Chapter 8: Alternative Minimum Tax (AMT)

Corrections were made to this workbook through January of 2005. No subsequent modifications were made.

INTRODUCTION

Alternative minimum tax (AMT) laws have been in existence since 1969. The minimum tax was enacted after Congress learned that 155 taxpayers with AGI of $200,000 or more in 1966 paid no federal income tax. The purpose of AMT was to prevent high income taxpayers from exploiting the regular income tax system benefits available to lower income taxpayers.

In the Taxpayer Advocate's 2003 Annual Report to Congress, it was reported that over 660,000 taxpayers with AGI under $200,000 paid AMT in 2001. The report states that the AMT appears to function "randomly, no longer with any logical basis in sound tax administration or any connection with its original purpose of taxing the very wealthy who escape taxation. Congress must address the AMT before it bogs down tax administration and increases taxpayers' cynicism to such a level that overall compliance declines."

The report also stated that the number of taxpayers with AGI under $50,000 who owed AMT in 2001 was about the same as the number of taxpayers with AGI between $475,000 and $500,000, who did not owe AMT. It is estimated in the report that, with no changes, the AMT will affect 32 million taxpayers by 2010 and that over 50% of AMT revenue will come from taxpayers whose income is less than $100,000.

Current AMT provisions were enacted with the Tax Reform Act of 1986 and were effective for 1987 and later. With this act, a second method of calculating an individual's tax was created which operates parallel to the "regular" tax system. After an individual's regular tax is calculated, the individual is required to calculate this "alternative" tax using different rates and definitions of income and deductions.

Little attention was given to AMT by taxpayers or Congress until the enactments of the 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA) and the 2003 Jobs Growth Tax Relief Reconciliation Act (JGTRRA) tax reform bills. Under these two tax bills, the number of taxpayers required to pay AMT increased exponentially. Although Congress took steps to reduce regular tax, more taxpayers now find themselves liable for the AMT because Congress has made very little change to its calculation. For example, EGTRRA introduced a 10% regular tax bracket, but no corresponding change was made to AMT rates. The number of taxpayers subject to AMT has increased from 600,000 seven years ago, to a projected 40 million by 2014. This projection is based on no changes to the current law.[1]

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[1] *CCH Federal Tax Guide Reports Tax Week,* Vol. 87, Issue No. 16, April 16, 2004

AMT may become as common as the home mortgage interest deduction. The Congressional Budget Office reports two million returns that were subject to AMT liability produced $11 billion in revenue. They predict this could grow to $55 billion by 2014. Some experts estimate the AMT will cost $1 trillion over 10 years.[2]

AMT FOR INDIVIDUALS

FORM 6251

AMT is computed using Form 6251, *Alternative Minimum Tax – Individuals.* This form is attached to the taxpayer's income tax return. It contains three parts.

- **Part I** identifies and computes the total adjustments and preference items to arrive at a taxpayer's alternative minimum taxable income (AMTI).
- **Part II** adjusts AMTI by exemptions based on AGI, capital gains and other credits to arrive at the taxpayer's tentative minimum tax (TMT). TMT is used to determine whether the taxpayer has AMT liability.
- **Part III** computes adjustments related to capital gains, which are reported in Part II.

CALCULATING AMT

To understand the AMT liability, it is important to review its calculation. First, the taxpayer's regular tax is calculated, and then it is compared to the taxpayer's tax calculated according to the AMT rules. Generally, AMT is calculated in three steps.

Step 1. After the taxpayer's regular tax is calculated, his regular income is adjusted for various tax benefits and credits. This is done by either eliminating them completely or reducing their application. Step 1 is the most complicated part of the AMT. Chart 1 in the Appendix at the end of the chapter summarizes adjustments and deferrals made for AMT. Adjustments and deferrals are accomplished in Part I of Form 6251. A blank Form 6251, Part I is shown.

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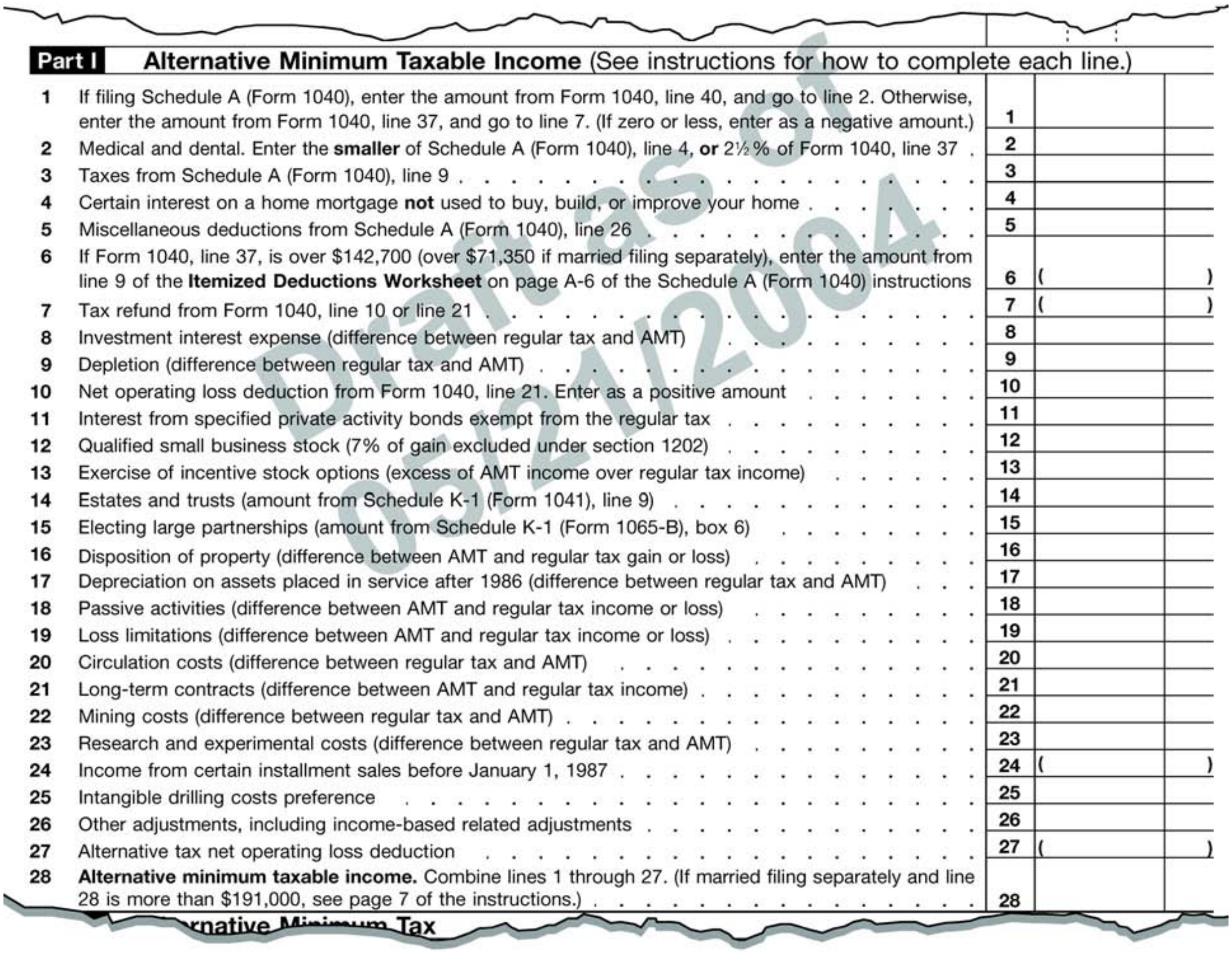
[2] *CCH Federal Tax Guide Reports Tax Week*, Vol. 87, Issue No. 16, April 16, 2004



Part I **Alternative Minimum Taxable Income** (See instructions for how to complete each line.)

