ALTERNATIVE MINIMUM TAX 1.

WHAT'S NEW THIS YEAR

A. Headlines

The Congressional Budget Office recently reported "in 2010, if nothing is changed, one in five taxpayers will have AMT liability, and nearly every married taxpayer with income between $100,000 and $500,000 will owe the alternative tax."

Nina Olson, the IRS National Taxpayer Advocate refers to the AMT as the Number 1 problem facing taxpayers.

B. New Creative AMT strategies

C. Circuit court issues

D. Special exemption and phase-out rates for 2004

II. JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003 (2003 ACT)

A. This legislation modified and enhanced certain provisions contained in the 2002 and 2001 Tax Acts. There are a number of significant provisions in the 2003 Act that directly impact the alternative minimum tax.

1. Prior to the 2003 Act taxation rates on long-term capital gains ranged from 8% to 20% (other than Code Section 1250 recapture). The 2003 Act reduces long-term capital gain rates from a minimum of 5% to a maximum of 15%, (other than Code Section 1250 recapture) for regular tax purposes. The reduced long-term capital gain rates are also effective for alternative minimum tax purposes. This is effective for tax years ending after May 5, 2003.

2. The 2003 Act provides that 7%, rather than 42% of the amount excluded from gross income relative to the qualified sale of Code Section 1202 small business stock will be treated as a preference for AMT purposes. The rate of tax imposed on the taxable profit, after exclusion, attained on the sale of Code Section 1202 stock remains constant at 28% for both regular tax and AMT purposes. All qualification requirements pertaining to the qualified sale of Code Section 1202 small business stock remain unchanged.

3. One of the major components of the 2003 Act pertained to reduced taxation relative to dividend income. As a result, qualified dividend income is taxed at the same rates that apply to net capital gain. This applies for both regular tax purposes and the alternative minimum **tax.**

4. For 2003 and 2004, the **AMT exemption is increased to $40,250 for unmarried individuals who aren't surviving spouses and to $58,000 for married couples filing a joint return and surviving spouses.** The exemption amount for married couples filing separately remains 50% of the married couples filing jointly and surviving spouse exemption amount, i.e.: $29,000.

5. For 2003 and **2004,** the **AMT exemption phase out range is increased by $18,000 for unmarried taxpayers and $36,000 for married taxpayers filing jointly and surviving spouses.** For married couples filing separately, the AMT exemption phase out range is increased by $18,000.

6. Code Section 168(k) 50% additional first year depreciation was provided by the 2003 Act and the AMT depreciation adjustment is not required for certain tangible property and computer software acquired after May 5, 2003 and before January 1, 2005.

NOTE: 50% (and 30%) bonus depreciation property are treated as qualified property for purposes of Code Section 168(k). Depreciation that is allowed or allowable is not subject to adjustment for AMT purposes. However, if a taxpayer chooses not to make use of Code Section 168(k), the AMT depreciation adjustment shall apply.

III. THE JOB CREATION AND WORKERS ASSISTANCE ACT OF 2002 (2002 ACT)

The 2002 Act provided for a temporary waiver of the limitation on use of net operating losses, (NOL), against the alternative minimum tax (AMT). Under the Act, an alternative tax net operating loss deduction, (ATNOLD), arising in years ending in 2001 and 2002, or NOL carry forward to the 2001 and 2002 tax years, may offset 100% of the taxpayer's tentative alternative minimum taxable income, (AMTI). This provision was temporary and concluded with tax years ending in 2002. For 2003 tax years and beyond, AMTI can be offset by the ATNOLD by up to 90%.

B. The 30% additional first year depreciation deduction for qualified property initiated in the Act will not constitute an adjustment or preference for AMT purposes. Additionally, any other depreciation allowable for regular tax purposes in 2002 or later years is not subject to adjustment for alternative minimum tax purposes. (Effective for qualified property placed in service after September 10, 2001, in tax years ending after September 10, 2001).

C. The 2002 Act created the New York Liberty Zone business employee credit as part of the Work Opportunity Tax Credit (WOTC). The portion of each employers WOTC credit attributable to the new targeted group (i.e. employees of New York Liberty Zone businesses), is allowed to offset the alternative minimum tax (Code Section 1 400L(b)(2)(E)).

