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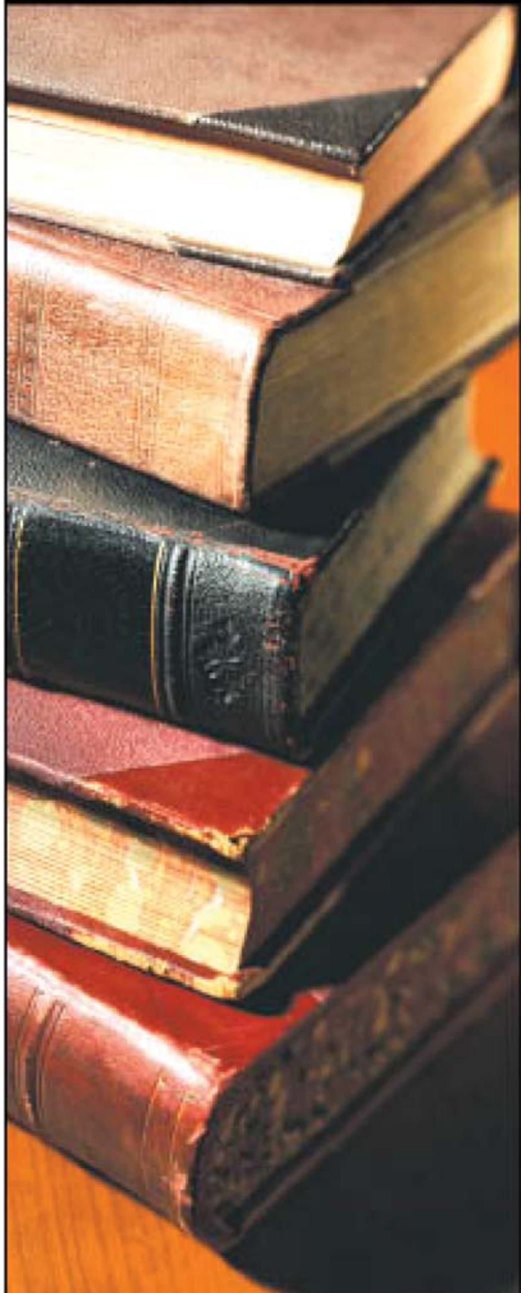

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Understanding the Alternative Minimum Tax
(Course #6510/QAS6510)

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Chapter 1: Introduction

A BRIEF HISTORY OF ALTERNATIVE MINIMUM TAX

Taxpayers who are not required to pay tax under the regular tax system may still be liable for tax under the Alternative Minimum Tax (AMT) laws. These laws create an equity in the system, requiring higher income individuals with certain deductions to pay tax. Without the AMT laws, these individuals would pay little or no tax while those with lower income levels and no deductions would pay higher tax.

The AMT laws began in 1969. Since that time, the laws surrounding the computation of the tax have been modified through various tax revision acts. The 1969 law subjected individuals to an add-on tax at a 10-percent rate in addition to their regular tax. The Tax Revision Act (TRA) of 1976 increased the rate from 10 to 15 percent and decreased the exemption amount.

The Revenue Act of 1978 introduced the first Alternative Minimum Tax. The taxpayer was liable for AMT only when the tentative AMT exceeded the sum of regular tax and any add-on minimum tax. In 1982, the AMT system was substantially overhauled. The new AMT enacted was calculated at a 20-percent rate less an exemption based on the taxpayer's filing status. Similar to current law, AMT was due only to the extent that it exceeded an individual's regular tax.

The last significant overhaul to the AMT system was the Tax Reform Act (TRA) of 1986, effective for 1987 and subsequent tax years. The law was changed to consider the deferral effect of AMT items over a long-term period, such as depreciation and amortization adjustments. For the first time, such deferral items could result in positive AMT adjustments in the initial years of a property's life and corresponding negative adjustments in subsequent years when the effect of the earlier years' accelerated depreciation reversed. A significant revision of the TRA of 1986 is the concept that AMT is now a separate, but parallel, tax system from the one used to compute an individual's regular tax. Accordingly, an individual taxpayer is required to maintain separate records for regular tax and AMT purposes.

Subsequent legislation, the Revenue Act of 1987, the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), the Revenue Reconciliation Acts of 1989, 1990, and 1993, and the Energy Act of 1992, made further modifications and clarifications to the AMT rules of the TRA of 1986.

In the Taxpayer Relief Act of 1997, IRC section 55(b)(3) was added to adjust the AMT for capital gains. In 1998, that section was revised to recognize the new capital gain rates.

Congress continued to tinker with the AMT exemption amounts in 2003-2011. By enacting temporary increases in the exemption amounts, Congress is ensuring that they will need to continue to address the AMT impact on taxpayers in the future. Congress has increased the AMT exemption amount for 2010 and 2011. Congressional leaders have stated they intend to address the issue for 2012 and future years at a later date. President Obama’s fiscal year 2013 proposed budget calls for eliminating the AMT. However, nothing will happen unless enacted by Congress.

CURRENT YEARS' AMT

Internal Revenue Code sections 55, 56, 57, 58, and 59 contain the current laws surrounding this computation. Prior years' laws will be discussed separately later in this course.

AMT is calculated by adjusting the taxpayer's regular taxable income with a number of tax preference items and adjustments. Tax preference items are positive items increasing Alternative Minimum Taxable Income (AMTI) and are excluded from regular taxable income. Tax preference items include tax-exempt interest from certain private activity bonds, depletion, intangible drilling costs, accelerated depreciation on leased personal or real property placed in service before 1987, amortization of certain pollution control costs or facilities placed in service before 1987, and certain leased property subject to accelerated cost recovery.

Adjustments for AMT may result in positive and negative amounts and may have implications in subsequent tax years. Adjustments include standard or itemized deductions, personal exemptions, 1987 and subsequent-year depreciation based on the alternative depreciation system, amortization of circulation and research and experimental costs, amortization of mining exploration and development costs, amortization of pollution control costs for facilities placed in service after 1986, use of percentage completion for long-term contracts entered into after February 28, 1986, installment sale adjustments, gain or loss adjustments on the disposition of business property, incentive stock options, tax shelter farm loss limitations, passive activity loss limitation, and AMT net operating loss.

Due to the increasing level of taxpayer frustration over the AMT, the IRS has introduced the “AMT Assistant.” The AMT Assistant is really just an automated version of the “worksheet to see if you should file a Form 6251.” It does not help much.

DID YOU KNOW?

- The minimum tax was enacted into law in 1969 after Congress learned that 155 taxpayers with adjusted gross incomes (AGI) of $200,000 or more for the 1966 tax year had paid no federal tax at all.
- The Joint Committee on Taxation projects that within the next decade, almost two million taxpayers with incomes as low as $30,000 will have to prepare the AMT schedule with their tax returns – if only to prove that they do not owe AMT.
- In tax year 2001, over 660,000 taxpayers with AGI under $200,000 paid more than $1.625 billion in AMT. The number of taxpayers with AGI of less than $50,000 owing AMT in 2001 is virtually the same as the number of taxpayers with AGI between $475,000 and $500,000 who owe no AMT.
- In 2010, it was estimated to cost less to repeal the regular income tax structure and keep the AMT ($74 billion) than to abolish the AMT ($85 billion).
- In 2012, the AMT is projected to affect nearly 32 million taxpayers. The majority will have incomes under $100,000, and more than 36 percent of taxpayers with incomes between $50,000 and $75,000 will owe AMT.
- Taxpayers must fill out a 12-line worksheet, read ten pages of instructions, and complete a 54-line form – only to find they owe little or no AMT after all. Other taxpayers must complete the 54-line form, even though they are not subject to the AMT, to substantiate their entitlement to certain tax credits.
- Taxpayers subject to the AMT must calculate their tax liability twice, once under regular income tax rules and again under AMT rules.
- Taxpayers were projected to lose the benefit of nearly 12 billion dollars in tax credits (such as business credits) in 2010 because of AMT.
- In December 2010, the 2010 and 2011 exemption amounts were increased. The 2010 exemption amounts are $47,450 for single filers, $72,450 for joint filers, and $36,225 for married filing separately. For 2011, the amounts above increase to $48,450, $74,450, and $37,225, respectively. The exemption amounts returned to their 2000 amounts on January 1, 2012 and will remain there unless Congress acts.

CHANGES TO NOTE

- For 2011, the exemption amount has increased to $48,450 for single filers ($74,450 if married filing jointly or qualifying widow(er); $37,225 if married filing separately).
- The 20% maximum tax rate on net capital gain has been reduced to 15%, and the 10% rate has been reduced to 5%, for sales and other dispositions after May 5, 2003 (and installment payments received after that date).
- Beginning in 2003, your alternative tax net operating loss deduction (ATNOLD) is generally limited to 90% of your alternative minimum taxable income (figured without regard to the ATNOLD).
- For 2011 and subsequent years, the minimum exemption amount for a child under age 18 has increased to $6,800.
- Unless the increased exemption amounts are extended by Congress, the exemption amounts for 2012 will revert to those that applied in 2000.
- Beginning in 2004, you may benefit from income averaging on Schedule J (Form 1040) even if you owe the alternative minimum tax.
- In most cases, no adjustment is required for the deduction of qualified mortgage insurance premiums. But see the discussion later in the course.
- The *Foreign Earned Income Tax Worksheet* has been revised to reflect changes made by the Tax Technical Corrections Act of 2007.
- For tax years beginning in 2008 through 2011, individuals may offset their entire regular tax liability and AMT liability by the nonrefundable personal credits.
- Special rules apply in 2008 and subsequent years for depreciation of qualified disaster assistance property and for benefits received in certain disaster areas.

Form **6251**

Department of the Treasury
Internal Revenue Service (99)

Alternative Minimum Tax—Individuals

► See separate instructions.
► Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074

2011

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 **smaller** 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	**Alternative minimum taxable income.** Combine lines 1 through 27. (If married filing separately and line 28 is more than $223,900, see instructions.)	28	

Part II Alternative Minimum Tax (AMT)

29 Exemption. (If you were under age 24 at the end of 2011, see instructions.)

IF your filing status is . . .	AND line 28 is not over . . .	THEN enter on line 29 . . .
Single or head of household	$112,500	$48,450
Married filing jointly or qualifying widow(er)	150,000	74,450
Married filing separately	75,000	37,225

If line 28 is **over** the amount shown above for your filing status, 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
- If you are filing Form 2555 or 2555-EZ, see instructions for the amount to enter.
- 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.
- **All others:** 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.

— **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	**AMT.** Subtract line 34 from line 33. If zero or less, enter -0-. Enter here and on Form 1040, line 45	35	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 13600G Form **6251** (2011)

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 Earned 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 this line		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 refigured 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 refigured 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 **smaller** of that result or the amount from line 10 of the Schedule D Tax Worksheet (as refigured 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 **smaller** 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: • $69,000 if married filing jointly or qualifying widow(er), • $34,500 if single or married filing separately, or • $46,250 if head of household.	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 **smaller** of line 36 or line 37	46	
47	Enter the **smaller** of line 45 or line 46	47	
48	Subtract line 47 from line 46	48	
49	Multiply line 48 by 15% (.15) . . . . . ▶		49
	If line 38 is zero or blank, skip lines 50 and 51 and go to line 52. Otherwise, go to line 50.		
50	Subtract line 46 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 **smaller** 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

Form **6251** (2011)

CHAPTER 1 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following taxpayers may be subject to tax under the Alternative Minimum Tax (AMT):

   a) only taxpayers that pay no regular tax
   b) any taxpayer, even those with a liability under the regular tax system
   c) only taxpayers with AGI in excess of $200,000
   d) only taxpayers with large business related tax preference items

2. The last significant overhaul of the AMT was in:

   a) 1978
   b) 1982
   c) 1986
   d) 1992

3. When calculating AMT, taxpayers need to identify which of the following:

   a) ”tax preferences” only
   b) ”adjustments” only
   c) both tax preferences and adjustments
   d) all taxpayers must identify adjustments but only businesses need to identify preferences

4. The Joint Committee on Taxation projects that within the next decade, almost ______ taxpayers with incomes as low as $30,000 will have to prepare the AMT schedule with their tax returns simply to prove that they do not owe AMT.

   a) 660,000
   b) two million
   c) 32 million
   d) all married

CHAPTER 1 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. The AMT is a parallel tax system whereby taxpayers pay the greater of the regular tax and the AMT. Most taxpayers subject to the AMT have some liability under the regular tax system

   B: Correct. The AMT is a parallel tax system whereby taxpayers pay the greater of the regular tax and the AMT. Most taxpayers subject to the AMT have some liability under the regular tax system.

   C: Incorrect. Taxpayers may be subject to the AMT regardless of their AGI if they have enough tax preferences and adjustments.

   D: Incorrect. Many itemized deductions like state taxes are preference items under the AMT.

   (See page 1-1 of the course material.)

2. A: Incorrect. The first AMT was introduced in 1978 as a replacement for the prior add-on minimum tax. However, the AMT was subsequently significantly overhauled.

   B: Incorrect. In 1982, the AMT was overhauled and a 20 percent rate was introduced. However, the AMT was subsequently significantly overhauled.

   C: Correct. The last significant overhaul to the AMT system was the Tax Reform Act (TRA) of 1986, effective for 1987 and subsequent tax years. The law was changed to consider the deferral effect of AMT terms over a long-term period such as depreciation and amortization adjustments. For the first time, such deferral items could result in positive AMT adjustments in the initial years of a property's life and corresponding negative adjustments in subsequent years when the effect of the earlier years' accelerated depreciation reversed. A significant revision of the TRA of 1986 is the concept that AMT is now a separate, but parallel, tax system from the one used to compute an individual's regular tax. Accordingly, an individual taxpayer is required to maintain separate records for regular tax and AMT purposes.

   D: Incorrect. The AMT has been tinkered with numerous times since its inception, but the last significant overhaul was prior to 1992.

   (See page 1-1 of the course material.)

3. A: Incorrect. Tax preference items are not the only items that must be identified.

   B: Incorrect. Adjustments are not the only items used in calculating AMTI.

   C: Correct. Tax preference items are positive items increasing Alternative Minimum Taxable Income (AMTI) and are excluded from regular taxable income. Adjustments for AMT may result in positive and negative amounts and may have implications in subsequent tax years.

   D: Incorrect. One of the most common preference items is the dependency exemption.

   (See page 1-2 of the course material.)

4. A: Incorrect. In 2001, 660,000 taxpayers with AGI under $200,000 were subject to AMT.

   B: Correct. These two million taxpayers will not owe the AMT but will need to file Form 6251 to prove that they are not subject to the AMT.

   C: Incorrect. By 2012, the AMT is projected to affect nearly 32 million taxpayers.

   D: Incorrect. The AMT impacts all filing statuses.

   (See page 1-3 of the course material.)

Chapter 2: Computing AMT

FORM 6251 ALTERNATIVE MINIMUM TAX-INDIVIDUALS

To help you understand the computation of AMT, this course will follow Form 6251 line by line. Page 1 of Form 6251 is included at the end of Chapter 1 for your reference. You will want to refer to this form as we discuss each item.

AMT is computed using Form 6251. This form must be attached to the income tax return. Form 6251 has three parts. Part I identifies and computes the total adjustments and preference items. Part II computes the AMTI. This computation requires the consideration of prior and current year net operating losses (NOLs). Part II also identifies the taxpayer's exemption amount and computes the AMT owed by the taxpayer. Part III calculates the AMT using the maximum capital gains tax rates. Each of these areas are addressed later in the material.

The applicability of AMT must be made on a return by return basis. If the return contains a Form 6251, the form should be analyzed to determine if the tax was properly computed. If not, a determination should be made as to whether AMT would apply. Upon completion of each audit, the IRS will decide whether or not the AMT applies and, if so, the amount of AMT owed by the taxpayer. Throughout this course we will attempt to identify the items an IRS examiner will scrutinize.

ADJUSTMENTS AND PREFERENCE ITEMS

To arrive at Alternative Minimum Taxable Income (AMTI), certain adjustments must be made to "regular" taxable income. When computing AMTI, we will begin with taxable income before exemptions and add or subtract all the applicable adjustments and tax preference items. Part I of Form 6251 calculates the AMTI.

LINE 1, ADJUSTED GROSS INCOME (AGI) OR MODIFIED TAXABLE INCOME

A taxpayer will either itemize deductions on Schedule A, Itemized Deductions, or use the standard deduction when computing his or her taxable income.

If the taxpayer claims the Standard Deduction per IRC section 63(c), this amount will not be allowed when computing the Alternative Minimum Taxable Income. IRC section 56(b)(1)(E) lists this amount as an adjustment for purposes of AMT. Form 6251 begins with AGI for those who claim the standard deduction.

IRC section 56(b)(1)(E) also disallows the personal exemptions under IRC section 151 for AMT purposes.

Taxpayers that do itemize deductions on Schedule A, begin with their AGI less allowable itemized deductions. This is the same figure as taxable income after adding back any personal exemptions claimed in arriving at taxable income.

Observation: The increased standard deduction as part of the much heralded "marriage penalty" relief may have the unintended consequence of pushing more couples into AMT. Since the standard deduction is not allowable for AMT, any increase in the standard deduction has the potential to lower the regular tax and expose taxpayers to the AMT.

Practice Pointer: Standard Deduction – Taxpayers who claim the standard deduction and are subject to the AMT should consider the counter-intuitive idea of itemizing their deductions.

LINE 2, MEDICAL AND DENTAL EXPENSES

This line applies only if the taxpayer itemized deductions. If the taxpayer took the Standard Deduction, this line should be blank.

For regular income tax purposes, medical and dental expenses are deductible to the extent they exceed 7.5 percent of AGI. For AMT purposes, medical and dental expenses are allowable only to the extent they exceed 10 percent of AGI.

On Line 2 of Form 6251, the taxpayer enters the smaller of Schedule A, Line 4 or 2.5 percent of AGI from Form 1040, which allows the taxpayer medical and dental expenses that exceed 10 percent of AGI.

The following example illustrates this point.

Example: Patrick has $13,000 in medical expenses. His AGI is $100,000. His medical expense for regular tax purposes is $5,500 ($13,000 - (7.5 percent x $100,000)). This amount would be reflected on Schedule A. His medical expense for AMT purposes would be $3,000 ($13,000 – (10 percent x $100,000)). Medical expense has been deducted on the tax return in the amount of $5,500; therefore, medical expenses of $2,500 must be added back to arrive at the allowable AMT medical expenses of $3,000 ($5,500-$2,500).

You arrive at the same $2,500 adjusted by using the directions on Line 2 of Form 6251, and entering the lesser of the amount of medical expenses on Schedule A ($5,500) or 2.5 percent of AGI ($2,500) (2.5 percent x $100,000).

Practice Pointer: Enrolling in an employer-sponsored cafeteria plan or a similar medical expense reimbursement arrangement will generally lower both the regular tax and the AMT.

Which AGI To Use

There had been some confusion as to whether AGI for regular income tax purposes should be used or if AGI should be recomputed for AMT purposes and the recomputed AMT AGI be used. In late 1994, IRS issued Treas. Reg. section 1.55-1, effective for taxable years beginning after December 31, 1993. Treas. Reg. section 1.55-1(b) states "In determining the alternative minimum taxable income of a taxpayer other than a corporation, all references to the taxpayer's adjusted gross income or modified adjusted gross income in determining the amount of items of income, exclusion, or deduction must be treated as references to the taxpayer's adjusted gross income or modified adjusted gross income as determined for regular tax purposes."

Therefore, in all computations requiring an AGI limitation, the AGI for regular tax purposes must be used.

IRS Audit Techniques

1. If no Form 6251 has been prepared, the examiner will include any medical expenses not allowed for AMT purposes.

2. If Form 6251 has been prepared, the examiner will verify that an adjustment has been made for the difference between 7.5 percent for regular tax purposes and ten percent for AMT purposes.

3. Any adjustments affecting AGI will affect the amount of medical deductions allowable for regular and AMT purposes. If changes are made to AGI, the examiner will make corresponding changes to medical adjustments.

4. If adjustments are made to itemized deductions, corresponding changes should be made to Form 6251.

LINE 3, TAXES

This line applies only if the taxpayer itemized deductions. If the taxpayer took the Standard Deduction, this line should be blank.

For AMT purposes, no deductions are allowed for:

- State, local, and foreign real property taxes,
- State and local personal property taxes,
- State, local and foreign income taxes,
- War profits and excess profits taxes, and
- State and local general sales taxes.

If any of these deductions are taken on Schedule A for regular tax purposes, they must be added back when computing AMT. Any items deducted in arriving at AGI are not adjusted for AMT purposes. Thus, any real estate taxes deducted on Schedules C (Profit or Loss From Business), F (Profit or Loss From Farming), or E (Supplemental Income and Loss) are fully deductible.

Example: Josh claims state and local income taxes of $2,500 and real estate taxes of $4,250 on his current year Schedule A. His taxable income before personal exemptions is $34,000. Excluding all other items, his AMTI will be $40,750 ($34,000 + $2,500 + $4,250).

In practice, the amount added back should be all taxes claimed on Schedule A, line 9 except generation skipping transfer taxes on income distributions.

IRS Audit Techniques

1. If no Form 6251 was prepared, prepare one including any unallowable taxes as an adjustment.

2. If Form 6251 was prepared, verify that the correct tax figure has been used for AMT purposes.

3. Verify that taxes paid were due and owing. Some taxpayers may attempt to shift tax payments and deductions from AMT to regular tax years when no AMT liability exists.

Practice Pointer: Taxpayers subject to the AMT in the current year should consider postponing the payment of state and local taxes to a future year in which the taxpayer may not be subject to the AMT.

Practice Pointer: Capitalizing Interest and Taxes – Taxpayers subject to the AMT should consider making the election under Section 266 to capitalize the taxes and interest on unproductive land. To make the election, attach a statement to the return itemizing the expenses to be capitalized. The election must apply to all similar expenses of the same project and only applies to the year made.

Practice Pointer: Foreign Taxes – Taxpayers subject to the AMT should consider claiming the foreign tax credit on Form 1116 instead of claiming the taxes as an itemized deduction. Tax preparation programs have made claiming the foreign tax credit easy.

Practice Pointer: Home Office Deduction – In the recent past, many sole proprietor taxpayers that qualified for the home office deduction elected not to claim it for a variety of reasons. The loss of itemized deductions due to the AMT adds another item to consider. By claiming the home office deduction, some of the taxes will be deducted on Schedule C in arriving at AGI and will not be added back as a preference item in calculating AMTI.

LINE 4, HOME MORTGAGE INTEREST ADJUSTMENT

This line applies only if the taxpayer itemized deductions. If the taxpayer took the Standard Deduction, this line should be blank.

This pertains to interest on a home mortgage not used to buy, build, or improve a home. The AMTI mortgage interest deduction is allowed in a similar manner to the regular mortgage interest deduction with one modification. Mortgage interest is allowed for AMTI purposes only if it is used to acquire, construct or improve the property. Property includes the taxpayer's qualified residence (defined in IRC section 121) and second home (defined in IRC section 163(h)(4)(A)(i)(II)). The only mortgage interest not allowed for AMTI purposes would be any home equity indebtedness taken out by the taxpayer which is not used to improve the property and certain refinanced debt.

Example: Jim and Donna deduct $12,000 of home mortgage interest on their Schedule A for the current tax year. Of this $12,000, $10,000 is from the original mortgage used to acquire the home two years ago. The remaining $2,000 is from a home equity loan. The home equity loan was taken out in last year for $22,000 and was used to add a bathroom and deck to the home. For AMTI purposes, no adjustment would need to be made because the home equity loan was used to improve the home.

Example: Assume the same facts above except that the home equity loan was used to purchase a new family car. Jim and Donna would have to add back the $2,000 interest from the home equity loan because the proceeds were not used to improve the residence. The $2,000 is allowed for regular tax purposes, assuming it meets the regular home mortgage interest rules of IRC section 163(h)(3)(C).

Include on this line home mortgage interest from all lines of Schedule A (Form 1040) **except** for interest on a mortgage whose proceeds were used to:

1. Buy, build, or substantially improve: a) your main home, or b) your second home that is a qualified dwelling (any house, apartment, condominium or mobile home); or

2. Refinance a mortgage that meets the requirements of 1 above, but only to the extent that the refinanced amount did not exceed the balance of that mortgage immediately before the refinancing.

