

Alternative Minimum Tax



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Alternative Minimum Tax (AMT)

The alternative minimum tax was originally enacted to ensure that high-income taxpayers pay at least a minimum amount of tax if they benefit from certain deductions and other tax preference items.

The AMT tax computation is a parallel system to the regular tax system with its own definitions of income and expenses, rules for income recognition and timing, and exemptions and tax rates. Although every taxpayer is subject to AMT rules, the additional tax is paid only if the tax computation under AMT rules is higher than the tax computed under regular rules.

Even though the AMT was originally targeted toward high-income taxpayers, factors, including inflation and treatment of certain tax credits, can sometimes push lower-income taxpayers into an AMT situation.

How AMT Works

Certain items called "adjustments and preferences" are added to federal gross income. Personal exemptions that reduce taxable income for regular tax purposes are not allowed for AMT purposes and are added back to taxable income. A separate AMT exemption amount is allowed, depending on the taxpayer's filing status. After the AMT adjustments and preferences are added to income, and the AMT exemption amount is subtracted, an AMT tax rate of 26% to 28% is applied. If the resulting tax is greater than regular tax, the difference is added to regular tax on line 45, Form 1040.

Example #1: When computed under regular rules, John's income tax is \$4,700. When computed under AMT rules, the tax amount is \$3,900. Since his tax computed under AMT rules is less than his tax computed under regular rules, John will not pay any additional amount for AMT.

Example #2: Assume the same facts as Example #1, except when computed under AMT rules, John's tax amount is \$5,100. Since his tax computed under AMT rules is higher than his tax computed under regular rules, John must pay the difference in additional tax. John must report additional AMT tax on line 45, Form 1040, in the amount of \$400.

AMT Triggers

Items that commonly trigger AMT include high deductions for state income tax, dependent exemptions, exercise of incentive stock options, and large miscellaneous itemized deductions reported on Schedule A, Form 1040. Other AMT adjustments and preferences include:

- Medical and dental expenses. A portion of these deductions may need to be added back for AMT purposes.
- Taxes from Schedule A, Form 1040.
- Certain mortgage interest deductions.
- Tax refunds reported on Form 1040.
- Certain investment interest expense.
- Certain depletion expense.
- Net operating losses.
- Interest from specified private activity bonds.
- A portion of gain from section 1202 small business stock.
- Certain gains from dispositions of property.
- Certain depreciation adjustments.
- AMT loss limitations.
- Certain circulation costs.
- Long-term contracts.
- Certain mining costs.
- Certain research and experimental costs.
- Pre-1987 installment sale income.
- Intangible drilling cost preferences.



AMT "Patch"

Because the original AMT law did not include a provision to index the exemption amount for inflation, over the years, a growing number of middle-income taxpayers have become subject to AMT. Historically, Congress limited the impact of the AMT by passing temporary legislation, often referred to as "patches," to provide relief for millions of middle-income taxpayers who might otherwise be affected by AMT. Congress has patched the AMT every year for the past several years.

The "fiscal cliff" tax law that was passed on January 2, 2013, included a provision making the AMT patch permanent. Exemption amounts were retroactively increased for 2012 and are indexed for inflation in future years. Under the new legislation, personal credits are allowed against the AMT on a permanent basis.

| AMT Exemption Amounts | | |
|-----------------------------|----------|----------|
| Filing Status | 2014 | 2013 |
| Single or Head of Household | \$52,800 | \$51,900 |
| Married Filing Jointly | \$82,100 | \$80,800 |
| Married Filing Separately | \$41,050 | \$40,400 |

Personal Credits

Originally, nonrefundable credits on Form 1040, such as education credits, the Child and Dependent Care Credit, and the Child Tax Credit did not reduce AMT. In 2000, Congress allowed such personal credits to offset AMT. The personal credit offset to AMT was also part of the AMT patch.

| 2014 Nonrefundable Personal Credits | |
|---|------|
| | Form |
| Child and Dependent Care Expense Credit..... | 2441 |
| Credit for the Elderly and the Permanently and Totally Disabled... Schedule R | |
| Child Tax Credit..... | 1040 |
| Mortgage Interest Credit..... | 8396 |
| America Opportunity (Hope) Credit and Lifetime Learning Credit..... | 8863 |
| Retirement Savings Contribution Credit..... | 8880 |
| Nonbusiness Energy Property Credit*..... | 5695 |
| Residential Energy Efficient Property Credit..... | 5695 |
| Foreign Tax Credit (see Foreign tax credit and AMT, below)..... | 1116 |
| Alternative Motor Vehicle Credit..... | 8910 |
| Alternative Fuel Vehicle Refueling Property Credit*..... | 8911 |
| Plug-in Electric Drive Motor Vehicle Credit..... | 8936 |
| Adoption Credit..... | 8839 |

*The provision expired for tax years after 2013.

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Foreign Tax Credit and AMT

The AMT treatment of the Foreign Tax Credit depends on whether Form 1116, *Foreign Tax Credit*, is being filed.

| | |
|---|---|
| <i>Taxpayer elects not to file Form 1116.</i> | <ul style="list-style-type: none"> • Report Foreign Tax Credit on line 47, Form 1040. • Credit is limited to amount of regular tax. • Unused foreign tax may not be carried over. |
| <i>Taxpayer elects to file Form 1116.</i> | <ul style="list-style-type: none"> • Recalculate Foreign Tax Credit using AMT rules. • AMT Foreign Tax Credit is used to offset AMT in Part II, Form 6251. • Unused AMT Foreign Tax Credit may be carried back one year and carried forward ten years. [IRC §904(c)] |

Credit for Prior Year AMT

The adjustments and preferences that result in AMT are of two types.

- 1) Deferral items, such as AMT basis adjustments, are temporary and do not cause a permanent difference in taxable income over time.
- 2) Exclusion items, such as personal exemptions, are not allowed for AMT and therefore cause a permanent difference in taxable income.

The potential exists for income from deferral items to be taxed twice—first under AMT, and again in a later year under regular tax. A credit against regular tax for prior year AMT is available to address this problem.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.