payment or second property tax installment. Taxes (such as a portion of the vehicle registration fee) that can be claimed above-the-line as business expenses on Schedule C will serve to reduce both regular and AMT liabilities. Finally, certain taxes may be capitalized (such as those paid on unimproved land).<sup>40</sup>

5. Mortgage Interest—allowable unless home equity loan is used for unrelated purpose.

STRATEGY: The AMT-taxpayer should pay off home equity debt and/or apply interest tracing rules since investment and business interest remain deductible for AMT purposes.

6. Charity—these deductions are limited to 20, 30, or 50% of Regular AGI and are not adjusted for higher AMT AGI.

7. Miscellaneous Deductions: NO deduction allowed; all must be added back.

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<sup>38</sup> IRC § 56(b)(1)(E).

<sup>39</sup> Patient Protection & Affordable Care Act, enacted March 23, 2010, raised the AGI threshold to 10% for taxpayers under 65. Seniors may continue to use the 7.5% threshold until 2016.

<sup>40</sup> Reg. § 1.266-1(b)(1)(i): Annual election can be made by attaching a statement to the tax return.

## AMT Tax Deferral Items

= items that change the timing of when to recognize income and deductions (usually accelerate income and postpone deductions)

1. Incentive Stock Options (ISOs)—no income is recognized upon exercise under Regular Tax, but bargain element must be added back for AMT. **NOTE:** Watch out for basis adjustments!
2. Depreciation—although taxpayer may use accelerated depreciation for Regular Tax, AMT gives less of an upfront deduction in early years and a greater deduction in later years. These differences must be added back in early years and subtracted later. Basis must be tracked separately for regular and AMT purposes.

To compute AMT, depreciation must be computed using the AMT method.<sup>41</sup> For assets placed in service after 1998, the GDS recovery period is used for both regular tax and AMT. So for these assets, there is an AMT depreciation adjustment only if the AMT and regular tax depreciation methods differ.

For assets placed in service after 1998, no AMT adjustment is required for assets depreciated on a straight-line (SL) basis for regular tax. Examples include non-residential real property with a class life of 27.5 years or more, residential rental property, qualified leasehold improvements, restaurant and retail improvement property, trees and vines bearing fruit.<sup>42</sup>

AMT Depreciation Adjustment Required		
Type of Property	Depreciation Method	
	Regular Tax	AMT
3-, 5-, 7- and 10-yr property	200% DB	150% DB
Section 1250 property	150% DB	SL

## Other AMT Adjustments

1. Tax-exempt Interest—although all muni interest is tax-free for Regular Tax, interest received from Private Activity Bonds must be added for AMT
2. Capital gains—large capital gains may cause taxpayer to exceed AMT exemption amounts.
3. Qualified Dividends must be added back as preference items for AMT.<sup>43</sup>

<sup>41</sup> Thomson Reuter's *1040 Quickfinder Handbook, 2011 Tax Year*.

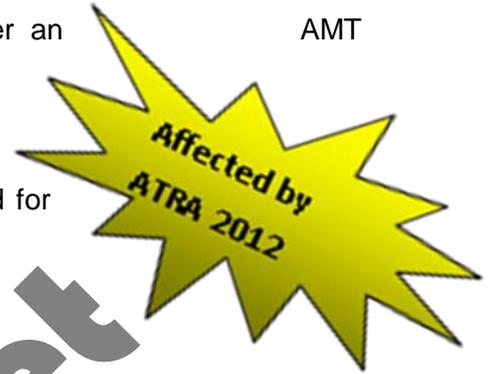
<sup>42</sup> IRC § 168(b)(3).

<sup>43</sup> *Weiss*, 129 TC No. 18. By adding qualified dividends into the AMT calculation, AMT taxable income is increased and thereby bringing the taxpayer closer to (or over) the AMT exemption threshold.

4. State tax refund—as a matter of equity, amounts received for prior year refunds are subtracted from AMT calculations since amounts paid to other authorities are not deductible and must be added back in the year paid
5. Net Operating Losses (NOLs)—a portion may be used to offset AMT
6. Passive Activities—most tax shelters will trigger an AMT consequence

#### AMT Exemption

- Indexed for inflation after 2010, but not adjusted for family size
  - 2010: \$47,450 (S) and \$72,450 (MFJ)
  - 2011: \$48,450 (S) and \$74,450 (MFJ)
  - 2012: \$50,600 (S) and \$78,750 (MFJ)<sup>44</sup>
  - 2013: \$51,900 (S) and \$80,800 (MFJ)
- AMT exemptions are phased out for high-income taxpayers at a rate of 25¢ per dollar of AMT income in excess of
  - \$112,500 in 2012; \$115,400 in 2013 (Single)
  - \$150,000 in 2012; \$153,900 in 2013 (MFJ)