IV. **ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 (2001** ACT)

Effective after 2001, the 2001 Act permanently allows the child tax credit to be taken against AMT. Specifically, the child tax credit will be allowed against the regular income tax plus the AMT, less other nonrefundable credits and the foreign tax credit. The Act also repeals the alternative minimum tax offset of refundable credits, effective for tax years beginning in 2001.

V. OTHER SIGNIFICANT ISSUES AND DEVELOPMENTS

A. Taxpayer incurred significant attorney fees relative to a successful wrongful termination lawsuit brought against former employer. The recovery from the former employer was deemed to be taxable income to recipient. Taxpayer attempted to reduce taxable settlement by the amount paid for attorney fees. The court rules that the attorney fee may not be used to reduce the settlement and must be treated as an itemized deduction subject to the 2% of AGI limitation. Taxpayer argued that because miscellaneous itemized deductions subject to 2% limitation are not deducted for AMT purposes; a ruling of this nature "smacks of injustice". The Court acknowledged that the ruling "smacks of injustice" and indicated that it is the job of Congress to cure the injustice. (Biehl(v. Commissioner, 118 T.C. 467).

B. Affirming a sharply divided Tax Court, the Seventh Circuit has held that an individual who settled a claim against a former employer under the Age Discrimination in Employment Act (ADEA) had to include the entire settlement in income even though a large part of it was paid directly to his attorney under a contingent fee arrangement. The Court rules that the contingent attorney fee could be claimed as a miscellaneous itemized deduction subject to the 2% limitation. As a result of the ruling and due to the fact that miscellaneous itemized deductions are disallowed for alternative minimum tax purposes, the Taxpayer was forced to settle for an AMT-gutted deduction. *(Kenseth, (CA7, 08-07-01), 87 AFTR 2d, paragraph 2001-5253)*

VI. **OVERVIEW (CODE SECTIONS 53, 55, 56,** 57, **58 AND 59)**

A. The concept of a minimum tax was introduced into the tax code by the Tax Reform Act of 1969. Over the years, Congress has repeatedly changed the computation of the minimum tax in an effort to make the tax an effective tool in allocating a fair share of the tax burden to taxpayers with substantial income who would otherwise avoid a tax liability through the use of deductions, exclusions and credits.

B. The Tax Reform Act of 1986 is the basis for the current Alternative Minimum Tax (AMT) which is a separate and parallel tax system.

C. In its present form, although it is called the Alternative Minimum Tax, it is not "alternative" or optional. It is a mandatory tax paid only if it exceeds the regular tax liability. it was never indexed to inflation and has morphed into a huge nightmare.

D. A "simplified" outline of how the AMT for individuals is calculated and is illustrated as follows:

Alternative Minimum Tax Structure (Simplified)

Regular taxable income before deduction for personal exemption
Plus: Regular tax net operating loss (NOL)

Minus: Itemized deduction limitations

Plus or Minus: Positive and negative adjustments (Code Sections 56 and 58)

Plus: Tax preferences (Code Section 57)

Minus: AMT NOL

Minus: Exemption allowed (Code Section 55(d))

Equals: Alternative minimum taxable income (AMTI)

Times: AMT rate: 26% on first $175,000

28% on excess over $175,000

Equals: Tentative minimum tax (TMT) before credits

Minus: AMT foreign tax credit and certain other tax credits

Equals: Tentative minimum tax (TMT) after credits Minus:

Regular tax liability

Equals: Alternative minimum tax (AMT)

THE EIGHT STEP APPROACH	
Step 1	Calculate regular taxable income
Step 2	Add or subtract adjustments
Step 3	Add tax preferences
Step 4	Subtract base exemption
Step 5	Multiply the result by AMT rate
Step 6	Subtract AMT foreign tax credit
Step 7	Results in TMT
Step 8	AMT if TMT is greater than regular tax

E. AMT adjustments and preferences are necessary to transform income and deduction items computed for regular tax purposes to the format necessary for AMT purposes. Adjustments can be either positive or negative amounts. Preferences are always positive amounts. A summary of common adjustment and preference items are listed below (Code Section 56, 57 and 58).