1	If filing Schedule A (Form 1040), enter the amount from Form 1040, line 40, and go to line 2. Otherwise, enter the amount from Form 1040, line 37, and go to line 7. (If zero or less, enter as a negative amount.)	**1**	
2	Medical and dental. Enter the **smaller** of Schedule A (Form 1040), line 4, **or** 2½ % of Form 1040, line 37 .	**2**	
3	Taxes from Schedule A (Form 1040), line 9	**3**	
4	Certain interest on a home mortgage **not** used to buy, build, or improve your home	**4**	
5	Miscellaneous deductions from Schedule A (Form 1040), line 26	**5**	
6	If Form 1040, line 37, is over $142,700 (over $71,350 if married filing separately), enter the amount from line 9 of the **Itemized Deductions Worksheet** on page A-6 of the Schedule A (Form 1040) instructions	**6**	( )
7	Tax refund from Form 1040, line 10 or line 21	**7**	( )
8	Investment interest expense (difference between regular tax and AMT)	**8**	
9	Depletion (difference between regular tax and AMT)	**9**	
10	Net operating loss deduction from Form 1040, line 21. Enter as a positive amount	**10**	
11	Interest from specified private activity bonds exempt from the regular tax	**11**	
12	Qualified small business stock (7% of gain excluded under section 1202)	**12**	
13	Exercise of incentive stock options (excess of AMT income over regular tax income)	**13**	
14	Estates and trusts (amount from Schedule K-1 (Form 1041), line 9)	**14**	
15	Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)	**15**	
16	Disposition of property (difference between AMT and regular tax gain or loss)	**16**	
17	Depreciation on assets placed in service after 1986 (difference between regular tax and AMT) . . .	**17**	
18	Passive activities (difference between AMT and regular tax income or loss)	**18**	
19	Loss limitations (difference between AMT and regular tax income or loss)	**19**	
20	Circulation costs (difference between regular tax and AMT)	**20**	
21	Long-term contracts (difference between AMT and regular tax income)	**21**	
22	Mining costs (difference between regular tax and AMT)	**22**	
23	Research and experimental costs (difference between regular tax and AMT)	**23**	
24	Income from certain installment sales before January 1, 1987	**24**	( )
25	Intangible drilling costs preference	**25**	
26	Other adjustments, including income-based related adjustments	**26**	
27	Alternative tax net operating loss deduction	**27**	( )
28	**Alternative minimum taxable income.** Combine lines 1 through 27. (If married filing separately and line 28 is more than $191,000, see page 7 of the instructions.)	**28**	

rnative Minimum Tax

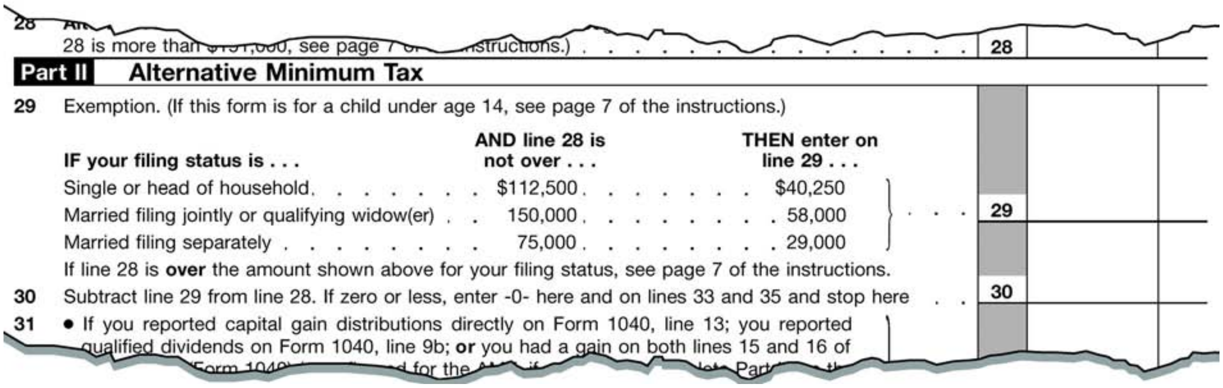
Step 2. Each taxpayer is allowed to deduct an AMT exemption amount after adjustments are made to income. The exemption amount is phased out for taxpayers based on income.

For 2003–2004

Filing Status	AMT Exemption	Exemption Phase-Out Begins (AGI)	Exemption Ends (AGI)
Married Filing Joint	$58,000	$150,000	$382,000
Single/Head of Household	40,250	112,500	273,500
Married Separate	29,000	75,000	191,000

Note. In 2005, the exemption amount is scheduled to revert back to amounts effective for tax year 2000. These amounts are: $49,000 for married filing joint, $35,750 for singles/head of household, and $24,500 for married filing separate.

The AMT exemption is reported on Form 6251, Part II, lines 29 and 30. A blank Form 6251, Part II is shown.



28 is more than see page 7 structions.) **28**

Part II **Alternative Minimum Tax**

29 Exemption. (If this form is for a child under age 14, see page 7 of the instructions.)

IF your filing status is . . .	**AND line 28 is not over . . .**	**THEN enter on line 29 . . .**
Single or head of household	$112,500	$40,250
Married filing jointly or qualifying widow(er)	150,000	58,000
Married filing separately	75,000	29,000

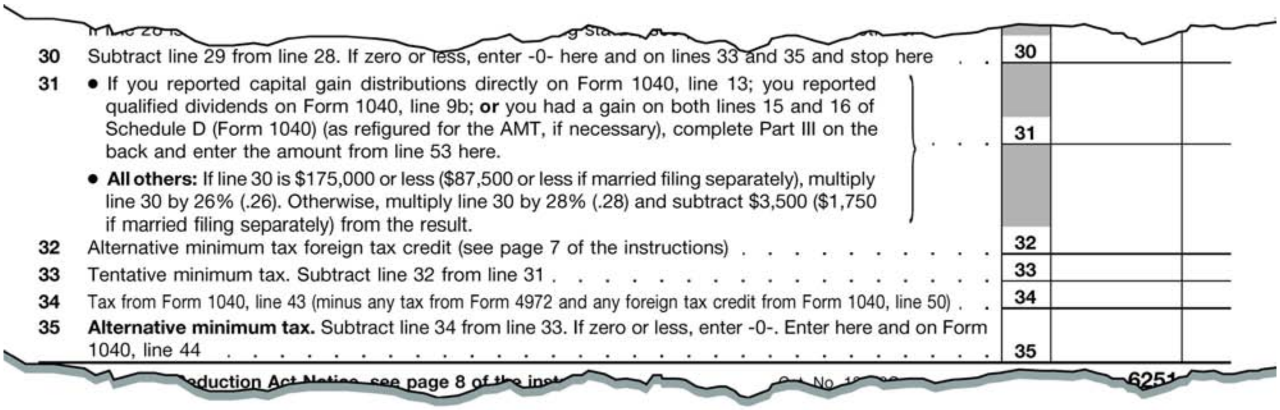
} . . . **29**

If line 28 is **over** the amount shown above for your filing status, see page 7 of the instructions.

30 Subtract line 29 from line 28. If zero or less, enter -0- here and on lines 33 and 35 and stop here . . **30**

31 • If you reported capital gain distributions directly on Form 1040, line 13; you reported qualified dividends on Form 1040, line 9b; **or** you had a gain on both lines 15 and 16 of

Step 3. After the application of the AMT exemption amount, the applicable tax rate of either 26% or 28% is applied, depending on the taxpayer's income level. This is accomplished by completing Form 6251, Part II, lines 31 through 35. A blank Form 6251, Part II is shown.



30 Subtract line 29 from line 28. If zero or less, enter -0- here and on lines 33 and 35 and stop here . . **30**

31 • If you reported capital gain distributions directly on Form 1040, line 13; you reported qualified dividends on Form 1040, line 9b; **or** you had a gain on both lines 15 and 16 of Schedule D (Form 1040) (as refigured for the AMT, if necessary), complete Part III on the back and enter the amount from line 53 here.

• **All others:** If line 30 is $175,000 or less ($87,500 or less if married filing separately), multiply line 30 by 26% (.26). Otherwise, multiply line 30 by 28% (.28) and subtract $3,500 ($1,750 if married filing separately) from the result.

} . . . **31**

32 Alternative minimum tax foreign tax credit (see page 7 of the instructions) **32**

33 Tentative minimum tax. Subtract line 32 from line 31 . . . . **33**

34 Tax from Form 1040, line 43 (minus any tax from Form 4972 and any foreign tax credit from Form 1040, line 50) . . **34**

35 **Alternative minimum tax.** Subtract line 34 from line 33. If zero or less, enter -0-. Enter here and on Form 1040, line 44 . . . . **35**

The result of this calculation is the tentative minimum tax (TMT). The TMT is then compared to the taxpayer's regular income tax. If the TMT is greater than the regular tax, the excess is considered the AMT liability. If TMT is less than the regular tax, there is no AMT liability. When there is an excess, it is added to the taxpayer's regular income tax liability.

> **Example 1.** Bill's regular income tax liability is $53,000. Bill's tax liability using the AMT rules results in a TMT of $48,000. Since his TMT is less than his regular tax, he has no AMT liability.
>
> **Example 2.** Sue's regular income tax liability is $38,000. Her tax liability using the AMT rules is $46,000 TMT. Since the TMT amount is greater than the regular tax amount, the excess of $8,000 is the AMT liability. Sue has a total tax liability of $46,000 ($38,000 + $8,000).

In **Example 2**, it is important to identify the amount of AMT as $8,000, not $46,000 TMT. The $8,000 is used to calculate the minimum tax credit which may reduce AMT liability in future years.

COMMON ADJUSTMENTS OR PREFERENCES[3]

1. Itemized Deductions

One of the most common preference items penalizing the majority of taxpayers is itemized deductions.