#### Allowable Tax Credits

1. Foreign Tax Credit (**Form 1116**) may be used to reduce AMT tax liability, but not below 90% (*fully refundable under Regular Tax*)

Generally, the AMT Foreign Tax Credit (AMTFTC) is calculated by refiguring the foreign tax credit limit considering only income and deductions allowed for AMT.<sup>45</sup>

Taxpayers may instead elect a simplified AMTFTC limit, which uses the ratio of foreign regular taxable income over total AMT taxable income. The election must be made for the first tax year the taxpayer claims an AMTFTC. Once made, the election applies to all later tax years and may be revoked only with IRS consent.

2. All credits other than adoption, child, and IRA credits are allowed only to the extent that Regular Tax liability exceeds AMT liability

<sup>44</sup> Children subject to the Kiddie Tax may owe AMT. The AMT exemption is the lesser of (1) the child's normal exemption or (2) the sum of the child's earned income plus \$6,950 (in 2012).

<sup>45</sup> Thomson Reuter's *1040 Quickfinder Handbook, 2011 Tax Year*.

## B. Capital Gains Treatment under AMT

### 1. Incentive Stock Options

Although the exercise of an ISO is generally not a taxable event, the bargain element is includible in Alternative Minimum Taxable Income (AMTI). Defined as the difference between the fair market value of the stock on the date of exercise and the actual purchase price of the stock using the option, the bargain element represents the savings enjoyed by the option holder who has the opportunity—due to his option—to purchase the stock for less than the prevailing market price. The taxpayer must include this “savings” as an AMT tax preference item.<sup>46</sup>

Due to differing treatment under the regular and the AMT tax systems, a taxpayer may well have two different bases for the same shares of stock: His regular tax basis will be the exercise price at which he purchased the stock with the help of the ISO. His AMT basis, on the other hand, will be the exercise price plus the includible AMTI income.

*Example # 1: When the company's stock was trading at \$75/share, the taxpayer exercised an ISO to purchase 100 shares at \$25/share. For AMT purposes, the taxpayer must report an adjustment of \$5K (\$50/share) if he holds the stock past the end of the year in which he exercised. His basis is \$25/share for regular tax purposes but \$75/share for AMT purposes.*

*Example # 2: If the taxpayer later sells the stock for \$100/share, he may use the difference between the regular tax gain of \$7,500 (= \$100/share - \$25/share regular basis) and the AMT tax gain of \$2,500 (= \$100/share - \$75/share AMT basis) to decrease his current year AMT liability.*

*Example # 3: If the taxpayer instead sells the stock after its value has declined to \$40/share, he would realize a \$15K capital gain for regular tax purposes (= \$40/share - \$25/share) but would realize a \$35K capital loss for AMT purposes (= \$40/share - \$75/share). However, since capital losses in excess of capital gains are limited to \$3K under both regular and AMT tax, the taxpayer may only claim a \$3K AMT loss. Therefore, his adjustment will equal \$18K (= \$15K regular gain - \$3K AMT loss).*

### 2. Net Operating Losses

An NOL results when allowable deductions exceed gross income.<sup>47</sup> However, capital losses in excess of capital gains are excluded from NOL computations. (Of course, \$3,000 of these excess capital losses may still be deducted against ordinary income and any remaining losses may be carried forward indefinitely, but not back).

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<sup>46</sup> IRC § 56(b)(3).

<sup>47</sup> IRC § 172.

For AMT purposes, taxpayers must re-compute the NOL to arrive at the Alternative Tax Net Operating Loss (ATNOL), beginning with the regularly computed NOL and making adjustments as mandated by IRS §§ 56, 57, and 58.<sup>48</sup>

While the Code does not specifically address the issue of an AMT capital loss, the Tax and 5<sup>th</sup> Circuit Courts have concluded that because ATNOL is merely a modified NOL, capital loss limitations remain unchanged. As a result, ATNOLs resulting from capital losses may—like their regular capital loss counter-parts—not be carried back to offset AMT capital gains in earlier years [as learned the hard way by a California taxpayer].<sup>49</sup>

#### AMT Credit

Saddled with a huge AMT tax liability in 2000 (due to the exercise of an ISO), the taxpayer sought to offset this liability with an ATNOL incurred in 2001 when his stock became worthless as the high-tech bubble burst. Although Merlo lost, a provision of the Tax Relief and Health Care Act of 2006 now grants relief to similarly situated taxpayers by offering a refundable AMT credit<sup>50</sup> for 2007 and beyond.

