

# Alternative Minimum Tax

Vaughn Ramsey  
Tuggle Duggins & Meschan, P.A.

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# How AMT Got Started

- 1964: 1,100 returns with income more than \$200K had 22% tax rate
  - (top rate was decreased to 70% in 1964 and 50% in 1981)
- 1969: Treasury finds 155 people with gross income more than \$200K paid 0 tax
- Result: Add on tax of 10% on tax preferences after the first \$30K of income and deduct regular tax

# AMT start

- Congress wanted everyone to pay
- Began with tax on preferences (excluded cap gain, stock options, depreciation)
- Initially an add on tax

# AMT: if at first.....

- 1970: allowed deduct of unused carryover
- 1971: minor foreign tax income change
- 1976: add preferences, rate to 15%(some were still not paying)
- 1977: reduced IDC preference
- 1978: restructure to AMT-no add on (worries over capital formation) with 10-25% rates
- 1981: lowered rates
- 1982: Flat 20% rate, now \$40K exempt (wealthy still avoiding)
- 1984: changes on tax credits and IDC
- 1986: exemption phase out (still not working), rate to 21%

# AMT: if at first.....

- 1987: More technical corrections
- 1988: More technical corrections
- 1989: further technical amendments
- 1990: rate to 24%
- 1992: more IDC changes
- 1993: 26/28% rates and \$45K exemption
- 1997: Changes re depreciation and farmer installment sales
- 1998: changed cap gain formula
- 1999: credits for 2000/2001 only

# The Saga Continues

- 2001: exemption to \$49K by 04
- 2002: NOL change/temp credit
- 2003: exemption to \$58K/Lower CG
- 2004: extend "temp" credit
- 2005: 2003 increase eff. for 05
- 1986: Corporate AMT born
- Bottom Line, the AMT is now the flat tax with no progressive rates but Congress can and will change it

# A Separate System

- AMT separate from regular system
- BUT regular rules apply when applicable
- Different rates, deductions, credits
- Requires parallel records for basis, tax credits, and other items.

# Current AMT Summary

- 26% of first \$175K AMTI
- 28% on excess
- Joint filers get \$58K exemption
- Exemption phase out at \$150K (joint)  
so lose \$1 exemption for every 4\$  
increase
- Exemption \$0 at \$382K

# Who does it apply to?

- Individuals regardless of tax rate  
(taxpayers have lost arguing only for the rich)
- Pass throughs to owners (not entity)
- Trusts and Estates-generally subject
- Nonresident aliens US source income
- Corporations have separate AMT-but  
not small corps with \$5M 3 yr avg  
gross receipts

# AMT Calculation Summary

- Start with Taxable Income
- Plus/minus IRC 55 & 58 adjustments
- Plus IRC 57 tax preference items
- Gives you AMTI
- Minus exemption amount (\$58K)
- Multiply 26% to \$175K and 28% above
- Equals pre credit min tax

# Calculation-contd

- Minus AMT foreign tax credit and any other applicable credits
- Equals tentative min tax
- Compare with regular tax
- AMT more, pay AMT
- Regular more, pay regular tax
- The computer does it anyway

# AMT adjustments

- Depreciation: uses an alternate system with longer recovery
- Mine Exploration and Development: amortize over 10 yrs vs deduct
- Long term contracts: % completion method required
- NOLs: Special IRS 56(d) calculation
- Pollution Control Facilities: Recalculate costs under AMT system vs nice IRC 169 (depends on year placed in service)

# More adjustments

- No alcohol fuel credit
- No standard deduction and no itemized deductions
- No state and local tax deducts
- Limited med expenses (over 10% AGI)
- itemized deductions restricted
- No interest on nonacquisition mort debt (home equity lines a bust)

# Even more adjustments

- No standard deduction
- No personal and dependency deductions (more kids means greater chance of AMT)
- Incentive stock options taxed in year granted if ascertainable FMV (creates major issue if stock not sold and no other source to pay tax and forced sale means no LTCG)

# Yes, even more adjustments

- Adjusts passive activity loss rules  
(rules still apply but are even less favorable)
- No passive farm losses
- Circulation expenditures are capitalized not deducted
- Research & Experimental costs are capitalized not deducted

# AMT Preference Items

- Excess depletion added to AMTI
- Intangible drilling costs by their "excess portion"
- Tax exempt interest on certain private activity bonds added to AMTI
- Accelerated depreciation on pre 87 realty in excess of straight line dep
- CG on qualified small business stock added back to extent of excluded gain

# AMT Credits

Allowed:

IRC 23 adoption credit

IRC 24 child credit

IRC 25B qualified retirement savings credit

Adjusted foreign tax credit

But no business credits if subject to

**AMT** (includes research credit, work opportunity credit, low income housing credit, oil recovery credit and various other business credits)

# AMT Tax Credit Against Regular Tax Liability

- Items in AMTI show up in regular income later (dep, ISO, mining)
- IRC 53 gives a credit against regular tax to avoid double inclusion
- When timing makes tentative AMT less than regular tax, taxpayer pays the tentative AMT
- Calculation is complicated

# AMT and Capital Gains

- Pre 1986 was a preference item
- Since 1986 cap gains rates have been cut but not a preference
- Different AMT basis from dep can result in different gain
- Large cap gain can eliminate the AMT exemption

# Kiddie AMT

- Applies to children under 14 who are subject to the IRC 1(g) kiddie tax
- Under 59(j) kid gets exemption equal to lesser of \$33,750 or earned income plus \$6,050
- AMT can apply to the child but not the parent

# The Expanding AMT

- 2004 married couple, 2 kids, \$140K income, \$10K mort int and \$17K state and local tax
- Regular Tax \$17,850
- AMT \$18,720
- \$870 AMT from loss of 5 exemptions and loss of state & local tax (are these people rich?)

# You don't have to be rich

- 2000/ 1% of taxpayers under AMT
- 2005 grows to 3%
- 2010 estimated to be 33% (may decrease if Bush tax cuts actually expire)
- In 2005, 65% of couples with 2 plus kids and \$75-100K income are AMT
- 2010 90% of \$100 to \$500K taxpayers under AMT

# AMT Premises Today

- \$200K high income focus of 1969 Congress would be \$1,100K today
- Original \$30K exemptions would be \$155K today (vs \$58K)
- But regular rates are much lower than the 70% max progressive rate, thus more chance of AMT

# Who are AMT Candidates

- Taxpayers with large families
- Taxpayers who itemize large expenses
- Taxpayers with large medical expenses
- Taxpayers in high tax states
- Taxpayers whose employers do not reimburse business expenses (no AMT use)

# More AMT Candidates

- Taxpayers who borrow on home equity
- Taxpayers with big tort settlements (There are cases where the tax exceeds the award net of the attorney fees and large award means no exemption and no 2% misc ded)
- Taxpayers with big LTCG (increased income leads to loss of the exemption on the phase out)
- Taxpayers exercising ISOs (unless they sell in the same year have tax with no cash)
- Taxpayers with large amounts of accelerated depreciation (results in greater AMTI in early years and less in later years)
- Taxpayer with large amounts of credits (many are limited or not allowed)

# AMT Planning

(opportunities are pretty limited)

- Try to spread out cap gains (but don't let the tax tail wag the dog) Try to spread out ISO exercises and be realistic on future value (exercise high/sell low killed many in the bubble)
- Use home equity lines wisely
- Move (to a lower tax state) and don't prepay taxes in Dec without AMT review
- Employers can reimburse employees for business expenses (vs losing itemized deduct in AMT)
- Maximize cafeteria plans use to limit medical expenses

# Why is the AMT Failing?

- It is not indexed
- Compliance is complex and costly
- Regular rates are at a historic low thus increasing the chance of AMT
- There are still many high income taxpayers with no tax-tax shelters? (to 2001, there had never been more than 1,500 taxpayers with income over \$200K who did not pay tax..overkill)
- Does not target tax shelters-poorly targeted
- It penalizes marriage and children
- The AMT raises marginal rates (not progressive)
- The number of taxpayers who would pay tax without the AMT is small, the AMT adds 1 taxpayer for every 6,600 already paying

# AMT Reform Challenges

- Repeal in 2005 would cost \$660B by 2014 (if tax cut expires) and \$1,090B if not
- By 2008, AMT repeal will cost more than to zero out the regular tax
- Indexing would cost \$450B (if tax cuts expire) and \$780B if not
- Doing nothing may be the only option from a revenue standpoint

# AMT Reform Proposals

- Repeal...too costly
- Indexing...too costly
- Treat LTCG as a preference item (as pre 87) plus above (LTCG really for the truly rich under this theory and makes much less costly)
- Raise the regular tax rate (2001 tax cuts are illusory for taxpayers subject to AMT)
- Allow AMT dependent exemptions (estimated 20% decrease in AMT population)
- Allow state and local tax deductions for the AMT (estimated 33% decrease in AMT population)
- Do nothing....Forbes achieves his flat tax