Medical and Dental Expenses. Medical expenses are deductible for AMT only to the extent they exceed 10% of the taxpayer's AGI.[4] On Form 6251, the adjustment for the medical and dental expenses adds back 2.5% (10% minus 7.5% allowable for regular tax) as the AMT preference adjustment.

> **Example 3.** Ron and Beth file a joint return for 2003 with an AGI of 100,000. Their total deductible medical expenses are $15,000. For regular tax purposes they have deductible medical expenses of $7,500 [$15,000 – (7.5% × $100,000)]. For AMT, the amount of deductible medical expense is $5,000 [$15,000 – (10% × $100,000)]. The difference of $2,500 ($7,500 – $5,000) is entered on line 2 of Form 6251.

Taxes. **No deductions are allowed for state, local, and foreign real property taxes.**[5] If any of these taxes are deducted on Schedule A for regular tax purposes, they must be added back when calculating AMT. Therefore, a taxpayer who resides in a state with high state and local taxes might be subject to the AMT as compared to a taxpayer who resides in a state with low or no state and local taxes. In addition, generation-skipping transfer taxes on income distributions are not included when calculating AMT. Adjustments are made on Form 6251, line 3.

> **Example 4.** Ramsey claims state and local taxes of $2,500 and real estate taxes of $4,250 on his 2004 Schedule A. His taxable income, before personal exemptions, is $34,000. Excluding all other preference or adjustment items, Ramsey's AMTI is $40,750 ($34,000 + $2,500 + $4,250).

Tax refunds claimed on Form 1040, line 10, are subtracted from AGI on Form 6251, line 7, to arrive at AMTI.

Home Mortgage Interest Expense. The AMTI mortgage interest deduction is allowed in a similar manner to the regular mortgage interest deduction with one exception. For AMT purposes, only **qualified housing interest** is permitted as deductible residential interest.[6] Qualified housing interest is defined as interest incurred on debt to purchase, construct, or substantially improve a qualified residence.[7] Refinanced indebtedness is included in the definition but only to the extent of the principal amount immediately before the refinancing. Home equity loan interest is deductible for AMT purposes unless the principal was used for personal expenditures.

For regular tax purposes, the term "qualified housing interest" includes interest paid on debt for the taxpayer's principal residence and for one other residence. The other residence can be a house, condominium, apartment, mobile home, boat, or motor home. For AMT, this definition does not include a boat or motor home.[8]

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[3] IRC §56(b)

[4] IRC §56(b(1)(B)

[5] IRC §56(b)(1)(A)(ii)

[6] IRC §56(b)(1)(C)(i)

[7] IRC §56(e)

[8] IRC §56(e)(1)

Example 5. Steve and Lillian divorce in 2002. Steve retains the marital residence and its corresponding original mortgage as part of the property settlement. Steve borrows $100,000 on a home equity loan to pay Lillian for her share in the property settlement. He uses $80,000 for the property settlement and builds a garage with the remaining $20,000. Steve also owns a motor home, which was financed through a local bank. His mortgage interest expense for 2004 for regular tax and AMT is as follows:

	Regular Tax	AMT
Original mortgage interest	$11,000	$11,000
Home equity interest	7,000	1,400*
Motor home debt (second residence)	2,800	0
Total deductible interest expense	$20,800	$12,400

* $7,000 × ($20,000 ÷ $100,000)

Steve includes $8,400 ($20,800 – $12,400) on Form 6251, line 4, to arrive at his AMTI.

Investment Interest Expense. Investment interest expense is deductible for regular tax and AMT to the extent of investment income. However, the amount of investment **income** and investment **interest expense** can differ for each.

The net **investment income** for AMT is recomputed after accounting for all AMT adjustments and preferences items. Investment income for AMT **includes** interest income from tax-exempt private-activity bonds issued after August 7, 1986.[9]

AMT investment **interest expense** includes interest expense to purchase private-activity bonds producing AMT income.

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[9] IRC §56(b)(1)(C)(v)

2. Miscellaneous Itemized Deductions Subject to the 2% AGI Limitation

No miscellaneous itemized deductions are allowed for AMT purposes.[10] All amounts deducted on Schedule A are added back.

Example 6. In 2003, Denny is a union electrician and travels all over the United States working at various temporary job locations. He earns $70,000 per year and pays union dues and travel expenses totaling $23,200. His wife Jean is a teacher, earning $42,000 per year. They earn $3,000 in interest from their investments. They own their house (no mortgage), have one child, age 18 years, and do not make any charitable contributions. The summary tax calculation follows:

Item		Regular Tax	AMT
Wages		$112,000	
Interest		3,000	
AGI		$115,000	
Itemized deductions			
Taxes	$ 4,000		
Misc. exp. in excess of 2%	20,900		
Total itemized deductions	$24,900	($24,900)	
Taxable income before exemptions		$ 90,100	$ 90,100
Less exemptions		(9,150)	
Taxable income		$ 80,950	
Adjustments for AMT calculation			
Taxes			4,000
Misc. exp in excess of 2% AGI			20,900
			$115,000
Less AMTI exemption			(58,000)
AMTI			$ 57,000
Regular tax/tentative minimum tax		$ 13,864	$ 14,820
Less regular tax			(13,864)
AMT		956	$ 956
Total Tax		$ 14,820	

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[10] IRC §56(b)(1)(A)(i)

3. Large Capital Gains

Long-term capital gains, other than the sale of IRC §1202 small business stock, are taxed at the same rates for regular and AMT purposes. There are situations where taxpayers will inadvertently be subject to AMT, even though the capital gains tax rates are the same for regular tax and AMT. A large capital gain combined with other income may result in AMT.

Example 7. Rick and Michelle are retired nurses. In 2003, they are both 63 years old. They received $12,000 from social security and their combined pension income is $30,000. They have interest income of $4,800. Rick inherited 100 acres of land from his uncle Dave in 1995. The land was valued for inheritance tax at $30,000. In 2004, Rick and Michelle sold the land for $400,000. They do not itemize. Rick and Michelle have the option to receive payment all in one year or in equal payments over two years.

If they are paid entirely in one year the results are as follows:

Item	Regular Tax	AMT
Interest	$ 4,800	
Long-term capital gain	370,000	
Pension income	30,000	
Taxable social security	10,200	
AGI*	$415,000	$415,000
Less standard deduction	(9,700)	
Taxable income before exemptions	$405,300	
Personal exemptions (full phaseout applies)	0	
AMT exemption (full phaseout applies)		0
Taxable income, AMTI	$405,300	$415,000
Regular tax (Sch. D)/TMT, Part III, capital gain (Form 6251)	$ 57,804	$ 64,920
Less regular tax		(57,804)
AMT	7,116	$ 7,116
Total tax	$ 64,920	

*Since the taxpayer does not itemize, AMT is computed beginning with AGI

The result will be total tax of $64,920 consisting of $57,804 of regular tax and $7,116 of AMT.

For Example 7

Schedule D Tax Worksheet

Keep for Your Records

Complete this worksheet only if line 18 or line 19 of Schedule D is more than zero. Otherwise, complete the Qualified Dividends and Capital Gain Tax Worksheet on page xx of the Instructions for Form 1040 to figure your tax.

Exception: Do not use the Qualified Dividends and Capital Gain Tax Worksheet **or** this worksheet to figure your tax if:

- Line 15 or line 16 of Schedule D is zero or less **and** you have no qualified dividends on Form 1040, line 9b, **or**
- Form 1040, line 42, is zero or less.

Instead, see the instructions for Form 1040, line 43.

1. Enter your taxable income from Form 1040, line 42 . . . **1.** 405,300
2. Enter your qualified dividends from Form 1040, line 9b . . . **2.** 0
3. Enter the amount from Form 4952, line 4g **3.** 0
4. Enter the amount from Form 4952, line 4e* **4.** 0
5. Subtract line 4 from line 3. If zero or less, enter -0- . . . **5.** 0
6. Subtract line 5 from line 2. If zero or less, enter -0- . . . **6.** 0
7. Enter the **smaller** of line 15 or line 16 of Schedule D . . . **7.** 370,000
8. Enter the **smaller** of line 3 or line 4 . . . **8.** 0
9. Subtract line 8 from line 7. If zero or less, enter -0- . . . **9.** 370,000
10. Add lines 6 and 9 . . . **10.** 370,000
11. Add lines 18 and 19 of Schedule D . . . **11.** 0
12. Enter the **smaller** of line 9 or line 11 . . . **12.** 0
13. Subtract line 12 from line 10. . . . **13.** 370,000
14. Subtract line 13 from line 1. If zero or less, enter -0- . . . **14.** 35,300
15. Enter the **smaller** of:

- The amount on line 1 **or**
- $29,050 if single or married filing separately; $58,100 if married filing jointly or qualifying widow(er); or $38,900 if head of household