#### **C. Refundable Minimum Tax Credit (MTC)<sup>51</sup>**

This credit is available to a taxpayer if, in a prior year, he paid AMT resulting from deferral (not preference) items which do not cause a permanent difference in taxable income over time (e.g. depreciation). MTC may only be used when the regular tax exceeds the tentative minimum tax after AMT has already been paid in a prior year. Of course, if the taxpayer remains subject to AMT in ensuing years, the MTC may remain unused unless...

...a portion of the MTC may be refundable, allowing the taxpayer to benefit from the credit even when the regular tax liability does not exceed the tentative AMT. The allowable portion equals the greater of (1) 50% of the long-term unused MTC or (2) the prior year AMT refundable credit. The long-term unused MTC is the amount of MTC credit that was applicable to tax years beginning three years before the current year [e.g., 2010 for the 2013 tax year].

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<sup>48</sup> Additional rules include:

- The AMT NOL must be carried back to the same year as the regular NOL.
- If election is made to forgo the NOL carryback under §172(b)(3) for regular tax purposes, the taxpayer will be required to also forgo the AMT NOL carry-back (Rev Rul 87-44).
- The AMT NOL deduction cannot exceed 90% of AMTI, which is computed without taking into account the AMT NOL and the Domestic Production Activities deduction (IRC § 56(d)(1)(A)).
- The AMT NOL must be used before the AMT exemption applied (IRC § 55(b)(1)(A)).

<sup>49</sup> *Merlo*, 100 AFTR 2d.

<sup>50</sup> IRC § 53(e)(1).

<sup>51</sup> IRC § 53.

All MTC carry-forwards must be used on a first-in-first-out basis, which means that the oldest MTC must be used first; thereby reducing the amount of carry-forwards which are considered “long-term” and, therefore, “refundable”.

To claim the credit, individual taxpayers must use **Form 8801**; corporations must file **Form 8827 Credit for Prior Year Minimum Tax – Corporations**.

## E. State Tax Issues

It seems hardly necessary to remind the reader that AMT treatment varies from state to state, with some jurisdictions confirming to federal provisions in whole or in part, and some jurisdictions striking out entirely on their own. An in-depth analysis of individual state laws is beyond the scope of this course; instead, allow me to illustrate some of the issues by examining portions of California’s tax code.

### 1. Tax Rate and Exemptions

California taxpayers compute their tentative minimum tax in accordance with IRC §§55-59; however, state exemption and exemption phase-out amounts, which are indexed annually for inflation, do not conform with federal amounts.<sup>52</sup> For 2012, the exemption amounts are \$62,420 (S) and \$83,225 (MFJ). The exemption phase-outs begin at \$234,072 (S) and \$312,095 (MFJ). The AMT tax rate is 7%.

### 2. Kiddie Tax

For children under age 14, the AMT exemption amount equals the child’s earned income plus \$6,950 (in 2012).<sup>53</sup> If the child’s income is taxed at the parents’ rate and that rate is less than the AMT rate, the child will be taxed at the AMT rate.

### 3. Business Income

All business income and associated AMT adjustments and preferences are excluded from AMTI if the taxpayer has less than \$1 million in gross receipts from all trades or businesses.<sup>54</sup>

### 4. Incentive Stock Options

California conforms to the treatment of ISOs under IRC §421 but extends that treatment to California Qualified Stock Options (CQSO)<sup>55</sup> as well as

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<sup>52</sup> California Revenue & Taxation Code § 17062(b).

<sup>53</sup> The federal AMT exemption for a child subject to the kiddie tax is the lesser of the AMT exemption for a single taxpayer or the total of the child's earned income plus \$5,000, indexed for inflation. For 2012, the amount indexed for inflation is \$6,950.

<sup>54</sup> R&TC § 17062(b)(4).

long as the disposition and income inclusion occur within the same taxable year.<sup>56</sup> To be eligible, CQSOs must be issued after January 1, 1997, and before January 1, 2002. The employee must have been employed by the granting corporation and the employee's income cannot exceed \$40,000 in the year of exercise. The number of shares granted cannot exceed 1,00 and the value cannot exceed \$100,000.

5. Private Activity Bonds

California does not conform to federal treatment and does not consider this type of interest to be a tax preference item.

6. Net Operating Loss

California conforms to federal treatment and computations but does not allow an NOL carryback for either regular or AMT tax purposes.

**REMINDER:** This is but a partial list of (non)conformity in California. Practitioners are urged to check applicable state provisions for California as well as all other states.