Item	AMT Treatment
Standard and Itemized Deductions	**No standard deduction** is **allowed;** Itemized deductions for taxes, certain interest, and most miscellaneous deductions not allowed, itemized deductions for medical expenses are limited.
Passive Activities	Passive activity gains and losses must be recomputed by taking into account all adjustments, preferences, and any prior year unallowed losses under the alternative minimum tax rules.
Post 1998 Depreciation	For property placed in service after 1998, other than realty. The method of depreciation used for AMT purposes is 150% declining balance method, switching to straight-line method for the first tax year for which using the straight-line method with respect to the adjusted basis as of the beginning of the year yields a higher allowance. (Note: This adjustment does not apply to qualified property placed in service for tax years beginning after 9/10101 if IRC 168(k) was elected. If not elected, then AMT preference would apply.
Post 1986 and Pre 1999 Depreciation	For property placed in service after 1986 and before 1999, AMT depreciation deductions are computed under the alternative depreciation system (ADS), using the 150 percent declining balance method, switching to the straight-line method for the first tax year for which using the straight-line method with respect to the adjusted basis as of the beginning of the year yields a higher allowance, unless the taxpayer uses straight-line depreciation for regular tax purposes (Code Section 56(a)(1)(A)).
Adjusted Gain or Loss	Gain or loss from the sale or exchange of property must be recomputed with regard to AMT adjustments.
Loss Limitations	Gains and loss from conduit activities for which the taxpayer has basis or at risk limitation must be recomputed taking into account all AMT adjustments and preferences applicable to that activity.
Certain Installment Sales	Dealers in personal property cannot use the installment method for regular tax purposes (Code Section 453(1)(1)). However, a dealer disposition does not include sales of property used or produced in the trade or business of farming (Code Section 452(1)(2)(A)). Thus, farmers **can** use the installment method for regular tax purposes. These taxpayers are permitted to use the installment method for AMT purposes as well (Code Section 56(a)(6)).
Long-term Contracts	Calculate income under the percentage of completion method except home construction contracts entered into after 1990.

Tax Shelter Farm Activities	Gain or loss from a tax shelter farm activity which the taxpayer materially participates must be recomputed by taking into account all adjustment and preferences relating to that activity.
Mining Exploration and Development Cost	Allowable costs must be capitalized and amortized ratably over 10 years.
Pollution Control Facilities	Amortization figured under the alternate depreciation system (ADS).
Research and Experimental	Allowable costs incurred after 1986 must be capitalized and amortized over 10 years.
Certain tax-exempt interest income from private activity bonds	Certain interest on specified private activity bonds is included in the AMT base.
	TIP: Check out www.investinginbonds.com to calculate AMT % of municipal funds.
	TIP: Fidelity and other municipal funds are developing AMT free funds.
Accelerated depreciation amount on depreciable real property recognized, and depreciable leased personal property placed in service before 1987 (pre-MACRS property)	Excess of depreciation or amortization taken over the amount allowed under the straight-line method.
Incentive Stock Options	Excess of fair market value over option price at the earlier of date the option rights become transferable or are no longer subject to a substantial risk of forfeiture must be included in the AMT tax base.
Intangible Drilling Costs	Excess of deducted costs related to productive wells over the total of the amount allowable if 60 month write-off is not elected. Costs in excess of 65% of net income from wells must be amortized over 120 months.
Qualified Small Business Stock	Seven percent of the amount of the gain excluded from regular taxable income.