Exception: If the mortgage was taken out before July 1, 1982, **do not** include interest on the mortgage if it was secured by property that was your main home or a qualified dwelling used by you or a member of your family at the time the mortgage was taken out. See section 56(e)(3).

The instructions for Form 6251 include a worksheet to guide taxpayers through this calculation.

IRS Audit Technique

Home equity loans should be verified to determine what the proceeds of the loan were used for. If home improvements were made, request documentation of the improvements. Any interest on loans or portion of home equity loans not used for home improvements should be added back on Line 4 of Form 6251 when computing AMT income.

Practice Pointer: Home Equity Debt – Since only acquisition indebtedness is deductible for AMT, taxpayers effectively lose (for AMT purposes) the deduction for home equity debt that is otherwise deductible on Schedule A. Taxpayers may make a special election under Temp. Reg. 1.163-10T(o)(5) to treat secured debt as unsecured. By making the election, the interest on the loan can be allocated to the use of the proceeds by using the general interest tracing rules.

Example: Assume the taxpayer's home is debt-free and the taxpayer obtains a loan of $125,000 to use as a down payment on a rental property. The loan is secured by his home. Under the general home mortgage interest rules, $100,000 is considered a home equity loan and $25,000 is allocated to the rental. For regular tax, the interest on the $100,000 home equity loan is deducted on Schedule A but is not allowed for AMT. If the election is made, then the entire $125,000 is considered to be unsecured and is therefore traced to the rental activity. The election may be made at any time, but once made, is irrevocable.

Type of Interest	Deductible for Regular Tax?	Deductible for AMT?
Qualified student loan interest	Yes	Yes
Business interest (Schedule C)	Yes	Yes
Rental interest (Schedule E)	Yes	Yes
Schedule A interest – Home acquisition interest	Yes	Yes
Home improvement interest	Yes	Yes
Home acquisition points	Yes	Yes
Home equity loan (used for personal purposes)	Yes	No
Amortized refinanced mortgage points	Yes	No
Refinanced home acquisition interest	Yes	Yes
Qualified mortgage insurance premiums	Yes	Yes, if the interest is deductible for AMT purposes

LINE 5, MISCELLANEOUS ITEMIZED DEDUCTIONS

This line applies only if the taxpayer itemized deductions. If the taxpayer took the Standard Deduction, this line should be blank.

No miscellaneous itemized deductions are allowed for AMT purposes. IRC section 56(b)(1)(A)(i). For regular tax purposes, taxpayers are allowed miscellaneous deductions in excess of two percent of their adjusted gross income.

Example: Jeff and Mary have adjusted gross income of $30,000. They have claimed $3,000 in miscellaneous deductions. For regular tax purposes, Jeff and Mary will have a deduction for miscellaneous items in the amount of $2,400 ($3,000-($30,000 x 2 percent)). For AMT purposes, no deduction is allowed. Therefore, the $2,400 will have to be added back on Line 5 of Form 6251 to compute AMTI and AMT.

Practice Pointer: "Other Miscellaneous Deductions" are not added back to compute AMTI. These other deductions include gambling losses to the extent of gambling winnings and certain casualty losses. These deductions are different than the "miscellaneous itemized deductions" discussed above.

IRS Audit Techniques

1. If no Form 6251 was prepared, prepare one disallowing any miscellaneous deductions allowed as deductions on Schedule A.

2. If a Form 6251 was prepared, verify that the amount of miscellaneous deductions deducted is included as an addition to income for AMT purposes.

3. If any audit adjustments are made which affect AGI, corresponding adjustments must be made for miscellaneous deductions for regular and AMT purposes.

4. If any audit adjustments are made that affect miscellaneous itemized deductions, corresponding adjustments must be made on Schedule A and Form 6251.

PHASED-OUT ITEMIZED DEDUCTIONS

Note: No adjustment is needed during 2010 and 2011 for this item. The adjustment will return in 2012 unless Congress acts.

IRC section 68 provides for an overall limitation on itemized deductions. This limitation is for taxpayers whose AGI exceeds a threshold amount (base amount of $100,000 adjusted for inflation). Itemized deductions are reduced by the lesser of three percent (one percent for 2008 and 2009; zero percent for 2010 and 2011) of the excess of AGI over the threshold amount or 80 percent of the amount of the itemized deductions otherwise allowable for such taxable year. For 2009, the threshold amount for a taxpayer filing as single was $166,800. This limitation does not exist for AMT purposes. Thus, an additional deduction is allowed for this amount for AMT purposes and is entered as a negative amount.

Example: Tom's itemized deductions are reduced by $2,500 due to IRS section 68 limitation. Since this limitation does not apply for AMT purposes, Tom should put negative $2,500 on Form 6251.

Observation: The itemized deduction phase-out declined to one percent for 2008 and 2009 and is eliminated for 2010 and 2011. This will have the unintended result of increasing the number of taxpayers subject to the AMT. Why? Simply by decreasing the regular tax without a similar decrease in AMT will result in more taxpayers feeling the impact of the AMT. This is true even though the total tax paid will be less than or equal to the tax that would have been due had the full three percent deduction phase-out still been in effect.

LINE 6

This line is reserved for future use.

LINE 7, REFUND OF TAXES

Since for AMT purposes no deduction is allowed for state, local, and foreign income taxes; state and local personal property taxes; and state, local, or foreign real property taxes, any refund of these amounts does not have to be included in income when arriving at AMTI. IRC section (56)(b)(1)(D). If previously included for regular tax purposes, this amount will be a negative adjustment when computing AMTI. However, these are only for amounts deducted on Schedule A. Thus, if the amounts are deducted in arriving at AGI (that is, deducted on Schedules C, E, or F) the amounts will be includible for AMT purposes.

Example: Jill included in her current year income for regular tax purposes a state income tax refund of $300. In the previous tax year, she itemized her deductions, including a deduction for all state taxes paid. Her taxable income before personal exemptions is $30,000. Excluding all other adjustments her AMTI will be $29,700.

Example: In the current year, John receives a refund for excess property taxes he paid last year on a rental house he owns. Because the property taxes were deducted on Schedule E, the refund should be reported on Schedule E for the current year and will not be subtracted in computing AMT.

Include any refund from Form 1040 that is attributable to state or local income taxes deducted after 1986. Also include any refunds received and included in other income on Form 1040 that are attributable to state or local personal property taxes, foreign income taxes, or state, local, or foreign real property taxes deducted after 1986.

IRS Audit Techniques

1. If the taxpayer has included a tax refund on Form 6251, verify that the taxpayer received a tax benefit from the amount of the tax refund.

2. If the taxpayer has not prepared Form 6251 and has received a tax refund for which a tax benefit was received, include the amount of the refund as a negative adjustment on Form 6251.

LINE 8, INVESTMENT INTEREST EXPENSE (Difference Between Regular Tax and AMT)

This line applies only if the taxpayer itemized deductions. If the taxpayer took the Standard Deduction, this line should be blank.

For regular tax purposes, investment interest is allowed up to the amount of investment income generated for the tax year. IRC section 163(d)(1). Investment interest is modified for AMT purposes to include interest on any private activity bond and any deduction referred to in IRC section 57(a)(5)(A). Therefore, any interest from these bonds is includible in income, and interest expense incurred in connection with these bonds is allowed as a deduction for AMT purposes. The interest from these bonds is included on Line 12 of Form 6251.

In addition, all adjustments contained in IRC sections 56, 57, and 58 apply when arriving at net investment income per IRC section 163(d) for AMT purposes.

Example: Jed has Investment Income of $25,000 reported on the return. He has also claimed investment interest expense of $9,000 on Schedule A. During the year, he earned interest of $5,000 from a private activity bond. In connection with this bond, he has investment interest expense of $1,000. Excluding all other AMT adjustments, if Jed's taxable income before personal exemptions is $115,000, his AMTI will be $119,000 ($115,000 + $5,000 - $1,000).

Most commercial tax preparation programs will compute a second Form 4952 for AMT purposes to document the AMT difference, if any.

If you filled out Form 4952, Investment Interest Expense Deduction, for your regular tax, you will need to fill out a second Form 4952 for the AMT as follows.

Step 1. Follow the Form 4952 instructions for Line 1, but also include the following amounts when completing Line 1:

- Any interest expense on Line 4 of Form 6251 that was paid or accrued on indebtedness attributable to property held for investment within the meaning of Section 163(d)(5) (for example, interest on a home equity loan whose proceeds were invested in stocks or bonds).
- Any interest that would have been deductible if interest earned on private activity bonds issued after August 7, 1986 had been includible in gross income.

Step 2. Enter your AMT disallowed investment interest expense from the prior tax year on Line 2. Complete Line 3.

Step 3. When completing Part II, refigure the following amounts, taking into account all adjustments and preferences.

- Gross income from property held for investment.
- Net gain from the disposition of property held for investment.
- Net capital gain from the disposition of property held for investment.
- Investment expenses.

Include any interest income and investment expenses from private activity bonds issued after August 7, 1986.

Step 4. Complete Part III.

Enter on Line 9 the difference between Line 8 of your AMT Form 4952 and Line 8 of your regular tax Form 4952. If your AMT expense is greater, enter the difference as a negative amount.

Note: If you did not itemize deductions and you had investment interest expense, do not enter an amount on Form 6251, Line 8, unless you reported investment interest expense on Schedule E. If you did, follow the steps above for completing Form 4952. Allocate the investment interest expense allowed on the AMT Form 4952 in the same way you did for the regular tax. Enter on Form 6251, Line 8, the difference between the amount allowed on Schedule E for the regular tax and the amount allowed on Schedule E for the AMT.

IRS Audit Techniques

1. The IRS will ask the taxpayer whether he or she has any interest from private activity bonds. Taxpayers are required to include tax-exempt interest on Line 8b of Form 1040. The taxpayer should be questioned in depth about the type of tax-exempt interest.

2. The taxpayer must recompute investment income allowing for adjustments and tax preference items per IRC sections 56, 57, and 58.

3. Any interest expense incurred in relation to specified bond interest will be allowed as an AMT deduction up to the amount of the specified bond interest.

LINE 9, DEPLETION (Difference Between Regular Tax and AMT)

For regular tax purposes, taxpayers who are involved in mining, oil, gas, timber, and other natural resources are allowed a depletion deduction per IRC section 611(a). The deduction is allowable only for exhaustible property in which the taxpayer has an economic interest.

Depletion deductions may be taken using one of the two available methods: cost depletion or percentage depletion.

Cost depletion is based on available units of the resource and the taxpayer's cost of the resource. At the beginning of each year, the taxpayer calculates his remaining cost of the resource and divides it by the remaining units available for sale. This amount is then multiplied by the number of units sold during the year. Once the taxpayer has taken depletion expenses equal to the amount of his or her cost, he or she is not allowed any more depletion deductions.

Percentage depletion takes percentages assigned by the Internal Revenue Code for various minerals and multiplies them by gross income of the property, subject to a maximum of 50-percent of the taxable income excluding the depletion deduction. IRC section 613. This can result in depletion deductions in excess of the cost of the resource. If a taxpayer is using the percentage depletion method, he or she may be subject to a tax preference item for AMT purposes. Per IRC section 57(a)(1), the amount of the preference item will be the excess of the deduction for depletion allowable under IRC section 611 for the taxable year over the adjusted basis of the property at the end of the taxable year. This preference item is computed on a property by property basis and is not applicable to percentage depletion for oil and gas wells of independent producers and royalty owners for tax years beginning after 1992. If the taxpayer uses cost depletion, there is no preference item.

IRS Audit Technique

If the taxpayer is involved in oil or gas (excluding small retailers and refiners of oil or gas), ask the taxpayer about the type of depletion method used. If the taxpayer is on the percentage depletion method, the basis for each property should be identified and any depletion in excess of basis should be included on Form 6251. Adjusted basis for purposes of the depletion preference should not include tangible costs which are depreciable in nature.

LINE 10, NET OPERATING LOSS (NOL) DEDUCTION

Since Line 1 lists the total of all income/loss for the year less itemized deductions, this amount includes any NOL taken on Form 1040. Because the NOL will be recomputed for AMT purposes, Form 1040 NOL will be added back on this line, and the AMTNOL deduction will be computed and deducted for AMT purposes on the next line.

LINE 11, ALTERNATIVE TAX NET OPERATING LOSS (AMTNOL) DEDUCTION

For regular tax purposes a taxpayer will have NOL when his or her business loss/deductions exceeds his or her gross income. The initial loss year is termed the "loss year" per IRC Section 172(c). This loss must then be modified to arrive at the deductible NOL.

Note that the 1996 Act adjusted this for the repealed special energy credit deduction and clarified the interaction of the energy deduction with other AMT rules, effective for tax years beginning after December 31, 1990.

These modifications include:

a) A taxpayer is not allowed NOL deduction (IRC Section172(d)(1));
b) Capital losses cannot exceed capital gains based on IRC Section 172(d)(2);
c) Personal Exemptions are not allowed based on IRC Section 172(d)(3); and
d) Nonbusiness expense deductions may not exceed nonbusiness income under IRC Section 172(d)(4).

In general, IRC Section 172(b)(1)(A)(i) allows an NOL carry back to three years before the loss year (two years for tax years beginning after August 5, 1997). A carryover of any unabsorbed NOL is allowed to any of the subsequent 20 taxable years based on IRC Section 172(b)(1)(A)(ii) except for the limited exceptions of paragraphs (B) and (E) which involve real estate investment trusts and corporate equity reduction for interest losses. IRC Section 172(b)(2) requires a taxpayer to carry back NOL to the earliest year possible unless an election under IRC Section 172(b)(3) has been made to forego the carryback period. The election to relinquish the carryback of regular tax NOL cannot be amended and, when made, is considered to be made for AMT purposes also. If NOLs are available for carrybacks from several years, the earliest NOL must be absorbed first according to Treas. Reg. Section 1.172-4(a)(3).

Note: Special NOL rules apply in 2008-2011. Be alert to future congressional changes.

The taxpayer must carry back a NOL to the earliest year and then recompute the unabsorbed NOL under IRC Section 172(d). After the NOL is taken into consideration, the tax liability of the earliest year is recomputed. A taxpayer should adjust any reported deductions with AGI limitations due to the NOL's reduction in reported AGI. Regular tax provisions in effect for the earliest carryback year to recompute a carryback year's tax liability are followed rather than the law in the loss year where the NOL originates. IRC Section 172(e).

If a taxpayer's NOL is not fully absorbed in the earliest carry back year, the remaining NOL is carried to each subsequent year in succession. Each of the carryback/carryover years, when a portion or all of the NOL is absorbed, is defined as an "intervening year."

NOLS FOR AMT PURPOSES

The AMTNOL deduction is defined in IRC section 56(d). It is computed the same as the NOL for regular tax purposes with two modifications. IRC section 56(d)(1)(B). The loss is computed by adjusting the taxable income per the adjustment amounts of IRC section 56 and IRC section 58 and reduced by the sum of tax preference items per IRC section 57. IRC section 56(d)(2)(A). However, any item of tax preference will be taken into consideration only to the extent that the item increased the amount of the NOL for the taxable year under IRC section 172(c). IRC section 56(d)(2).

Example: Gary has $700,000 of gross income and $1,000,000 in deductions in the current year. The deductions include $100,000 of depreciation. Depreciation for AMT purposes is $60,000, resulting in an AMT adjustment of $40,000. Gary's AMTNOL is computed as follows:

Gross Income	$ 700,000
Less: Deductions	($1,000,000)
Regular Tax NOL	($ 300,000)
Plus: AMT depreciation Adjustment	$ 40,000
AMTNOL	($ 260,000)

Example: Assume the same facts as the last example, except that Gary also had tax preference items of $225,000, all of which were included as deductions for regular tax purposes. Gary's current year NOL would be computed as shown:

Gross Income	$ 700,000
Less: Deductions	($1,000,000)
Regular Tax NOL	($ 300,000)
Plus: AMT depreciation Adjustment	$ 40,000
	($ 260,000)
Plus: Preference Items	$ 225,000
AMTNOL	($ 35,000)
	===========

Be alert to the rare circumstances where the taxpayer may not have an NOL for regular tax purposes, but may have an NOL for AMT purposes. Thus, the computation should begin with the taxpayer's regular taxable income adjusted for AMT adjustment and preference items as shown above.

Example: Bob has gross income of $36,000, and his depreciation for regular tax purposes is $20,000. His AMT depreciation is $40,000. For regular tax purposes, no NOL exists since Bob has taxable income of $16,000. For AMT purposes, he will have NOL of ($4,000). Thus, the AMTNOL should not be computed as the difference between the regular tax NOL ($-0-) in this case and the AMT adjustment of $20,000. Rather, taxable income or loss must be recomputed.

For AMT purposes the taxpayer must follow the carryback/carryover treatment of the regular NOL. If a taxpayer elects to forego the carryback of an NOL under IRC section 172(b)(3) for regular tax purposes, the taxpayer must also forego the carryback of the AMTNOL for AMT purposes. When carrying back/forward the AMTNOL, the AMTNOL is absorbed in the carryback or carryover years even if the taxpayer was not liable for AMT in those years.

Example: Mark incurs an AMTNOL of $16,000 in 2010 and does not elect to forego the carryback period. In 2008, Mark had AMTI of $20,000 but was not liable for AMT. The $16,000 AMTNOL will be carried back to 2008 and be absorbed by the $20,000 of AMTI. Mark will, therefore, not benefit from the carryback of the AMTNOL.

The AMTNOL deduction is limited to 90 percent of AMTI determined without regard to the AMTNOL deduction. This rule insures that taxpayers will not wipe out their AMT liability with the NOL deduction. IRC section 56(d)(1)(A).

Example: Jed and Wilma file a joint return and have an AMTNOL in 2010 of $425,000. Their AMT income in 2008 was $100,000. Because the AMTNOL deduction is limited to 90 percent of AMTI, they are allowed to offset only $90,000 ($100,000 x 90 percent) of their 2008 AMT income. The remaining AMTNOL of $335,000 can be carried forward to 2009 and subsequent years.

Once the IRC Section 56(d)(1)(A) 90-percent limitation is applied, a taxpayer may not use other AMTNOLs to offset the remaining 10 percent of AMT income.

- The 90% limit on the alternative tax net operating loss deduction (ATNOLD) does not apply to the portion of an ATNOLD attributable to qualified GO Zone losses. Such portion can be applied to offset up to 100% of alternative minimum taxable income (AMTI) (figured without regard to ATNOLD and the domestic production activities deduction).
- The domestic production activities deduction is not taken into account in figuring the ATNOLD.

LINE 12, INTEREST FROM SPECIFIED PRIVATE ACTIVITY BONDS ISSUED AFTER 8/7/86 (Exempt From Regular Tax)

IRC section 57(a)(5)(A) lists tax-exempt interest as an item of tax preference for AMT purposes. This preference item involves specified private activity bonds paying interest that is excludable from gross income under IRC section 103(a).

Generally, interest on obligations of state or local governments is excluded from income under IRC section 103(a). This exclusion does not apply to a private activity bond unless that bond is a qualified private activity bond. IRC section 103(b)(1).

IRC section 141(a) defines private activity bonds. Generally, a bond is a private activity bond if it meets (1) both the private use and private payment or security test under IRC section 141(b), or (2) the private loan financing test under IRC section 141(c). A qualified private activity bond is defined in IRC section 141(e).

For AMT purposes, IRC section 57(a)(5)(A) states that interest from specified private activity bonds and deductions not otherwise allowable because of tax-exempt status must be included in income for AMT purposes, with the exceptions of qualified 501(c)(3) bonds and any refunding bond (whether a current or advance refunding) if the refunded bond (or in the case of a series of refunding, the original bond) was issued before August 8, 1986. In addition, IRC section 57(a)(5)(B) provides that "* * * any exempt-interest dividend (as defined in section 852(b)(5)(A)) shall be treated as interest on a specified private activity bond to the extent of its proportionate share of the interest on such bonds received by the company paying such dividend."

Example: Connie purchases qualified private activity bonds in 2000. In the current year these bonds generated $40,000 in interest. Connie will be required to include for AMT purposes the $40,000 as income. This amount will be shown as a positive figure on Form 6251.

As discussed above, this interest is reduced by any deduction (not already deducted for regular tax purposes) which would be allowed if the amounts are includible in income. Thus, for regular tax purposes, interest on tax-exempt bonds is not required to be included in income and no investment interest deduction is allowed.

However, for AMT purposes, since the amount is required to be included in income, the corresponding interest deduction would be allowed.

Exempt-interest dividends paid by a regulated investment company are treated as interest income on specified private activity bonds to the extent the dividends are attributable to interest on the bonds received by the company, minus an allocable share of the expenses paid or incurred by the company in earning the interest.

If you are filing Form 8814, Parents' Election To Report Child's Interest and Dividends, any tax-exempt interest income from Line 1b of that form that is a preference item must be included on this line.

Observation: Most private activity bonds are easy to identify. A common example is a city issuing bonds to build a stadium for a professional sports team where the team will ultimately repay the bonds.

IRS Audit Techniques

1. Question the taxpayer during the initial interview regarding all investments, including stocks and bonds.

2. When analyzing the income of the taxpayer, any sales of bonds during the year should be analyzed to determine if any of these bonds are specified private activity bonds. Any interest earned on these bonds must be included for AMT purposes. This may also alert you to other bonds not yet sold. But the interest from those bonds must be included for AMT purposes.

Practice Pointer:

- The minimum exemption amount for a child has increased to $6,700.
- Interest on private activity bonds issued in 2009 or 2010 is not a tax preference item.

LINE 13, QUALIFIED SMALL BUSINESS STOCK

Effective for tax years ending after May 6, 1997, taxpayers who claim the exclusion under IRC Section 1202 for gain on qualified small business stock held more than 5 years must include a percent of the exclusion amount, as shown on Schedule D, Capital Gains and Losses, as a tax preference on Form 6251. The amount is entered as a positive amount. IRC Section 57(a)(7).

If you claimed the exclusion under Section 1202 for gain on qualified small business stock held more than five years, compute the amount to enter on this line as follows:

- If you sold qualified small business stock after May 5, 2003, multiply the excluded gain (as shown on Schedule D (Form 1040)) by 7% (.07).

Observation: Prior to May 6, 2003, the preference amount was 42%. The preference amount decreased for sales after May 5, 2003 because the general capital gains tax rate decreased. This preference amount will be increased if the capital gains tax rate increases.

LINE 14, EXERCISE OF INCENTIVE STOCK OPTIONS (Excess of AMT Income Over Regular Tax Income)

IRC Section 421 contains the rules for taxing stock transferred pursuant to the exercise of employee incentive stock options (ISO). For regular tax purposes, these rules allow the employee to defer (and possibly avoid) recognizing the income attributable to the difference between the option's exercise price and the stock's fair market value (FMV) on the date of exercise (the spread). For the stock to receive this treatment, IRC Section 422(a) requires that it cannot be disposed of within two years from the date the option is granted or within one year after the option is exercised. If the stock is disposed of after the holding periods expire, the excess (if any) of the amount realized over the employee's basis in the stock is long-term capital gain. If the stock is disposed of before the holding periods expire, the employee recognizes compensation income, in the year of sale, equal to the lesser of the spread at exercise or the spread between the employee's basis and the amount realized on the sale. IRC Section 421 (b).

IRC Section 422(b) defines an ISO to be "an option granted to an employee for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation to purchase stock of any such corporations." To qualify as an ISO, IRC section 422(b) requires that the option be granted under an adopted plan that is approved by the corporation's shareholders; that the option be granted within 10 years after the earlier of the dates when the plan was adopted or approved; that the option cannot be exercisable beyond 10 years after the date of grant; that the exercise price be not less than the fair market value of the stock on the date that the option is granted; that the option be exercisable during the employee's lifetime only by the employee and not be transferable other than by will or the laws of descent and distribution; and that, when the option is granted, the employee cannot own more than 10-percent of the total combined voting stock of any corporation in the controlled group. However, otherwise conforming options granted to more than 10-percent of the shareholders will qualify as ISO if the option's exercise price is at least 110-percent of the stock's fair market value (FMV) on the date of grant and the option is exercisable for only five years. IRC Section 422(c)(5).