## VI. AMT Tax Planning

While each taxpayer's situation is unique and requires individualized planning, some AMT avoidance and reduction strategies are common to all.

*Example: Where taxpayers in the past have elected not to itemize expenses if they did not exceed the Standard Deduction, AMT-affected taxpayers may prefer to file Schedule A after all. Although relatively nominal itemized deductions will not serve to reduce the Regular Tax Liability, they may help to mitigate the AMT impact, especially if the bulk of the deductions claimed are not considered preference items, such as charitable contributions and home mortgage interest.*

### Standard Deduction

The Tax Court held that the taxpayer could not elect to claim the Standard Deduction for regular tax and itemize for AMT purposes since AMT calculations were derived from Regular Taxable Income which was based upon selection of one or the other method of deducting expenses.<sup>57</sup>

**REMINDER:** Taxpayers who claim the Standard Deduction for Regular Tax may not itemize for AMT.

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<sup>55</sup> R&TC §17502.

<sup>56</sup> FTB Publication 1004, *Stock Option Guideline*, REV 10-2007 [available at <https://www.ftb.ca.gov/forms/misc/1004.pdf>, last accessed May 21, 2013].

<sup>57</sup> *Marx V. Commissioner*, T.C. Summ. Op. 2003-23 (Mar. 19, 2003), 2003 Tax Ct. Summary LEXIS 22.

Sales of securities could be strategically timed to avoid bunching realized gains into a single year rather than spreading them uniformly over several years. ISOs could be exercised soon after receipt, giving taxpayers the option to sell the acquired securities before year-end, since no AMT adjustment is required if the exercise and sale occur within the same year.<sup>58</sup> However, taxpayers should consider that the ordinary rates imposed on short-term capital gains by the regular tax system for dispositions of assets held one year or less may outweigh the benefits of the AMT savings.

There just are no easy answers. And taxpayers should always heed the caveat that while tax consequences should be considered when making financial decisions, they are not the only factor to be contemplated.

### AMT TAX STRATEGIES

- Decelerate deductions—e.g., don't pre-pay 4<sup>th</sup> quarter state ES
- Employee business expenses—those reimbursed by the employer are not subject to AMT adjustments
- Itemize deductions on Schedule A for Regular Tax—some taxpayers whose Itemized Deductions are smaller than the Standard Deduction may be better off itemizing if most of the deductions are not AMT preferences (e.g., charitable contributions or mortgage interest)
- Time securities sales to avoid large capital gains bunched into one year
- Defer interest income to reduce AMT taxable income by investing in short-term CDs and savings bonds scheduled to mature in the next tax year
- Exercise ISOs early in the year—buy the stock at the option price and then sell it if the price goes down before year-end since no AMT adjustment is required if you exercise and sell in the same year
- Watch out for short-term consequences for securities held less than 1 year and weigh the alternatives!
- Use the IRS AMT Assistant at <http://www.irs.gov/businesses/small/article/0,,id=150703,00.html>

<sup>58</sup> 2004-16 I.R.B. 783, Notice 2004-28: *Frivolous arguments to avoid concerning statutory and non-statutory stock options*. The Notice alerts taxpayers that the IRS will challenge positions taken upon the advice of promoters regarding income tax or AMT due when exercising stock options.

## VII. The Future of AMT

A few years back, rumblings on the Hill were building to a crescendo, but in fact fizzled with a whimper due to the sway of political winds and the ferocious appetite of a bureaucracy starved for capital. Introduced in early 2005 by Senator Max Baucus (D-Montana), the ranking minority member of the Senate Finance Committee, the Individual Alternative Minimum Tax Repeal Act of 2005<sup>59</sup> sought to eliminate the AMT by year-end. However, neither this nor any other similar piece of legislation was enacted, in part due to the havoc wreaked upon Gulf Coast states by Hurricanes Katrina and Rita.

Spurred by true necessity as well as a collective guilt for the federal government's slow response to the disaster, Congress was quick to enact the Katrina Emergency Tax Relief Act<sup>60</sup> extending significant tax credits to affected taxpayers and generous deductions to the population as a whole. For example, in an effort to encourage private party donations to charitable organizations, contributions made to qualified entities became deductible in full without the usual restriction limiting the tax deduction to 50% of the taxpayer's AGI. While the provision was intended to spur relief efforts geared toward the rehabilitation of New Orleans, it was applicable to all donations regardless of the receiving organization's use of the funds.