CHECKLIST OF AMT ADJUSTMENTS AND TAX PREFERENCE ITEMS

AMT adjustments applicable to all taxpayers include:

MACRS depreciation of property placed in service after 1986

Mining exploration and development costs

Long-term contracts

Net operating losses (i.e., AMTNOL's)

Certified pollution control facilities

Installment sales of certain property

Passive (business and farming) activity losses

AMT adjustments applicable to individuals:

Limits on deductions (i.e., standard deduction, personal exemptions and certain itemized deductions (e.g. medical expenses))

Circulation and research and experimental expenditures

Incentive stock options

Tax Preference Items:

Tax exempt interest from certain private activity bonds

Accelerated depreciation of certain property placed in service before 1987

Exclusion for gain on the sale of certain small business stock

F. A base exemption amount is determined by the taxpayer's filing status for regular tax purposes and is permitted to reduce alternative minimum taxable income as follows (Code Section 55(d)(1):

Filing Status	2004 Base Exemption Amount
Single and Head of Household	$40,250
Married Filing Joint and Qualifying Widow(er)	$58,000
Married Filing Separate	$29,000
WARNING: The base exemption is scheduled to reduce in 2005.	

The base exemption deduction permitted will be diminished under the phase out rules by 25% of AMTI that exceeds certain levels. A summary is as follows:

Filing Status	2004 Phase out Range		Exemption Eliminated
	Begins	Ends	
Single and Head of Household	$112,500	$273,500	$273,500
Married Filing Joint and Qualifying Widower)	$150,000	$382,000	$382,000
Married Filing Separate	$75,000	$191,000	$191,000(see note)

NOTE: Special rules apply to married taxpayers filing separate when AMTI exceeds $191,000. If this occurs, AMTI must be increased by the lesser of $29,000 or 25% of the excess AMTI exceeding $191,000.

H. There are two-tier rates relating to Alternative Minimum Tax.

1. Tier 1 consists of a flat 26% rate that is applied to the first $175,000 ($87,500 for MFS) of a taxpayer's AMTI.

2. *Tier 2 consists of a* flat 28% rate that is applied to all AMTI in excess of $175,000 ($87,500 *for MFS).*

3. If the taxpayer received qualified dividends, capital gain distributions or reported long-term capital gains on Form 1040; those amounts will be subject to tax at a maximum rate of 15% for both regular and AMT purposes.

I. The Foreign Tax Credit is a credit allowed in computing AMT.

1. The AMT Foreign Tax Credit is computed similarly to the regular tax foreign tax credit except when computing the limit of the credit.

2. AMT taxable income is used instead of regular taxable income.

3. The tax against which the credit is taken is the tentative minimum tax.

4. The AMT Foreign Tax Credit cannot offset more than 90% of the tentative minimum tax as computed without regard to the exception for intangible drilling costs and before claiming the foreign tax credit and the net operating loss deduction.

VII. ITEMIZED DEDUCTIONS UNDER AMT

Certain itemized deductions are deductible in full for alternative minimum tax purposes, without being subject to the limits based on adjusted gross income. These items include:

1. Casualty Losses;

2 Miscellaneous Itemized Deductions NOT subject to the 2% AGI requirement (i.e., gambling losses);

3. Returns of Amounts included in income under Code Section 1341 (Claim of Right); and,

4. Estate tax paid on income in respect of a decedent.

B, Certain itemized deductions are completely disallowed for AMT purposes including:

1. State and local taxes;

TIP: If possible, a taxpayer should avoid paying deductible state and local taxes in an AMT year. As long as the taxpayer can deduct the taxes, paying them in a year in which the taxpayer owes AMT offers no benefit.

COUNTERINTUITIVE TIP: Say this fast three times!
In certain situations, taxpayers could owe less tax by claiming less deductions. Taxpayers are permitted to choose the itemized deduction instead of the standard deduction by writing "IE" on the dotted line next to Form 1040 line 37. Taxpayers with high mortgage interest and charitable contributions and low state and local taxes have planning opportunities. You can file an amended return on prior years.

EXAMPLE: Al & Alyssa Turnative file jointly, have six children, have AGI of $100,000 and live in Florida (home of no state income tax). They had $6,400 mortgage interest and $3,000 charitable contributions. The standard deduction for 2003 is $9,500 ($100 more than itemizing). By using the itemized election, the Turnative's save $744 in taxes.

EXAMPLE: Bertha pays $10,000 of state and local taxes in Year 1 (an AMT year). In Year 2 (a regular tax year) she receives a $2,000 refund on account of the Year 1 payment. The $2,000 refund should not be included in gross income because the taxpayer received no tax benefit from the deduction in Year 1.