} . . . **15.** 58,100

16. Enter the **smaller** of line 14 or line 15 . . . **16.** 35,300
17. Subtract line 10 from line 1. If zero or less, enter -0- . . . **17.** 35,300
18. Enter the **larger** of line 16 or line 17 . . . ▶ **18.** 35,300
If lines 15 and 16 are the same, skip lines 19 and 20 and go to line 21. Otherwise, go to line 19.
19. Subtract line 16 from line 15 . . . ▶ **19.** 22,800
20. Multiply line 19 by 5% (.05) . . . **20.** 1,140
If lines 1 and 15 are the same, skip lines 21 through 33 and go to line 34. Otherwise, go to line 21.
21. Enter the **smaller** of line 1 or line 13 . . . **21.** 370,000
22. Enter the amount from line 19 (if line 19 is blank, enter -0-) . . . **22.** 22,800
23. Subtract line 22 from line 21. If zero or less, enter -0- . . . ▶ **23.** 347,200
24. Multiply line 23 by 15% (.15) . . . **24.** 52,080
If Schedule D, line 19, is zero or blank, skip lines 25 through 30 and go to line 31. Otherwise, go to line 25.
25. Enter the **smaller** of line 9 above or Schedule D, line 19 . . . **25.** ______
26. Add lines 10 and 18 . . . **26.** ______
27. Enter the amount from line 1 above . . . **27.** ______
28. Subtract line 27 from line 26. If zero or less, enter -0- . . . **28.** ______
29. Subtract line 28 from line 25. If zero or less, enter -0- . . . ▶ **29.** ______
30. Multiply line 29 by 25% (.25) . . . **30.** ______
If Schedule D, line 18, is zero or blank, skip lines 31 through 33 and go to line 34. Otherwise, go to line 31.
31. Add lines 18, 19, 23, and 29 . . . **31.** ______
32. Subtract line 31 from line 1 . . . **32.** ______
33. Multiply line 32 by 28% (.28) . . . **33.** ______
34. Figure the tax on the amount on **line 18**. Use the Tax Table or Tax Computation Worksheet, whichever applies . . . **34.** 4,584
35. Add lines 20, 24, 30, 33, and 34 . . . **35.** 57,804
36. Figure the tax on the amount on **line 1.** Use the Tax Table or Tax Computation Worksheet, whichever applies . . . **36.** 116,498
37. **Tax on all taxable income (including capital gains and qualified dividends).** Enter the **smaller** of line 35 or line 36. Also enter this amount on Form 1040, line 43 . . . **37.** 57,804

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*If applicable, enter instead the smaller amount you entered on the dotted line next to line 4e of Form 4952.

Example 8. Use the same facts as **Example 7** except, Rick and Michelle are paid over a two-year period (half in 2004 and the balance in 2005). Their tax computation is as follows:

Item	Regular Tax	AMT
Interest	$ 4,800	
Long-term capital gain	185,000	
Pension income	30,000	
Taxable social security	10,200	
AGI*	$230,000	$230,000
Less standard deduction	(9,700)	
Taxable income before exemptions	$220,300	
Personal exemptions (partial phaseout)	(5,332)	
AMT exemption (partial phaseout)		(38,000)
Taxable income, AMTI	$214,968	
AMTI less partial AMT exemption		$192,000
Regular tax (Sch. D)/TMT, Part III, capital gain (Form 6251)	$ 28,717	26,757
Less regular tax		(28,717)
AMT	0	0
Total tax	$ 28,717	

*Since the taxpayer does not itemize, the AMT computation begins with AGI.

The result is total tax of $28,717 for 2004. They are not subject to AMT since their regular tax exceeds TMT. The AMT is avoided by spreading the sale proceeds over a two-year period (tax savings of $7,120). There will be additional regular tax in 2005 on the remaining installment sale; however, there will be no AMT in 2005.

4. Depreciation Adjustments

Post-1986 and Pre-1999 Depreciation.[11] For property placed in service after 1986 and before 1999, AMT depreciation deductions are computed under the alternative depreciation system (ADS), using the 150% declining balance method, switching to the straight-line method for the first tax year that the straight-line method results in a greater depreciation deduction versus 150% declining balance. This depreciation amount is compared to the amount claimed for tax purposes, and the difference is reported as a preference item, either positive or negative.

Property Placed in Service after 1998. For property placed in service after 1998, the **recovery periods** for both regular tax and AMT are the regular MACRS recovery periods. Prior to 1999, the recovery periods were different. The longer recovery periods are no longer required for AMT. Therefore, the taxpayer can minimize the AMT depreciation adjustment by carefully selecting the applicable **depreciable method. Any depreciable method** other than **150% declining balance will result in a depreciation AMT adjustment, unless the 30%/50% bonus depreciation was elected.**

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[11] IRC §56(a)(1)(A)(i)

Example 9. Tony and Lois file a joint return. Tony is a long-distance truck driver and Lois owns an excavating business. The following tables illustrate AMT depreciation adjustments for their return.

Tax Year 2001

Date Acquired	Asset Description	Total Cost	MACRS Life	Reg. Tax Deprec.	AMT Deprec.	AMT Adjustment
06/15/01	Big truck	$135,900	3	$45,300	$33,975	$11,325
07/12/01	Big trailer	45,000	5	9,000	6,750	2,250
08/14/92	Garage	115,000	31.5	3,650	2,875	775
06/11/99	Office eq.	15,000	7	4,477	2,255	2,222
Total				$62,427	$45,855	$16,572

Tax Year 2002

Date Acquired	Asset Description	Total Cost	MACRS Life	Reg. Tax Deprec.	AMT Deprec.	AMT Adjustment
06/15/01	Big truck	$135,900	3	$ 60,400	$50,962	$ 9,438
07/12/01	Big trailer	45,000	5	14,400	11,475	2,925
08/14/92	Garage	115,000	31.5	3,650	2,875	775
06/11/99	Office eq.	15,000	7	1,874	1,837	37
02/08/02	Excavator	110,000	5	22,000	16,500	5,500
Total				$102,324	$83,649	$18,675

Tax Year 2003

Date Acquired	Asset Description	Total Cost	MACRS Life	Reg. Tax Deprec.	AMT Deprec.	AMT Adjustment
06/15/01	Big truck	$135,900	3	$10,067	$16,988	($ 6,921)
07/12/01	Big trailer	45,000	5	4,320	4,016	304
08/14/92	Garage	115,000	31.5	3,499	2,755	744
06/11/99	Office eq.	15,000	7	669	919	(250)
02/08/02	Excavator	110,000	5	17,600	14,025	3,575
Total				$36,155	$38,703	($2,548)

Note. No IRC §179 or bonus depreciation was taken on any asset.

5. Gain Adjustments: Dual Basis Assets

The amount of gain from the disposition of an asset is usually different for regular tax and AMT. This difference is caused by the depreciation methods chosen for regular tax and AMT. **Example 10** illustrates these differences.

Example 10. Use the same facts as **Example 9.** Tony and Lois decide to sell everything and retire in the Florida Keys. In December 2003, all their equipment is sold and the garage is sold at auction. The gain for regular tax and AMT are computed as follows:

Asset: Big Truck

	Regular Tax		AMT	
Selling price		$ 55,000		$ 55,000
Cost	$135,900		$135,900	
Accumulated depreciation	(115,767)		(101,925)	
Adjusted basis	20,133	(20,133)	33,975	(33,975)
Gain		$ 34,867		$ 21,025

Asset: Big Trailer

	Regular Tax		AMT	
Selling price		$25,000		$25,000
Cost	$45,000		$45,000	
Accumulated depreciation	(27,720)		(22,241)	
Adjusted basis	$17,280	(17,280)	$22,759	(22,759)
Gain		$ 7,720		$ 2,241

Asset: Garage

	Regular Tax		AMT	
Selling price		$200,000		$200,000
Cost	$115,000		$115,000	
Accumulated depreciation	(41,367)		(32,583)	
Adjusted basis	$ 73,633	(73,633)	$ 82,417	(82,417)
Gain		$126,367		$117,583

Asset: Office Equipment

	Regular Tax		AMT	
Selling price		$ 4,000		$ 4,000
Cost	$15,000		$15,000	
Accumulated depreciation	(10,984)		(9,488)	
Adjusted basis	$ 4,016	(4,016)	$ 5,512	(5,512)
Gain (loss)		($ 16)		($ 1,512)

Asset: Excavator

	Regular Tax		AMT	
Selling price		$80,000		$80,000
Cost	$110,000		$110,000	
Accumulated depreciation	(39,600)		(30,525)	
Adjusted basis	$ 70,400	(70,400)	$ 79,475	(79,475)
Gain		$ 9,600		$ 525

All Assets

	Regular Tax	AMT
Total gains	$178,538	$139,862

The AMT adjustment for Tony and Lois's gains would be negative $38,676 ($178,538 – $139,862) reported on Form 6251, line 16.