Similarly, standard mileage allowances were increased, additional exemptions were introduced for taxpayers housing displaced persons, and early withdrawal penalties for retirement plan distributions were waived, as were casualty loss limitations. While these provisions were not necessarily available to all taxpayers, they nevertheless promised to significantly reduce tax collections which, together with the costs of rebuilding the coastal communities, were expected to create budget deficits for years to come.<sup>61</sup>

It is, therefore, not surprising that proposals to eliminate the AMT were abandoned, if only temporarily. It appears that as long as voters demand tax equity, their Congressional representatives will respond with plan after plan. And some day, one such plan is bound to come to fruition...

...at significant cost. If current suggestions are any indication, revenues foregone<sup>62</sup> under the AMT system will have to be replenished under the regular income tax. Hence, rumors are circulating that the once sacrosanct mortgage deduction may be eliminated, which the National Association of Realtors projects will cause housing prices to drop by as much as 15%.<sup>63</sup>

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<sup>59</sup> Sen. Res. 1103, 109th Cong. (May 23, 2005).

<sup>60</sup> Pub. L. No. 109-73, 119 Stat. 2016 (2005).

<sup>61</sup> *Federal Budget*, The Clarion-Ledger (Oct. 2, 2005) at <http://www.clarionledger.com/apps/pbcs.dll/article?AID=/20051002/OPINION01/510020304/1008/OPINION> (last accessed Dec. 21, 2005).

<sup>62</sup> \$1.2 trillion over the next ten years as per Daniel Kadlec, *Why They're After your Favorite Tax Break*, TIME Magazine, 47 (Nov. 14, 2005).

<sup>63</sup> *Id.*

On the other hand, repeal of the AMT may spur demand for private activity bonds which would no longer be subject to discriminatory tax treatment.<sup>64</sup> An important source of revenue for state and local infrastructure, tax-free bonds allow municipalities to attract more investors and borrow at reduced rates, which may well become necessary if the regular tax deduction for state and local taxes is eliminated. Lobbyists from low-taxed states have long argued that taxpayers from such states as New York and California with marginal tax rates of 8.97 and 10.3%<sup>65</sup> respectively receive an unfair benefit from this deduction. They argue that high-tax states, frequently represented by Democrats, can use this federal deduction to keep more tax dollars at home.<sup>66</sup>

And so the argument becomes political. “DO House Republicans harbor some sort of deep rage against moderately affluent families with lots of children?”<sup>67</sup> Andrews argues that while the AMT seems to single out residents of “blue states” on the East and West coasts, it does so more by fiscal coincidence than political design since New York, New Jersey, Connecticut, Massachusetts, and California have the highest concentrations of wealthy people, precisely those originally targeted by the AMT. Happenstance alone will not eliminate the yin and yang across the aisle. In the end, the balance will likely tilt toward tax simplification and an eventual repeal of a tax that has simply become too difficult to administer and too politically incorrect to maintain.

And yet... “It is exceedingly unlikely [that] a comprehensive tax reform bill [will] receive serious consideration until 2013, so the fate of expiring provisions, including the provisions to address the alternative minimum tax ‘patch’ is unclear.”<sup>68</sup> Of course, ATRA put the uncertainty to rest – presumably, “permanently”. But tax law is never permanent in the sense that it will remain forever untouched. Permanent simply means that provisions will remain in effect until such time that they are once again changed.

“Now that the major components of the AMT have been ensconced in permanent law, the next major changes are not likely to happen until Congress gets around to enacting fundamental tax reform.”<sup>69</sup> While there is no guarantee that substantial reform will happen any time soon, most legislative observers agree that “[n]o one would design a tax system that would have regular income tax and AMT in it.”<sup>70</sup> In fact, if an ideal system were put in place, there would no longer be a need for AMT which was originally

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<sup>64</sup> Alison McConnell, *Private Activity Bonds Could Benefit from AMT Repeal*, The Bond Buyer, at <http://www.financial-planning.com/pubs/fp/20050701008.html> (last accessed Dec. 21, 2005).

<sup>65</sup> In 2011.

<sup>66</sup> Wikipedia, the free encyclopedia, *Alternative Minimum Tax* at [http://en.wikipedia.org/wiki/Alternative\\_Minimum\\_Tax](http://en.wikipedia.org/wiki/Alternative_Minimum_Tax) (last accessed Dec. 21, 2005).

<sup>67</sup> Edmund Andrews, *Hmmm. What’s this Alternative Tax? Hey, Wait! Ouch!*, The New York Times (Dec. 4, 2005).

<sup>68</sup> Schensky, *Expiring Tax Provisions – Extended or Not?* As excerpted in NSAlert, May 25, 2012.

<sup>69</sup> Kroh, *A New Era for the AMT*, Tax Notes, January 14, 2013.

