



Dbriefs U presents:

The Alternative Minimum Tax
The Least Understood Issue in
Individual Taxation Today

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Agenda

What is the Alternative Minimum Tax (AMT)?

AMT history, current and future impact

Calculating the AMT

Minimum Tax Credit

Tax planning for AMT

What is the Alternative Minimum Tax?

Definition of the Alternative Minimum Tax

The AMT is a separate (but parallel) tax computation that eliminates many deductions and credits available under the regular tax system and creates a tax liability for an individual who would otherwise pay little or no tax.

Section 55 (c)	Regular Tax
Section 55 (d)	AMT Exemptions
Section 56	AMT Adjustments
Section 57	Tax Preference Items
Section 58	Losses
Section 59	Credits

How the Alternative Minimum Tax (AMT) originated

1967	155 people with adjusted gross income of \$200,000 (1.1 million in today's dollar) paid no federal income tax
1969	Congress enacts the "minimum tax"; an "add-on" tax of 10% on the amount to which their reductions of tax liability exceeded \$30,000
1976	Congress makes major changes to the minimum tax after a treasury study found that 244 taxpayers with AGI above \$200,000 in 1974 paid no tax
1978	Congress excludes capital gains from the minimum tax, but creates the AMT to apply to capital gains for certain taxpayers
1982	Congress repeals the minimum tax and expanded the AMT
1986, 1990, 1993	Congress raises the rate of the AMT in steps to its current levels of 26 and 28 percent

AMT factors which differ from regular tax

- AMT tax brackets and exemption amounts are not automatically indexed for inflation
- Marginal tax rates decreasing: The 2001 tax act resulted in regular rates reduced, but not AMT rates
- AMT rates 26% and 28% — lower than 35% top rate for regular tax — but offset by the loss of deductions. Because the two AMT brackets for ordinary income are only 2 points apart, and many deductions are lost, it is more like a “flat tax” than the regular tax system.
- Exemption for AMT phases out at lower limits than exemptions for regular tax

AMT — Impact of tax cuts

AMT Recent History and Projections (2001-2020)