Example: CLC Corporation grants Jean an Incentive Stock Option on February 10, 2006 to buy 3,000 shares of CLC Corporation stock at $10 per share ($10 is also the fair market value on this day). On July 1, 2007, Jean exercises her option, when CLC's stock's fair market value is $21 a share and CLC transfers 3,000 substantially vested shares at $10 per share. On November 3, 2011, Jean sells all her stock at $40 per share. For regular tax purposes, Jean has a long-term capital gain of $90,000 on the sale ($120,000 selling price less $30,000 purchase).

IRC Section 56(b)(3) states that IRC section 421 will not apply for AMT purposes. Since IRC Section 421 will not apply, the rules of IRC Section 83 dealing with property transferred in connection with performance of services will apply. This section requires the recognition of the excess of the stock's FMV over the stock's exercise price when the stock is substantially vested. See Treas. Reg. Section 1.83-3(b). An AMT adjustment is required only when the FMV of the stock exceeds its exercise price.

Example: Assume the same facts as in the last example. For regular tax purposes, Jean will not recognize any taxable income on July 1, 2007, the day of exercise. However, for AMT purposes, Jean will recognize income of $33,000 ($63,000 FMV less price paid of $30,000) on July 1, 2007, the day of exercise. This $33,000 will be a positive addition to AMTI.

This recognition of income will also cause the taxpayer to have different bases for regular and AMT purposes. Using the examples shown above, Jean has a basis of $30,000 for regular tax purposes and $63,000 for AMT purposes. Thus, when the stock is sold, a regular tax gain will have to be computed, as will an AMT gain. The difference between the gains will be shown on the appropriate line of Form 6251.

Having different bases for regular and AMT purposes as well as an AMT preference item can be problematic if the stock price drops greatly.

Example: Assume the same facts as the prior two examples, except that instead of selling the stock, Jean holds on to it while the value plummets to $1 per share. Jean has stock worth only $3,000 but may have to pay AMT based on the $33,000 preference item. If Jean sells the stock, she is not much better off. By selling the stock, she has a capital loss of $27,000 ($30,000 - $3,000) for regular purposes and $60,000 ($63,000 - $3,000) for AMT purposes. The $3,000 per year capital loss deduction limitation prevents Jean from utilizing the entire capital loss. This is what happened in Silicon Valley in the late 90's. Techies who were once millionaires on paper were left with worthless stock, unused capital loss carryforwards, and a large tax bill due to the AMT.

The general rule of IRC Section 83, as shown above, is that the difference between the FMV of the stock and price paid when exercising the option is includible in income in the year exercised. The general rule applies if the stock is substantially vested in the year of exercise.

If the stock is not substantially vested in the year of exercise, income is includible for AMT purposes when the option is exercised (if an IRC Section 83(b) election is filed, see below) or when the stock becomes substantially vested (not subject to a substantial risk of forfeiture). Treas. Reg. Section 1.83-3(c) discusses what constitutes a substantial risk of forfeiture.

If the stock is subject to substantial risk of forfeiture and is, therefore, not subject to AMT for the current year, the taxpayer may elect to recognize this difference in the current year pursuant to IRC Section 83(b). Treas. Reg. section 1.83-2 contains the procedures for filing the election. This election must be filed with the IRS within 30 days of the exercise of the ISO. A copy must be sent to the employer and a copy must also be attached to the individual's tax return. Note, however, that the election is not effective for regular federal income tax purposes because IRC Section 83 does not apply to property transferred pursuant to the exercise of an option governed by the rules of IRC sections 422 and 423. IRC Section 83(e)(1); Treas. Reg. Section 1.83-7(a).

Under IRC Section 56(b)(3), if the taxpayer exercises the options and sells the stock in the same taxable year, he or she must report the sale as a disqualified disposition. Because there is no tax preference, the taxpayer does not include the ISO adjustment in AMT taxable income. This exception was enacted because a taxpayer who reports the full amount of the difference between the stock's basis and the amount realized on the stock's sale in regular taxable income in the year of the stock's sale should not be required to duplicate the income for AMT purposes.

FMV of ISO for AMT

The AMT adjustment is generally the difference between the stock's FMV at exercise and the basis of the stock when the ISO is exercised. The FMV calculation for stock sold on a Security and Exchange Commission (SEC) regulated exchange based on the exercise of the ISO option was held to be based on the average price at which the stock traded on the New York Stock Exchange in the decision of Kolom v. Commissioner, 81-1 U.S.T.C. paragraph 9359, 644 F.2d 1282 (9th Cir. 1981), cert. denied, 81-2 U.S.T.C. paragraph 9741.

The Service has not issued any guidelines to determine the FMV of the stock purchased when the ISO involves non-SEC issuances.

For the regular tax, no income is recognized when an incentive stock option (ISO), as defined in Section 422(b), is exercised. However, this rule does not apply for the AMT. Instead, you generally must include on Line 15 the excess, if any, of:

- The fair market value of the stock acquired through exercise of the option (determined without regard to any lapse restriction) when your rights in the acquired stock first become transferable or when these rights are no longer subject to the substantial risk of forfeiture **over**
- The amount you paid for the stock, including any amount you paid for the ISO used to acquire the stock.

Note: Even if your rights in the stock are not transferable and are subject to a substantial risk of forfeiture, you may elect to include in AMT income the excess of the stock's fair market value (determined without regard to any lapse restriction) over the exercise price upon the transfer to you of the stock acquired through exercise of the option. You must make the election by the 30th day after the date of the transfer.

If you acquired stock by exercising an ISO and you disposed of that stock in the same year, the tax treatment under the regular tax and the AMT is the same, and no adjustment is required.

Increase your AMT basis in any stock acquired through the exercise of an ISO by the amount of the adjustment. Keep adequate records for both the AMT and regular tax so that you may figure your adjustment.

Form 3921. If your client received a Form 3921, it may help you figure your adjustment.

Example: You exercised an ISO to acquire 100 shares of stock in 2011. Your rights in the acquired stock first became transferable on the date you exercised the ISO and were not subject to a substantial risk of forfeiture. You did not pay anything for the ISO. You did not sell the acquired stock during 2011. You received a Form 3921 that shows $10 in box 3 (the exercise price you paid for each share), $25 in box 4 (the fair market value of each share), and 100 shares in box 5. To figure your adjustment, multiply the amount in box 4, $25, by the 100 shares in box 5. The result is $2,500, the fair market value of all the shares. Then multiply the amount in box 3, $10, by the 100 shares in box 5. The result is $1,000, the amount you paid for all the shares. Your adjustment is $1,500 ($2,500 - $1,000). Enter it on Form 6251, line 14.

IRS Audit Techniques

1. Ask the taxpayer during the initial interview about the types of benefits offered by the employer including stock options. Also ask whether any of these options were exercised during the year under examination.

2. Sales of stock per the taxpayer's Schedule D, Capital Gains or Losses, or per Information Returns Program (IRP) documents should be analyzed to determine if the taxpayer has sold any stock of the employing corporation. This may aid in determining if options were exercised in the current year.

LINE 15, BENEFICIARIES OF ESTATES AND TRUSTS

This amount applies to beneficiaries of estates or trusts. The estate or trust will identify in total the adjustments for AMT purposes of the estate or trust on Schedule K-1, (Beneficiary's Share of Income Deductions, Credits, etc.) in box 12, Code A. When examining a taxpayer who is a beneficiary of an estate, analyze Form K-1 to determine that the proper amount was included on Form 6251.

IRS Audit Technique

Ask the taxpayer for Schedules K-1 from the trust or estate. Verify that the AMT adjustments the estate or trust should have some AMT adjustments and none are present, pursue the issue further.

LINE 16, LARGE PARTNERSHIPS

For tax years beginning after December 31, 1997, partners in an electing Large Partnership must take into account amounts from Schedule K-1 (Form 1065-B), Partner's Share of Income (Loss) From an Electing Large Partnership, as an adjustment on Form 6251. IRC Section 772(b)(5). The partnership will calculate and report this amount to the partner on Form K-1.

LINE 17, DISPOSITION OF PROPERTY (Difference Between AMT and Regular Tax Gain or Loss)

As mentioned in the depreciation section, the taxpayer must use a specific method for computing the gain or loss on disposition of property when computing AMT. Unless the taxpayer also uses this method for regular tax purposes, an adjustment is generated for AMT purposes. The taxpayer must also maintain a record of AMT basis. If the taxpayer disposes of a piece of property in a tax year, the AMT gain must be computed using the sales price and the basis as adjusted for AMT depreciation. The difference between this gain and the gain computed for regular tax purposes will be an adjustment for purposes of AMT.

Example: Assume that Samantha sold a word processor during the third year of use for $5,950.

Gain for Regular Tax Purposes

Sales Price		$ 5,950
Less: Adjusted Basis		
Basis:	$6,500	
Less: Depreciation	($4,004)	($2,496)
Gain on Sale – Regular Tax Purposes		$ 3,454

Gain for AMT Purposes

Sales Price		$ 5,950
Less: Adjusted Basis		
Basis:	$6,500	
Less: AMT Depreciation	($3,213)	($3,287)
Gain on Sale – AMT Purposes		$ 2,663

In this example, Samantha would have a negative adjustment to AGI of $791 ($3,454 less $2,663).

Use this line to report any AMT adjustment related to the disposition of property resulting from refiguring:

1. Gain or loss from the sale, exchange, or involuntary conversion of property reported on Form 4797, Sales of Business Property;
2. Casualty gain or loss to business or income-producing property reported on Form 4684, Casualties and Thefts;

3. Ordinary income from the disposition of property not already taken into account in 1 or 2 above or on any other line on Form 6251, such as a disqualifying disposition of stock acquired in a prior year by exercising an incentive stock option; and
4. Capital gain or loss (including any carryover that is different for the AMT) reported on Schedule D (Form 1040), Capital Gains and Losses.

Note: The $3,000 capital loss limitation for the regular tax applies **separately** for the AMT. See the instructions and example below.

First figure any ordinary income adjustment related to 3 above. Then, refigure Form 4684, Form 4797, and Schedule D for the AMT, if applicable, by taking into account any adjustments you made this year or in previous years that affect your basis or otherwise result in a different amount for the AMT. If you have a capital loss after refiguring Schedule D for the AMT, apply the $3,000 capital loss limitation separately to the AMT loss. For each of the four items listed above, figure the difference between the amount included in taxable income for the regular tax and the amount included in income for the AMT. Treat the difference as a negative amount if: a) both the AMT and regular tax amounts are zero or more and the AMT amount is less than the regular tax amount; or b) the AMT amount is a smaller loss of zero or more.

Enter on Line 17 the combined adjustments for the four items above.

Example: On March 13, 2010, Victor Ash, whose filing status is single, paid $20,000 to exercise an incentive stock option (which was granted to him on January 2, 2009) to buy 200 shares of stock worth $200,000. The $180,000 difference between his cost and the value of the stock at the time he exercised the option is not taxable for the regular tax. His regular tax basis in the stock at the end of 2010 is $20,000. For the AMT, however, Ash must include the $180,000 as an adjustment on his 2010 Form 6251. His AMT basis in the stock at the end of 2010 is $200,000.

On January 18, 2011, Ash sold 100 of the shares for $75,000. Because Ash did not hold these shares more than one year, that sale is a disqualifying disposition. For the regular tax, Ash has ordinary income of $65,000 (proceeds minus his $10,000 basis in the 100 shares). Ash has no capital gain or loss for the regular tax resulting from the sale. For the AMT, Ash has no ordinary income, but has a short-term capital loss of $25,000 (proceeds minus his $100,000 AMT basis in the 100 shares).

On April 21, 2011, Ash sold the other 100 shares for $60,000. Because he held the shares for more than one year, the sale is not a disqualifying disposition. For the regular tax, Ash has a long-term capital gain of $50,000 (proceeds minus his regular tax basis of $10,000). For the AMT, Ash has a long-term capital loss of $40,000 (proceeds minus his AMT basis of $100,000).

Ash has no other sales of stock or other capital assets for 2010. Ash enters a total negative adjustment of $118,000 on Line 17 of his 2010 Form 6251, figured as follows:

- Ash figures a negative adjustment of $65,000 for the difference between the $65,000 of regular tax ordinary income and the $0 of AMT ordinary income for the first sale.
- For the regular tax, Ash has $50,000 capital gain net income reported on Schedule D for the second sale. For the AMT, Ash has a $25,000 short-term capital loss from the first sale, and a $40,000 long-term capital loss from the second sale, resulting in a net capital loss of $65,000 for the AMT. However, only $3,000 of the $65,000 net capital loss is allowed for 2010 for the AMT. The difference between the regular tax Schedule D gain of $50,000 and the $3,000 loss allowed for the AMT results in a $53,000 negative adjustment to include on Line 17.

Ash has an AMT capital loss carryover from 2011 to 2012 of $62,000, of which $22,000 is short-term and $40,000 is long-term. If he has no other Schedule D transactions for 2012, his adjustment reported on his 2012 Form 6251 would be limited to ($3,000), the amount of his capital loss limitation for 2012.

IRS Audit Technique

As discussed previously, the AMT rules require the taxpayer to use 150-percent declining balance or straight-line depreciation instead of the more accelerated methods.

Thus, the basis for AMT purposes and regular purposes will differ. Any sale of assets during the year should be verified for AMT basis versus regular tax basis.

LINE 18, DEPRECIATION OF ASSETS PLACED IN SERVICE AFTER 1986 (Difference Between Regular Tax and AMT)

This line applies if the taxpayer claimed depreciation on Schedule C or Schedule C-EZ (Net Profit From Business). If the taxpayer did not have depreciation deductions, this line should be blank.

The Tax Reform Act of 1986 modified the previous Accelerated Cost Recovery System (ACRS). The name for the current depreciation system is Modified Accelerated Cost Recovery System (MACRS). Under this system, personal property, placed in service after 1986 is grouped into eight recovery classes of property. The property is placed in these classes based on the Asset Depreciation Range (ADR) guidelines. These guidelines are stated in Rev. Proc. 87-56.

1. *3-Year Class* - Property with an ADR life of 4 years or less and certain race horses. IRC Sections 168(e)(1), (e)(3)(A)(i). Automobiles are not included in this class even though they have a 4- year ADR life.

2. *5-Year Class* - Property with an ADR life of more than 4 years, but less than 10 years. IRC Section 168(e)(1). This includes automobiles, light trucks, computers and peripheral equipment, office machinery, property used in research and experimentation and breeding and dairy cattle. IRC Section 168 (e)(3)(B).

3. *7-Year Class* - Property with an ADR life of at least 10 years but less than 16 years. IRC Section 168(e)(1). It includes office furniture and fixtures.

4. *10-Year Class* - Property with an ADR life of at least 16 years, but less than 20 years. IRC Section 168(e)(1). This includes water transportation equipment and single purpose agriculture and horticultural structures. IRC Section 168(e)(3)(D)(i).

5. *15-Year Class* - Property with ADR life of at least 20 years, but less than 25 years. IRC Section 168(e)(1). It includes certain depreciable improvements made directly to or added to land such as fences, roads, bridges and shrubbery.

6. *20-Year Class* - Property with an ADR life of at least 25 years. IRC Section 168(e)(1). It includes farm buildings and municipal sewage treatment plants.

7. *Nonresidential Real Property* - This is IRC Section 1250 property that is not Residential Rental Property or property with an ADR life of less than 27.5 years. IRC Section 168(e)(2)(B). The recovery period is 31.5 years for property placed in service before May 13, 1993, or 39 years for property placed in service after May 12, 1993.

8. *Residential Rental Property* - This includes real property such as rental homes or structure if eighty percent or more of its gross rental income for the tax year is from dwelling units. IRC Section 168(e)(2)(i). The ADR life for this property is 27.5 years.

Under MACRS, depreciation can be computed one of five ways. But first, two terms need to be identified. They are General Depreciation System (GDS) and Alternative Depreciation System (ADS). GDS uses the life per the eight main property classes. ADS uses the specific assigned class life per Rev. Proc. 87-56.

The five methods for computing depreciation under MACRS are:

1. 200-percent declining balance method over the GDS recovery period. This method switches to straight line in the year that it provides a greater deduction.

2. 150-percent declining balance method over the GDS recovery period. This method also switches to straight line when it provides a greater deduction.

3. Straight line (SL) using the GDS recovery period.

4. 150-percent declining balance over the ADS recovery periods, switching to straight line when that method provides a greater deduction.

5. Straight line using the ADS recovery period.

The declining balance methods provide greater deductions in the first years of service with lesser amounts at the end of the asset's life. By contrast, straight line provides equal deductions over the life of the asset. In addition, the GDS methods provide shorter periods for depreciation than do the ADS methods. Also, there are certain restrictions on which types of property can use which of the above methods.

While a method is prescribed for each type of property, the taxpayer may elect to use an alternative method. The chart on the next page summarizes the prescribed method and the alternative method available for each type of property.

Recovery Class	Prescribed Methods	Alternative Methods
3-Year Class	200% DB-GDS	150% DB-ADS
5-Year Class	200% DB-GDS	SL-GDS
7-Year Class	200% DB-GDS	SL-ADS
10-Year Class (Non-Farm)	200% DB-GDS	
3-year Class	150% DB-GDS	DB-ADS
5-Year Class	150% DB-GDS	SL-GDS
7-Year Class	150% DB-GDS	SL-ADS
10-Year Class (Farm)	150% DB-GDS	
15-Year Class	150% DB-GDS	SL-ADS
20-Year Class (Nonfarm and Farm)	150% DB-GDS	SL-GDS
Nonresidential Residential Property	SL-GDS	SL-ADS

For purposes of AMT, the taxpayer must use the 150-percent declining balance method with a half-year convention using the asset's ADR class life. IRC Section 56(a)(1)(A). For real property, the taxpayer must use straight line using the ADR class life. IRC Section 56(a)(1)(A). The ADR class life for all real property is 40 years. IRC section 168(g)(2)(c)(iii).

If the taxpayer elects the ADR method for regular tax purposes, no adjustment would have to be made for AMT purposes. However, most taxpayers will use the accelerated methods which provide for maximum deductions in the assets' early years. Therefore, an adjustment will have to be made for AMT purposes. The adjustment will be the difference between the amount of depreciation claimed by the taxpayer and the amount of depreciation per the AMT SL-ADS method.

Changes for property placed in service after December 31, 1998

Taxpayers have to keep two depreciation tables. One for regular tax purposes and one for AMT purposes. These tables will also be necessary to compute the gain or loss if the asset is disposed of during the taxable year. Most commercial tax preparation packages compute AMT depreciation.

Use the tables in Rev. Proc. 87-57 to determine the applicable depreciation for each year in question. There are tables for depreciation for regular tax purposes and for AMT purposes.

For property placed in service after December 31, 1998, the taxpayer may elect to use AMT depreciation for regular tax purposes.

Example: Samantha is an independent court reporter. She purchases and places into service a new word processor costing $6,500.

For regular tax purposes, depreciation was computed as follows: 200 percent Declining Balance – 5-Year Property

Year	Basis	Percentage	Depreciation
1	$6,500	20%	$1,300
2	$6,500	32%	$2,080
3	$6,500	19.2%	$1,248
4	$6,500	11.52%	$ 749
5	$6,500	11.52%	$ 749
6	$6,500	5.76%	$ 374

For AMT purposes, depreciation is computed as follows:

Year	Basis	Percentage	Depreciation
1	$6,500	15%	$ 975
2	$6,500	25.5%	$1,658
3	$6,500	17.85%	$1,160
4	$6,500	16.66%	$1,083
5	$6,500	16.66%	$1,083
6	$6,500	8.33%	$ 541

Comparison of Depreciation, regular versus AMT:

Year	Regular	AMT	AMT Adjustment
1	$1,300	$ 975	$325
2	$2,080	$1,658	$422
3	$1,248	$1,160	$ 88
4	$ 749	$1,083	($334)
5	$ 749	$1,083	($334)
6	$ 374	$ 541	($167)

Therefore, years 1, 2, and 3 will require a positive adjustment of $325, $422 and $88 respectively. Years 4, 5, and 6 will result in negative adjustments of ($334), ($334), and ($167), respectively.

If the taxpayer is allowed a deduction under IRC section 179, Election to Expense Depreciable Property, no AMT adjustment is required. Examiners should be aware that if the IRC section 179 deduction is disallowed and regular depreciation is taken, this could affect AMT.

Leasing property does not affect the AMT calculation. Lease payments are fully deductible for both regular and AMT purposes.

In addition to the rules discussed above, listed below are some items peculiar to specific industries. Per IRC sections 168(e)(3)(D)(i) and 168(g)(3)(B), single purpose agricultural and horticultural structures are depreciated over a 10 year period for MACRS and over 15 years for AMT.

1. Per IRC sections 168(e)(3)(D)(i) and 168(g)(3)(B), single purpose agricultural and horticultural structures are depreciated over a 10 year period for MACRS and over 15 years for AMT.

2. Depreciable farming property placed in service after 1988 must be depreciated under MACRS using the 150-percent declining balance method. IRC section 168(b)(2)(B).

3. No AMT adjustment is required for property depreciated on the units-of-production or machine hours run method.

This section describes when depreciation must be refigured for the AMT and how to figure the amount to enter on this line.

Do not use this line for depreciation related to the following:

- Employee business expenses claimed on Schedule A (Form 1040). Take this adjustment into account on the miscellaneous itemized deduction line.
- Passive activities. Take this adjustment into account on the passive activity line.
- An activity for which you are not at risk, or income or loss from a partnership or an S corporation if the basis limitations apply. Take this adjustment into account on the loss limitations line.
- A tax shelter farm activity. Take this adjustment into account on the other adjustments line.

What Depreciation Must Be Refigured for the AMT?

Generally, you must refigure depreciation for the AMT, including depreciation allocable to inventory costs, for:

- Property placed in service after 1998 that is depreciated for the regular tax using the 200% declining balance method (generally, 3-, 5-, 7-, and 10-year property under the modified accelerated cost recovery system (MACRS), except for qualified property eligible for the special depreciation allowance for Gulf Opportunity Zone property;
- Section 1250 property placed in service after 1998 that is **not** depreciated for the regular tax using the straight-line method; and
- Tangible property placed in service after 1986 and before 1999 (if the transitional election was made under Section 203(a)(1)(B) of the Tax Reform Act of 1986, this rule applies to property placed in service after July 31, 1986).

What Depreciation Is Not Refigured for the AMT?

Do not refigure depreciation for the AMT for the following:

- Residential rental property placed in service after 1998.
- Nonresidential real property with a class life of 27.5 years or more placed in service after 1998 that is depreciated for the regular tax using the straight-line method.
- Other Section 1250 property placed in service after 1998 that is depreciated for the regular tax using the straight-line method.
- Property (other than Section 1250 property) placed in service after 1998 that is depreciated for the regular tax using the 150% declining balance method or the straight-line method.
- Property for which you elected to use the alternative depreciation system (ADS) of Section 168(g) for the regular tax.
- Qualified property eligible for a special depreciation allowance if the depreciable basis of the property for the AMT is the same as for the regular tax. If the depreciable basis for the AMT is the same as for the regular tax, no adjustment is required for any depreciation figured on the remaining basis of the qualified property. However, if an election is in effect to not have the special allowance apply, the corporation must refigure depreciation for the AMT.
- Any part of the cost of any property for which you made the election under Section 179 to treat the cost of the property as a deductible expense. The reduction to the depreciable basis of Section 179 property by the amount of the Section 179 expense deduction is the same for the regular tax and the AMT.
- Certain public utility property (if a normalization method of account is not used), motion picture films and video tape, sound recordings, and property that the corporation elects to exclude from MACRS by using a depreciation method that is not based on a term of years, such as the unit-of-production method.
- Qualified Indian reservation property.
- Qualified revitalization expenditures for a building for which you elected to claim the commercial revitalization deduction under Section 1400I.
- A natural gas gathering line placed in service after April 11, 2005.

Practice Pointer: Taking the Section 179 deduction does not result in an AMT adjustment.

IRS Audit Technique

If depreciation is shown on the tax return, ask the taxpayer for a detailed depreciation schedule for regular and AMT purposes. If the taxpayer is claiming a depreciation deduction and no adjustment item is listed for AMT, there is a high probability that there should be an adjustment on Form 6251 for AMT. Depreciation on the schedule should be verified to insure that the taxpayer is using the correct method for both regular and AMT purposes.

