Chapter 14

Alternative Minimum Tax

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Alternative Minimum Tax (AMT)

- AMT is separate but parallel income tax system
- The AMT computation reconciles taxable income, through adjustments and preferences, with Alternative Minimum Taxable Income (AMTI)
- AMT is based on AMTI

Computation of AMT

- AMT formula:

Taxable income
+ - Adjustments
<u>+ Preferences</u>
AMTI
<u>- Exemption</u>
AMT tax base
<u>x AMT rate(s)</u>
Tentative minimum tax
- Foreign tax credit
<u>- Regular tax</u>
Equals AMT

Components of AMT
(slide 1 of 3)

- Exemption amount
  - The exemption reduces AMTI to arrive at the base on which AMT is computed
  - The initial exemption amount is:
    - $35,750 for single
    - $49,000 for married, filing jointly
    - $24,500 for married, filing separately

Components of AMT
(slide 2 of 3)

- Exemption amount
  - Exemption amount is reduced by 25% of AMTI in excess of
    - $112,500 for single
    - $150,000 for married, filing jointly
    - $75,000 for married, filing separately

Components of AMT
(slide 3 of 3)

- AMT rates
  - A progressive rate structure is applied to the tax base (AMTI less exemption amount)
    - 26% on first $175,000 ($87,500 for married, filing separately) of tax base
    - 28% on remaining amount of tax base
  - Net capital gain included in AMT base is taxed at favorable alternative tax rates for capital gains (20% or 10%)

Adjustments (slide 1 of 16)

- Adjustments tend to arise from timing differences between regular tax and AMT
- Thus, adjustments can be positive or negative, and will generally reverse in later years

Adjustments (slide 2 of 16)

- Circulation expenditures
  - Amortized over 3 years for AMT
    - Expensed in year incurred for regular tax

Adjustments (slide 3 of 16)

- Depreciation of post-1986 property
  - AMT requires depreciation to be recomputed under the alternative depreciation system (ADS)
  - Taxpayer may elect to use ADS for regular tax purposes and thus avoid the AMT adjustment

Adjustments (slide 4 of 16)

- Depreciation of post-1986 real property
  - Realty: AMT life is 40 years
    - Regular tax MACRS lives are 27.5, 31.5, and 39 years

Adjustments (slide 5 of 16)

- For real property placed in service after December 31, 1998, MACRS recovery periods apply for AMT
  - Thus, the AMT adjustment is effectively eliminated
  - AMT adjustment is still required for real property placed in service prior to January 1, 1999

Adjustments (slide 6 of 16)

- Depreciation of post-1986 property
  - Personalty: AMT method is 150% DB over ADS life
    - Regular tax is generally MACRS method based on 200% DB over shorter lives
  - Effective for personalty placed in service after 12/31/98, MACRS recovery periods are to be used for AMT
    - If 150% DB is elected for this property, there is no AMT adjustment

Adjustments (slide 7 of 16)

- Pollution control facilities
  - Depreciate under the ADS over appropriate class life for AMT
    - Amortize over 60 months for regular tax purposes
  - Effective for pollution control facilities placed in service after 12/31/98, MACRS recovery periods are to be used for AMT

Adjustments (slide 8 of 16)

- Mining exploration/development costs and research/experimental expenditures
  - Amortized over 10 years for AMT
    - Expensed in year incurred for regular tax purposes
  - Taxpayer may elect to capitalize and amortize over 10 years for regular tax purposes and thus avoid the AMT adjustment

Adjustments (slide 9 of 16)

- Completed contract method
  - AMT requires the use of percentage of completion method for long-term contracts rather than completed contract method

Adjustments (slide 10 of 16)

- Incentive stock options (ISOs)
  - The exercise of an ISO can cause income for AMT purposes that is not currently taxable for regular tax purposes
    - Excess of FMV over exercise price is adjustment in year stock is freely transferable or not subject to substantial risk of forfeiture

Adjustments (slide 11 of 16)

- Adjusted gain or loss
  - Since the adjusted basis of an asset can be different for regular tax and AMT, gain or loss recognized upon the disposition of an asset may vary for the two tax systems
  - Difference between regular tax gain (loss) and AMT gain (loss) is adjustment

Adjustments (slide 12 of 16)

- Passive activity losses
  - Passive losses must be recomputed for AMT using AMT provisions

Adjustments (slide 13 of 16)

- Net operating loss (NOL)
  - NOL must be recomputed for AMT using AMT provisions

Adjustments (slide 14 of 16)

- Itemized deductions allowed for AMT purposes include:
  - Casualty losses
  - Gambling losses
  - Charitable contributions
  - Medical expenses in excess of 10% of AGI
  - Estate tax attributable to IRD
  - Qualified interest
    - May differ from regular tax allowed qualified residence and investment interest

Adjustments (slide 15 of 16)

- Itemized deductions not allowed for AMT:
  - Taxes and miscellaneous itemized deductions subject to the 2% AGI limit
- Itemized deduction cutback does not apply for AMT
  - Regular tax cutback amount reduces AMTI

Adjustments (slide 16 of 16)

- Other adjustments
  - AMT does not allow the standard deduction and personal and dependency exemptions

Preferences (slide 1 of 5)

- Preferences tend to arise because of deductions or exclusions that provide substantial benefits
  - Unlike adjustments, preferences can only be positive (i.e., increase AMTI)
  - Thus, preferences reduce the benefits initially received when computing regular tax

Preferences (slide 2 of 5)

- Percentage depletion
  - Preference is the amount of percentage depletion taken for regular tax which is in excess of the adjusted basis of the property at the end of the year

Preferences (slide 3 of 5)

- Intangible drilling costs
  - AMT requires 10 year amortization; deductible currently for regular tax
  - Preference is excess of regular tax deduction over [AMT amortization plus (65% X net oil & gas income)]

Preferences (slide 4 of 5)

- Interest on private activity bonds
  - This interest is not taxable for regular tax purposes but is included in income for AMT purposes
  - Expenses incurred in carrying these bonds are not deductible for regular tax purposes, but offset the interest income in computing the AMT preference

Preferences (slide 5 of 5)

- 50% exclusion of gain on sale of certain small business stock is excludible from gross income for regular tax
  - 28% (or 42% if holding period begins before 01/01/2001) of the excluded amount is a tax preference for AMT

AMT Credit

- AMT attributable to timing differences is AMT Credit
  - Excess of AMT over AMT computed without timing differences
- AMT credit can be carried forward (indefinitely) to be used to offset regular income tax liability
  - Cannot carryback or use against AMT liability

Corporate AMT

(slide 1 of 4)

- Major differences in AMT rules for corporations
  - AMT rate is a flat 20%
  - Exemption amount is $40,000
    - Reduced by 25% of amount by which AMTI exceeds $150,000

Corporate AMT
(slide 2 of 4)

- Major differences in AMT rules for corporations (cont'd)
  - Adjusted current earnings (ACE) adjustment
    - Adjustment = 75% x (ACE - AMTI before ACE)
    - ACE employs earnings and profits concepts but certain differences exist
    - Adjustment can be positive or negative

Corporate AMT
(slide 3 of 4)

- AMT is repealed for small corporations for tax years beginning after 12/31/97
  - Small corporation has average annual gross receipts of not more than $5 million for the 3 year period beginning after December 1993
  - Retains classification if average gross receipts for the 3 year period preceding the current year do not exceed $7.5 million

Corporate AMT
(slide 4 of 4)

- A new corporation is automatically classified as a small corporation it’s first tax year of existence

If you have any comments or suggestions concerning this PowerPoint Presentation for West's Federal Taxation, please contact:

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