OBSERVATION: A recovery of a tax that is included within gross income for regular tax purposes is not included in calculating AMTI. For example, state income tax refunds that are required to be included within gross income for the regular tax under Code Section 111 are not included in the AMTI.

2. Miscellaneous itemized deduction subject to the 2% AGI floor.

WARNING: The biggest problems in this area are awards for age, sex or race discrimination. Certain circuit courts are requiring taxpayers to report gross settlements as income and deductions for legal fees as an itemized deduction subject to the 2% limitation. Because AMT requires this to be added back, an inequitable scenario is created. It is even possible to owe more tax than what is received. At the time of writing, a Senate bill was approved (but not passed as law) to fix this injustice.

EXAMPLE: Oldie Butgoodie won an age discrimination suit for $1,200,000. The lawyer received 33% or $400,000. Oldie gets the remaining $800,000. In his circuit, Oldie is required to report income of $1,200,000 and an itemized deduction of $400,000 which will be significantly limited by AMT.

3. Home mortgage interest that was not used to buy, build or substantially improve the primary or secondary home of the taxpayer or interest paid relative to a refinanced mortgage that exceeded the balance of the existing encumbrance immediately prior to the refinancing.

CAUTION: Mobile homes and boats are not qualified housing for AMT.

TIP: Planning to take advantage of the qualified housing interest deduction for AMT purposes is difficult, primarily because AMT problems usually are short-term and mortgage financing usually is long-term. The taxpayer might be subject to the AMT in one year, but not in later years. On the other hand, mortgages generally are long-term, and any changes typically involve substantial transaction costs. Thus, planning tips are likely to offer long-term solutions to short-term problems. Nevertheless, there are choices the taxpayer can make. For example, if the taxpayer owns three or more residences, the taxpayer can decide each year which residence, in addition to his principal residence, to use in claiming the qualified housing interest deduction.

EXAMPLE: In addition to her principal residence, Ci-Ci owns two vacation homes: a ski condo and a seaside condo. The mortgage interest expense for the seaside condo is less than the mortgage interest expense for the ski condo. Ci-Ci used the $70,000 loan proceeds from the **seaside** condo's mortgage to purchase the seaside condo, such that the interest on the indebtedness is deductible for both AMT and regular tax purposes. Ci-Ci used the $90,000 proceeds from the ski condo mortgage to purchase a personal automobile, such that the interest on the indebtedness is deductible for regular tax purposes, but not for AMT purposes. Thus, Ci-Ci might want to select the seaside condo as her second home in an AMT year, and the ski condo as her second home in a regular tax year.

C. AMT limits on investment interest generally conform to the regular tax limits on investment interest.

1. To the extent that investment interest is not deductible in computing AMTI, it may be carried forward and deducted in a future year.

2. Investment income for purposes of the minimum tax included any tax-exempt interest included in alternative minimum taxable income.

3. For taxable years beginning after December 31, 1992, net capital gains (i.e., net long-term capital gains less net short-term capital losses) are not included as investment income unless the taxpayer elects not to have such net capital gain or portion thereof taxed at the rate of 15 percent, 25 percent, or 28 percent.

D. Medical expenses are deductible for AMT purposes only to the extent they exceed 10% of taxpayer's AGI.

EXAMPLE: Lee and Ness Sick who file a joint return for 2004 have an AGI of $100,000 and total medical expenses of $12,000. For regular tax purposes, they have deductible medical expenses of $4,500; but for the AMT, their medical expenses deduction is limited to $2,000.

E. A charitable contribution deduction is allowed for both regular and AMT tax calculations in the amount of the contributed property's fair market value where the taxpayer donates real, intangible or tangible personal property whose use is related to the donee's tax-exempt purposes.

VIII. DEPRECIATION AND BASIS ADJUSTMENT

A. For AMT purposes, depreciation on property placed in service after 1986 and before 1999 may require an adjustment in preparing Form 6251.

B. The actual AMT adjustment is the difference between total depreciation for all property for AMT purposes and the total depreciation for regular tax purposes.