<sup>70</sup> William Gall of the Urban-Brookings Tax Policy Center as quoted by Kroh, *A New Era for the AMT*.

designed to promote tax equity. Where AMT failed, an entirely new regime might succeed...

#### REASONS TO WORRY

- As Regular Tax rates drop below AMT rates, more taxpayers will be asked to pay their “minimum” share
- As incomes continue to rise, more taxpayers will exceed the AMT exemption amounts which are not indexed for inflation
- Most tax credits used to reduce Regular Tax liability cannot be used to offset AMT liability



# APPENDIX A

## AMT Adjustments & Preferences for Individuals

	Regular Income Tax (Form 1040)	Alternative Minimum Tax (Form 6251)	Type
<b>Standard Deduction</b>	Can be deducted instead of itemized deductions.	Not deducted. <b>Note:</b> No entry made on Form 6251 since form starts with income before standard deduction.	Exclusion
<b>Deduction for Personal Exemptions</b>	Deduct the number of exemptions claimed multiplied by a set amount (adjusted annually). Deduction partially phased out at higher income levels.	Not deducted. <b>Note:</b> No entry made on Form 6251 since form starts with income before deduction for personal exemptions.	Exclusion
<b>Home Mortgage Interest</b>	Qualified residence interest (QRI) to acquire or improve a principal and one second home(including certain boats and motor homes) and interest on a home equity loan of up to \$100,000are deductible.	Qualified housing interest, which is QRI (except interest on a second home that is a boat or motor home) and interest on a home equity loan, but only to the extent used to acquire or improve the residence, are deductible. If an eligible mortgage is refinanced, interest on any portion of the refinancing that exceeds the balance of the refinanced mortgage is not deductible.	Exclusion
<b>Depletion Depreciation After 1986</b>	Depletion deduction limited by taxable income. Cost depletion limited to basis. Choice between general depreciation system(GDS) and alternative depreciation system (ADS).	Deduction limit must be refigured using allowable AMT income and deductions. Cost depletion limited to basis refigured under AMT rules. Asset placed in service before 1999: If MACRS 200% DB used for regular tax, refigure for AMT using MACRS 150% DB over ADS recovery period. Otherwise, use regular tax method and ADS recovery period. Asset placed in service after 1998: If MACRS 200% DB used for regular tax, refigure for AMT using MACRS 150% DB over GDS recovery period. Property is not adjusted for AMT if special depreciation claimed.	Exclusion Deferral
<b>Disposition of Property</b>	Gain or loss computed based on regular tax basis.	Gain or loss from the sale of property recalculated for AMT if property's basis different for AMT than for regular tax. Adjustments such as depreciation, research and development and incentive stock options may cause basis differences.	Deferral
<b>Exercise of Incentive Stock Options</b>	Exercise of an incentive stock option (ISO) is generally not a taxable event.	Difference between amount paid and fair market value (FMV) must be added to AMTI unless the stock is sold before year-end (in the same year).	Deferral
<b>Intangible Drilling Costs (IDC)</b>	Deductible currently or elect to write off over 60 months.	If 60-month write-off is not elected, "excess IDC" in excess of 65% of net income from well is added back for AMT. Excess IDC = productive well IDC less 120-month SL or cost depletion method recovery. Limited application to independent producers.	Deferral
<b>Interest From Private Activity Bonds</b>	Exempt from income tax. Allocable interest expense not deductible.	If issued after August 7, 1986, income must be included for AMT purposes. Income may be reduced by allocable expenses that were not deductible for regular tax. Does not apply to interest from bonds issued in 2009 and 2010.	Exclusion
<b>Investment Interest Expense</b>	Interest relating to tax-exempt income is not deductible. Other investment interest limited to net investment income (reported on Form 4952).	Use a separate Form 4952 to calculate investment income under AMT rules. Interest used to carry tax-exempt private activity bonds is deductible, subject to limits.	Exclusion
<b>Long-Term Contracts</b>	Certain taxpayers can use completed contract method.	Generally must use percentage of completion method. There are certain exceptions for home construction.	Deferral
<b>Medical and Dental Expenses</b>	Amounts over 7.5% of AGI are deductible (10% after 12/31/12).	Amounts over 10% of AGI are deductible. Add back 2.5% of AGI or actual amount deducted on Schedule A, whichever is less.	Exclusion
<b>Miscellaneous Deductions</b>	Amount that exceeds 2% of AGI is deductible on Schedule A.	Not allowed. Add back any amount deducted on Schedule A.	Exclusion
<b>Deductions Limited By Income</b>	Certain deductions such as Section 179, business use of home expenses, SE health insurance deduction, Keogh, SEP, SIMPLE and IRA contributions are limited to earned income (or taxable income from a trade or business)computed for regular tax.	Deductions must be recalculated for AMT based on income limitations that take into account all AMT adjustments and preferences. Enter the difference between amount calculated for regular tax and the amount allowed forAMT. Also, taxable IRA distributions may have to be recomputed, if prior deductions were different for regular tax and AMT. <b>Note:</b> Deductions limited by AGI (or modified AGI) for regular tax do not have to be recomputed.	Must Be Allocated
<b>Passive Activities</b>	Loss limited to passive income. Calculate on Form 8582, Passive Activity Loss Limitations.	Use a separate Form 8582 to calculate passive gains or losses taking into account all AMT adjustments and preferences that apply.	Deferral
<b>Qualified Small Business Stock</b>	50% capital gain exclusion is allowed for Section 1202 stock sold in 2011.	7% of excluded gain is added back to AMT.	Exclusion
<b>Tax Refund</b>	Add to income if previously deducted (under the tax-benefit rules).	Tax refunds (including property tax refunds) are not included in income for AMT purposes. Enter negative amount on Form 6251.	Exclusion
<b>Taxes</b>	State and local income taxes or state and local general sales tax, real estate tax, etc., are deductible.	Not allowed. Add back any taxes deducted on Schedule A.	Exclusion