6. Net Operating Loss: Alternative Minimum Tax Net Operating Loss

If the taxpayer has a net operating loss (NOL) for regular tax, the NOL must be recomputed for AMT purposes (AMTNOL). The regular tax NOL is modified by the AMT adjustments and preferences, but only to the extent the preference items are included in the regular NOL.

Example 11. Larry and Gail own a commercial contracting business. They report their income on the tax return using the cash method of accounting. For financial statement purposes and AMT calculations, they are required to use the percentage of completion method under IRC §56(a)(3). They report a Schedule C loss of $75,000, while the business financial statements report a profit of $25,000. For regular tax, the Schedule C contributes $75,000 toward their NOL. But for AMT, the difference between the two accounting methods results in an adjustment ($100,000). Therefore, they do not have an AMTNOL, because of the Schedule C loss.

Example 12. Dan and Kim own an equipment leasing business. Their Schedule C reports a loss of $125,000. Their regular tax depreciation exceeds the AMT depreciation by $30,000. If there were no other adjustments or preference items, their regular tax NOL would be $125,000, while their AMTNOL would be $95,000 ($125,000 – 30,000).

The AMTNOL must be carried to the same years as the regular NOL. However, the AMTNOL is only allowed to offset 90% of the AMTI. Any AMTNOL not used due to the limitation can be carried to future tax years.

Note. For tax years 2001 and 2002, the AMTNOLs were allowed to offset 100% of AMTI.

The AMTNOL is utilized to offset AMTI in the carryback or carryover year, even if no AMT exists for that year.

The election to forgo the carryback period for a regular NOL also applies to the AMTNOL.

7. Incentive Stock Options

Incentive stock options (ISO) are a form of deferred compensation for employees of a corporation. The corporation may grant an employee the opportunity, or option, to purchase company stock at a discounted value. For example, the employee has the option after a given time period to purchase shares of the company stock for $10 per share. If the fair market value (FMV) of the stock at the time the option is executed is $25 per share, the employee receives a deferred compensation benefit of $15 per share. The option must be exercised within a 10-year period.[12]

An ISO can be of two types.

Cashless Transaction. In a cashless transaction, the employee executes the option and sells the stock on the open market simultaneously. Her W-2 reflects the entire proceeds from the sale of the stock. The applicable taxes are withheld, and the employee receives the balance of the stock proceeds in her paycheck. A Form 1099-B is issued for the gross proceeds of the stock. The taxpayer reports the entire FMV plus execution costs as her basis on Schedule D. This usually results in no gain or a minor loss due to the broker commissions on the sale of the stock. This type of ISO is not subject to AMT since the taxpayer realized all tax benefits in the same tax year.

> **Example 13.** In 1998, Lisa is granted an incentive stock option to purchase 1,000 shares of her company's stock at $10 per share. In 2003, she exercises her option and simultaneously disposes of the stock. Her regular salary is $50,000 per year. She exercises her option and disposes of the stock at $35 per share. The gain of $25 per share is added to her gross W-2 earnings.

Regular salary	$50,000
Option gain on stock (1,000 shares × $25)	25,000
Total gross W-2 wages	$75,000

> The net cash she receives from the transaction is summarized as follows:

Total sale proceeds (1,000 shares × $35)	$35,000
FICA and Medicare taxes (7.65% × $25,000)	(1,913)
Federal income tax (20% × $25,000)	(5,000)
Brokerage fee charged	(250)
Option execution price (1,000 shares × $10)	(10,000)
Net cash to Lisa after execution/disposition	$17,837

> Her tax basis in the stock is calculated as follows:

Option execution price	$10,000
Deferred compensation included in Form W-2	25,000
Brokerage fee	250
Total stock cost basis	$35,250

> Lisa receives a Form 1099-B for $35,000, which reports the gross proceeds of the stock. Lisa reports a **capital loss** on Schedule D of $250 ($35,000 – $35,250).

Option Executed with Personal Funds. In the situation where the employee uses personal money to purchase the company stock at the discounted price, the difference between the discount price and the FMV (the median price at which the stock trades that day) of the company stock on the date of execution is an **AMT adjustment.**

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[12] IRC §422(b)

Example 14. Sandra works for an international energy company. In 1994, her employer adopts an ISO plan. Under the plan, Sandra is entitled to purchase 500 shares of the company stock for $40 per share. She is awarded the option but does not have any money to immediately execute it and waits for five years. In 1998, Sandra receives an inheritance of $20,500. In 1999, Sandra decides to execute the ISO for $40 per share and uses her inheritance to purchase the stock. Sandra will have an AMT adjustment for 1999 calculated as follows:

Median price on date of execution ($65 × 500 shares)	$32,500
Option execution price paid by Sandra ($40 × 500 shares)	(20,000)
AMT adjustment for 1999	$12,500

When Sandra disposes of the stock, any gain or loss will be long-term.

In 2004, Sandra decides to dispose of the stock. However, the value of the stock has dropped drastically below her execution price and is currently trading at $2.50 per share. Her regular tax and AMT computation are as follows:

Item	Regular Tax	AMT
Stock basis		
Original cost basis, 1999	$20,000	$20,000
1999 AMT gain recognized		12,500
Tax basis	$20,000	$32,500
Stock disposition		
Selling price (500 shares × $2.50)	$ 1,250	$ 1,250
Less tax basis	(20,000)	(32,500)
Long-term capital loss	($18,750)	($31,250)
Less regular tax loss		18,750
AMT adjustment in future years		($12,500)

8. Other Items

IRC §168(k), pertaining to the 50% and 30% bonus depreciation, is not an AMT adjustment or preference item.

For 2003, nonrefundable personal credits could offset both regular tax and AMT. These credits include the following:

- Adoption credit,
- Child tax credit,
- Credit for child and dependent care expenses,
- Elderly or disabled credit,
- Education credits,
- Saver's credit,
- Mortgage interest credit, and
- The District of Columbia first-time homebuyer credit.

These credits were allowed by JCWAA of 2002 and expired at the end of 2003. Therefore, unless new legislation is enacted to extend their application, for 2004 and beyond, these credits will not be able to offset AMT. The only exception to this is the child tax credit, which was permanently allowed to offset AMT by EGTRRA of 2001.

UNDERSTANDING THE MINIMUM TAX CREDIT (MTC) FORM 8801

The minimum tax credit (MTC) is only generated by AMT attributable to **deferral** (timing) adjustments and preferences. AMT attributable to **exclusions,** or permanent differences, do not generate the MTC. The MTC equals the difference between actual AMT and the AMT owed only if the exclusion items were considered in computing AMT. The chart at the end of the chapter identifies these exclusions. All other items generate or increase the MTC. The MTC may be carried forward indefinitely.

> **Example 15.** Larry and Krista file a joint return for 2003. They have two children ages 16 and 17. Larry is a stockbroker at a large national company. Krista is employed by a local public accounting firm. Larry's company offered him an ISO in 2001 to purchase 1,000 shares of company stock for $10 per share. Larry executed his option and purchased the shares in 2003 with personal funds. On the date of execution, the median price of the stock was $25 per share. They also had $12,000 of private activity bond interest. Capital gains rates do not apply. The following illustrates their AMT and MTC:

Item		**Regular Tax**	**Item**		**AMT**
Wages		$120,000	Wages		$120,000
Interest income		2,800	Interest income		2,800
AGI		$122,800	AGI		$122,800
Less itemized deductions:			Less itemized deductions:		
Taxes	($ 8,500)		Taxes	($ 8,500)	
2% misc. itemized deductions	(6,280)		2% misc. itemized deductions	(6,280)	
Total itemized deductions	($14,780)	(14,780)	Total itemized deductions	($14,780)	(14,780)
Taxable income before exemptions		$108,020	Taxable income before exemptions		$108,020
			AMT adjustments & preferences:		
			Taxes from Schedule A	8,500	
			2% misc. deductions Sch. A	6,280	
			ISO	15,000	
			Private activity bond interest, tax-exempt	12,000	
			Total AMT adjustments and preferences	$41,780	41,780
			AMTI		$149,800
Less exemptions		(12,200)	Less AMT exclusion		(58,000)
Taxable income		$ 95,820	AMTI		$ 91,800
			Tentative minimum tax (TMT)		$ 23,868
Regular tax		$17,576	Less regular tax		(17,576)
AMT		6,292	AMT		$ 6,292
Total tax		$ 23,868			

For Example 15

Form **6251**

Department of the Treasury
Internal Revenue Service (99)

Alternative Minimum Tax— Individuals

▶ See separate instructions.

▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0227

2003

Attachment Sequence No. **32**

Name(s) shown on Form 1040: **Larry and Krista**

Your social security number: **123 45 6789**

Part I Alternative Minimum Taxable Income (See instructions for how to complete each line.)