LINE 19, PASSIVE ACTIVITIES (Difference Between AMT and Regular Tax Income or Loss)

The passive activity loss (PAL) rules were enacted during the Tax Reform Act of 1986 and are effective for tax years beginning after 1986. IRC Section 469 defines the rules regarding these laws. These rules apply to individuals, estates, trusts, personal service corporations and closely held C corporations. Generally, under IRC Section 469 a loss or credit generated by a passive activity will be limited to the income generated from other passive activities. The excess of the loss or credit is carried forward to future years and is allowed when passive income from passive activities is generated in these years. IRC Section 469(b). Losses are also allowed in full in the year of disposition.

IRC Section 469(c)(i) defines "passive activity" to mean " . . . any activity (A) which involves the conduct of a trade or business, . . ." and (B) in which the taxpayer does not materially participate." A rental activity is also considered a passive activity. It does not need to constitute a trade or business. IRC Section 469(c)(2).

IRC Section 469(h)(i) defines "material participation" as: "A taxpayer shall be treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is (A) regular, (B) continuous, and (C) substantial." Participation by a spouse is included when applying the rules for materially participating. IRC Section 469(h)(5).

Each passive activity is accounted for separately. The income items and loss items are then aggregated. If the losses exceed the income, the resulting loss is the "passive activity loss." IRC Section 469(d)(1).

A "passive activity credit" is the sum of business credits derived from passive activities which exceed the taxpayer's regular tax liability for the taxable year allocable to passive activities. IRC section 469 (d)(2). The credits subject to the limitation as passive credits are those in subpart D of part IV of subchapter A, and those in subpart B (other than Section 27 (a)) of part IV of the Code.

Income or losses from passive activities do not include earned income, portfolio income (interest, dividends, annuities, royalties, and investment gains), expenses other than interest which are directly related to portfolio income, and interest expense allocable to portfolio income.

IRC Section 469(i) provides an exception for individuals who actively participate in rental real estate activities. A taxpayer may deduct losses up to $25,000 (or the amount of credit that is the deduction equivalent of the passive loss). If the taxpayer's adjusted income exceeds $100,000, the amount of the loss is phased out; at $150,000 no loss is allowed. IRC Section 469(i)(3)(A).

To qualify for the loss the taxpayer must "actively participate" in the rental activity. The taxpayer must own at least 10-percent of the activity to actively participate. Limited partnership interests are not considered when applying the 10-percent ownership rule. IRC Section 469(i)(6)(C). Ownership by a spouse is considered when applying the 10 percent ownership rule. IRC Section 469(i)(6)(A).

Some special rules exist for the rehabilitation credit and the low-income housing credit. The $25,000 (in the deduction-equivalent sense) does not require active participation and the threshold for the phase-out is $200,000. IRC Section 469(i)(3)(B), (C).

"Deduction-equivalent" is the amount of credits which, if allowed as a deduction, would reduce the regular tax liability by an amount equal to the tax credits. IRC Section 469(j)(6). Assume a taxpayer's income is taxed at the rate of 15-percent and there are no itemized deductions subject to AGI limitations. The deduction equivalent of credits equal to $25,000 is $3,750.

If a loss or credit is not allowed in a current year, the loss or credit is suspended and allowed in subsequent years when the taxpayer has passive income. IRC Section 469(b). If a taxpayer sells his or her interest, the loss will be allowed in full in the following order: first, against income or gain from the activity for the tax year, including any gain recognized on the disposition; second, against net income or gain for the taxable year from other passive activities; and third, against all other income or gain. IRC Section 469(g)(1).

For a more in-depth look at the regular passive loss rules, see the Passive Activity Loss Audit Techniques Guide (Training 3149-115). The guide is available from the IRS Internet web site at www.irs.ustreas.gov.

IRC Section 58(b) discusses the AMT provisions when dealing with passive activity losses. This section states that IRC Section 469 will apply for AMT purposes except that the adjustments of IRC Sections 56 and 57 shall apply, the phase-in of losses prior to 1990 will not apply and the passive activity loss will be computed without regard to qualified housing interest (as found in IRC Section 56(e)).

The easiest way to apply the AMT rules, as they relate to passive activity losses, is to prepare a separate loss computation solely for AMT purposes. The difference between this computation and the computation for regular tax purposes will be your adjustment on Form 6251. All items of adjustment and tax preference items relating to the passive activity will have to be considered when computing the AMT passive activity loss. Depreciation will be the most common area requiring recomputation. However, all adjustments must be considered and applied when applicable.

Example: Don actively participates in a rental real estate activity and incurs the following expenses:

	Regular Tax	AMT	Difference
Income	$50,000	$50,000	
Real Estate Taxes	($ 9,000)	($ 9,000)	
Wages	($11,000)	($11,000)	
Operating Expenses	($25,000)	($25,000)	
Depreciation (27.5 Years) Basis = $400,000	($14,544)		
Depreciation (40 Years)		($10,000)	
Total Losses	($ 9,544)	($ 5,000)	$4,544
	==========	=========	=======

The adjustment required to be shown on Form 6251 will be the difference between the two amounts shown above, an add back of $4,544. This depreciation must be made as a passive loss adjustment and will not be considered on the line item adjustment for depreciation. This is true of all IRS section 56 and 57 adjustments required to be made for passive activity losses.

Example: Assume the same facts as in the example above, except that the activity is not a rental real estate activity. For regular tax purposes, the taxpayer will have a suspended loss of ($9,544) and a suspended AMT loss of ($5,000). No adjustment is made on Form 6251 in the current year for these suspended losses. This shows the importance of the taxpayer's maintaining two sets of records: one for regular tax purposes and one for AMT purposes.

Special rules apply regarding passive farm activity losses. These losses are subject to rules IRC section 58(a), which specifically deals with farm losses. The rules of IRC section 58(b) which deal with general passive activities may also apply. For AMTI purposes, any loss deduction from a "tax shelter farm activity" will not be allowed. IRC section 58(a)(1)(A). An insolvent taxpayer (one whose liabilities exceed his or her assets), will be allowed to reduce his or her disallowed loss by the amount of his or her insolvency. IRC section 58(c)(1)(A). The disallowed loss is carried over into future years and deductible against any passive income generated in those years from that specific activity. A passive farm activity loss is different from general passive losses in that losses carried over from year to year can be offset only against income from that same activity in future years. IRC section 58(a)(1)(B). However, in the year of disposition the entire loss is allowed and can be used to offset other passive income as well as earned income. IRC section 58(c)(2).

A "tax shelter farming activity" can be either a farming syndicate, as defined in IRC section 464(c), or any farming activity which meets the general passive rules of IRC section 469(c). IRC section 58(a)(2). IRC section 464(c) defines a "Farming Syndicate" as:

* * * (A) a partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, if at any time interest in such partnership or enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale, (B) a partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs.

IRC section 464(c)(2) provides an exception for those taxpayers who are characterized as a farming syndicate because more than 35-percent loss allocation is to limited partners or entrepreneurs. This exception exempts them (1) if they previously actively participated in the management of any trade or business of farming during the last 5 years or (2) if their personal residence is on the farm which is farmed by the entity.

Thus, passive farming activities are first subject to adjustment under IRC section 58(a). If the loss is not disallowed for AMT under this section, it will then need to be considered under the general passive rules for AMT under IRC section 58(b).

Your passive activity gains and losses must be refigured for the AMT by taking into account all adjustments and preferences and any AMT prior year unallowed losses that apply to that activity. You may fill out a second Form 8582, Passive Activity Loss Limitations, and the other forms or schedules on which your passive activities are reported, to determine your passive activity loss allowed for the AMT, but **do not** file the second set of forms and schedules with your tax return.

Example: You are a partner in a partnership and the Schedule K-1 (Form 1065) you received shows the following:

- A passive activity loss of $4,125
- A positive depreciation adjustment of $500 on post-1986 property, and
- A positive adjustment of $225 on the disposition of property.

Because the two adjustments above are not allowed for the AMT, you must first reduce the passive activity loss for the AMT to $3,400 (($4,125) + $500 + $225). You then enter this amount on the AMT Form 8582 and refigure the allowable passive activity loss for the AMT.

Note: The amount of any AMT passive activity loss that is not deductible and is carried forward is likely to differ from the regular tax amount, if any. Therefore, keep adequate records for both the AMT and regular tax.

Enter the difference between the amount that would be reported for the activity on Schedule C, C-EZ, E, or F or Form 4835, Farm Rental Income and Expenses, for the AMT and the regular tax amount. If: a) the AMT loss is more than the regular tax loss, b) the AMT gain is less than the regular tax gain, or c) you have the AMT loss and a regular tax gain, enter the adjustment as a negative amount.

Enter any adjustment for amounts reported on Schedule D, Form 4684, or Form 4797 for the activity.

Insolvency

If at the end of the tax year your liabilities exceed the fair market value of your assets, increase your passive activity loss allowed by that excess (but not by more than your total loss). See Section 58(c)(1).

IRS Audit Techniques

1. If the taxpayer shows passive losses for regular tax purposes, he or she should also have a separate schedule showing AMT passive losses. If the AMT schedule is not shown on the return, ask the taxpayer to supply the schedule. If no schedule exists, the nature of the activity should be considered. Most activities will have some assets which indicate at the minimum a depreciation adjustment would exist. Each AMT preference and adjustment item must be considered as it relates to the activity. If any adjustments exist, prepare a separate AMT schedule.

2. The adjustments for the passive activity losses must be reflected on Line 19. Thus, if a taxpayer explains the passive adjustments are on other lines of Form 6251, verify this and inform the taxpayer of the correct format.

LINE 20, LOSS LIMITATIONS

If the taxpayer has a loss that is limited on his or her tax return, an AMT computation will also be required. Passive losses are limited but are computed separately on Form 6251, as are tax shelter farm activities. Examples of loss limitations reported on this line are losses limited due to basis rules in an S-Corporation or partnership, or the at-risk rules applicable to losses. Losses limited under IRC section 280A may also be affected. These losses should be recomputed taking into account all other AMT preference items and adjustments. Depreciation is usually the most common item affecting the change in loss limitations; however depending on the nature of the item limited, any of the adjustments or preference items could have an effect on the loss limitation for AMT purposes. Any losses reported on the taxpayer's return subject to limitations should be analyzed to determine if an AMT adjustment is needed.

Example: Chris is at-risk for a property in the amount of $100,000 in 2011. For regular tax purposes, the property has a loss of $125,000. The loss will be limited to the amount at risk of $100,000. After considering all AMT adjustments and preferences, the property has an AMT loss of $90,000, all of which will be deductible in 2011. If in 2012 he has a regular loss of $30,000 and an AMT loss of $15,000, he will be allowed no loss for regular tax purposes and a $10,000 loss for AMT purposes. The 2011 return will show a positive adjustment of $10,000 and the 2012 return will show a negative adjustment or additional loss of $10,000. The suspended loss for regular tax purposes will be $55,000 ($25,000 for 2011 plus the $30,000 for 2012) and for AMT purposes will be $5,000 (no suspended loss in 2011 and $5,000 in 2012).

IRS Audit Technique

If the taxpayer is involved in any activities in which losses may be limited due to an office in the home, basis or at-risk provisions, a separate calculation should be made for AMT and regular tax purposes. The taxpayer should be asked for this computation. If none exists, a computation should be prepared and AMT adjusted accordingly.

LINE 21, CIRCULATION COSTS

For regular tax purposes, IRC Section 173(a) allows a taxpayer to deduct currently all expenses to establish, maintain or increase the circulation of a newspaper, magazine or other periodical for the tax year the expenses are incurred. Without this Code section, the costs would have to be capitalized under IRC Section 263. However, if the expenditures are for land, depreciable property, or the acquisition of circulation through the purchase of any part of the business of another publication, they will not be allowed as a current deduction. Taxpayers are not required to expense circulation costs for regular tax purposes. Instead, they may elect to capitalize costs for the portion of circulation expenses which would normally be chargeable to a capital account. Treas. Reg. Section 1.173-1(c)(1) provides the following example. If a newspaper normally employs five people to obtain renewals of subscriptions, the expenses attributable to obtaining the renewals are not chargeable to a capital account. If, however, the newspaper in a campaign to increase circulation employs 20 additional people for a limited time to solicit new subscriptions, these expenses would be properly chargeable to a capital account. This election is revokable only with the Commissioner's consent.

For AMT purposes, under IRC Section 56(b)(2)(A)(i), circulation expenditures must be capitalized and amortized over a 3-year period beginning with the year incurred. These expenses will result in a positive adjustment to AMT in the year the expenses are incurred and a downward adjustment in the following 2 years.

Example: Jackie owns and operates a small town newspaper. She incurs circulation expenditures of $1,000 in 2010. (These expenditures were not incurred in the purchase of a business or a depreciable property). She elects to take the expenditures as a current deduction under IRC Section 173. For AMT purposes, a deduction of $333 would be allowed in 2010, 2011, and 2012. Thus, for 2010 AMT purposes a positive adjustment of $667 would be required to be made. If no additional circulation expenses were incurred in 2011 and 2012, Jackie would have additional deductions of $333 in each year for AMT purposes. Therefore, Form 6251 would show negative adjustments of $333 in 2011 and 2012.

Under IRC Section 56(b)(2)(B), if a loss occurs regarding expenses deducted under IRC Section 173(a), the unamortized portion of these expenses may be allowed for AMT purposes. The AMT deduction is limited to the lesser of the amount allowable as a loss under IRC Section 165(a), if the circulation expenditure had remained capitalized, or the amount of such expenditures which have not previously been amortized for AMT.

Taxpayers can also make an election under IRC section 59(e) to capitalize and amortize the expenditures ratably over a 3-year period beginning with the taxable year in which the expenses are incurred in computing their regular taxable income. If an IRC Section 59(e) election is made, there will be no AMT adjustment.

IRS Audit Techniques

1. Analyze the tax return to determine if an election under IRC section 173(a) has been made. If it has, Form 6251 should have a corresponding AMT adjustment. The circulation expense adjustment applies to amounts paid or incurred after December 31, 1986.

2. If the taxpayer's business involves publications, and, therefore, lends itself to the nature of these expenditures, ask the taxpayer if any circulation expenditures have been incurred and, if so, how they were treated on the tax return.

LINE 22, LONG-TERM CONTRACTS

Under IRC Section 460(f), which provides the general rules regarding long-term contracts, the taxpayer must use the percentage of completion method for contracts which are for the manufacture, building, installation, or construction of any property, if the contract is not completed within the taxable year it was entered into. A contract for the manufacture of property must be for a unique item of a type that is not normally included in a taxpayer's finished goods inventory and for any item requiring longer than 12 months to complete.

There are also exceptions for certain construction contracts. Taxpayers, whose average annual gross receipts for the 3 preceding taxable years are $10,000,000 or less and who estimate at the time the contract is entered into that such contract will be completed within a 2-year period, will not be required to use the percentage of completion method of accounting for their contracts. Home construction contractors are also not required to use percentage of completion to account for their contracts. These contractors may use any other available method including completed contract, accrual and cash. See the Audit Techniques Guide on Construction Industry (Training 3147-123).

To compute the income under the percentage of completion method, the "percentage complete" must be calculated. This percentage is computed on a contract by contract basis by dividing actual costs of the contract to the estimated total contract costs. Notice 87-61. This method is known as the cost-to-cost method. A taxpayer can also elect to use the "simplified cost-to-cost method." IRC Section 460(b)(3)(A). To use this method, all contracts must be computed under the percentage of completion method for all items under all long-term contracts in a trade or business. Notice 87-61; Treas. Reg. Section 1.451-3(a)(1). Under this method: (1) direct material costs and direct labor costs and depreciation, (2) amortization and cost recovery allowances on equipment and facilities directly used to produce or construct the contract's subject matter over the estimated contract costs are used to compute the percentage of completion. Notice 87-61.

For AMT purposes, under IRC Section 56(a)(3), all taxable income from long-term contracts entered into by the taxpayer on or after March 1, 1986, must be computed using the percentage of completion method. The only exception to this rule is for home construction contracts. When computing the percentage of completion for AMT purposes, all AMT adjustments must be made. Thus, if the taxpayer has depreciable items which require an AMT adjustment, the depreciation for AMT will be used when computing the percentage of completion.

Example: During the current tax year, Carol was a commercial contractor with gross receipts under $10,000,000 for the last 3 years. She completes her contracts within 2 years. For regular tax purposes she uses the completed contract method to report income. However, for AMT purposes she is required to use the percentage of completion method. If her income under the completed contract method was $125,000 and under the percentage of completion method would be $200,000, the AMT adjustment for the current year would be $75,000.

An election is available to taxpayers, which allows them to use their regular method (cost-to-cost or simplified cost-to-cost) to compute the percentage complete. IRC section 460(b)(3). This election is, however, used only to compute the percentage complete. When computing the amount of income generated from a particular contract, the taxpayer must use the costs as computed for AMT purposes. Notice 87-61. Thus, the taxpayer could use the regular cost-to-cost method (using depreciation as allowed for regular tax purposes) in arriving at the percentage complete, but when computing the actual amount of expenses for the contract, the depreciation expense would have to be computed using the depreciation as adjusted for AMT purposes. Therefore, whether the taxpayer uses the general AMT rules or the election, the taxpayer should have an adjustment to AMT.

IRS Audit Technique

All taxpayers in the contracting industry, with the exception of home construction contractors, are required to use the percentage of completion method for AMT purposes. Thus, with the exception of home construction contractors, contractors could have an adjustment for AMT purposes. Larger contractors who are required to use percentage of completion for regular tax also could have an adjustment due to the AMT percentage of completion including all AMT preference items and adjustments such as depreciation. These adjustments will affect the percent complete and costs to date of the projects.

LINE 23, MINING COSTS

For regular tax purposes, the taxpayer is allowed an election to take a current expense deduction for mining exploration and development costs. IRC Sections 616 and 617.

Mining development costs are the costs incurred to determine the existence, location, extent, or quality of any deposit of ore or other mineral (other than oil or gas). If the taxpayer does not elect to deduct the costs currently, they will be capitalized and written off through depletion. This election is only revocable with the Commissioner's consent. IRC Section 617.

If the property is disposed of and the costs written off as current deductions, the costs must be recaptured as ordinary income. Once a mine reaches production, any costs deducted as current expenses also must be recaptured under IRC Section 617(b).

After deposits of minerals or ore are discovered in sufficient quality and quantity that a taxpayer may justify commercial exploitation, the development stage of mineral mining begins based on Treas. Reg. Section 1.617-1(a). Rev. Rul. 69-540 defines developmental expenditures as those resulting directly from the mining process or activity of making the mineral in place more accessible for production operations through the removal of material, by driving shafts, tunnels, etc., and similar processes.

IRC Section 616(a) allows the taxpayer a current deduction for these amounts. However under IRC Section 616(b), the taxpayer may elect to capitalize the costs. The deduction is reported ratably as the minerals are produced or sold. The amortization deduction is equal to the excess of development costs over the net receipts in each taxable year. These costs are accounted for separately and are not capitalized for regular depletion purposes. The election is made on a mine-to-mine basis and applies only to those expenses incurred in the taxable year it is made. The election is irrevocable.

For further discussion of the regular tax rules regarding mining exploration and development costs, see IRC Sections 616 and 617 and the corresponding Treasury Regulation sections.

For AMT purposes, under IRC Section 56(a)(2), mining development and exploration costs paid or incurred after 1986 and currently deducted under IRC Section 616(a) and IRC section 617(a) must be capitalized and amortized over a 10-year period beginning with the year the expenses are incurred. If a mining property becomes worthless or is abandoned, the deductible loss is equal to the lesser of the amount of unamortized costs or the amount of loss that would be allowed under IRC Section 165 had the costs remained capitalized.

Example: Candy makes the IRC Section 616(a) and 617(a)(1) election to currently deduct mining exploration and development costs. In the current year, she deducts $20,000 of these costs. For AMT purposes, she is allowed 10 percent of these costs ($2,000). This year she will have a positive adjustment of $18,000. In each of the subsequent nine years, she will have a negative adjustment of $2,000 allowing 1/10 of the costs in each year.

Similar to the election available for circulation costs and research and experimental expenditures, a regular tax election available to a taxpayer for mining exploration and development costs is the election to amortize such expenses ratably over a 10-year period based on IRC Section 59(e). If an IRC Section 59(e) election is made, such costs are excluded from AMT based on IRC Section 59(e)(6). IRC Section 59(e) can be elected for all or a portion of a specific mine's exploration or development expenses.

IRS Audit Technique

If the taxpayer is involved in the mining industry, the tax treatment of each mine and what elections, if any, the taxpayer has made should be determined. If the taxpayer currently deducts the mining exploration and development costs, AMT adjustments must be made. The taxpayer should have separate records for regular and AMT purposes for each mine.

LINE 24, RESEARCH AND EXPERIMENTAL COSTS

IRC Section 174(a) allows a current year deduction for research and experimental (R&E) costs. R&E expenditures are defined in Treas. Reg. Section 1.174-2(a)(1) as expenditures incurred in connection with the taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense, and includes all such costs incidental to the development of an experimental or pilot model, a plant process, a patent, a formula, an invention, or similar property.

To fully deduct the costs under IRC Section 174(a), the taxpayer treats the costs as current deductions for the first taxable year the costs are incurred.

IRC Section 174(b) allows the taxpayer to elect to amortize R&E expenses over a period of at least 60 months. If the property resulting from the expenditures has a useful life, amortization is required over the useful life. Treas. Reg. Section 1.174-4(a)(2). If the election is made under IRC section 174(b), it will apply to all subsequent tax years, unless the Commissioner's permission to change methods is granted.

If the expenses incurred result in the development of an actual depreciable asset, the remaining unamortized R&E expenses must be recovered as a depreciation deduction over the property's useful life.

An AMT adjustment is required only if the taxpayer elects to deduct the costs as current year costs under IRC Section 174(a). For AMT purposes, under IRC Section 56(b)(2)(A)(ii), the taxpayer must capitalize these costs and amortize them ratably over a 10-year period beginning with the year the costs were incurred, unless the taxpayer qualifies for the material participation exception discussed in IRC Section 56(b)(2)(B).

If the taxpayer suffers a loss with respect to the R&E costs deducted under IRC Section 174(a), for AMT purposes, the entire unamortized R&E costs are deductible in the year of the loss. This loss is limited to the lesser of the amount of loss allowable under IRC Section 165(a) if the costs had been capitalized, or the amount of the expenditures that have not previously been amortized.

Example: Mark has research and experimental expenditures which he has elected under IRC section 174(a) to deduct currently. His costs are $10,000. For AMT purposes, he will be allowed $1,000 each year for the next 10 years. In the current year he will have a positive AMT adjustment of $9,000 and for the next 9 years he will have a negative $1,000 adjustment.

If the taxpayer elects to capitalize and amortize R&E expenses pursuant to IRC Section 174(b), no AMT adjustment is necessary. An election is also available to the taxpayer under IRC Section 59(e) to capitalize and amortize these costs ratably over a 10-year period beginning with the year the costs were first incurred for regular tax purposes. This election would reduce the burden on taxpayers because they would not have to make an AMT adjustment. The election under IRC Section 59(e) is a year-to-year election made by the taxpayer. The election may be revoked only with the consent of the Secretary. IRC Section 59(e)(4)(B).

Example: Assume the same facts as the prior example, except that Mark elects under IRC Section 59(e) to capitalize and amortize the costs. Therefore, for both regular tax purposes and AMT purposes Mark will be allowed $1,000 each year for 10 years. Since the deduction for regular tax purposes and AMT purposes is the same, there will be no AMT adjustment.

For tax years after 1990, IRC Section 56(b)(2)(D) allows a taxpayer to avoid the AMT adjustment for R&E if he or she materially participates in the activity. The rules of material participation are the same as the passive activity rules of IRC Section 469(h). The taxpayer must participate in a regular, continuous and substantial manner. This law will affect only those who are actually a part of the inventing process. Most investors will not meet these rules.

Example: Assume the same facts as the first example, except that Mark materially participates in the research activity. Mark deducts the $10,000 of costs for regular tax. There is no AMT adjustment.