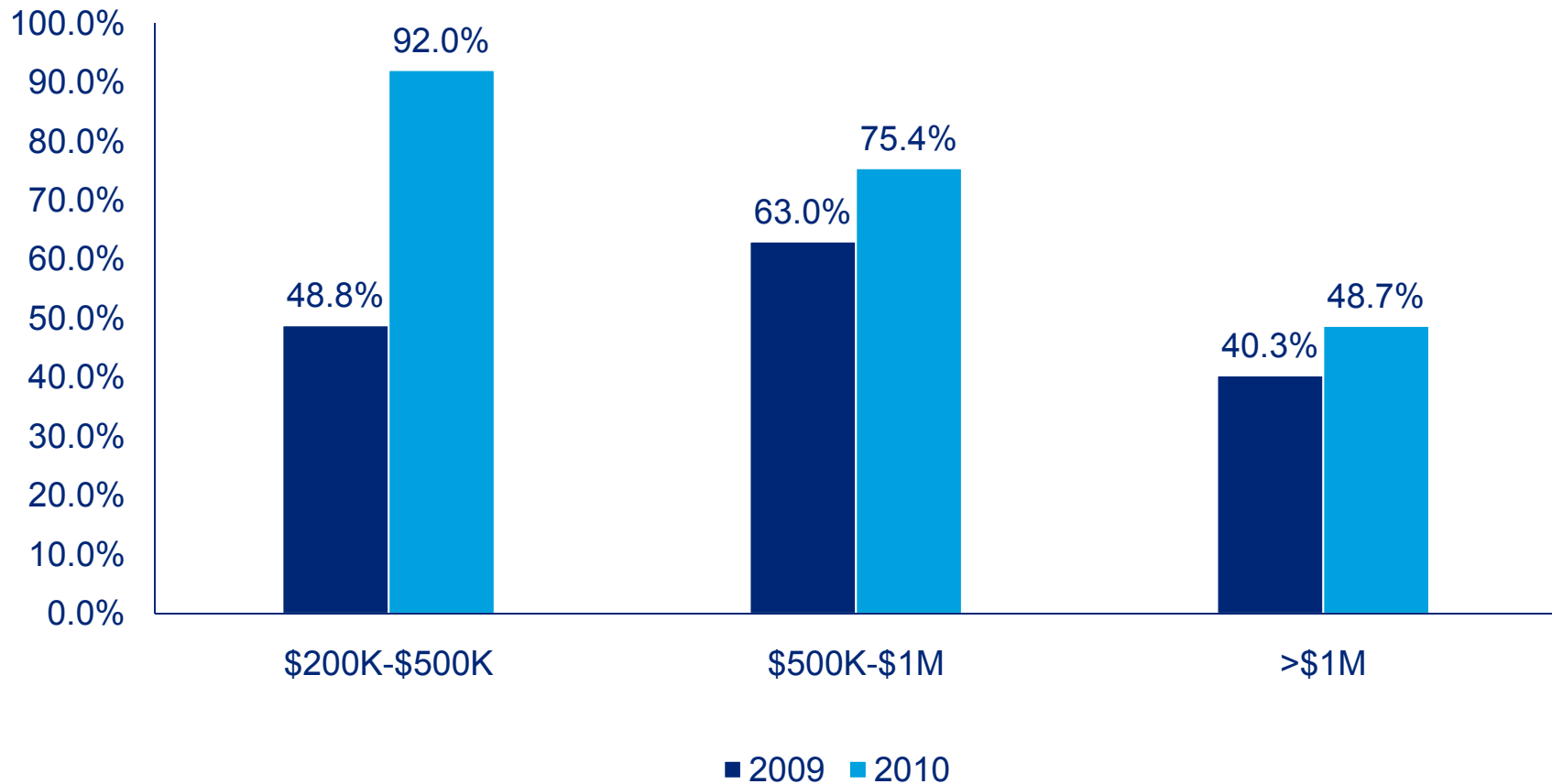


Source: Urban Institute and Brookings Institution Tax Policy Center

Who is paying AMT?

- Almost half of filers with income between \$200,000 to \$500,000 paid AMT in 2009
- In 2009, AMT affected 4.9% of taxpayers
- Under current law, AMT is expected to affect 32.4% of taxpayers by 2010 and if tax cuts are extended, more than 50% by 2018

Who is paying AMT? (cont.)



Source: Urban Institute and Brookings Institution Tax Policy Center

Calculation of the Alternative Minimum Tax

IRS Form 6251 — Alternative Minimum Taxable
Income (AMTI) formula

Regular taxable income...

+ Exemption amounts

+ Positive AMT adjustments

- Negative AMT adjustments

+ Preference items

= AMTI

Calculating the AMT — Adjustments

- AMT adjustments — Section 56
 - Deduction amounts that are recalculated for AMT purposes
 - Adjustments can be UPWARD (POSITIVE/ increase taxable income) or DOWNWARD (NEGATIVE/ decrease taxable income)
- List of common adjustments
 - State and local tax, property tax
 - Personal exemptions
 - Miscellaneous deductions above the 2% floor
 - State and local tax refunds
 - Standard deduction
 - Post-1986 depreciation
 - Incentive stock options
 - Net operating loss
 - Medical deductions
 - Certain home-mortgage interest
 - Investment interest expense

Calculating the AMT — Tax preference items

- Tax preference items — Section 57
 - AMT “preferences” are items that receive special or preferential treatment for regular tax purposes
 - Preferences are ALWAYS positive adjustments
- Examples
 - Private activity bond interest
 - Pre-1987 accelerated depreciation
 - Depletion
 - Intangible drilling costs
 - Addback 7% of gain excluded on the sale of small business stock

Calculating the AMT — Exemptions

2009 Exemptions — Section 55 (d)

Filing status	Exemption amount	Phase out begins at AMTI	Exemption eliminated at AMTI
Single or head of household	\$46,700	\$112,500	\$299,300
Married filing joint or surviving spouse	\$70,950	\$150,000	\$433,800
Married filing separately	\$35,475	\$ 75,000	\$216,900

Calculating the AMT — Summary

Regular Taxable Income

- + Medical Expense Deduction
 - + Miscellaneous Itemized Deductions
 - + State and Local Income Taxes
 - + Real Estate Taxes
 - + Personal Exemptions Allowed
 - + Bargain Element of Incentive Stock Options
-

Alternative Minimum Taxable Income (AMTI)

- AMT Exemption
 - × AMT Tax Rate (26% or 28%)
-

Tentative Minimum Tax

- Regular Tax
-

Alternative Minimum Tax

Calculating the AMT — Summary (cont.)

Regular tax	AMT
Income	Income + excluded items
- Deductions	- Deductions (some not allowed, some adjusted)
- Personal exemptions	- AMT exemption
= Taxable income	= AMT income
X rate: 10% - 35% on ordinary income + 15% on long term capital gains (LTCG)/ qualified dividends	X AMT rate: 26%-28% on ordinary income + 15% on LTCG/qualified dividends
= Regular tax	= TMT (Tentative Minimum Tax)

Example — Will Joe be in AMT?