1	If filing Schedule A (Form 1040), enter the amount from Form 1040, line 38, and go to line 2. Otherwise, enter the amount from Form 1040, line 35, and go to line 7. (If zero or less, enter as a negative amount.)	1	108,020
2	Medical and dental. Enter the **smaller** of Schedule A (Form 1040), line 4, **or** 2½% of Form 1040, line 35	2	
3	Taxes from Schedule A (Form 1040), line 9	3	8,500
4	Certain interest on a home mortgage **not** used to buy, build, or improve your home	4	
5	Miscellaneous deductions from Schedule A (Form 1040), line 26	5	6,280
6	If Form 1040, line 35, is over $139,500 (over $69,750 if married filing separately), enter the amount from line 9 of the worksheet for Schedule A (Form 1040), line 28	6	( )
7	Tax refund from Form 1040, line 10 or line 21	7	( )
8	Investment interest expense (difference between regular tax and AMT)	8	
9	Depletion (difference between regular tax and AMT)	9	
10	Net operating loss deduction from Form 1040, line 21. Enter as a positive amount	10	
11	Interest from specified private activity bonds exempt from the regular tax	11	12,000
12	Qualified small business stock (see instructions)	12	
13	Exercise of incentive stock options (excess of AMT income over regular tax income)	13	15,000
14	Estates and trusts (amount from Schedule K-1 (Form 1041), line 9)	14	
15	Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)	15	
16	Disposition of property (difference between AMT and regular tax gain or loss)	16	
17	Depreciation on assets placed in service after 1986 (difference between regular tax and AMT)	17	
18	Passive activities (difference between AMT and regular tax income or loss)	18	
19	Loss limitations (difference between AMT and regular tax income or loss)	19	
20	Circulation costs (difference between regular tax and AMT)	20	
21	Long-term contracts (difference between AMT and regular tax income)	21	
22	Mining costs (difference between regular tax and AMT)	22	
23	Research and experimental costs (difference between regular tax and AMT)	23	
24	Income from certain installment sales before January 1, 1987	24	( )
25	Intangible drilling costs preference	25	
26	Other adjustments, including income-based related adjustments	26	
27	Alternative tax net operating loss deduction	27	( )
28	**Alternative minimum taxable income.** Combine lines 1 through 27. (If married filing separately and line 28 is more than $191,000, see page 7 of the instructions.)	28	149,800

Part II Alternative Minimum Tax

29 Exemption. (If this form is for a child under age 14, see page 7 of the instructions.)

IF your filing status is . . .	**AND line 28 is not over . . .**	**THEN enter on line 29 . . .**
Single or head of household	$112,500	$40,250
Married filing jointly or qualifying widow(er)	150,000	58,000
Married filing separately	75,000	29,000

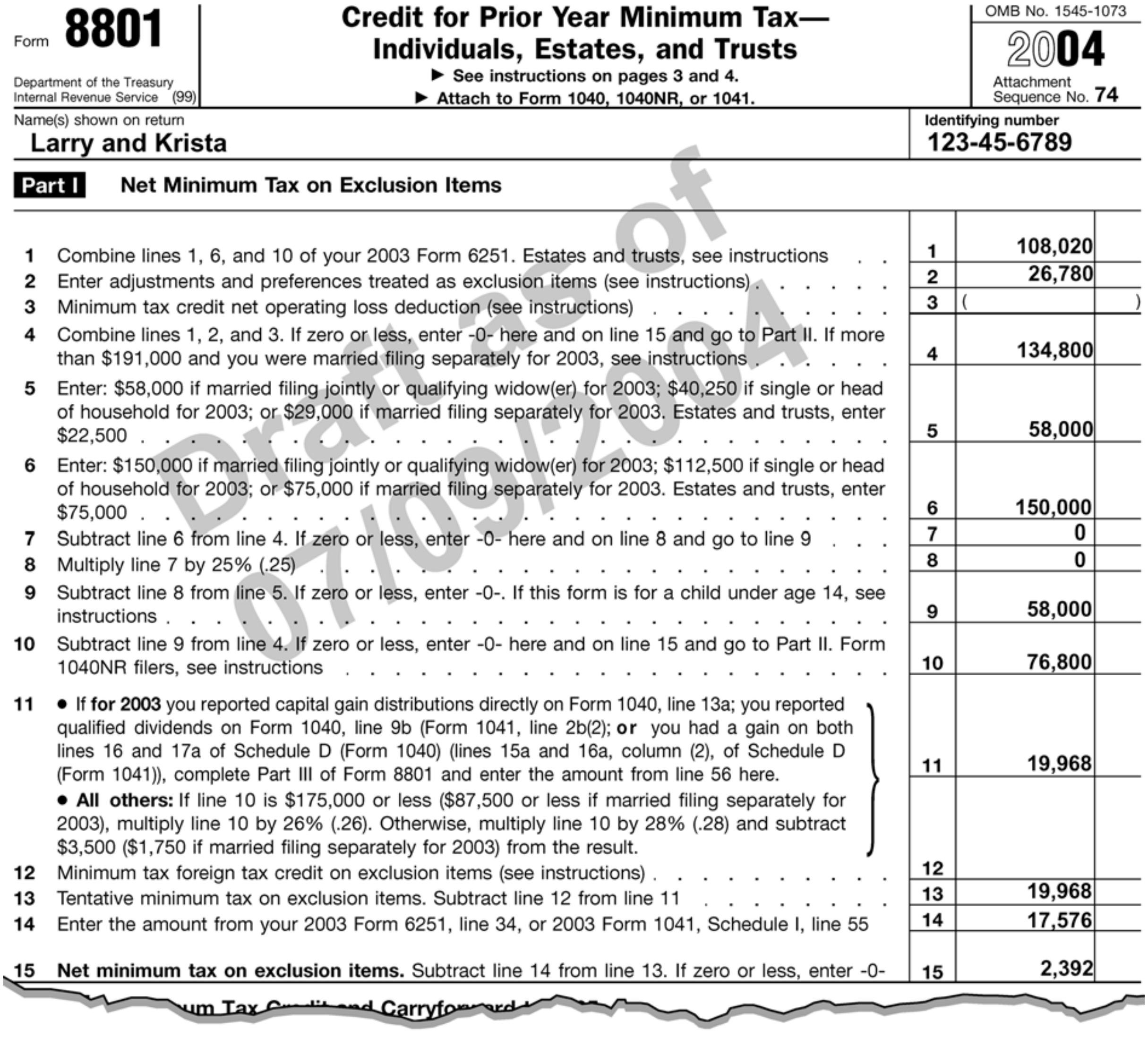
If line 28 is **over** the amount shown above for your filing status, see page 7 of the instructions.

29		29	58,000
30	Subtract line 29 from line 28. If zero or less, enter -0- here and on lines 33 and 35 and stop here	30	91,800
31	• If you reported capital gain distributions directly on Form 1040, line 13a; you reported qualified dividends on Form 1040, line 9b; **or** you had a gain on both lines 16 and 17a of Schedule D (Form 1040) (as refigured for the AMT, if necessary), complete Part III on the back and enter the amount from line 65 here. • **All others:** If line 30 is $175,000 or less ($87,500 or less if married filing separately), multiply line 30 by 26% (.26). Otherwise, multiply line 30 by 28% (.28) and subtract $3,500 ($1,750 if married filing separately) from the result.	31	23,868
32	Alternative minimum tax foreign tax credit (see page 7 of the instructions)	32	
33	Tentative minimum tax. Subtract line 32 from line 31	33	23,868
34	Tax from Form 1040, line 41 (minus any tax from Form 4972 and any foreign tax credit from Form 1040, line 44)	34	17,576
35	**Alternative minimum tax.** Subtract line 34 from line 33. If zero or less, enter -0-. Enter here and on Form 1040, line 42	35	6,292

For Paperwork Reduction Act Notice, see page 8 of the instructions. Cat. No. 13600G Form **6251** (2003)

The MTC carryforward is computed as follows:

Unadjusted AMT			$6,292
Recalculation of AMT using only exclusions:			
Taxable income before exemptions		$108,020	
Exclusion preferences:			
Taxes from Schedule A	$ 8,500		
2% misc. itemized deductions	6,280		
Private activity bond interest	12,000		
Total exclusion preferences	$26,780	26,780	
AMTI before exemption		$134,800	
AMT exemption		(58,000)	
Recomputed AMTI		$ 76,800	
Recomputed tentative minimum tax (TMT)		$ 19,968	
Less regular tax		(17,576)	
Recomputed AMT		$ 2,392	(2,392)
Minimum tax credit			$3,900



Form **8801**

Department of the Treasury
Internal Revenue Service (99)

Credit for Prior Year Minimum Tax— Individuals, Estates, and Trusts

▶ See instructions on pages 3 and 4.
▶ Attach to Form 1040, 1040NR, or 1041.