IRS Audit Technique

If the taxpayer is taking a deduction for research and experimental costs, any elections made by the taxpayer should be determined. If current deductions are being taken, the taxpayer should have separate computations for regular and AMT purposes.

LINE 25, INSTALLMENT SALES

The installment method does not apply for the AMT to any non-dealer disposition of property after August 16, 1986, but before January 1, 1987, if an installment obligation to which the proportionate disallowance rule applied arose from the disposition. Enter on this line the amount of installment sale income reported for the regular tax. The figure is entered as a negative number.

Observation: Since this item only applied to sales originated in 1986, no new items are being created. You should look on the prior year return for an entry on this line.

LINE 26, INTANGIBLE DRILLING COSTS

When accounting for Intangible Drilling Costs (IDCs) the taxpayer can either capitalize the costs or deduct the items as current year expenses. IRC Section 263(c). Per Treas. Reg. Section 1.612-5, IDCs are those costs which, in and of themselves, have no salvage value. These include all expenditures made by an operator for wages, fuel, repairs, hauling, and supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of geothermal steam or hot water.

This includes the above items used in: (1) the drilling, shooting, and cleaning of wells, (2) in such clearing of ground, draining, road making, surveying, and geological work as are necessary in preparation for the drilling of wells, and (3) in the construction of such derricks, tanks, pipeline, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of geothermal steam or hot water. If the expenses are incurred in the production of physical property which has a salvage value, the individual expenses will still not be considered to have a salvage value.

IDCs also include costs incurred in connection with the installation of tangible equipment for the drilling of wells and the preparation of wells for production. The equipment itself must be capitalized and depreciated. However, the installation costs of these items will be considered an IDC and may be used as a current deduction.

Once the installation of production equipment begins, the taxpayer is no longer allowed any IDCs. At this point the normal rules of capitalization apply. Thus, if labor is incurred for the installation of a piece of equipment in production, this cost will be required to be capitalized as a part of the equipment cost. However, labor for the day-to-day operations of the oil well itself will be considered a current expense.

If the taxpayer elects to capitalize the cost and the well later becomes non-productive, the loss will be deducted in the year that the well becomes worthless. If the taxpayer elects to capitalize the cost and the well is productive, the capitalized cost will be recovered through depreciation (if the cost was incurred for physical property) or depletion.

IRC Section 57(a)(2) discusses the AMT rules surrounding IDCs. The tax preference item is the amount by which the excess IDCs arising in the taxable year are greater than 65 percent of the net income of the taxpayer from oil, gas and geothermal properties for the taxable year. Net income from oil, gas, and geothermal properties is the gross income from all the taxpayer's oil, gas, or geothermal properties less any deductions allocable to these properties reduced by the excess IDCs.

For tax years beginning after 1992, this preference item will apply only to taxpayers who are integrated oil companies. IRC Section 291(b)(4). However, the reduction in AMTI because of this law change may not exceed 40-percent (30-percent in cases of taxable years beginning in 1993) of the AMTI computed as if the tax preference item for IDC had not been changed. Prior to this law change, the excess IDC tax preference item applied to all taxpayers with oil, gas, or geothermal properties.

Excess IDCs are the excess of the amount of intangible drilling and development costs paid or incurred with respect to oil, gas or geothermal properties that the taxpayer elects to expense under IRC Section 263(c) over the amount that would be allowed for the taxable year if the costs had been capitalized and amortized under one of the methods provided in IRC Section 57(b). The two methods available under IRC Section 57(b) are: (1) a ratable amortization over a 120-month period beginning with the first month is which the production begins, or (2) at the election of the taxpayer, any method permitted for determining cost depletion with respect to a well.

If the taxpayer elects to compute excess IDCs under IRC section 57(b)(2) using the cost depletion method, the election must be made in the year that the IDCs are paid or incurred. This election must be made on a well-to-well basis. This election can be made to arrive at excess IDCs, even if the taxpayer uses another method to arrive at taxable income for regular tax purposes. Tem. Treas. Reg. section 7.57(d)-1(b).

When computing the excess IDCs using the cost depletion method under IRC section 57(b), both depreciable property and depletable property are considered.

The IRC Section 59(e) election is also available to the taxpayer. This election allows the taxpayer to deduct the IDCs over a 60-month period beginning with the month the IDCs are paid or incurred. (The write-off period was 10 years instead of 60 months before 1989. The change to 60 months is effective for costs paid or incurred in tax years beginning after 1989.) If the taxpayer makes this election, no preference item will result. This election is made on a year-to-year basis and is revocable only with the consent of the secretary. IRC Section 59(e)(4)(B).

Example: During the current year, the taxpayer incurs IDCs of $100,000 and elects to take a current deduction for these costs under IRC Section 263(a). The taxpayer’s gross income is $90,000 and operating expenses are $60,000. Production began on the wells in April of the current year.

(1) Calculate the excess IDCs. IDCs currently deducted are $100,000, less the allowed amortization $7,500 ($100,000/120 months=$833 per month at 9 months) equals excess IDCs of $92,500 ($100,000 - $7,500).

(2) Calculate the net income. Gross income is $90,000. Deductions include IDCs of $100,000, operating expenses of $60,000, and depletion of $13,500, for total allocable expenses of $173,500 less excess IDCs of $92,500 which equals $81,000. Net income is equal to $9,000 ($90,000 - $81,000).

(3) Compute the tax preference item as the excess IDC of $92,500 less 60 percent of net income $5,850 (65 percent x $9,000), which equals $86,650.

A taxpayer should, at the end of each year, determine whether a well is productive or nonproductive. A nonproductive well is not considered when computing the tax preference item. A nonproductive well is one which is plugged and abandoned without producing a significant amount of oil or gas for a substantial period of time. The IDCs relating to a nonproductive well may be capitalized and deducted at the time the well is considered nonproductive or written off as a current deduction. Treas. Reg. section 1.612- 4(b)(4). If the taxpayer considers a well productive at year end and later discovers it to be a nonproductive well, the taxpayer may file an amended return.

IRS Audit Technique

If the taxpayer is involved in the oil, gas, or geothermal industry, the treatment of excess IDCs should be established during the audit and a determination made as to whether any AMT adjustment is needed.

LINE 27, OTHER ADJUSTMENTS, INCLUDING INCOME-BASED RELATED ADJUSTMENTS

LINE 27, PATRON'S ADJUSTMENT

Distributions received from cooperatives should be included in income, unless the distributions are nontaxable. The total AMT patronage dividend and allocation adjustment should be reported.

LINE 27, POLLUTION CONTROL FACILITIES

Under the regular tax rules of IRC Section 169(a), a taxpayer is allowed to amortize the cost of a certified pollution control facility over a 60-month period. This election applies to tangible depreciable property. If elected, this amortization deduction is substituted for any allowable depreciation.

IRC Section 56(a)(5) describes the method applicable for AMT purposes. For property placed into service after December 31, 1986, the deduction determinable under IRC Section 169 shall be determined under the alternative system of IRC Section 168(g). The pollution control adjustment is determined by substituting the recomputed AMT amortization for the regular tax deduction. Thus, the difference between the two amounts will be the amount of the AMT adjustment.

Upon disposition of the pollution control facility, a taxpayer is required to compute a separate regular tax and AMT gain/loss taking into account prior regular tax and AMT accumulated amortization.

Example: Ann has incurred $1,000,000 of costs relating to a certified pollution control facility for the current year. The facility was placed in service in February. For regular tax purposes, the costs will be amortized over a 60-month period. Thus, for the current year, she will be allowed a deduction of $183,333 ($16,667 x 11 months). For AMT purposes, she must use the alternative method per IRC section 168(g). Assuming that the property is 12-year property, using straight-line depreciation with a half-year convention, she will be allowed $41,667 for AMT purposes. Therefore, for AMT purposes, Ann will have a positive AMT adjustment of $141,666 in the current year.

IRS Audit Technique

If a taxpayer is deducting amounts related to certified pollution control facilities, determine if she has filed an election under IRC section 169. If so, an AMT adjustment should be present. Again, the taxpayer should have separate records for amortization deductions for regular tax purposes and AMT purposes.

LINE 27, TAX SHELTER FARM ACTIVITIES

If a taxpayer is involved in a tax shelter farm activity which is not a passive activity, an adjustment for AMT purposes must be made. Tax shelter farm activities were discussed with the passive activity loss adjustment on Line 19. Remember, if a tax shelter farm activity is considered passive, it must be reported with all other passive items on Line 19. Thus, Line 27 deals only with non-passive tax shelter farm activities.

The income or loss from each tax shelter farm activity must be recomputed using all AMT preference items and adjustments found in IRC sections 56, 57, and 58. If the activity has depreciable property, the AMT depreciation must be used in arriving at the AMT income or loss amount. Per IRC Section 58(a), no loss will be allowed on any tax shelter farm activity for AMT purposes unless the taxpayer is insolvent, in which case a loss will be allowed up to the amount of insolvency. Income or loss for each activity (as defined in IRC Section 469) is computed on a separate basis. A loss from one activity cannot be used to offset income from another. Committee Report on P.L. 99-514. The loss must be carried forward to offset future income from that activity. The loss also may be used upon a disposition of the activity.

The amount entered on Form 6251 is the difference between the amount that would be reported for the activity on Schedules E or F, or on Form 4835, Farm Rental Income and Expenses for the AMT and the regular tax amount. If: (1) the AMT loss is more than the regular tax loss, (2) the AMT gain is less than the regular tax gain, or (3) there is an AMT loss and a regular tax gain, the adjustment is entered as a negative amount.

Example: Drew has a tax shelter farm loss for regular tax purposes of $10,000 in the current year. For AMT purposes, the amount of the loss is $5,000. The amount deductible for AMT purposes is $0. The suspended loss for AMT purposes is $5,000. This loss is carried forward until the farm interest is sold or generates income. Drew puts $10,000 on Form 6251.

IRS Audit Technique

If the taxpayer is involved in any farming activities, carefully determine if these activities are part of a tax shelter. Each farm activity should be considered independently, as losses from each activity are offset only against income from the same activity.

LINE 27, CHARITABLE CONTRIBUTIONS OF CERTAIN PROPERTY

If you made a charitable contribution of property to which section 170(e) applies and you had a different basis for AMT purposes, you may have to make an adjustment.

LINE 27, ALCOHOL, BIODIESEL, AND RENEWABLE DIESEL FUELS CREDITS

If your taxable income includes an amount from the alcohol fuel credit or the biodiesel and renewable diesel fuels credit under section 87, include that amount as a negative amount.

LINE 27, RELATED ADJUSTMENTS

If an adjustment is made for items such as investment interest, post-1986 depreciation, adjusted gains or losses, or incentive stock options and passive activities, an adjustment may have to be made regarding any item of income or deduction based on a limit of income other than AGI or modified AGI. Examples of these items include IRC Section 179 deduction, expenses for business or rental use of the home, conservation expenses, taxable IRA (Individual Retirement Account) distributions, self-employed health insurance, Keogh or SEP (Simplified Employee Pension) deductions, and IRA deductions. The difference between the AMT and regular tax amount will result in the adjustment figure. Treas. Reg. Section 1.55-1(a), -1(b).

Example: On your Schedule C (Form 1040) you have a net profit of $9,000 before figuring your section 179 deduction. You do not report any other business income on your return. During the year, you purchased an asset for $10,000 for which you elect to take the section 179 deduction. You also have an AMT depreciation adjustment of $700 for other assets depreciated on your Schedule C.

Your section 179 deduction for the regular tax is limited to your net profit (before any section 179 deduction) of $9,000. The $1,000 excess is a section 179 deduction carryforward for the regular tax.

For the AMT, your net profit is $9,700, and you are allowed a section 179 deduction of $9,700 for the AMT. You have a section 179 deduction carryforward of $300 for the AMT.

You include a $700 negative adjustment on line 27 because your section 179 deduction for the AMT is $700 greater than your allowable regular tax deduction. In the following year, when you use the $1,000 regular tax carryforward, you will have a $700 positive related adjustment for the AMT because your AMT carryforward is only $300.

IRS Audit Technique

Examine the tax return to determine if there are deductions subject to income limitations other than AGI. If any exist, recompute income limitations based on the AMT income amounts.

LINE 28, ALTERNATIVE MINIMUM TAXABLE INCOME

This is the total of taxable income per the tax return adjusted for the adjustments, preference items and AMTNOL. Special rules apply for married taxpayers filing separately.

EXEMPTION AMOUNT AND AMT

LINE 29, EXEMPTION AMOUNT

The next step in the process is for taxpayers to determine their AMT exemption amount. This amount is based on the taxpayers' filing status and is phased-out at certain dollar limitations. The taxpayers' AMT exemption is reduced by $1 for every $4 (25 percent) in excess of the amount designated in IRC Section 55(d)(3). IRC Section 55(d)(1) lists the exemption amount. The following chart summarizes the exemption amounts and the exemption phase-out amounts.

	2011 AMTI Exemption	Phase-out Begins at AMTI	Phase-out Ends at AMTI
Married Filing Jointly/ Qualifying Surviving Spouse	$74,450	$150,000	$447,800
Single/ Head of Household	$48,450	$112,500	$306,300
Married Filing Separately	$37,225	$ 75,000	$223,900

IRC Section 55(d)(3) provides a special phase-out for taxpayers who are married filing separately. A married taxpayer filing separately must increase his or her AMT taxable income, before the AMT exemption, by the lesser of (a) 25-percent of the excess of his or her AMT income over $223,900 (the phase-out of the married filing separately exemption shown in the above chart) or (b) $37,225. This provision was enacted to prevent married taxpayers from filing separately to avoid the phase-out of the married filing jointly exemption when one spouse had income less than the $75,000 phase-out level for a married filing separately return.

Example: Joe and Ann file jointly and have AMTI of $200,000 for the tax year 2011. Since Joe and Ann's income exceeds the phase-out amount, their exemption amount will be reduced as follows:

AMTI	$200,000
Less: AMT Exemption Phase-out Amount for married filing jointly	($150,000)
Difference	$ 50,000
Multiplied by 25%	25%
Exemption Reduction Amount	$ 12,500
	==========
Exemption Amount	$ 74,450
Reduction Amount	($ 12,500)
Allowed Exemption Amount	$ 61,950

AMT Exemption By Year

Filing Status	**2007**	**2008**	**2009**	**2010**	**2011**	**2012 and Later Years**
MFJ	$66,250	$69,950	$70,950	$72,450	$74,450	$45,000
Single	$44,350	$46,200	$46,700	$47,450	$48,450	$33,750
MFS	$33,125	$34,975	$35,475	$36,225	$37,225	$22,500

Without legislation, millions more people will be subject to the AMT in 2012.

Practice Pointer: The AMT exemption amount has been changed temporarily many times in the past few years. Congress will likely continue to tinker with the AMT exemption amount until the AMT is restructured or regular tax rates increase.

LINE 30, LINE 29 MINUS LINE 28

This is the AMTI less the taxpayer's exemption amount. The result is the amount that the AMT is calculated on.

Example: In the prior example, Joe and Ann's AMTI of $200,000 less the exemption amount of $61,950 equals $138,050.

LINE 31, CALCULATION OF THE ACTUAL AMT

IRC Section 55(b)(1)(A) lists the actual rates for AMT. The tax is calculated at the rate of 26-percent of the amount which does not exceed $175,000 and 28-percent of the amount which exceeds $175,000. IRC section 55(b)(3). For taxable years ending after May 6, 1997, the amount determined under section 55(b)(1)(A)(I) cannot exceed certain amounts for noncorporate taxpayers because of the maximum rate on net capital gain for those taxpayers.

Example: Since Joe and Ann's income is under $175,000, the $138,050 will be taxed at the 26-percent rate. If Joe and Ann's AMTI less exemption amount was $225,000, their tentative minimum tax (before calculating the AMT foreign tax credit) would be $59,500. This amount can be computed one of two ways.

$175,000 x 26%	$45,500
($225,000 - $175,000) x 28%	$14,000
	________
	$59,500
	=======
OR	
$225,000 x 28%=	$63,000
Less: $175,000 x 2%=	($ 3,500)
	________
	$59,500
	=======

Foreign Earned Income Inclusion: If you excluded foreign earned income, you will need to perform a special calculation to figure AMT as well as to factor in otherwise disallowed deductions. Fortunately, the IRS has a worksheet in the instructions to help with the calculation. Most commercial tax preparation programs also provide a worksheet to perform the calculation.

LINE 32, ALTERNATIVE MINIMUM TAX FOREIGN TAX CREDIT (AMTFTC)

Individual citizens, resident aliens and domestic corporations are taxed on their worldwide income. This income may be taxed at both the source country of the income and in the United States. IRC Section 164(a)(1). Taxpayers are allowed a foreign tax credit for income which is taxed in both the country of source and in the United States. This credit is a dollar for dollar credit against United States income tax.

IRC Sections 901-908 and 960 describe in detail the tax laws surrounding the foreign tax credit. This text will be limited to the general rules and the AMT consequences. The premise behind the FTC is to prevent the income from being taxed in both the country of source and the United States, and not to reduce the U.S. tax on the income earned within the United States. IRC section 904 imposes a limit on the foreign tax credit so that the credit does not exceed the U.S. tax attributable to the foreign income. The following formula is used.

$$\frac{\text{Foreign Source Taxable Income}}{\text{Worldwide Taxable Income}} \times \text{Tentative U.S. Tax}$$

Any credit not allowed because of the limitation is carried back two years and forward five years.

To calculate the FTC for AMT purposes, tentative AMT is used. This is because tentative U.S. tax and foreign source taxable income and worldwide taxable income must be calculated, by applying all AMT adjustment items and preference items per IRC sections 56, 57, and 58. Adjusting for the adjustment and preference items may provide for a different ratio of foreign source taxable income to worldwide taxable income, thus resulting in a different amount of foreign tax credit being allowed. The credit carryback of 2 years and carryover of 5 years is also allowed for AMT purposes. This is another example of why it is important for the taxpayer to keep a separate set of books for AMT purposes.

In the previous discussion of NOLs for AMT purposes, it was noted that the AMTNOL deduction is limited to 90 percent of AMTI determined without regard to the NOL deduction. Thus, if a taxpayer has both an AMTNOL deduction and an AMTFTC, the NOL deduction is applied first.

2004 Tax Act Changes

- Foreign tax carryover period extended to ten years (effective for tax years ending after enactment).

- Foreign tax carryback period reduced to one year (effective for years beginning after enactment).

- Repeal of 90% AMTFTC limitation. Thus, 100% of the AMTFTC may be used against AMT (effective for years beginning after 12/31/04).

Example: In the current year, Jack has $500,000 of AMTI (without regard to the AMTNOL deduction) and an AMTNOL carryover into the current year of $750,000. Jack's AMTNOL deduction is limited to $450,000, which is 90 percent of AMTI without regard to the AMTNOL deduction. Jack's FTC limitation is computed as follows: tentative minimum tax (computed without regard to the FTC) is $1,469 ($50,000 AMTI - $44,350 exemption, x 26 percent).

Note: Any FTC not allowed as a result of the IRC section 904 limitation or the IRC section 59(a) limitation may be carried to other tax years in accordance with the regular tax FTC rules. Those same limitations must be applied for each year to which the FTC is carried.

LINE 33, TENTATIVE MINIMUM TAX

This is the result of the AMTI, multiplied by the applicable AMT tax rate, and then reduced by the foreign tax credit.

LINE 34

On this line, taxpayers enter an amount equal to their "regular tax liability" minus any foreign tax credit on Form 1040.

"Regular tax" is defined in IRC Section 26(b).

Per IRC Sections 26(b) and 55(c)(1), the following taxes are disregarded when arriving at "regular" tax.

- IRC Sections 42(j) and (k), 49(b) and 50(a) relating to increases in tax;
- IRC Section 55 relating to minimum tax;
- IRC Sections 72(m)(5)(B),(q)(t) and (v) relating to additional taxes on certain distributions;
- IRC Section 143(m) relating to recapture of proration of federal subsidy from use of mortgage bonds and mortgage credit certificates;
- IRC Section 402(d) relating to the tax on lump sum distributions eliminated for tax years beginning after December 31, 1999;
- IRC Sections 453(l)(3) and 453A(c) relating to interest on certain deferred tax liabilities;
- IRC Section 531 relating to accumulated earnings tax;
- IRC Section 541 relating to personal holding company;

- IRC Sections 860E(e) relating to taxes on transfers of residual interest to certain organizations;

- IRC Sections 871(a) and 881 relating to certain income of nonresident aliens and foreign corporations;

- IRC Sections 884 relating to branch profit taxes;

- IRC Section 1351(d)(1) relating to recoveries of foreign expropriation losses;

- IRC Section 1374 relating to tax on certain income of nonresident aliens and foreign corporations;

- IRC Section 1375 relating to tax imposed when passive investment income of S Corporation having subchapter C earnings and profits exceeds 25 percent of gross receipts; and

- IRC Section 7518(g)(6)(A) relating to nonqualified withdrawals from capital construction funds taxed at highest marginal rate.

For tax years beginning after December 31, 1997, the following taxes are also disregarded when arriving at "regular tax."

- IRC Section 59A relating to environmental tax;

- IRC Section 220(f)(4) relating to additional tax on medical savings account distributions not used for qualified medical expenses;

- IRC Section 530(d)(3) relating to additional tax on certain distributions from individual retirement accounts; and

- IRC Section 860K relating to treatment of transfers of high-yield interest to disqualified holders.

LINE 35, ALTERNATIVE MINIMUM TAX

Alternative minimum tax is the amount by which the tentative minimum tax exceeds the amount of the regular tax. If the tentative minimum tax exceeds the regular tax, the taxpayer will pay an amount equal to the entire tentative minimum tax. In general, no credits (other than FTC) will be allowed to offset the amount of regular tax. However, an exception for 2004 through 2011 allows the use of nonrefundable personal credits against both the regular tax and the AMT.

Example: In 2011, Cheryl has a regular tax liability of $200,000. Her tentative minimum tax (ignoring the AMTFTC) for the year is $250,000. Her alternative minimum tax is $50,000. She will not be able to use nonrefundable tax credits to reduce the $200,000 of regular tax. The only credit available to offset the $50,000 in alternative minimum tax is the AMTFTC.

If the regular tax (reduced by FTC) is greater than the tentative minimum tax, the taxpayer will not be liable for AMT. However, nonrefundable credits are allowed only up to the amount that the regular tax exceeds the tentative minimum tax. IRC Section 55(c)(1).

The nonrefundable credits are allowed against the regular tax in the following order:

1. IRC Sections 21 (Dependent Care Credit), 22 (Credit for the Elderly), 25A (Education Credits), 25B (Retirement Savings Credit), 24 (Child Tax Credit – Nonrefundable Part), 23 (Adoption Expenses), 25 (Mortgage Interest Credit), and The Credit for First-time Homebuyers in DC.

2. IRC Section 27 (Foreign Tax Credit).

3. IRC Section 28 (Clinical Testing Credit) (redesignated in 1997 as IRC section 45C).

4. IRC Section 29 (Credit for Producing Fuel from a Nonconventional Source).

5. IRC Section 38 (General Business Credits).

6. IRC Section 53 (Credit for Prior Year Minimum Tax Liability).

Any unabsorbed personal credits are lost by the taxpayer, with one exception. Any mortgage interest credit unused will be allowed to be carried forward for 3 years.

After the absorption of the personal credits, the FTC is allowed against both the regular and tentative minimum tax.

The IRC Section 28 clinical testing credit is allowed. Next, any unused remaining credit is lost. (But see, IRC Section 53(d)(1)(13)(iv)(II).)

The IRC Section 29 credit for producing fuel from a nonconventional source is the next credit allowed. Any credit not allowed also will be permanently lost. (But see IRC Section 53(d)(1)(B)(iv)(II).)

The final credits allowed against the liability are the general business credits listed under IRC Section 38(b). The more common credits include the investment tax credit (composed of the rehabilitation credit, energy credit and the reforestation credit), the targeted jobs credit, the alcohol fuel credit, the research credit and various other credits listed in IRC section 38(b).