C. The effect of using two different types of depreciation is that taxpayers may have a different basis in property for AMT purposes.

1. When the property is sold, the gain may be different for regular tax and AMT purposes.

2. This will result in another AMT adjustment, known as the basis adjustment.

D. The basis adjustment is triggered by a disposition of property acquired after 1986 and is the difference between the gain or loss computed for regular tax purposes and the gain or loss computed for AMT purposes.

E. Since AMT may use a different depreciation system, a minimum of two depreciation schedules, and thus two basis calculations, must be maintained on all assets placed in service after 1986. (NOTE: This does not apply to qualified property placed in service for tax years beginning after 9/10/01 if Code Section 168(k) was elected.)

CAUTION: If the taxpayer does not utilize the provisions provided under Code Section 168(k) for qualified property; there will be an adjustment for depreciation when computing AMTI.

F. The required adjustments can be summarized as follows:

Property Class	Placed In Service After 1986 and Before 1999	Placed In Service After 1998
Section 1250 property	SL method over 40 years using the same mid-month convention used for regular tax purposes	No adjustment
Other tangible property for which the SL method was used	SL method over the property's ADS class life using the same convention used for regular tax	SL method using the same recovery period and convention used for regular tax
All other tangible property	150% DB method, switching to the SL method in the year in which it yields a larger deduction, over the property's ADS class life using the same convention used for regular tax	150% DB method switching to SL in the year in which it yields a larger deduction, using the same recovery period and convention used for regular tax.

TIP: Expensing property under Code Section 179 requires no AMT adjustment!

IX. PASSIVE ACTIVITY LOSS ADJUSTMENT

A. The passive activity loss adjustment is the difference between the passive activity loss allowed for regular tax purposes and the passive activity loss allowed for AMT purposes.

B. The AMT passive rules are similar to the regular rules except income and deductions are calculated using the AMT system rather than regular tax rules, (i.e., depreciation, etc).

C. The amount of the passive losses that is disallowed by the passive loss limitation is reduced by the amount of taxpayer's insolvency (liabilities exceed fair market value of assets) at the end of the year.

D. If the passive activity involves active participation in rental real estate an adjustment is required to re-compute Modified Adjusted Gross Income for AMT purposes.

E. When a passive activity is disposed of, the calculations become more complicated because the following items must be accounted for:

1. Current year AMT adjustments and preference items;

2. Suspended losses that are triggered by the disposition; and the AMT basis adjustment.

X. **ALTERNATIVE NET OPERATING LOSS** (AMT NOL)

A. All post-1986 NOL's must be recalculated using the AMT system. (This did not apply in 2001 and 2002 due to special rules that have expired).

B. See the Gear Up NOL section to determine how to calculate regular NOL.

C. The AMT NOL equals the regular NOL except that the following modifications must be made to reflect the difference between the regular tax and AMT rules.

1. Reduce or increase the regular NOL by the AMT adjustments, except for personal exemptions, and

2. Reduce the regular NOL by tax preference items, except for charitable contributions of appreciated property.

D. The difference between the regular NOL and the AMT NOL is included in the calculation of AMTI on Form 6251 by:

1. Entering the regular NOL on the proper line and adding it to the regular taxable income; and

2. Entering the AMT NOL on the proper line and subtracting it from regular taxable income.

E. The 90% limitation AMT NOL that was disallowed in prior years, by reason of the pre-2002 Act, may be carried over to other taxable years.

XI. **AMT FOR CHILDREN UNDER AGE OF 14**

A. The reduction in individual income tax rates also applies to children under age l4.

B. If a child under age 14 has substantial adjustments or preferences subject to the alternative minimum tax rules, the child could be *subject* to AMT.