# APPENDIX B

## Form 6251

Form <b>6251</b> Department of the Treasury Internal Revenue Service (99)	<b>Alternative Minimum Tax—Individuals</b> ▶ Information about Form 6251 and its separate instructions is at <a href="http://www.irs.gov/form6251">www.irs.gov/form6251</a> . ▶ Attach to Form 1040 or Form 1040NR.	OMB No. 1545-0074 <div style="text-align: center; font-size: 2em; font-weight: bold;">2012</div> Attachment Sequence No. 32
Name(s) shown on Form 1040 or Form 1040NR		Your social security number

Part I Alternative Minimum Taxable Income (See instructions for how to complete each line.)		
1	If filing Schedule A (Form 1040), enter the amount from Form 1040, line 41, and go to line 2. Otherwise, enter the amount from Form 1040, line 38, and go to line 7. (If less than zero, enter as a negative amount.)	1
2	Medical and dental. Enter the <b>smaller</b> of Schedule A (Form 1040), line 4, or 2.5% (.025) of Form 1040, line 38. If zero or less, enter -0-	2
3	Taxes from Schedule A (Form 1040), line 9	3
4	Enter the home mortgage interest adjustment, if any, from line 6 of the worksheet in the instructions for this line	4
5	Miscellaneous deductions from Schedule A (Form 1040), line 27	5
6	Skip this line. It is reserved for future use	6
7	Tax refund from Form 1040, line 10 or line 21	7
8	Investment interest expense (difference between regular tax and AMT)	8
9	Depletion (difference between regular tax and AMT)	9
10	Net operating loss deduction from Form 1040, line 21. Enter as a positive amount	10
11	Alternative tax net operating loss deduction	11
12	Interest from specified private activity bonds exempt from the regular tax	12
13	Qualified small business stock (7% of gain excluded under section 1202)	13
14	Exercise of incentive stock options (excess of AMT income over regular tax income)	14
15	Estates and trusts (amount from Schedule K-1 (Form 1041), box 12, code A)	15
16	Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)	16
17	Disposition of property (difference between AMT and regular tax gain or loss)	17
18	Depreciation on assets placed in service after 1986 (difference between regular tax and AMT)	18
19	Passive activities (difference between AMT and regular tax income or loss)	19
20	Loss limitations (difference between AMT and regular tax income or loss)	20
21	Circulation costs (difference between regular tax and AMT)	21
22	Long-term contracts (difference between AMT and regular tax income)	22
23	Mining costs (difference between regular tax and AMT)	23
24	Research and experimental costs (difference between regular tax and AMT)	24
25	Income from certain installment sales before January 1, 1987	25
26	Intangible drilling costs preference	26
27	Other adjustments, including income-based related adjustments	27
28	<b>Alternative minimum taxable income.</b> Combine lines 1 through 27. (If married filing separately, see instructions.)	28
Part II Alternative Minimum Tax (AMT)		
29	Exemption. See instructions	29
30	Subtract line 29 from line 28. If more than zero, go to line 31. If zero or less, enter -0- here and on lines 31, 33, and 35, and go to line 34	30
31	<ul style="list-style-type: none"> <li>• If you are filing Form 2556 or 2556-EZ, see instructions for the amount to enter.</li> <li>• If you reported capital gain distributions directly on Form 1040, line 13; you reported qualified dividends on Form 1040, line 9b; or you had a gain on both lines 15 and 16 of Schedule D (Form 1040) (as refigured for the AMT, if necessary), complete Part III on the back and enter the amount from line 54 here.</li> <li>• <b>All others:</b> If line 30 is \$175,000 or less (\$87,500 or less if married filing separately), multiply line 30 by 26% (.26). Otherwise, multiply line 30 by 28% (.28) and subtract \$3,500 (\$1,750 if married filing separately) from the result.</li> </ul>	31
32	Alternative minimum tax foreign tax credit (see instructions)	32
33	Tentative minimum tax. Subtract line 32 from line 31	33
34	Tax from Form 1040, line 44 (minus any tax from Form 4972 and any foreign tax credit from Form 1040, line 47). If you used Schedule J to figure your tax, the amount from line 44 of Form 1040 must be refigured without using Schedule J (see instructions)	34
35	<b>AMT.</b> Subtract line 34 from line 33. If zero or less, enter -0-. Enter here and on Form 1040, line 45	35