Per IRC Section 38(c)(1), the credit allowed for this section shall not exceed the excess of the taxpayer's net income tax over the greater of (1) the tentative minimum tax for the taxable year, or (2) 25-percent of the taxpayer's net regular tax liability as it exceeds $25,000. "Net income tax" means the sum of the regular tax liability plus the AMT under IRC Section 55, less the previously discussed credits. IRC Section 38(c). "Net regular tax liability" is defined as regular tax reduced by all the credits previously discussed (IRC sections 21, 22, 25, 27, 28, and 29). The business credits not allowed due to this limitation will be allowed to be carried back three years and forward 15 years.

Example: In 2011, Bryan has a regular tax liability of $150,000. His tentative minimum tax (before the AMTFTC) for the year is $100,000. Therefore, Bryan will not be subject to any alternative minimum tax. The maximum credits Bryan can claim against his regular tax liability is, however, limited to the amount that the regular tax exceeds his tentative minimum tax. The maximum credits (excluding the AMTFTC) that Bryan can claim is $50,000. The remaining tentative minimum tax can be offset only by the AMTFTC.

Personal Tax Credits and the AMT

The use of nonrefundable personal tax credits against both the regular tax and the AMT has been extended. Thus, all nonrefundable personal tax credits are allowed in full for the 2004-2011 tax years. Unless, extended by Congress, this exception ends for tax years beginning on or after January 1, 2012.

Business Credits and the AMT

At this point, you may believe that you will be able to claim all of the business credits reported on Form 3800. Unfortunately, Form 3800 has its own set of instructions that impacts the amount of credits that may offset AMT. In general, only a specified percentage of the credits are allowable though a few obscure credits like the Indian Coal Production Credit are available without limitation. To make matters worse, special interest groups are constantly getting Congress to tinker with the credits that are allowed without limitation. See the instructions for Form 3800 for more details.

New Refundable AMT Credit from ISO Related AMT

Under the provision, an individual's minimum tax credit allowable for tax years 2007-2012 is not less than the "AMT refundable credit amount." The "AMT refundable credit amount" is the greater of: (1) the lesser of $5,000 or the long-term unused minimum tax credit, or (2) 20 percent of the long-term unused minimum tax credit. The long-term unused minimum tax credit for any taxable year means the portion of the minimum tax credit attributable to the adjusted net minimum tax for taxable years before the 3rd taxable year immediately preceding the taxable year (assuming the credits are used on a first-in, first-out basis). In the case of an individual whose adjusted gross income for a taxable year exceeds the threshold amount (within the meaning of section 151(d)(3)(C)), the AMT refundable credit amount is reduced by the applicable percentage (within the meaning of section 151(d)(3)(B)). The additional credit allowable by reason of this provision is refundable.

Example: Assume in 2007 an individual has an adjusted gross income that results in an applicable percentage of 50 percent under section 151(d)(3)(B), a regular tax of $45,000, a tentative minimum tax of $40,000, no other credits allowable, and a minimum tax credit for the taxable year (before limitation under section 53(c)) of $1.1 million of which $1 million is a long-term unused minimum tax credit.

The AMT refundable credit amount for the taxable year is $100,000 (20 percent of the $1 million long-term unused minimum tax credit reduced by an applicable percentage of 50 percent). The minimum tax credit allowable for the taxable year is $100,000 (the greater of the AMT refundable credit amount or the amount of the credit otherwise allowable). The $5,000 credit allowable without regard to this provision is nonrefundable and the additional $95,000 of credit allowable by reason of this provision is treated as a refundable credit. Thus, the taxpayer has an overpayment of $55,000 ($45,000 regular tax less $5,000 nonrefundable AMT credit less $95,000 refundable AMT credit). The $55,000 overpayment is allowed as a refund or credit to the taxpayer. The remaining $1 million minimum tax credit is carried forward to future taxable years.

If, in the above example, the adjusted gross income did not exceed the threshold amount under section 151(d)(3)(C), the AMT refundable credit amount for the taxable year would be $200,000, and the overpayment would be $155,000.

2008 Legislation

The new law generally allows the long-term unused minimum tax credit to be claimed over a two-year period (rather than five years) and eliminates the AGI phase-out.

The provision provides that any underpayment of tax outstanding on the date of enactment which is attributable to the application of the minimum tax adjustment for incentive stock options (including any interest or penalty relating thereto) is abated. No tax which is abated is taken into account in determining the minimum tax credit.

The provision provides that the AMT refundable credit amount and the AMT credit for each of the first two taxable years beginning after December 31, 2007, are increased by one-half of the amount of any interest and penalty paid before the date of enactment on account of the application of the minimum adjustment for incentive stock options.

Effective Date

The provision generally applies to taxable years beginning after December 31, 2007.

2010 Legislation

The 2010 Act increased the exemption amounts for 2010 and 2011. The Act also allows the unlimited use of nonrefundable personal tax credits for 2010 and 2011.

CHAPTER 2 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. For individuals, AMT is calculated using Form:

   a) 4952
   b) 6251
   c) 8582
   d) 8801

2. If a taxpayer does not itemize deductions and claims the standard deduction, which of the following is true regarding claiming the standard deduction for AMT purposes:

   a) a taxpayer that does not itemize deductions will always get to claim the standard deduction against the AMT
   b) a taxpayer that does not itemize deductions begins the AMT calculation with AGI and does not get to deduct the standard deduction
   c) all taxpayers get to deduct the standard deduction even if they itemize deductions
   d) taxpayers who do not itemize deductions will get to deduct the standard deduction if their income is below certain "phase-out" levels

3. For taxpayers who itemize deductions, both regular tax and the AMT allow a deduction for medical expenses. The AMT allows medical expenses to the extent they exceed ______ of AGI.

   a) 2.5%
   b) 5%
   c) 7.5%
   d) 10%

4. Which of the following is true regarding real property taxes and the AMT:

   a) all real property taxes are allowed for AMT purposes
   b) real property taxes are allowed for AMT purposes only for those taxpayers who itemize their deductions
   c) real property taxes deducted on Schedule A are not deductible for AMT purposes
   d) real property taxes deducted on Schedule A or elsewhere are not deductible for AMT purposes

5. Which of the following is true regarding foreign income taxes and the AMT:

   a) all foreign taxes are allowed for AMT purposes
   b) foreign taxes are allowed for AMT purposes only for those taxpayers who itemized their deductions
   c) foreign taxes deducted on Schedule A are not deductible for AMT purposes
   d) foreign taxes deducted on Schedule A are deductible for AMT purposes only to the extent foreign source income is included in AGI

6. Interest on home equity indebtedness of up to $100,000 is deductible for regular tax purposes. Assume a taxpayer takes out a $50,000 home equity loan and uses $30,000 to add on to the house and $20,000 to purchase a car used completely for business purposes (Schedule C). Which of the following is true:

   a) interest on the entire $50,000 loan deducted on Schedule A will be deductible for AMT purposes
   b) the entire $50,000 is deductible on Schedule A and for AMT purposes since the majority of the loan balance was used to improve the home
   c) only interest on $30,000 can be deducted for AMT purposes under any circumstances
   d) interest on the entire loan may be deductible for AMT purposes – 60% on Schedule A and 40% on Schedule C

7. Which of the following types of interest expense deductible for the regular tax is <u>not</u> deductible for the AMT:

   a) qualified student loan interest
   b) rental interest (Schedule E)
   c) home acquisition interest (Schedule A)
   d) home equity loan used to purchase a $20,000 car

8. Taxpayers who itemize are allowed to deduct miscellaneous itemized deductions for regular tax to the extent they exceed 2% of AGI. Which of the following is true regarding miscellaneous deductions and the AMT:

   a) there is no AMT adjustment for miscellaneous itemized deductions
   b) there is no AMT adjustment for miscellaneous itemized deductions if the taxpayer elects to amortize these costs over a five-year period
   c) the amount of miscellaneous itemized deductions allowable for the AMT depends on the income of the taxpayer and the applicable phase-out threshold
   d) the miscellaneous deduction for gambling losses to the extent of gambling winnings claimed on Schedule A is not adjusted for AMT purposes

9. IRC Section 68 provides for an overall limitation on itemized deductions. This limitation is for taxpayers whose AGI exceeds a threshold amount. Itemized deductions are reduced by the lesser of one percent (for 2008 and 2009) of the excess of AGI over the threshold amount or 80 percent of the amount of the itemized deductions otherwise allowable for such taxable year. Although this provision is suspended for 2010 and 2011, how are the disallowed itemized deductions treated for AMT purposes:

   a) the disallowed itemized deductions are entered as a “negative” amount when calculating AMT
   b) the disallowed itemized deductions are entered as a “positive” amount when calculating AMT just like other preference items
   c) since the disallowed itemized deductions are not allowed for regular tax or AMT purposes, no adjustment is required
   d) the disallowed deductions are added to AMTI but may create an AMT credit to be used in future years

10. Which of the following is true regarding tax refunds and the AMT:

   a) state income tax refunds are always taxable for AMT purposes
   b) state income tax refunds are never taxable for AMT purposes
   c) when previously deducted on Schedule A and included in income for regular tax purposes, tax refunds are typically a negative adjustment for AMT purposes
   d) property tax refunds properly reported on Schedule E are not taxable for AMT purposes

11. Which of the following is true regarding investment interest expense and the AMT:

   a) investment interest expense deductible for regular tax purposes is always the same as investment interest deductible for AMT purposes
   b) investment interest expense deductible for regular tax purposes is never deductible for AMT purposes
   c) investment interest expense must be recomputed for AMT purposes using interest includible for AMT purposes
   d) investment interest expense is deductible for both regular and AMT purposes, but the amount deductible for AMT purposes will always be lower

12. Taxpayers using the “cost method” of determining their depletion deduction will not have any AMT depletion adjustment.

   a) true
   b) false

13. A taxpayer may use 100% of their AMTNOL to offset income.

   a) true
   b) false

14. Tax-exempt interest from certain private activity bonds is a tax preference item for AMT purposes.

    a) true
    b) false

15. Taxpayers who claim the exclusion under IRC Section 1202 for gain on qualified small business stock held more than five years must include 42 percent of the exclusion amount as a tax preference on Form 6251.

    a) true
    b) false

16. The AMT adjustment for an Incentive Stock Option (ISO) is generally the value of the stock upon exercise.

    a) true
    b) false

17. An AMT adjustment can occur upon the taxable disposition of depreciable property.

    a) true
    b) false

18. Taxpayers may need to keep two sets of depreciation records for business assets in order to calculate AMT.

    a) true
    b) false

19. Taxpayers subject to AMT will have to refigure AMT depreciation for all assets.

    a) true
    b) false

20. The AMT exemption is the same for all taxpayers regardless of filing status.

    a) true
    b) false

21. The AMT exemption amount can be phased out for high-income taxpayers.

    a) true
    b) false

CHAPTER 2 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Although Form 4952 may need to be recalculated using AMT figures, this is only one of the steps needed to calculate the AMT. There is a form used just for the AMT, as well as numerous worksheets and other schedules.

   B: Correct. Individuals use Form 6251 to calculate and report the AMT. Numerous other records and schedules are also needed to correctly calculate the numerous preference items and adjustments.

   C: Incorrect. Although Form 8582 may need to be recalculated using AMT figures, this is only one of the steps needed to calculate the AMT. There is a form used just for the AMT, as well as numerous worksheets and other schedules.

   D: Incorrect. Form 8801 is used to calculate the minimum tax credit, not the AMT.

   (See page 2-1 of the course material.)

2. A: Incorrect. If the taxpayer claims the standard deduction per IRC Section 63(c), this amount will not be allowed when computing the Alternative Minimum Taxable Income. IRC Section 56(b)(1)(E) lists this amount as an adjustment for AMT purposes.

   B: Correct. Form 6251 begins with AGI for those who claim the standard deduction. IRC Section 56(b)(1)(E) also lists this amount as an adjustment for AMT purposes.

   C: Incorrect. The standard deduction is not allowed when computing the Alternative Minimum Taxable Income.

   D: Incorrect. Form 6251 begins with AGI for those who claim the standard deduction. IRC Section 56(b)(1)(E) also lists the standard deduction as an adjustment for AMT purposes. The "phase outs" refer to the AMT exemption not the standard deduction, which is never allowed for AMT purposes.

   (See page 2-1 of the course material.)

3. A: Incorrect. 2.5% is the difference between what is allowed for regular tax and the amount allowed for the AMT.

   B: Incorrect. Neither the regular tax nor the AMT use a 5% threshold.

   C: Incorrect. The regular tax uses a 7.5% threshold, but not the AMT.

   D: Correct. While the regular tax has a 7.5% threshold, the AMT uses a 10% threshold.

   (See page 2-2 of the course material.)

4. A: Incorrect. For AMT purposes, no deductions are allowed for real property taxes.

   B: Incorrect. Real property taxes are not allowed for AMT purposes, regardless of whether or not the taxpayer itemizes deductions.

   C: Correct. If they are deducted for regular tax purposes, they must be added back when computing AMT.

   D: Incorrect. Any real estate taxes deducted on Schedule C, F, or E are fully deductible for AMT purposes, but not if taken on Schedule A.

   (See page 2-3 of the course material.)

5. A: Incorrect. Foreign taxes are not allowed as a deduction for AMT.

   B: Incorrect. Foreign taxes are not allowed as a deduction for AMT regardless of their itemized deductions.

   C: Correct. Taxpayers subject to the AMT should consider claiming the foreign tax credit on Form 1116 instead of claiming the taxes as an itemized deduction.

   D: Incorrect. If any foreign income taxes are taken on Schedule A for regular tax purposes, they must be added back when computing AMT.

   (See pages 2-3 to 2-4 of the course material.)

6. A: Incorrect. The entire interest can be deducted on Schedule A for regular purposes, but only 60% can be deducted for AMT purposes.

   B: Incorrect. The entire interest can be deducted on Schedule A for regular purposes, but only 60% can be deducted for AMT purposes.

   C: Incorrect. The taxpayer can elect to treat the loan as unsecured and allocate the loan interest to the use of the loan proceeds. Under this election, 40% of the interest would be deducted on Schedule C and the remainder on Schedule A. There would be no adjustment for AMT purposes.

   D: Correct. The taxpayer can elect to treat the loan as unsecured and allocate the loan interest to the use of the loan proceeds. Under this election, 40% of the interest would be deducted on Schedule C and the remainder on Schedule A. There would be no adjustment for AMT purposes.

   (See page 2-5 of the course material.)

7. A: Incorrect. Since qualified student loan interest is deducted in arriving at AGI, it is fully deductible for AMT purposes.

   B: Incorrect. Since Schedule E rental loan interest is deducted in arriving at AGI, it is fully deductible for AMT purposes.

   C: Incorrect. The AMTI mortgage interest deduction is allowed in a similar manner to the regular mortgage interest deduction with one modification. Mortgage interest is allowed for AMTI purposes only if it is used to acquire, construct, or improve the property. A refinanced mortgage qualifies to the extent it replaces a qualifying mortgage.

   D: Correct. Mortgage interest is allowed for AMTI purposes only if it is used to acquire, construct, or improve the property. The only mortgage interest not allowed for AMTI purposes would be any home equity indebtedness taken out by the taxpayer which is not used to improve the property and certain refinanced debt.

   (See page 2-6 of the course material.)

8. A: Incorrect. No miscellaneous itemized deductions are allowed for AMT purposes.

   B: Incorrect. No miscellaneous itemized deductions are allowed for AMT purposes. Unlike interest and taxes, there is no election to capitalize miscellaneous itemized deductions.

   C: Incorrect. No miscellaneous itemized deductions are allowed for AMT purposes. There is no phase-out provision.

   D: Correct. Gambling losses and other "miscellaneous deductions" are treated differently than miscellaneous itemized deductions.

   (See page 2-6 of the course material.)

9. **A: Correct.** This is one of the few negative items. Practitioners need to be sure it is entered as a negative.

   B: Incorrect. This is one of the few negative items, and should not be entered as a positive amount.

   C: Incorrect. This is one of the few negative items. Practitioners need to be sure it is entered as a negative. The adjustment is necessary because the disallowance has already been subtracted in arriving at taxable income.

   D: Incorrect. This is one of the few negative items. Practitioners need to be sure it is entered as a negative. Permanent items like this do not create an AMT credit.

   (See page 2-7 of the course material.)

10. A: Incorrect. Since no deduction is allowed for state income taxes, any refund of these amounts does not have to be included in income when arriving at AMTI.

    B: Incorrect. These amounts are not taxable for AMT purposes unless they were originally deducted on Schedules C, E, or F.

    C: Correct. If previously included for regular tax purposes, this amount will be a negative adjustment when computing AMTI. However, these are only for amounts deducted on Schedule A.

    D: Incorrect. If amounts are deducted in arriving at AGI on Schedule E, the amounts are includible for AMT purposes.

    (See page 2-8 of the course material.)

11. A: Incorrect. For AMT purposes, investment interest is modified to include interest on any private activity bonds.

    B: Incorrect. For AMT purposes, investment interest is modified to include interest on private activity bonds as well as the investment income deducted for regular tax purposes.

    C: Correct. The taxpayer must recompute investment income allowing for adjustments and tax preference items per IRC sections 56, 57, and 58.

    D: Incorrect. For regular tax purposes, investment interest is allowed up to the amount of investment income generated for the tax year. For AMT purposes, it can also include interest on any private activity bonds. Therefore, it could be higher for AMT purposes.

    (See page 2-8 of the course material.)

12. **A: True is correct.** The AMT preference item only applies to "percentage depletion" not "cost depletion."

    B: False is incorrect. If a taxpayer is using the percentage depletion method, he or she may be subject to a tax preference item for AMT purposes. Per IRC Section 57(a)(1), the amount of the preference item will be the excess of the deduction for depletion allowable under IRC Section 611 for the taxable year over the adjusted basis of the property at the end of the taxable year.

    (See page 2-10 of the course material.)

13. A: True is incorrect. Only 90% of an AMTNOL can be used to offset AMTI.

    B: False is correct. The AMTNOL deduction is limited to 90 percent of AMTI determined without regard to the AMTNOL deduction. This rule insures that taxpayers will not wipe out their AMT liability with the NOL deduction.

    (See page 2-13 of the course material.)

14. **A: True is correct.** IRC Section 57(a)(5)(A) lists tax-exempt interest as an item of tax preference for AMT purposes. This preference item involves specified private activity bonds paying interest that is excludable from gross income under IRC Section 103(a).

    B: False is incorrect. Generally, interest on obligations of state or local governments is excluded from income under IRC Section 103(a). This exclusion does not apply to a private activity bond unless that bond is a qualified private activity bond. IRC Section 103(b)(1).

    (See pages 2-13 to 2-14 of the course material.)

15. A: True is incorrect. The preference amount varies. If you sold qualified small business stock before May 6, 2003, multiply the excluded gain (as shown on Schedule D) by 42%.

    B: False is correct. The preference amount varies. If you sold qualified small business stock after May 5, 2003, multiply the excluded gain (as shown on Schedule D) by 7%.

    (See page 2-15 of the course material.)

16. A: True is incorrect. The adjustment is the <u>difference</u> between the stock's FMV at exercise and the basis of the stock when the ISO is exercised.

    B: False is correct. The AMT adjustment is generally the difference between the stock's FMV at exercise and the basis of the stock when the ISO is exercised. The FMV calculation for stock sold on a Security and Exchange Commission (SEC) regulated exchange based on the exercise of the ISO option was held to be based on the average price at which the stock traded on the New York Stock Exchange in the decision of *Kolom v. Commissioner*.

    (See page 2-17 of the course material.)

17. **A: True is correct.** Taxpayers must use a specific method for computing the gain or loss on disposition of property when computing AMT. Unless the taxpayer also uses this method for regular tax purposes, an adjustment is generated for AMT purposes. The taxpayer must also maintain a record of AMT basis. If the taxpayer disposes of a piece of property in a tax year, the AMT gain must be computed using the sales price and the basis as adjusted for AMT depreciation. The difference between this gain and the gain computed for regular tax purposes will be an adjustment for purposes of AMT.

    B: False is incorrect. Any difference in regular vs. AMT depreciation will result in an AMT adjustment. The adjustment can be positive or negative.

    (See page 2-19 of the course material.)

18. **A: True is correct.** Taxpayers have to keep two depreciation tables. One for regular tax purposes and one for AMT purposes. These tables will also be necessary to compute the gain or loss if the asset is disposed of during the taxable year. Most commercial tax preparation packages compute AMT depreciation.

    B: False is incorrect. Many assets will have two sets of depreciation records – one for regular tax and another for AMT.

    (See page 2-23 of the course material.)

19. A: True is incorrect. Numerous asset types are not refigured for AMT.

    B: False is correct. Do <u>not</u> refigure depreciation for the AMT for the following:
    - Residential rental property placed in service after 1998.
    - Nonresidential real property with a class life of 27.5 years or more placed in service after 1998 that is depreciated for the regular tax using the straight-line method.
    - Other Section 1250 property placed in service after 1998 that is depreciated for the regular tax using the straight-line method.
    - Property (other than Section 1250 property) placed in service after 1998 that is depreciated for the regular tax using the 150% declining balance method or the straight-line method.
    - Property for which you elected to use the alternative depreciation system (ADS) of Section 168(g) for the regular tax.

- Qualified property eligible for a special depreciation allowance if the depreciable basis of the property for the AMT is the same as for the regular tax. If the depreciable basis for the AMT is the same as for the regular tax, no adjustment is required for any depreciation figured on the remaining basis of the qualified property. However, if an election is in effect to not have the special allowance apply, the corporation must refigure depreciation for the AMT.
- Any part of the cost of any property for which you made the election under Section 179 to treat the cost of the property as a deductible expense. The reduction to the depreciable basis of Section 179 property by the amount of the Section 179 expense deduction is the same for the regular tax and the AMT.
- Certain public utility property (if a normalization method of account is not used), motion picture films and video tape, sound recordings, and property that the corporation elects to exclude from MACRS by using a depreciation method that is not based on a term of years, such as the unit-of-production method.
- Qualified Indian reservation property.
- Qualified revitalization expenditures for a building for which you elected to claim the commercial revitalization deduction.

(See page 2-26 of the course material.)

20. A: True is incorrect. The AMT exemption amount varies based on filing status and is phased-out at certain dollar limitations.

    B: False is correct. The AMT exemption varies based on filing status. The highest exemption is for those taxpayers filing jointly.

    (See pages 2-42 to 2-43 of the course material.)

21. **A: True is correct.** The AMT exemption for a married couple filing jointly in 2011 is $74,450. The phaseout begins at AMTI of $150,000 and ends at $447,800.

    B: False is incorrect. The AMT exemption can be completely phased out for taxpayers with income as low as $223,900.

    (See page 2-43 of the course material.)

Chapter 3: Other Provisions that Affect AMT

KIDDIE TAX

Congress was concerned that some higher income individuals may have been transferring earnings to their children so that the earnings would be taxed at a lower rate. The TRA of 1986 offered a remedy to this potential inequity. Under IRC section 1(g), a child may be subject to the kiddie tax if he or she is under the age of 24 for 2008 and beyond, has unearned income, and at least one parent is alive at the close of the tax year. Generally, the kiddie tax taxes at the parent's tax rate the unearned income in excess of $1,900 for tax years 2010 and 2011.

Children will also be subject to the AMT rules of IRC section 53 through IRC section 59. Under the AMT rules, children are not allowed the normal AMT exemption for single individuals, but are allowed an exemption for AMT purposes of $6,050 (indexed for inflation), plus earned income.

IRC section 59(j) was enacted for tax years beginning after 1988. The Form 6251 worksheet (Limit on Alternative Minimum Tax for Children Under the Age of 24) can be used to calculate the AMT kiddie tax for a child. The first step, in computing the AMT kiddie tax, is to compute the child's AMT in the usual manner except that the AMT exemption is equal to earned income plus the exemption amount under IRC section 59(j)(1).

Note: For tax years beginning after December 31, 1997, IRC section 59(j)(1) provides that the IRC section 55 exemption amount for children subject to IRC section 1(g) is capped at the child's earned income plus $5,000 adjusted for inflation ($6,700 for 2009 and 2010, and $6,800 for 2011).

Note: For tax years beginning after December 31, 2005, the limit on the standard deduction is the greater of $950 for 2009, 2010, and 2011 or earned income + $300. IRC section 63(c)(5)(B).