C. The child's AMT exemption cannot exceed his/her earned income for the tax year plus $5,600 for 2004. The exemption computed under this limit cannot be more than the child's regular AMT exemption *($40,250 before* the phase out),

XII. COMPREHENSIVE AMT EXAMPLE

A. The following comprehensive example illustrates the operation *of the AMT. Al* and Alyssa Turnative are married joint filers. Their 2003 taxable income and regular tax were computed as follows:

Gross Income:		
Salary	$ 90,000	
Interest	12,000	
Dividends (ail qualifying)	16,000	
Short term capital gain	2,000	
Adjusted gross income:	$120,000	
Itemized deductions:		
Medical expenses (11,000 total minus 7.5% of AGI)	2,000	
Real property taxes on home	12,000	
Real property taxes on lake property	6,000	
Qualified residence interest	20,000	
Investment debt on lake property, $32,000 total, limited to net investment income	14,000	(Note A)
Charitable contributions	21,100	(Note B)
Casualty loss ($15,000 total minus 10% of AGI - $100 personal loss limitation)	2,900	
Miscellaneous itemized deductions ($23,300 total minus 2% of AGI)	20,900	
Total itemized deductions	(100,900)	
Personal exemptions (2 x $3,050)	(6,100)	
Taxable income	13,000	
Regular tax	**$ 650**	

Note A: The lake property was acquired as a speculative investment and was 90 percent debt-financed. Interest on investment indebtedness is allowed as a deduction under Code Section 163(d) to the extent of net investment income, Net investment income is $14,000 ($12,000 interest + $2,000 short term capital gain), Thus, the $32,000 interest expense is limited to $14,000, $13,000 of the $16,000 qualifying dividend could have been treated by an election as net investment income to eliminate all regular tax, However, the taxpayer would lose the favorable capital gain rate by the election,

Note B: The charitable contribution deduction results from a gift to Al and Alyssa's church of stock worth $21,000. They purchased the stock two years earlier for $2,000,

B, Al and Alyssa's 2003 alternative tax itemized deductions (ATID's) determined as follows:

Medical expenses (in excess of 10% of AGI)	$ 0
Real and personal property taxes (not allowed)	0
Qualified housing interest	20,000
Other qualified interest (limited to net investment income) ($12,000 + $2,000 = $14,000)	14,000
Casualty losses	2,900
Charitable contributions	21,100
Miscellaneous itemized deductions (not allowed)	0
Total ATIDs	$ 58,000

These computations are similar to the computations for regular itemized deductions except:

1. The reduction in medical expenses is 10 percent rather than 7,5 percent;
2. Deductions for state and local taxes paid are not allowed;
3. Other qualified interest is allowed only to the extent of net investment income; and
4. The miscellaneous itemized deductions are not allowed,

C, Al and Alyssa's AMT liability for 2003 was computed as follows:

Regular taxable income:	$ 13,000
Add-backs:	
Personal exemptions	+ 6,100
Regular itemized deductions	+ 100,900
Subtract: ATID'S	- 58,000
AMTI	$ 62,000
Less: exemption amount (for joint filers)	- 58,000
ATM! base	$ 4,000
Multiplied by the qualifying dividend tax rate	x .05
Gross AMT	$ 200
Less: AMT FTC	- 0
Tentative minimum tax	$ 200
Less: regular tax	**650**
AMT for 2003	**-** 0 -

OBSERVATION: Because of the increase of the AMT exemption in 2003 and 2004, no tax is due. Had this computation been made in either 2002 or 2005; taxpayers would have been subject to the Alternative Minimum Tax.

XIII, ALTERNATIVE MINIMUM **OF TAX CREDIT CARRYFORWARD – FORM 8801**

A. The general theory of the alternative minimum tax credit (MTC) is that timing differences which result in additional tax in the year in which they occur should also give a tax benefit in the future when they reverse.

EXAMPLE OF DOUBLE TAXATION, WHICH COULD RESULT WITHOUT AN **AMT CREDIT:** In 2003, Al had a regular tax liability of $180,000 and a tentative minimum tax of $200,000. In 2004, Al's regular tax was $260,000, and his tentative minimum tax was $245,000, Al could use $15,000 of his MTC carryover in 2004. Thus, his tax in 2004 was $245,000, The remaining $5,000 of MTC is carried forward to 2005 and later years,

B. The MTC alleviates this potential inequity by giving the taxpayer a credit, which he may use against his regular tax. The law, however, does not tie the use of the MTC created by a particular deferral preference to the payment of the regular tax attributable to the reversal of that specific time difference. For example, a taxpayer who pays AMT in 2003, due solely to the exercise of an ISO, will have a MTC available for 2004 even though the taxpayer does not sell the stock until 2005 or beyond.