**Part III Tax Computation Using Maximum Capital Gains Rates**

Complete Part III only if you are required to do so by line 31 or by the Foreign Eamed Income Tax Worksheet in the instructions.

36	Enter the amount from Form 6251, line 30. If you are filing Form 2555 or 2555-EZ, enter the amount from line 3 of the worksheet in the instructions for line 31 . . . . .				36
37	Enter the amount from line 6 of the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for Form 1040, line 44, or the amount from line 13 of the Schedule D Tax Worksheet in the instructions for Schedule D (Form 1040), whichever applies (as figured for the AMT, if necessary) (see instructions). If you are filing Form 2555 or 2555-EZ, see instructions for the amount to enter . . . . .	37			
38	Enter the amount from Schedule D (Form 1040), line 19 (as figured for the AMT, if necessary) (see instructions). If you are filing Form 2555 or 2555-EZ, see instructions for the amount to enter . . . . .	38			
39	If you did not complete a Schedule D Tax Worksheet for the regular tax or the AMT, enter the amount from line 37. Otherwise, add lines 37 and 38, and enter the <b>smaller</b> of that result or the amount from line 10 of the Schedule D Tax Worksheet (as figured for the AMT, if necessary). If you are filing Form 2555 or 2555-EZ, see instructions for the amount to enter . . . . .	39			
40	Enter the <b>smaller</b> of line 36 or line 39 . . . . .				40
41	Subtract line 40 from line 36 . . . . .				41
42	If line 41 is \$175,000 or less (\$87,500 or less if married filing separately), multiply line 41 by 26% (.26). Otherwise, multiply line 41 by 28% (.28) and subtract \$3,500 (\$1,750 if married filing separately) from the result . . . . .				42
43	Enter: <ul style="list-style-type: none"> <li>• \$70,700 if married filing jointly or qualifying widow(er),</li> <li>• \$35,350 if single or married filing separately, or</li> <li>• \$47,350 if head of household.</li> </ul>	43			
44	Enter the amount from line 7 of the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for Form 1040, line 44, or the amount from line 14 of the Schedule D Tax Worksheet in the instructions for Schedule D (Form 1040), whichever applies (as figured for the regular tax). If you did not complete either worksheet for the regular tax, enter -0- . . . . .	44			
45	Subtract line 44 from line 43. If zero or less, enter -0- . . . . .	45			
46	Enter the <b>smaller</b> of line 36 or line 37 . . . . .	46			
47	Enter the <b>smaller</b> of line 45 or line 46 . . . . .	47			
48	Subtract line 47 from line 46 . . . . .	48			
49	Multiply line 48 by 15% (.15) . . . . .				49
	<b>If line 38 is zero or blank, skip lines 50 and 51 and go to line 52. Otherwise, go to line 50.</b>				
50	Subtract line 48 from line 40 . . . . .	50			
51	Multiply line 50 by 25% (.25) . . . . .				51
52	Add lines 42, 49, and 51 . . . . .				52
53	If line 36 is \$175,000 or less (\$87,500 or less if married filing separately), multiply line 36 by 26% (.26). Otherwise, multiply line 36 by 28% (.28) and subtract \$3,500 (\$1,750 if married filing separately) from the result . . . . .				53
54	Enter the <b>smaller</b> of line 52 or line 53 here and on line 31. If you are filing Form 2555 or 2555-EZ, do not enter this amount on line 31. Instead, enter it on line 4 of the worksheet in the instructions for line 31 . . . . .				54