PARTNERSHIP AND S-CORPORATION FLOW-THROUGHS

AMT pass-through items are required to be reported on each shareholder's or partner's tax return. The allocation for these items should follow the regular tax allocation rules.

Example: An S-Corporation is made up of two individuals, Sally and George, each 50-percent shareholders. Each shareholder would report 50-percent of the income or loss (disregarding the basis, passive and at-risk rules) on their individual returns. If the S-Corporation has AMT tax preference items or adjustments, these will be computed at the S-Corporation level and divided by percentage of ownership between the shareholders. If the S-Corporation had a regular depreciation of $2,000 and AMT depreciation of $1,000, of the $1,000 AMT adjustment, $500 would be allocable to each 50-percent partner. This figure is then reported on the depreciation adjustment line of Form 6251 and is added with the shareholder’s other AMT adjustment and preference items.

AT-RISK RULES AND BASIS LIMITATIONS

Per IRC section 59(h), the at-risk rules of IRC section 465 and basis limitation rules of IRC section 704(d) and IRC section 1366(d) require a separate computation of allowable deductions.

Example: Wendy has a property for which she is at risk for $1,000. For regular tax purposes, if her deductions exceed the $1,000 she will not be allowed to take these amounts and will have a suspended loss. If, however, for AMT purposes the deductions are less than $1,000 then she will have less unused at-risk for AMT purposes.

Therefore, it is important to keep separate records regarding the at-risk amount (as well as any basis limitations) for regular tax purposes and for AMT purposes.

ESTIMATED TAX PAYMENTS

For purposes of making estimated tax payments per IRC section 6654, the taxpayer's AMT liability must be considered and included in the taxpayer's computations regarding estimated payments.

SHORT TAX YEARS

AMT computed for a short taxable year requires a taxpayer to annualize AMT taxable income (multiply by 12 and divide by number of months in the short year). Then multiply the resulting tentative AMT by a fraction which is the number of months in the short year divided by 12. IRC section 443(d).

CHAPTER 3 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Taxpayers do not need to make estimated tax payments for the AMT.

   a) true
   b) false

CHAPTER 3 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: True is incorrect. AMT is a tax for estimated tax purposes.

   B: False is correct. For purposes of making estimated tax payments per IRC Section 6654, the taxpayer's AMT liability must be considered and included in the taxpayer's computations regarding estimated payments.

   (See page 3-2 of the course material.)

Chapter 4: Minimum Tax Credit

MINIMUM TAX CREDIT/GENERAL RULES

The Minimum Tax Credit (MTC) is the difference between the AMT computed "with exclusion and deferral items" in the usual manner and the AMT computed using only exclusion items or "without deferral preferences." The MTC is carried forward (no carrybacks are allowed) to the next year and can reduce only the excess of the regular tax (reduced by all other nonrefundable credits) over the tentative minimum tax in a subsequent year. If all of the credit is not used in the subsequent year, it is aggregated in future years and becomes part of the MTC for that year. This credit is carried forward indefinitely until used in full.

The MTC is computed only on deferral items. IRC section 53(d)(1)(B)(ii) lists the "exclusion" amounts which are not allowed in the computation of MTC. These exclusion items include adjustment for miscellaneous itemized deductions and certain taxes (IRC section 56(b)(1)), depletion preference (IRC section 57(a)(1)), tax-exempt interest on private activity bonds (IRC section 57(a)(5)), and the exclusion for gains on sale of certain small business stock (IRC section 57(a)(7)). All other AMT adjustments and preference items are deferral items and are included in the computation of the MTC.

Example: Don and Tanya file a married filing joint return for 2011. They have regular taxable income of $80,000 and a regular tax liability of $6,000. They have deferral items of $50,000 and exclusion items of $20,000. The MTC carryforward to 2012 is computed as follows:

AMT with both deferral items and exclusion items.

Regular Taxable Income	$ 80,000
Deferral Items	$ 50,000
Exclusion Items	$ 20,000
AMT Exemption	($ 74,450)

	$ 75,550 @ 26%

Tentative AMT	$ 19,669
Regular Tax	($ 6,000)
Net Minimum Tax	$ 13,669

AMT with only exclusion items or "without deferral items"

Taxable Income	$80,000
Exclusion Items	$20,000
Exemption	($74,450)
	$25,550 @ 26%

Tentative AMT	$ 6,693
Regular Tax	($ 6,000)

Net Minimum Tax	$ 643

MTC to be carried over to 2012 is $13,026 ($13,669 - 643). The amount of this credit to be used in 2012 is limited to the amount that the taxpayers' regular tax exceeds their tentative minimum tax for 2012.

Example: Assume that in 2012 Don and Tanya have a regular tax liability of $25,000 and a minimum tax of $20,000. The amount of MTC available for Don and Tanya for 2012 is $5,000 (the difference between the regular tax liability of $25,000 and the tentative minimum tax of $20,000). The remaining $8,026 ($13,026 - 5,000) is carried forward and used in future tax years.

In certain circumstances, such as the sale of depreciable property or assets nearing the end of their depreciable life (where the straight-line AMT adjustment exceeds the accelerated method), a negative MTC adjustment may result. The following example illustrates this point.

Example: Jim and Marsie file a joint tax return for the current year. Their regular taxable income is $107,450. They had deferral items (depreciation) of ($10,000) and exclusion items of $60,000.

AMT with both exclusion and deferral items

Regular Taxable Income	$ 107,450
AMT Deferral Items	($ 10,000)
AMT Exclusion Items	$ 60,000

AMTI with deferrals and exclusions	$ 157,450
Exemption	($ 74,450)

	$ 83,000 @ 26%

Tentative Minimum Tax	$ 21,580
Regular Tax	($ 19,215)
AMT	$ 2,365
	=========

AMT using exclusion items only or "without deferral items"

Regular Taxable Income	$ 107,450
AMT Exclusion Items	$ 60,000

AMTI with exclusion items	$ 167,450
Exemption	($ 74,450)

	$ 93,000 @ 26%

Tentative Minimum Tax	$ 24,180
Regular Tax	($ 19,215)

AMT	$ 4,965
	==========

Difference between AMT with exclusions and deferrals $2,365 and AMT with exclusion items only $4,965 is ($2,600). This negative amount will offset prior positive credits generated in the earlier years of the asset's life when the accelerated depreciation exceeds the AMT depreciation.

This computation shows once again the importance of the taxpayer keeping separate books for regular and AMT purposes.

MINIMUM TAX CREDIT NET OPERATING LOSS (MTCNOL)

When computing the NOL for MTC purposes (known as MTCNOL), the NOL for the exclusion items only or without deferral items should be computed using only the exclusion items. IRC section 53(d)(1)(B)(i)(II) further states that this amount will not be subject to the ninety percent limitation of tax per IRC section 59(a)(2) (relating to foreign tax credit). If a taxpayer used a carryback of an AMTNOL to reduce a prior year's AMT liability and the prior year's AMT liability generated a MTC which was carried forward and used, the taxpayer will have to recapture the MTC in the year in which it was used.

MINIMUM TAX CREDIT AND AMT FOREIGN TAX CREDIT

As previously discussed under the MTCNOL, the 90-percent limitation of taxable income does not exist when computing the FTC for AMT with exclusion items only. IRC section 53(d)(1)(B)(i)(II).

Example: If tentative income tax before credits for both AMT with deferrals and exclusions and AMT with exclusions only is $34,000, and the FTC is $40,000, the FTC allowed for AMT with deferrals and exclusions would be limited to 90 percent or $30,600. When computing the FTC for AMT with exclusions only, the 90-percent limitation does not apply. Thus, the full $34,000 can be offset by the FTC. In this example, there would be an MTC of $3,400.

SPECIAL RULES RELATING TO REGULAR TAX CREDITS FROM NONCONVENTIONAL FUEL SOURCES, ORPHAN DRUG CREDIT* AND QUALIFIED ELECTRIC VEHICLE CREDIT

In the limited circumstances when a taxpayer has a nonconventional fuel credit under IRC section 29, special MTC provisions can apply. For regular tax purposes, such fuel credit is usually limited to the excess of a taxpayer's regular tax over the tentative minimum tax. If this regular tax limitation causes a taxpayer to lose the benefit of a portion of the fuel credit, the taxpayer is allowed to increase the MTC by the disallowed credit amount. IRC section 53(d)(1)(B)(iii).

For example, a taxpayer who cannot use $5,000 of his nonconventional fuel credit due to the IRC section 29(b)(6)(B) limitation can increase his or her MTC by $5,000. A similar rule for the nonconventional fuel credit is provided for the orphan drug credit and the qualified electric vehicle credit. IRC section 53(d)(1)(B)(iii).

COMPUTING THE MINIMUM TAX CREDIT

The computation of the MTC is completed by taxpayers on Form 8801, Credit for Prior Year Minimum Tax-Individuals, Estates, and Trusts. Form 8801 should be filed for each year that a taxpayer had a MTC carryover.

If you have any unused minimum tax credit carryforward from 2004 or earlier years, you may qualify for a refundable credit for part or all of that amount, even if the total amount of your current year credit exceeds the tax liability limit. To figure your current year refundable credit, complete Part IV of Form 8801.

* P.L. 104-188,Sec. 1205(d)(5)(A) deleted reference to Orphan Drug Credit (IRC section 28) from IRC section 53(d)(1)(B)(iii), for amounts paid or incurred in tax years ending after June 30, 1996.

CHAPTER 4 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. If a taxpayer pays the AMT, there is no possibility of ever recouping that tax.

    a) true
    b) false

CHAPTER 4 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: True is incorrect. The taxpayer may qualify for the minimum tax credit in a future year.

   B: False is correct. The Minimum Tax Credit (MTC) is the difference between the AMT computed "with exclusion and deferral items" in the usual manner and the AMT computed using only exclusion items or "without deferral preferences." The MTC is carried forward (no carrybacks are allowed) to the next year and can reduce only the excess of the regular tax (reduced by all other nonrefundable credits) over the tentative minimum tax in a subsequent year. If all of the credit is not used in the subsequent year, it is aggregated in future years and becomes part of the MTC for that year. This credit is carried forward indefinitely until used in full.

   (See page 4-1 of the course material.)

Chapter 5: AMT - Problems and Possible Solutions

ANALYSIS OF PROBLEM PER THE IRS' TAXPAYER ADVOCATE

BACKGROUND OF THE AMT

The concept of a minimum tax was initially developed in response to reports that a small, wealthy group of taxpayers was avoiding taxes altogether through the use of tax avoidance techniques.[1] In 1969, the House of Representatives adopted recommendations of the Treasury Department and passed a bill to impose a minimum tax by limiting certain tax preference items, in the aggregate, to 50 percent of gross income.[2] This approach required the use of a complex formula designed to allocate itemized deductions between taxable income and non-taxable income and to disallow those deductions allocated to non-taxable income.[3]

The Senate changed the bill, adopting instead a tax on specified preference items in excess of a $30,000 exemption amount.[4] The final bill followed the Senate's approach and imposed an add-on tax of 10 percent of nine specific tax preference items when the sum of the preference items exceeded $30,000.[5]

The Tax Reform Act of 1976 and the Revenue Act of 1978 both made modifications to the add-on tax. The 1976 Act, among other things, increased the add-on tax rate to 15 percent and lowered the exemption amount from $30,000 to $10,000.[6] The 1978 Act went a step further, restructuring the tax into two components. The add-on tax was retained for all tax preferences except the capital gains deduction and excess itemized deductions, and a new alternative minimum tax was established to adjust the taxpayer's income for these two items of tax preference. This new alternative minimum tax (AMT) imposed a progressive three-tiered rate structure on AMT: 10 percent on AMT income between $20,001 and $60,000; 20 percent on AMT income between $60,001 and $100,000; and 25% on AMT income over $100,000.[7]

In 1982, Congress repealed the add-on tax and replaced it with the alternative minimum tax (AMT).[8] Although Congress has enacted many technical changes over the past two decades, the basic structure of the AMT rules has remained intact.

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[1] The 1969 Economic Report of the President: Hearings before the Joint Economic Comm. 91st Cong. pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury); Committee on Ways and Means of the U.S. House of Representatives and Committee on Finance of the U.S. Senate, 91st Cong., Tax Reform Studies and Proposals, U.S. Treasury Department, pt. 1, p. 132 (Comm. Print 1969).
[2] H.R. 13270, §301(a) (version passed by the House of Representatives on Aug. 8, 1969).
[3] See H.R. Conf. Rep. No. 91-782, p. 301 (1969).
[4] H.R. 13270 (substituted version passed by the Senate on Dec. 11, 1969).
[5] Tax Reform Act, Pub. L. No. 91-172, §301 (1969). The nine specified tax preference items were: 1) excess investment interest income, 2) accelerated depreciation on personal property, 3) accelerated depreciation on real property, 4) amortization of certified pollution control facilities, 5) amortization of railroad rolling stock, 6) tax benefits from stock options, 7) bad debt deductions of financial institutions, 8) depletion, and 9) the deduction for capital gains.
[6] Tax Reform Act, Pub. L. No. 94-455, §301 (1976).
[7] Revenue Act, Pub. L. No. 95-600, §421 (1978).
[8] Tax Equity and Fiscal Responsibility Act, Pub. L. No. 97-248, §402(a) (1982).

HOW THE AMT IS COMPUTED

The AMT is a separate system from the regular income tax, with unique rules governing the recognition of income and the timing of deductions and credits. Taxpayers are often required to maintain two sets of records – one for regular income tax purposes and one for AMT purposes.

The determination of AMT liability, if any, is complex:

- First, the taxpayer must calculate his or her regular tax liability. The regular income tax rules provide preferred treatment for certain types of income and allow taxpayers to claim certain exemptions, deductions, exclusions and credits.

- Second, the taxpayer must determine whether he or she is subject to additional tax under the AMT regime. The IRS has developed a 12-line worksheet (Worksheet To See If You Should Fill in Form 6251)[9] to help taxpayers determine whether they may be subject to the AMT. If the worksheet indicates that a taxpayer is potentially subject to the AMT, the taxpayer must complete Form 6251 (Alternative Minimum Tax – Individuals), which contains 55 lines. Many taxpayers are required to complete Form 6251 – only to find that they do not have an AMT liability.

- Third, the taxpayer must compute their alternative minimum taxable income (AMTI) on Form 6251. This computation generally requires taxpayers to give up the benefit of tax preference items to which they are entitled under the regular tax system (e.g., dependence exemptions, a standard deduction, and itemized deductions for state and local taxes, employee business expenses and legal fees).[10]

- Fourth, the taxpayer must determine an "exemption amount" to which he is entitled based on filing status.

- Fifth, the taxpayer must compute his "taxable excess" by subtracting his exemption amount from his AMTI.

- Sixth, a taxpayer with a positive "taxable excess" must compute his "tentative minimum tax." A "taxable excess" of $175,000 or less is taxed at a 26 percent rate and any additional "taxable excess" is taxed at a 28 percent rate. (The total amount is the tentative minimum tax).[11]

[9] 2003 Form 1040 Instructions, p. 38.
[10] Required adjustments listed on Form 6251 include adjustments for medical and dental expenses, state and local taxes, certain non-allowable home mortgage interest, miscellaneous itemized deductions, tax refunds, investment interest, depletion, certain net operating losses, interest from specified private activity bonds, qualified small business stock, the exercise of incentive stock options, estates and trusts, electing large partnerships, property dispositions, depreciation on certain assets, passive activities, loss limitations, circulation costs, long-term contracts, mining costs, research and experimental costs, income from pre-1987 installment sales, intangible drilling costs, certain other adjustments and alternative tax net operating loss deductions. See IRC §§56 and 57; IRS Form 6251 (Alternative Minimum Tax – Individuals), Part I.
[11] IRS §55(b)(I)(A).

- Seventh, the taxpayer must compute his "alternative minimum tax" or "AMT." The AMT is equal to the excess of the taxpayer's tentative minimum tax, if any, over his regular tax liability (reduced by any tax from Form 4972 (Tax on Lump Sum Distributions) and any foreign tax credit from Form 1040). If the net result is a negative number or zero, the taxpayer does not owe AMT.

- Eighth, if the taxpayer owes AMT, he computes his final tax liability by adding his regular tax liability and his AMT liability.[12]

The "exemption amount" described above replaces the standard deduction and personal exemptions for purposes of computing the AMT.[13] Prior to 2001, the AMT exemption amounts were $45,000 for married taxpayers[14] and $33,750 for most other taxpayers. Congress increased the exemption amounts in 2001 and then again in 2003 and 2004 to $58,000 for married individuals and $40,250 for most other taxpayers through 2005,[15] but these higher exemption amounts are set to expire and revert to pre-2001 levels in 2012. In 2006, 2007, 2008, 2009, 2010, and 2011 Congress again tinkered with the AMT exemption amount, but only for the current years. The exemption amount is phased out for married taxpayers with AMTI exceeding $150,000 and non-married taxpayers with AMTI exceeding $112,500.[16]

A taxpayer who is subject to the AMT accrues AMT credits.[17] However, these credits may be applied only to timing items – not to exclusion items. Timing items are those that are accounted for in different tax years in the regular tax and AMT systems. For example, the AMT in some instances requires taxpayers to depreciate property over a longer period of time. Exclusion items are adjustments and tax preference items that result in the permanent disallowance of certain tax benefits such as the standard deduction, personal exemptions and certain itemized deductions. In addition, AMT credits can only be used when the regular tax liability reduced by other non-refundable credits exceeds the tentative minimum tax for the tax year.

To claim AMT credits, taxpayers must complete Form 8801 (Credit For Prior Year Minimum Tax – Individuals, Estates, and Trusts), which the IRS estimates will take more than five hours.[18]

[12] In most cases, the taxpayer's final tax liability is simply the greater of his regular tax liability or his tentative minimum tax liability. But because the Code requires adjustments for tax from Form 4972 (Tax on Lump Sum Distributions) and any foreign tax credit from Form 1040, the Seventh and Eighth steps are required to ensure that taxpayers with these tax items obtain the correct result.
[13] IRC §§55(d)(1) & 56(b)(1)(E).
[14] In cases where married persons file separate returns, each taxpayer is entitled to 50 percent of the exemption amount allowable to married taxpayers who file joint returns.
[15] Economic Growth and Tax Relief Reconciliation Act, Pub. L, No. 107-16, §701 (2001); Jobs and Growth Tax Relief Reconciliation Act, Pub. L. No. 108-27, §106(a) (2003).
[16] IRC §55(d)(3).
[17] IRS §53.
[18] IRS Form 8801, Credit for Prior Year Minimum Tax – Individuals, Estates, and Trusts.

PROBLEMS ARISING FROM THE AMT

Some of the most significant problems arising from AMT include the following:

- Impact on "Wrong" Taxpayers – The AMT no longer targets just wealthy taxpayers who are not paying regular income taxes, but encroaches upon other groups. The number of AMT filers is projected to grow to over 30 million by 2012.[19] By that time, the AMT will become the de facto tax system for households with incomes between $100,000 and $500,000, with 92 percent of them facing the tax.[20]
- Lack of AMT Knowledge – Taxpayers often file their returns not knowing about AMT or expecting to be subject to it, but subsequently receive bills relating to the AMT that they are not prepared to pay. In fiscal year 2003, the IRS closed more than 19,000 examinations that were initiated because of suspected AMT liabilities. These examinations resulted in additional tax assessments of nearly $39 million – more than $2,000 per return.[21]
- Complexity – The individual AMT is completely separate from the regular income tax structure. Taxpayers may need to fill out a 12-line worksheet and then a 54-line form (IRS Form 6251, Alternative Minimum Tax – Individuals) just to determine whether they are subject to AMT. Other complexities of AMT include the re-computation of the foreign tax credit,[22] its effect on incentive stock options[23] and capital gains rates,[24] and the treatment of minor children (the so-called kiddie tax.)[25]
- Failure to Index AMT Exemptions for Inflation – Regular income tax standard deductions, exemptions and filing thresholds are all adjusted for inflation. The AMT exemption amounts, however, have not been indexed for inflation. When Congress enacted the add-on tax in 1969, the exemption amount was $30,000. If that amount had been indexed, it would be worth nearly $150,000 today.[26] Instead, as discussed above, the AMT exemptions are scheduled to return to $45,000 for married taxpayers and $33,750 for most other taxpayers in 2012.[27] The absence of an AMT indexing provision is largely responsible for the increasing numbers of middle-class taxpayers who are subject to the AMT regime.[28]

[19] Joint Committee on Taxation (unpublished data furnished on Nov. 5, 2003); see also Leonard E. Burman, William G. Gale & Jeffrey Rohaly. Urban-Brookings Tax Policy Center, *The AMT: Projections and Problems*, Tax Notes, July 7, 2003, p. 107.
[20] Leonard E. Burman, William G. Gale, Jeffrey Rohaly, Urban-Brookings Tax Policy Center, *The AMT: Projections and Problems*, Tax Notes, July 7, 2003, p. 105-106.
[21] IRS Wage & Investment Operating Division, Audit Information Management System (FY 2003 data).
[22] IRC §59(a).
[23] IRC §56(b)(3).
[24] IRC §55(b)(3).
[25] IRC §59(j).
[26] Department of Labor, Bureau of Labor Statistics, Consumer Price Index – All Urban Consumers (CPI-U) (Sept. 16, 2003).
[27] Economic Growth and Tax Relief Reconciliation Act, Pub. L. No. 107-16, §701 (2001); Jobs and Growth Tax Relief Reconciliation Act, Pub. L. No. 108-27, §106(a) (2003).
[28] The effect of the absence of AMT-exemption indexing is compounded by the fact that key tax preference items that are included in AMTI – e.g., the standard deduction and personal exemptions – are indexed annually.

- Adverse Impact on Families – Married taxpayers will be more than 20 times as likely as single taxpayers to pay AMT in tax year 2012. Approximately 5.7 million taxpayers can be expected to pay AMT in 2012 simply because they lose the benefit of dependency exemptions under the AMT.[29]
- Loss of Itemized Deductions – An individual taxpayer must add back certain itemized deductions when computing AMT.[30] This causes difficulties for those with large expenditures such as legal fees in court settlements, state and local taxes, or employee business expenses.
- Unpredictability of Estimated Tax Payments – Because the law is so complicated, it is difficult if not impossible to predict whether an individual will be subject to AMT. This causes problems in paying the correct estimated tax for the year and can result in penalties for underpayment. In tax year 2001, over 176,000 taxpayers facing AMT were also required to pay nearly $103 million in estimated tax penalties.[31]
- Taxation of Incentive Stock Options – A taxpayer's exercise of incentive stock options creates paper (phantom) gain in the year the stock is purchased (the option exercise). This gain is not taxed under the regular tax rules but is taxed for AMT purposes. The gain is the difference between the option price and the market value of the stock on the date the option is exercised to purchase the shares.
- Two Computations of Foreign Tax Credits – Taxpayers who claim the foreign tax credit (and thus must complete the complex Form 1116 (Foreign Tax Credit)) are required to recompute the amount of the foreign tax credit if they are subject to the AMT pursuant to special rules in Internal Revenue Code section 59(a).
- Limitation on Availability of General Business Credits – General business tax credits are not denied for purposes of computing AMTI but are limited by the taxpayer's tentative minimum tax.[32] To illustrate, assume a taxpayer has a regular tax liability of $10,000 prior to credits, tentative minimum tax of $9,000, and a $2,000 credit under IRC §44 for constructing an access ramp to his business for disabled individuals. Absent the credit, the AMT would have no effect on this taxpayer because his regular tax liability exceeds his tentative minimum tax. However, the disabled access credit would reduce the taxpayer's regular tax liability to $8,000, which is below his tentative minimum tax. Therefore, the taxpayer is only entitled to a credit amount of $1,000 and must carry back or carry forward the $1,000 credit balance. Under these circumstances, the taxpayer would be required to complete Form 6251 and attach it to his return – even though the taxpayer does not have an AMT liability – to substantiate his entitlement to a portion of the credit. In all, taxpayers are projected to lose nearly 12 billion dollars in tax credits, mostly business credits, in 2012 because of the AMT.[33]

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[29] Leonard E. Burman, William G. Gale & Jeffrey Rohaly, Urban-Brookings Tax Policy Center, *The AMT: Projections and Problems*, Tax Notes, July 7, 2003, p. 105-106.