- Example: Joe
 - Married filing joint, 2 kids
 - Ordinary income — \$250K
 - Long-term capital gains — \$10K
 - Charitable contributions — \$1K
 - Primary residence interest expense — \$20K
 - Property tax — \$10K
 - State income tax — \$12K

Example — Will Joe be in AMT? (cont.)

	Regular tax	AMT
Ordinary income	\$ 250,000	\$ 205,585
Long-term capital gains	10,000	0
3% phase-out (Sch. A)	2,796	(2,796)
Charitable contributions	(1,000)	0
Interest expense	(20,000)	0
Property tax	(10,000)	10,000
State income tax	(12,000)	12,000
Personal exemptions	(14,211)	0
AMT exemption	0	(47,344)
Taxable income/AMTI	\$ 205,585	\$ 177,445

Is Joe in AMT? Yes, AMT = \$508

Regular Tax		AMT	
\$10,000	15% LTCG	\$10,000	15% LTCG
\$ 16,700	10%		
+ \$51,200	15%	\$167,445	26%
+ \$69,150	25%	+ \$0	28%
+ \$58,535	28%		
+ \$0	33%		
<u>= \$205,585</u>	Taxable inc.	<u>= \$177,445</u>	AMTI
<u>\$44,528</u>	Regular tax	<u>\$45,036</u>	TMT

Net AMT: \$508

Minimum Tax Credit — Section 53

- Payment of AMT in one year may generate a tax credit to offset AMT in future years
- AMT adjustments and tax preference items can be divided into two categories:
 - Exclusion Items (“Permanent” differences): cause a permanent difference in AMT; are never deductible for AMT or are never taxable for AMT
 - Deferral Items (“Timing” differences): do NOT cause a permanent difference in AMT
- Minimum Tax Credit (MTC) exists to the extent that the payment of AMT is attributable to timing differences
- MTC ensures that income is not double taxed

Minimum Tax Credit — Section 53 (cont.)

“Permanent” vs. “Timing” Differences

Permanent-exclusion	Timing-deferral
State taxes	Net operating loss
Personal exemptions	Incentive stock options
Misc. deductions subject to 2%	Passive activity loss
Standard deductions	Post-1986 depreciation
Medical deductions	Adjusted gain or loss
Private activities bond interest	Intangible drilling costs
Depletion	Pre-1987 accelerated depreciation
Gain excluded on small business stock	

Minimum Tax Credit — Section 53 (cont.)

- MTC is calculated on Form 8801
- MTC is generally limited to the amount by which regular tax exceeds your tentative minimum tax
- Thus, MTC is usually only utilized in years when AMT is not paid
- Current exception to this rule — refundable use of “long-term AMT credit” from 2007-2012
- MTC has an unlimited carry forward period
- Even though you are “refunded” tax paid through AMT system, you still have lost time value of money and investment income

Long-term minimum credit

- Credit for prior-year minimum tax liability made refundable over period of years
 - Allows taxpayers who have unused MTC credits to claim a refundable credit at 50% of the long-term unused MTC
 - Long-term unused MTC only applies to MTC at least five years old; for example, in 2009, a taxpayer could utilize 50% of his MTC from years 2005 and earlier
 - Credit is calculated in Part IV of Form 8801
 - Provision is effective for taxable years beginning after December 20, 2006 and sunsets on December 31, 2012

Tax planning for AMT

- Know the taxpayer's profile and understand why they are subject to AMT
- Be on the lookout for high preferential rate income
- Use tax projections
 - Project income for multiple years and consider alternatives
 - Must run the numbers every year since the AMT calculation is complex
- Taxpayers who will be in AMT only one year and then return to regular tax can benefit from deferring state income taxes, miscellaneous itemized deductions, and other AMT adjustments to the year of regular tax

Tax planning for AMT (cont.)

- Examples of income that could be accelerated or deferred into an AMT year include:
 - Accelerate income:
 - Executive bonuses/salaries
 - Short term capital gains
 - Dispositions of investments or activities
 - Withdrawals from qualified plans or IRA's
 - Defer deductions:
 - Taxes — state, local, real estate
 - Medical expenses
 - Miscellaneous 2% itemized deductions

Poll question #1

Why was AMT enacted?

- People were paying too much in tax
- Congress wanted to increase charitable giving
- People were not paying enough tax
- Taxpayers needed more deductions

Poll question #2

Which of the following items is deductible for both regular tax *and* AMT tax?

- Post-1986 depreciation
- Charitable contributions
- State taxes
- Miscellaneous 2% deductions

Poll question #3

Which of the following items is a deferral item for AMT?

- Private activity bonds
- State taxes
- Incentive stock options
- Miscellaneous 2% deductions

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