OMB No. 1545-1073
2004
Attachment Sequence No. 74

Name(s) shown on return: **Larry and Krista**

Identifying number: **123-45-6789**

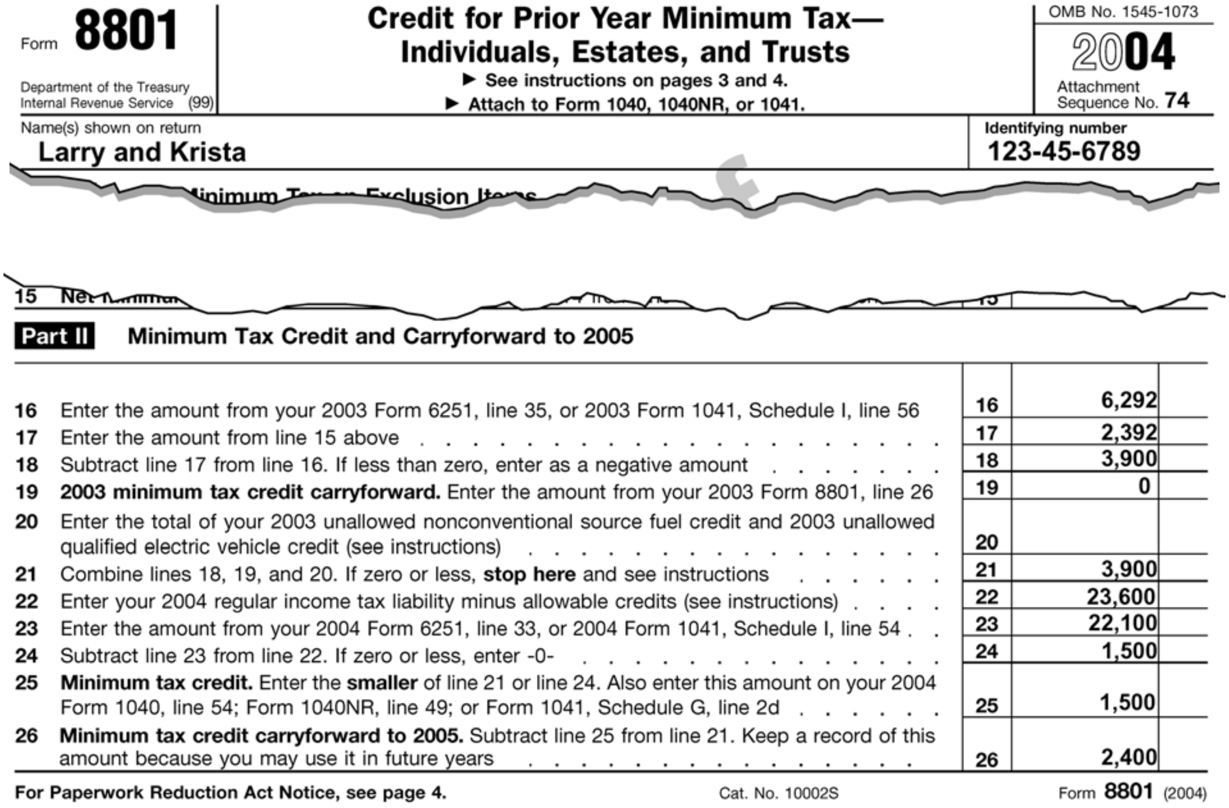
Part I **Net Minimum Tax on Exclusion Items**

1	Combine lines 1, 6, and 10 of your 2003 Form 6251. Estates and trusts, see instructions	1	108,020
2	Enter adjustments and preferences treated as exclusion items (see instructions)	2	26,780
3	Minimum tax credit net operating loss deduction (see instructions)	3	( )
4	Combine lines 1, 2, and 3. If zero or less, enter -0- here and on line 15 and go to Part II. If more than $191,000 and you were married filing separately for 2003, see instructions	4	134,800
5	Enter: $58,000 if married filing jointly or qualifying widow(er) for 2003; $40,250 if single or head of household for 2003; or $29,000 if married filing separately for 2003. Estates and trusts, enter $22,500	5	58,000
6	Enter: $150,000 if married filing jointly or qualifying widow(er) for 2003; $112,500 if single or head of household for 2003; or $75,000 if married filing separately for 2003. Estates and trusts, enter $75,000	6	150,000
7	Subtract line 6 from line 4. If zero or less, enter -0- here and on line 8 and go to line 9	7	0
8	Multiply line 7 by 25% (.25)	8	0
9	Subtract line 8 from line 5. If zero or less, enter -0-. If this form is for a child under age 14, see instructions	9	58,000
10	Subtract line 9 from line 4. If zero or less, enter -0- here and on line 15 and go to Part II. Form 1040NR filers, see instructions	10	76,800
11	• If **for 2003** you reported capital gain distributions directly on Form 1040, line 13a; you reported qualified dividends on Form 1040, line 9b (Form 1041, line 2b(2); **or** you had a gain on both lines 16 and 17a of Schedule D (Form 1040) (lines 15a and 16a, column (2), of Schedule D (Form 1041)), complete Part III of Form 8801 and enter the amount from line 56 here. • **All others:** If line 10 is $175,000 or less ($87,500 or less if married filing separately for 2003), multiply line 10 by 26% (.26). Otherwise, multiply line 10 by 28% (.28) and subtract $3,500 ($1,750 if married filing separately for 2003) from the result.	11	19,968
12	Minimum tax foreign tax credit on exclusion items (see instructions)	12	
13	Tentative minimum tax on exclusion items. Subtract line 12 from line 11	13	19,968
14	Enter the amount from your 2003 Form 6251, line 34, or 2003 Form 1041, Schedule I, line 55	14	17,576
15	**Net minimum tax on exclusion items.** Subtract line 14 from line 13. If zero or less, enter -0-	15	2,392

Carrying Forward and Utilizing the Minimum Tax Credit

The taxpayer's regular tax liability is reduced by the MTC, but only to the extent regular tax exceeds current year tentative minimum tax.

> **Example 16.** The MTC calculated in **Example 15** is being carried forward to 2005. In 2005, the taxpayer has regular tax of $23,600 and TMT of $22,100. In 2004, The taxpayer can use $1,500 ($23,600 regular tax – $22,100 TMT) of the MTC to offset regular tax. The remaining MTC of $2,400 is carried forward to subsequent years indefinitely.



Form **8801**

Department of the Treasury
Internal Revenue Service (99)

Credit for Prior Year Minimum Tax—
Individuals, Estates, and Trusts
▶ See instructions on pages 3 and 4.
▶ Attach to Form 1040, 1040NR, or 1041.

OMB No. 1545-1073
2004
Attachment
Sequence No. 74

Name(s) shown on return: Larry and Krista

Identifying number: 123-45-6789

inimum Tax on Exclusion Items

15 Net

Part II Minimum Tax Credit and Carryforward to 2005

16	Enter the amount from your 2003 Form 6251, line 35, or 2003 Form 1041, Schedule I, line 56	16	6,292
17	Enter the amount from line 15 above	17	2,392
18	Subtract line 17 from line 16. If less than zero, enter as a negative amount	18	3,900
19	**2003 minimum tax credit carryforward.** Enter the amount from your 2003 Form 8801, line 26	19	0
20	Enter the total of your 2003 unallowed nonconventional source fuel credit and 2003 unallowed qualified electric vehicle credit (see instructions)	20	
21	Combine lines 18, 19, and 20. If zero or less, **stop here** and see instructions	21	3,900
22	Enter your 2004 regular income tax liability minus allowable credits (see instructions)	22	23,600
23	Enter the amount from your 2004 Form 6251, line 33, or 2004 Form 1041, Schedule I, line 54	23	22,100
24	Subtract line 23 from line 22. If zero or less, enter -0-	24	1,500
25	**Minimum tax credit.** Enter the **smaller** of line 21 or line 24. Also enter this amount on your 2004 Form 1040, line 54; Form 1040NR, line 49; or Form 1041, Schedule G, line 2d	25	1,500
26	**Minimum tax credit carryforward to 2005.** Subtract line 25 from line 21. Keep a record of this amount because you may use it in future years	26	2,400

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It is important to note that even if a deferral item generates AMT, it does not automatically mean that MTC is generated. The following example illustrates this issue.

Example 17. Dave and Linda are in their early 70s and retired. They have retirement income of $48,000, and $4,500 of interest income. The only investment they have is a rental property which they purchased in July 1987 for $75,000. In September 2003, they sell the rental property for $325,000. They have no suspended losses from the rental. A summary of the basis and depreciation is as follows:

Item	Regular Tax		AMT	
Selling price		$325,000		$325,000
Basis				
Original cost	$75,000		$75,000	
Accumulated depreciation	(44,091)*		(30,313)**	
Adjusted basis	$30,909	(30,909)	$44,687	(44,687)
Taxable gain		$294,091		$280,313
AMT gain adjustment		(13,778)		
Gain as adjusted		$280,313		$280,313

*The property was depreciated using the straight-line method over 27.5 years.
**The property was depreciated using the straight-line method over 40 years.