[30] IRC §56(b) & (e). Common itemized deductions that must be added back to income include, but are not limited to, state and local taxes, real estate and personal property taxes, mortgage interest not used for the purchase or improvement of a personal residence, medical expenses exceeding 7.5 percent but less than 10 percent of adjusted gross income, and certain miscellaneous itemized deductions such as employee business expenses and legal fees.

[31] Tax Year 2001, Compliance Research Information System (CRIS), Model IFM 2003.

[32] IRC §38(c)(1).

[33] Department of the Treasury, Office of Tax Analysis, Paper 87, table 1 at p. 19, June 2000; IRC §55(c)(2).

- Timing Issues Resulting from AMT Tax Credit Regime – The portion of AMT attributable to timing items reflects the difference between when certain deductions are allowable under the AMT and when the same deductions are allowable under the regular income tax. The taxpayer can only claim an AMT credit in subsequent years when the regular tax exceeds the AMT.
- Requirement of Two Sets of Records – Taxpayers often must keep separate records for regular tax and AMT purposes. For example, assume a taxpayer placed an office building into service prior to 1999 and is claiming straight-line depreciation on the building. The taxpayer would depreciate the building over a 39-year period for regular tax purposes,[34] but for AMT purposes the depreciation period would be 40 years instead.[35]
- Inconsistent Treatment of Carryover Items – When a taxpayer loses a tax benefit because of the AMT, the taxpayer may or may not be entitled to carry the benefit to another tax year, and the carryover periods vary from item to item. For example, an unused credit otherwise allowable for placing a qualified electric vehicle into service may not be carried over.[36] If the credit cannot be used in the year in which the vehicle is placed into service, it is permanently lost. Unused general business credits, on the other hand, generally may be carried back one year and carried forward 20 years.[37] Unused foreign tax credits generally may be carried back two years and forward five years.[38]
- Two Computations of Capital Gains Tax – Capital gains are taxed for regular tax purposes at lower rates than the AMT rates. Because Congress wanted to preserve tax-favored capital gains treatment under the AMT regime, a taxpayer with capital gains who owes AMT must complete 20 lines on Form 6251 after having already completed the 2-page Schedule D (Capital Gains and Losses) for regular tax purposes.
- Increased Use of Paid Preparers – Approximately 55 percent of taxpayers without AMT liabilities pay to have their returns prepared. Where a taxpayer has an AMT liability, the use of paid preparers jumps to nearly 80 percent.[39]
- High AMT Marginal Tax Rates Due to Phase-out of AMT Exemption – As described above, the AMT rules impose tax at a rate of 26 percent on a “taxable excess” (i.e., AMTI reduced by the applicable AMT exemption amount) up to $175,000 and 28 percent on higher amounts. However, the AMT exemptions phase out at a 25 percent rate for married taxpayers with AMTI exceeding $150,000 and non-married taxpayers with AMTI exceeding $112,500.[40] Therefore, the AMT marginal tax rate can reach 35 percent.

[34] IRC §168(c).
[35] IRC §56(a)(1)(A)(i) (referencing IRC §168(g)).
[36] A credit may be carried to another taxable year only if the Code expressly provides for it. In the case of the credit for placing a qualified electric vehicle into service, carryovers are not authorized. See IRC §30(a).
[37] IRC §39(a).
[38] IRC §904(c).
[39] Tax Year 2001, Compliance Research Information System (CRIS), Model IFM 2003.
[40] Irc §55(D)(3).

IMPACT OF THE AMT

From October 2002 through August 21, 2003, the Taxpayer Advocate Service accepted more than 500 hardship cases directly related to difficulties taxpayers faced because of the AMT.[41] Many of these taxpayers did not understand that they were subject to AMT. A sample of 100 of these hardship cases found more than half were the result of IRS examinations, while many others were caused by math errors.[42] Other factors that produced AMT hardship cases were incorrect computations by the taxpayer or the IRS, taxpayers not being aware of the AMT, the impact of legal fees from employment-related settlements, the number of dependency exemptions claimed, filing status, foreign income, and credits for prior years. The following examples and tables highlight some of the AMT problems and inequities encountered by taxpayers.[43]

Example 1 – AMT and Filing Status: In 2002, a married man with three children earned $20,000, received a lump sum settlement of $50,000 from a job-related injury, and incurred legal fees (i.e., attorney fees plus related legal costs) from the settlement of $25,000. If the taxpayer lived in New York and filed a joint return, he would report 100 percent of the settlement income and deduct the $25,000 in legal fees on Schedule A (miscellaneous itemized deductions). The AMT would be $1,346. If the husband decided to file a separate return, he would be required to file using married-filing-separate status and would face an AMT of $5,637. If the husband were not married and had custody of his three children, he would file as head-of-household and be liable for $4,241 in AMT.

[41] Taxpayer Advocate Management Information System (TAMIS) query on Alternative Minimum Tax, Form 6251 (Oct. 1, 2002 to Aug. 21, 2003).

[42] Taxpayer Advocate Management Information System (TAMIS) query on Alternative Minimum Tax, Form 6251. Of the 100 cases sampled, 40 were due to IRS errors and 40 were due to taxpayer or preparer errors. Seventeen taxpayers did not know they were subject to AMT. AMT was attributable to exemptions or filing status in 15 cases, Schedule D or capital gains transactions in 14 cases, employee business expenses and other miscellaneous deductions in 10 cases, and foreign tax credits and legal fees for settlements in 5 cases each.

[43] For simplicity, the following examples do not take into account the effects of the child tax credit for purposes of computing the "Total Tax" rows. Examples 1 and 2 illustrate common AMT issues but are not drawn from specific TAS cases. Example 3 describes the facts of a TAS case.

The following table compares the AMT effects on the Married Filing Joint, Married Filing Separate and Head of Household filing status using 2002 tax rates.

TABLE 1.1.1, AMT AND FILING STATUS

Filing Status	Married Filing Joint	Married Filing Separate	Head of Household
Adjusted Gross Income (AGI)	$70,000	$70,000	$70,000
Schedule A Miscellaneous – Legal Expenses	$25,000	$25,000	$25,000
Tentative Minimum Tax	$5,460	$11,830	$8,905
Regular Tax	$4,114	$6,193	$4,664
AMT	$1,346	$5,637	$4,241
Total Tax	$5,460	$11,830	$8,905

Although the AMT exemption amounts have temporarily increased for tax years after 2002, Schedule A itemized deductions continue to be a source of inconsistent treatment for middle income families. The type of Schedule A itemized deduction is a key factor in determining whether an AMT obligation is triggered, because the AMT does not treat itemized deductions uniformly. A married couple with three children living in a high tax area or incurring high employee business expenses is more likely to owe AMT than a similar family that had other itemized deductions, such as mortgage interest or charitable contributions, which are not taken into account for AMT purposes.

Example 2 – AMT and Deductions: In 2002, a married couple with five children had combined wages of $75,000 and paid $10,000 in state and local taxes. This couple was subject to $756 in AMT. If the couple had incurred $10,000 in employee business expenses or job-related legal fees instead, the couple would have been subject to AMT of $531. However, if the $10,000 in itemized deductions were a combination of $5,000 of mortgage interest and $5,000 of taxes, the couple would not have paid any AMT. Therefore, even though the couple had the same total income and itemized deductions under the regular tax rules, the difference in treatment of taxes and deductions under the AMT would produce different AMT liabilities and, in the third case, a total tax liability that is $756 lower.

TABLE 1.1.2, AMT AND ITEMIZED DEDUCTIONS

	Tax Year 2002: High Tax	**Tax Year 2002: High EBE or Legal Fees**	**Tax Year 2002: Tax and Mortgage Interest Split**
Filing Status	MFJ	MFJ	MFJ
Adjusted Gross Income (AGI)	$75,000	$75,000	$75,000
S&L Taxes	$10,000		$5,000
Schedule A Miscellaneous		$10,000	
Mortgage Interest			$5,000
Tentative Minimum Tax	$6,760	$6,760	$5,460
Regular Tax	$6,004	$6,229	$6,004
AMT	$756	$531	$0
Total Tax	$6,760	$6,760	$6,004
Difference	0	0	($576)

Example 3 – The AMT and Incentive Stock Options: A taxpayer who worked as a computer programmer was granted incentive stock options. The fair market value of the stock was much higher than the price of the option, so the taxpayer decided to exercise her options and purchase the stock. However, because the difference between the option price (purchase price) and the market value is added back to income in determining AMT, this decision created AMT of over $520,000 even though the taxpayer had merely purchased stock and had not yet sold it. The following year, the stock price dropped sharply and the taxpayer lost her job. She could not pay the AMT liability, so she filed an offer-in-compromise with the IRS seeking relief from the AMT. The IRS declined the offer because of the taxpayer's substantial investment holdings and because she was still young with significant potential future earnings.[44]

TAXPAYER ADVOCATE COMMENTS AND RECOMMENDATIONS

PRIOR RECOMMENDATIONS: REPEAL OF AMT

The National Taxpayer Advocate first recommended repeal of the AMT in the Annual Report to Congress for 2001.[45] *We reiterate this recommendation.*

The AMT is extremely and unnecessarily complex and results in an inconsistent and unintended impact on taxpayers. A recent newspaper column provided a description of the AMT that, although sarcastic, is accurate in detail:

[44] Taxpayer Advocate Management Information System (TAMIS) query on Incentive Stock Options and AMT (Oct. 1, 2002 to Sept. 12, 2003).
[45] National Taxpayer Advocate, *Annual Report to Congress*, Publication 2104 (Rev. 12-2001), p. 172-173.

> Here's an idea: Let's devise a politically inept tax policy. We'll begin by eliminating tax breaks people have been accustomed to for decades, such as those for qualified retirement accounts, and state and local taxes. Next, we'll negate the child tax credit so that families with young children will be hit especially hard. Then, we won't adjust for inflation, so that our tax will affect more people each year as their incomes grow along with the economy and inflation. We'll tell people that they must calculate their taxes twice, using two different formulas – and finally we'll add insult to injury by requiring them to pay whichever amount is higher.[46]

For reasons discussed in this report and the reasons highlighted in this newspaper passage, the AMT is bad policy, and its repeal would simplify the Internal Revenue Code, provide more uniform treatment for all taxpayers, and eliminate the oddity of dual tax systems. AMT repeal would also allow the IRS to realign compliance resources to facilitate more efficient overall administration of the tax code.

Members of Congress have considered the repeal of the AMT for several years. In 1999, Congress voted to repeal the individual AMT, but the legislation was vetoed.[47] During the 108th Congress alone, approximately 15 bills to modify or repeal the AMT were introduced.[48]

As the reach of the AMT has expanded to ensnare increasing numbers of taxpayers, support has grown for its outright repeal or major reform. The American Bar Association Section of Taxation, the American Institute of Certified Public Accountants Tax Division, and the Tax Executives Institute have jointly called for the repeal of the AMT.[49] In testimony before the House Committee on Ways and Means on April 8, 2003, the National Association of Enrolled Agents also advocated outright repeal or substantial restructuring of the AMT for Individuals.[50] In the alternative, the Tax Division of the American Institute of Certified Public Accountants has advocated making state and local taxes fully deductible for AMT purposes.[51]

If the AMT were repealed, Congress would have to determine how to treat unused prior-year minimum tax credits. AMT repeal would eliminate the timing issues of using claimed credits against AMT tax paid in prior years. However, a transition rule would be needed to address the outstanding AMT credits that have not yet been used as of the repeal date.

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[46] Kevin Adler & Annette F. Simon, *Not Rich? You'll Pay Anyway*. The Washington Post, Nov. 2, 2003, p. B1.

[47] Taxpayer Relief Act, H.R. 2488, 106th Cong. (1999).

[48] A search of the term "alternative minimum tax" in the Library of Congress's THOMAS online database turned up 45 bills in the 108th Congress. It appears that the principal purpose of approximately 15 bills was to modify or repeal the AMT. The balance of the bills had unrelated objectives and addressed the AMT only incidentally.

[49] American Bar Association Section of Taxation, American Institute of Certified Public Accountants Tax Division & Tax Executives Institute, Tax Simplification Recommendations (Feb. 25, 2000), reprinted at 2000 TNT 39-82.

[50] 2003 Tax Return Filing Season and the IRS Budget for Fiscal Year 2004: Hearing before the House Ways and Means Subcommittee on Oversight, 108th Cong. (2003) (statement of Claudia Hill on behalf of the National Association of Enrolled Agents).

[51] American Institute of Certified Public Accountants, Taxation Division, *Comments on H.R. 22, The Individual and Small Business Tax Simplification Act of 2003*, April 17, 2003, p. 2.

We acknowledge that the repeal of the individual AMT would carry a huge price tag. The cost of repealing or significantly reforming the AMT continues to grow. According to the study, by tax year 2008 it would cost less to repeal the regular income tax structure and keep the AMT ($74 billion) than to abolish the AMT ($85 billion).[52]

Therefore, if Congress decides to repeal the AMT, it would have to compensate for the lost AMT taxes by raising revenue through the regular tax system or reducing spending. Notwithstanding that admittedly daunting challenge, we believe it would be fairer, more transparent, and less burdensome to fund the government through the regular tax system than through the AMT, whose effects bear scant resemblance to what Congress intended when it originally enacted a minimum tax regime.

The National Taxpayer Advocate recognizes that repealing the AMT will result in some taxpayers owing nominal or no tax.[53] It may be possible to revise the definition of tax preferences under the AMT to lessen its impact on middle income taxpayers while applying the AMT to those taxpayers who are the modern day analogue of the original zero-tax high income taxpayers of 1967. Identifying new tax preferences, better aligned to today's tax avoidance techniques, may prove fruitful.

ALTERNATIVE RECOMMENDATIONS TO LIMIT THE IMPACT OF THE AMT

If Congress determines that full repeal of the individual AMT is not viable at this time, we suggest that Congress consider revising the rules to align AMT more closely with its original purpose and application and take steps to reduce the complexity and burden the AMT imposes on taxpayers. The National Taxpayer Advocate recommends that Congress make at least one of the following changes to the individual AMT.

1. Establish a Gross Income Threshold for AMT

Establishing a return-based gross income threshold according to filing status would promote simplification and greatly aid taxpayers in determining their exposure to AMT without requiring complicated and time-consuming calculations. For example, Congress could exempt married taxpayers with gross incomes under $150,000 and other taxpayers with gross incomes under $75,000 from the AMT. This concept is already incorporated into the corporate AMT regime. Corporations with annual gross receipts not exceeding $5 million generally are exempt from the corporate AMT.[54]

If gross income thresholds are established, taxpayers would be able to determine from their tax returns whether they are subject to the AMT. The thresholds should be adjusted annually for inflation. This would shift the AMT back onto higher income taxpayers not paying taxes, and away from low income and middle income taxpayers.

The use of adjusted gross income for the gross income threshold would be the simplest option for taxpayers to apply. The taxpayer could simply look at the AGI amount on his

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[52] Leonard E. Burman, William G. Gale & Jeffrey Rohaly, Urban-Brookings Tax Policy Center, *The AMT: Projections and Problems*, Tax Notes, July 7, 2003, p. 109.

[53] One study estimates that in 2003, 600 taxpayers with income over $1 million escaped federal taxation entirely and another 2,700 high income taxpayers escaped taxation before the application of the AMT, Leonard E. Berman, William G. Gale, and Jeffrey Rohaly, *The AMT: Projections and Problems*, Tax Notes 105 (July 7, 2003).

[54] IRC §55(e)(1)(B).

or her return and readily determine whether the AMT could apply. However, this approach would create a potential advantage for taxpayers who have tax preference items from business ventures, including depreciation deductions, mining exploration and development costs, certain long-term contracts, or gains from the exercise of incentive stock options.[55] These items are some of the tax deductions Congress sought to limit when it initially enacted the AMT.

According to the tax year 2001 data, approximately 40 percent of all AMT taxpayers would have been eliminated from AMT liability using AGI thresholds of $150,000 for married and $75,000 for other taxpayers. These taxpayers paid roughly $840 million in AMT in 2001, representing about 13 percent of the total $6.4 billion AMT paid for that tax year. A significant number of taxpayers – nearly 640,000 – would be relieved from AMT by using such an AGI approach.[56]

2. Index Individual AMT Exemptions for Inflation

Indexing the AMT exemption amounts would prevent the AMT from affecting increasing numbers of taxpayers each year solely because of the effects of inflation. Congress established an exemption amount of $30,000 when it initially enacted a minimum tax in 1969. While the exemption amounts have been changed several times since then, they have not kept pace with inflation. As described above, the $30,000 exemption amount enacted in 1969 would be worth nearly $150,000 today if it had been indexed for inflation.[57]

Legislation introduced in the House of Representatives in the 108th Congress would increase the exemption amounts for individuals and repeal the phase-out of exemptions. Under this proposal, the incremental increase to the exemption amounts would be phased in over ten years, and after 2012 the AMT would be repealed.[58]

A similar recommendation has been formulated by the Tax Policy Center, a joint project of the Brookings Institution and the Urban Institute.[59] Indexing AMT exemptions for inflation after 2002 would mirror the indexing of exemptions thresholds in the regular tax system and reduce the number of projected AMT filers in 2010 by 70 percent (over 20 million taxpayers).

This would significantly benefit the middle class, as the number of AMT filers with AGI between $15,000 and $75,000 would fall by 90 percent and the number with AGI between $75,000 and $100,000 would drop by 84 percent.[60]

[55] IRC §56(a)(1), (a)(2), (a)(3) & (b)(3).
[56] Tax Year 2001, Compliance Research Information System (CRIS), Model IFM 2003.
[57] Department of Labor, Bureau of Labor Statistics, Consumer Price Index – All Urban Consumers (CPI-U) (Sept. 16, 2003).
[58] Alternative Minimum Tax Repeal Act of 2003, H.R. 43 §3.
[59] Leonard F. Burman, William G. Gale, Jeffrey Rohaly & Benjamin H. Harris, *The Individual AMT: Problems and Potential Solutions*, Sept. 2002, p. 37.
[60] Id.

3. **Eliminate Personal Exemptions, the Standard Deduction, State and Local Taxes, and Miscellaneous Itemized Deductions as Adjustment Items for AMT**

Middle class taxpayers are particularly susceptible to the AMT because some of the most common deductions – such as the personal exemption, the standard deduction, and itemized deductions like state and local taxes and attorney fees – are added back to income for AMT purposes.

Studies indicate that by 2007, nearly 95 percent of AMT revenues will be attributable to four specific adjustments – the personal exemption, the standard deduction, state and local taxes, and miscellaneous itemized deductions.[61] This equates to nearly $53 billion in AMT revenue in 2007.[62]

The National Taxpayer Advocate recommends that Congress consider eliminating these deductions as add-backs in the AMT computation as a means of removing from the rolls of AMT filers substantial numbers of taxpayers against whom Congress never intended to impose AMT in the first place. This recommendation would reduce or eliminate the AMT burden for many taxpayers with large families, many taxpayers who live in areas with high state and local taxes, and many taxpayers who incur high miscellaneous itemized deductions.

For tax year 2001, this recommendation would have benefited 3.4 million taxpayers reporting state and local taxes and 1.2 million taxpayers reporting miscellaneous itemized deductions as part of their AMT calculations. The amount of AMT adjustments attributable to the state and local tax deduction in 2001 was $79.9 billion, and the amount attributable to the miscellaneous itemized deduction was $16.7 billion.[63]

CONCLUSION

Compared with the regular tax system, the AMT is a parallel "secret" tax system that most taxpayers have not yet experienced personally. As discussed in this report, the AMT imposes enormous burdens on those taxpayers whom it affects. Although the AMT was originally enacted to prevent wealthy taxpayers from avoiding tax liability through the use of tax avoidance techniques, it now affects substantial numbers of middle-income taxpayers and will, absent a change of law, affect more than 30 million taxpayers by 2012. In short, it is a time bomb on a short fuse. We urge Congress to face up to the hard choices that lie ahead sooner rather than later. The AMT is already creating major headaches for tax administration, and without reform, it will become a true crisis in the very near future.

Observation: President Obama's fiscal year 2013 budget proposal would repeal the AMT. Lost revenues would be offset by higher marginal tax rates on certain taxpayers.

[61] Richard M. Lipton, Chair, American Bar Association Section of Taxation, *To Simplify the Code, Start by Repealing the AMT*, Comments on the Economic Perspective of Code Simplification, TNT 122-131, June 4, 2001.
[62] This statistic is computed from data furnished by the Joint Committee on Taxation on Nov. 5, 2003.
[63] IRS Statistics of Income Division, Individual Statistics of Income Study (Tax Year 2001).

CHAPTER 5 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. According to the IRS Taxpayer Advocate, the AMT has significant problems.

   a) true
   b) false

CHAPTER 5 – SOLUTIONS AND SUGGESTED RESPONSES

1. **A: True is correct.** Some of the most significant problems arising from AMT include the following:

    - Impact on “Wrong” Taxpayers – The AMT no longer targets just wealthy taxpayers who are not paying regular income taxes, but encroaches upon other groups. The number of AMT filers is projected to grow to over 30 million by 2010. By that time, the AMT will become the de facto tax system for households with incomes between $100,000 and $500,000, with 92 percent of them facing the tax.
    - Lack of AMT Knowledge – Taxpayers often file their returns not knowing about AMT or expecting to be subject to it, but subsequently receive bills relating to the AMT that they are not prepared to pay. In fiscal year 2003, the IRS closed more than 19,000 examinations that were initiated because of suspected AMT liabilities. These examinations resulted in additional tax assessments of nearly $39 million – more than $2,000 per return.
    - Complexity – The individual AMT is completely separate from the regular income tax structure. Taxpayers may need to fill out a 12-line worksheet and then a 54-line form just to determine whether they are subject to AMT.
    - Failure to Index AMT Exemptions for Inflation – Regular income tax standard deductions, exemptions and filing thresholds are all adjusted for inflation. The AMT exemption amounts, however, have not been indexed for inflation.

    B: False is incorrect. The taxpayer advocate believes that AMT has so many problems that it should be repealed.

    (See page 5-4 of the course material.)

Glossary

Adjustments – May result in positive or negative amounts and may have implications in subsequent tax years. Include standard or itemized deductions, personal exemptions, and more.

Alternative Minimum Tax – This is a second parallel tax system that many wealthier taxpayers will have to consider when calculating their tax. The alternative minimum tax (AMT) is calculated by starting with your taxable income calculated according to the regular tax rules. Add certain tax preference items and adjustments required by the AMT. Only certain itemized deductions are allowed. Next, subtract an exemption amount. The result is multiplied by the amount rate for individuals. If the tax due exceeds the tax you owe under the regular tax system, you must pay the larger alternative minimum tax.

At-risk Rules – Tax laws that apply to any activity carried on as a trade or business or for production of income. In general, financial losses from such activities are only allowable as tax deductions to the extent of the taxpayer's actual financial risk from the activity. Losses that exceed the 'at-risk' amount are not deductible.

Depreciation – Recover the cost of income producing property through yearly tax deductions.

Fair Market Value – The price at which the property would change hands between a buyer and a seller, neither having to buy or sell, or both, having reasonable knowledge of all the relevant facts.

Intangible Drilling Costs – These costs, in and of themselves, have no salvage value. Include expenditures made by an operator for wages, fuel, repairs, hauling, and supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of geothermal steam or hot water.

Kiddie Tax – In the US, a tax imposed on the investment income of children under the age of 24 (2009) where such income exceeds a certain level. The tax level is at the parents' highest rate.

Minimum Tax Credit (MTC) – The difference between the AMT computed "with exclusion and deferral items" in the usual manner and the AMT computed using only exclusion items or "without deferral preferences."

Preference Items – Positive items increasing Alternative Minimum Taxable Income (AMTI) and are excluded from regular taxable income.

Private Activity Bonds – Generally a bond that meets both the private use and private payment or security test under IRC section 141(b) and the private loan financing test under IRC section 141(c).

Research and Experimental Costs – Expenditures incurred in connection with the taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense, and includes all such costs incidental to the development of an experimental or pilot model, a plant process, a patent, a formula, an invention, or similar property.

Tentative Minimum Tax – The result of multiplying the AMTI by the applicable AMT tax rate, and then reduced by the foreign tax credit.

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