

# Alternative Minimum Tax

## Chapter 15

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### The Alternative Minimum Tax (AMT)

- ▶ Applies to individual and corporate taxpayers who take advantage of *items of tax preference*
- ▶ AMT is primarily designed to change the timing of tax payments
  - Some preferences yield permanent differences
- ▶ A taxpayer is liable for the greater of
  - Regular tax liability, or
  - The AMT

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### AMT Formula

<b>Taxable Income (from regular tax system)</b>
Add: Adjustments that increase AMTI
Less: Adjustments that decrease AMTI
Add: Preferences
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<b>Alternative Minimum Taxable Income (AMTI)</b>
Less: Exemptions
<hr/>
<b>AMT Tax Base</b>
Application of Appropriate AMT Rate
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<b>Tentative Minimum Tax</b>
Less: Foreign Tax Credit
Less: Regular Tax Liability (Form 1040)
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Alternative Minimum Tax (AMT)

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## AMT Exemption Amounts (2012)

Filing Status	AMT Exemption
Single and Head of Household	\$23,750
Married Filing Jointly and Surviving Spouse	\$45,000
Married Filing Separately	\$22,500
Estates and Trusts	\$22,500

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## Exemption Amount Phaseout

- ▶ Exemption amount is reduced by 25% of the amount by which AMTI exceeds

2012		
Filing Status	Phaseout Begins At	Phaseout Ends At
Single and Head of Household	\$112,500	\$247,500
Married Filing Jointly and Surviving Spouse	\$150,000	\$330,000
Married Filing Separately and Estates and Trusts	\$75,000	\$165,000

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## AMT Tax Rates

- ▶ **Corporations:** 20%
- ▶ **Individuals**
  - 26% for first \$175,000 of taxable income subject to AMT
  - 28% on income in excess of \$175,000
- ▶ **Married filing separately**
  - 28% rate applies to income in excess of \$87,500

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## Adjustments and Preferences

- ▶ Itemized deduction changes
- ▶ Investment-related changes
- ▶ Business-related changes
  
- ▶ Note that the personal exemption is always added back in calculating AMTI

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## Types of Adjustments/Preferences

- ▶ **Exclusion Items**
  - Result in permanent increase in tax
  - Includes:
    - Itemized/Standard deduction changes
    - Private Activity Municipal Bond Interest
  
- ▶ **Deferral Items**
  - Result in a timing difference in the payment of tax
  - Credit is created with unlimited carryforward

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## Itemized Deduction Differences

	Deductible for Regular Tax	Deductible for AMT	Differences
<b>Home Mortgage Interest</b>	Regular rules	Qualified mortgage interest only	Lose tax deduction for excess refinance interest. Add back interest or refinance.
<b>Medical</b>	Excess above 7.5% AGI	Excess above 10% AGI (Add back 2.5%)	AMT costs extra 2.5%
<b>Taxes</b>	Property/sales/use ad valorem deductible	Not deductible	Lose all tax deductions under AMT (Add all back)
<b>Misc.</b>	Subject to 2%	Not deductible	Lose all miscellaneous itemized deductions (Add back with exceptions)
<b>Charitable</b>	Regular rules	Same as regular	No change
<b>Casualty</b>	Regular rules	Same as regular	No change

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## Itemized/Standard Deduction Differences

- ▶ If taxpayer does not itemize, standard deduction is added back
- ▶ Itemized/Standard deduction changes are Exclusion preferences
  - Do not result in credit against future tax liability

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## Deductions Lost with AMT

- |   |
|---|
| ▶ 100% of home mortgage interest on excess refinancing (current mortgage – amortized original mortgage) |
| ▶ An additional 2.5% of medical and dental expenses   |
| ▶ 100% of state and local income, property, and sales taxes   |
| ▶ Almost 100% of miscellaneous itemized deductions  |

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## Investment Related Changes

	Regular Tax	AMT	Differences
<b>Private Activity Municipal Bonds</b>	Not taxable	Taxable	AMT preference item
<b>NQSOs</b>	At exercise W-2 income	Same	None
<b>ISOs</b>	At exercise No regular tax	At exercise AMT income equal to FMV – Strike	AMT preference at exercise

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## Municipal Bond Interest

- ▶ **General Rule:**
  - Interest is exempt from income tax
- ▶ **Exceptions:**
  - Taxable Municipal Bonds
  - Non-Public Purpose municipal bonds when the taxpayer is subject to the AMT
- ▶ Gains on sale of municipal bonds are subject to income tax

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## Municipal Bonds: Tax Equivalent Yield

$$\text{Tax Equivalent Yield} = \frac{\text{Tax-Exempt Municipal Yield}}{1 - \text{Marginal Tax Rate}}$$

*Because Municipal Bonds are exempt from regular federal taxes (and, in some cases, state taxes), the above formula should be applied to compare the return on municipal bonds with the return on regular taxable bonds.*

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## Types of Municipal Bonds

Type	Use	Regular Tax*	AMT*
Public Purpose	Essential Government Functions: • Roads • Schools • Facilities	Exempt	Exempt
Non-Governmental Purpose Bonds	Certain Private Activity Bonds & Subsidized Housing/Student Bonds	Exempt	Preference Item
Taxable	Private Purposes • Arbitrage bonds • Sports stadiums • Convention facilities • Air/water pollution control facilities	Taxable	Taxable
Qualified Redevelopment Bonds	Finance land acquisition and redevelopment in blighted areas	Exempt	Preference Item

*\* Applies to Municipal Bonds issued after August 6, 1986.*

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## Investment Expenses and Municipal Bonds

- ▶ Generally, investment expenses incurred to purchase municipal bonds are not deductible
- ▶ If municipal bond interest is taxed under the AMT system, investment expenses incurred may be deducted for AMT purposes

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## Other Investment Related Changes

- ▶ Recalculation of
  - Gains/Losses on asset dispositions
    - If AMT basis differs from regular tax basis
  - Loss limitations (due to depreciation adjustments) imposed by
    - At risk rules
    - Passive activity loss rules

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## Business-Related Changes

- ▶ **Depreciation** (Deferral Item)
  - Asset class lives lengthen when a taxpayer becomes an AMT taxpayer
- ▶ **Oil and Gas Operations** (Deferral Item)
  - Percentage depletion
    - The amount of percentage depletion taken for regular tax in excess of the adjusted basis of the property at the end of the year is added back
  - 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 and gas income)]

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## Business-Related Changes

- ▶ **Depletion** (Exclusion Item)
  - Deduction must be recomputed taking into account allowable AMT income and deductions from the activity
  - Limited to AMT tax basis in the activity
- ▶ **Qualified Small Business Stock Section 1202** (Exclusion Item)
  - Allows exclusion of 50% of capital gain from income
  - When AMT applies, 7% of excluded gain is added back

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## Miscellaneous Adjustments

- ▶ Section 179 deductions
- ▶ Home office deductions
- ▶ Deductions for IRAs, Keogh, SEP, and SIMPLE plans
- ▶ Self-employed health insurance deduction
- ▶ Distributions from IRAs

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## Small Corporation AMT Exemption

- ▶ Small Corporation
  - Average gross receipts of \$5 million or less for the past 3 taxable years
  - Remains exempt from AMT as long as 3 year average gross receipts do not exceed \$7.5 million
- ▶ This has important planning implications for small and family held businesses

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