C. An important point to remember is that the MTC can be used only against the regular tax liability, It cannot reduce the regular tax liability below what would be the AMT liability for the year. The MTC is used only after all other nonrefundable credits have been utilized and there remains a regular tax liability in excess of the tentative AMT,

D. Since the MTC can carry forward indefinitely, it is not necessary to determine which prior year's MTC is being used in a particular year. The MTC cannot be carried back,

E. In some cases, a taxpayer's accumulated MTC's from prior tax years may be reduced even though they are not used to reduce the taxpayer's regular tax liability. This occurs when: (1) taking into account solely the deferral items, AMTI is less than regular taxable income, and (2) because of the exclusion items, the taxpayer would incur AMT liability for the year if AMTI were treated as equal to regular taxable income with respect to the deferral items,

EXAMPLE: Carrie Over had an MTC carryover of $40,000 from Year 1 and the following for Year 2 and Year 3:

	Year 2	Year 3
Regular taxable income	$300,000	$400,000
Deferral adjustments	(112,500)	(83,000)
Exclusion preferences	200,000	200,000

Carrie's MTC carryover to Year 2 is computed as follows:

	Regular tax Year 2	AMT Year 2	
Taxable income	$300,000	Taxable income	$300,000
		Deferral adjustment	(112,500)
Regular tax	$ 97,813	Exclusion preference	200,000
		AMTI	387,500
		(.26 x $175,000 + ,28 x $212,500)	
		Tentative AMT	S105.000

In year 2, Carrie could not use any MTC to offset regular tax of $97,813 because the MTC cannot be used to reduce regular tax below the amount of tentative minimum tax. However, in year 2, Carrie used $38,687 of the MTC even though there was no reduction in regular tax. The calculation is made as follows:

Hypothetical AMT:

Taxable income	$300,000
Exclusion preference	200,000
AMTI	500,000
(.26 x $175,000 + ,28 x $325,000)	-----------
Tentative minimum tax	$136,500
Less regular tax	(97,813)
Hypothetical AMT	38.687

Because Carrie was subject to a hypothetical AMT of $38,687, the taxpayer is deemed to have used $38,687 of the $40,000 MTC carry forward in Year 2, which resulted in an MTC carry forward to Year 3 of $1,313. If the same calculations are made in Year 3, the entire MTC carry forward is absorbed in year 3, resulting in no additional carry forward to Year 4,

F. Deferral and exclusion items are summarized in the following table:

1. Deferral items are AMT adjustments that do not cause permanent differences in taxable income over time.

2. Exclusion items are AMT adjustments that result in a permanent change in **tax.**

Deferral	**Exclusion**
Passive activities	Standard and itemized deductions
Depreciation	Interest from private activity bonds
Loss limitations	Depletion
Installment sales	Qualified small business stock
Long-term contracts	Tax refund
Disposition of property	
Mining costs	
Research and experimental costs	
Incentive stock options	
Intangible drilling costs	

XIV. TAX CREDITS

A. Tax credits generally may not reduce regular tax liability below the TMT.

B. The EIC, post-2003 child tax credit, post-2003 adoption credit, and post-2003 retirement savings credit are not limited by TMT.

C. Minimum tax liability must be reduced by the amount of these credits,

XV. WHEN TO FILE FORM 6251

A. Taxpayer is liable for AMT;

B. Taxpayer claims a general business, qualified electric vehicle, non-conventional source fuel or prior year minimum tax credit; or

C. Would be liable for AMT but there are preferences that offset the income.

TIP: Filing the Form 6251 will prevent a follow up IRS letter.

TIP: Practitioners should consider calculating AMT on all clients to see how close the client is to being subject to AMT tax,

XVI. WHERE TO GO FOR MORE INFORMATION:

IRS Form 6251 and instructions

IRS Form 8801 and instructions

www.investinginbonds,com — to find AMT % on various municipal bonds