Their AMT calculation is as follows:

Item	Regular Tax	AMT
Retirement income	$ 48,000	$ 48,000
Interest income	4,500	4,500
Capital gain on sale of rental	294,091	294,091
Adjusted gross income*	$346,591	$346,591
Standard deduction	(11,400)	
AMT adjusted gain		(13,778)
Exemptions, phased out	0	(12,297)**
Taxable income	$335,191	$320,516
Regular income tax, Schedule D	52,424	55,531
		(52,424)
AMT	3,107	$ 3,107
Total tax	$ 55,531	

*Since the taxpayer does not itemize, the AMT calculation begins with the AGI.
**The AMT exemption is partially phased out.

Dave and Linda's MTC carryover is calculated as follows:

Unadjusted AMT		$3,107
Recalculation of AMT using only exclusions:		
Taxable income before exemptions	$346,591	
Exclusion preferences	0	
AMTI before exemption	$346,591	
AMT exemption, partial phase out	(8,852)	
Recomputed AMTI	$337,739	
Recomputed TMT	$ 60,009	
Less regular tax	(52,424)	
Recomputed AMT		$7,585
Minimum tax credit		$ 0

TAX PLANNING FOR AMT

As more taxpayers are faced with the AMT, it becomes important to develop a plan to minimize the AMT burden. Knowing where AMT becomes an issue for a taxpayer is imperative.

Itemized Deductions

Since many itemized deductions are disallowed for AMT, if the taxpayer itemizes for regular tax he should attempt to delay these deductions until a year where he has a lower income and AMT is not an issue. Assuming a year has abnormally high income, creating an AMT problem, the taxpayer could:

- Hold medical bills and make the payment in the following year,
- Not make the state estimated payment until January, or
- Defer making payments on the miscellaneous deductions such as tax preparation fees, investment interest, and nonreimbursed employee business expenses.

Incentive Stock Options

Since incentive stock options are taxable for AMT in the year exercised, a taxpayer has two alternatives. One alternative is to sell the stock in the same year as the option is exercised. This way he will at least have money to pay the tax. The second alternative is to exercise the options over a number of years, keeping the AMTI under the AMT threshold.

Observation. Delaying the sale of stock into later years would not only create an AMT liability in the year exercised, it may also create a potential loss of value in the stock price as evidenced by the drop in Internet and tech stocks in the early part of this decade.

Tax-Free Interest

Taxpayers who are faced with AMT should consider not investing in private activity bonds. There are many types of tax-free interest that are not a preference for AMT.

Capital Gains

If capital gains are the cause of the AMT, a taxpayer could consider delaying a sale into a later year, or selling on the installment basis. However, because of the AMT exemption reduction after 2004, a delay might increase the AMT liability.

CALCULATING AMT FOR PARTNERSHIPS AND S CORPORATIONS

S corporations and partnerships are not subject to the AMT.[13] These entities pass through AMT adjustments to their shareholders and partners, and the individuals include the pass through on their individual returns. The adjustments and preferences computed by the flow-through entities are similar to those calculated by individuals. These net AMT adjustments are disclosed on the K-1 of the shareholder or partner. These must be combined with the other preferences and adjustments of the taxpayer to determine if AMT applies at the individual's level.

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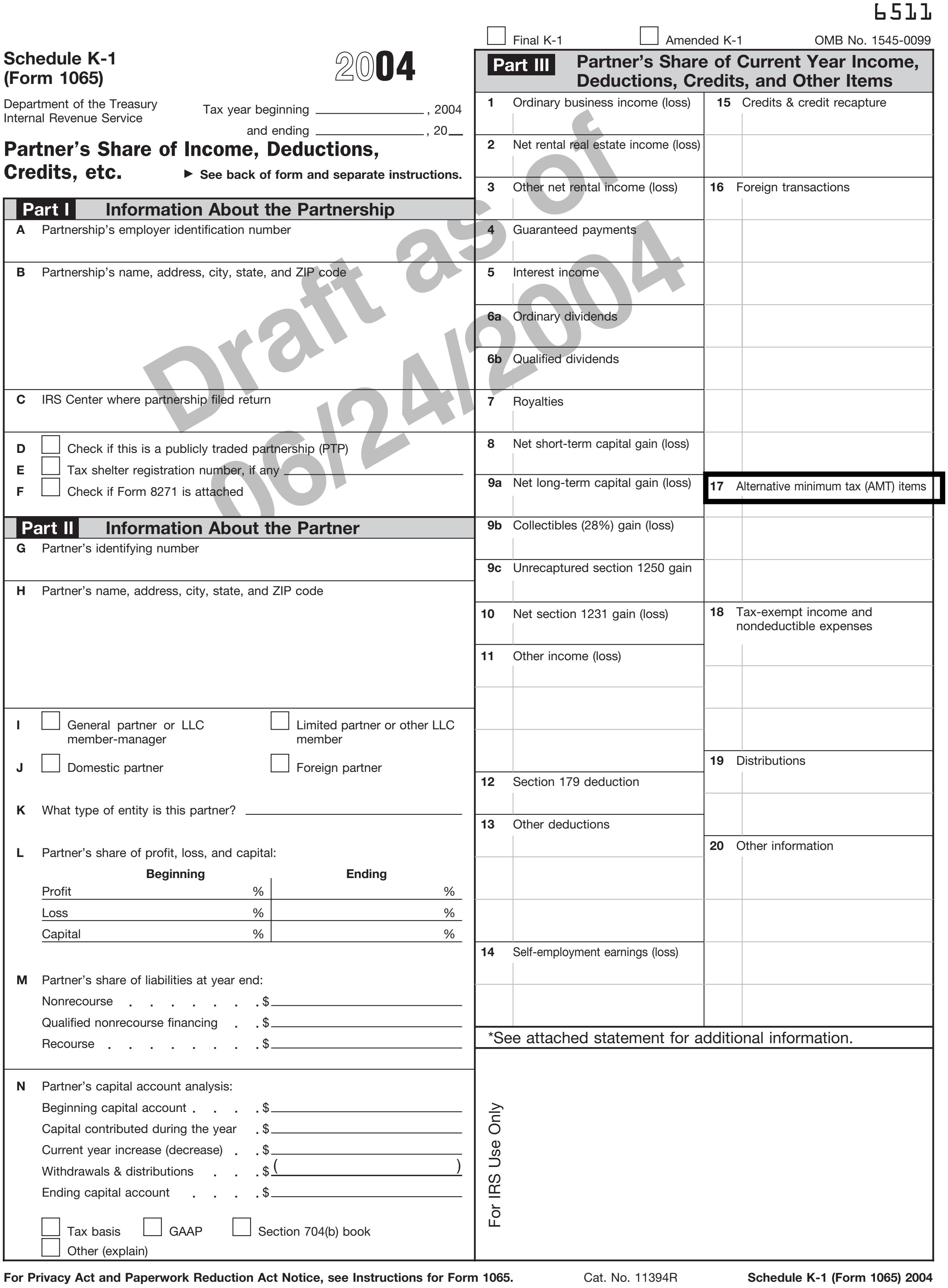
[13] IRC §§701 and 1363(a)

The AMT adjustments from a **partnership** are shown on line 17.



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☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0099

Schedule K-1 (Form 1065) 2004

Department of the Treasury
Internal Revenue Service

Tax year beginning ____________, 2004
and ending ____________, 20__

Partner's Share of Income, Deductions, Credits, etc. ► **See back of form and separate instructions.**

Part I Information About the Partnership

A Partnership's employer identification number

B Partnership's name, address, city, state, and ZIP code

C IRS Center where partnership filed return

D ☐ Check if this is a publicly traded partnership (PTP)

E ☐ Tax shelter registration number, if any ____________

F ☐ Check if Form 8271 is attached

Part II Information About the Partner

G Partner's identifying number

H Partner's name, address, city, state, and ZIP code

I ☐ General partner or LLC member-manager ☐ Limited partner or other LLC member

J ☐ Domestic partner ☐ Foreign partner

K What type of entity is this partner? ____________

L Partner's share of profit, loss, and capital:

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%

M Partner's share of liabilities at year end:

Nonrecourse . . . . $____________
Qualified nonrecourse financing . . $____________
Recourse . . . . $____________

N Partner's capital account analysis:

Beginning capital account . . . . $____________
Capital contributed during the year . $____________
Current year increase (decrease) . . $____________
Withdrawals & distributions . . . $(____________)
Ending capital account . . . . . $____________

☐ Tax basis ☐ GAAP ☐ Section 704(b) book
☐ Other (explain)

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1 Ordinary business income (loss)
2 Net rental real estate income (loss)
3 Other net rental income (loss)
4 Guaranteed payments
5 Interest income
6a Ordinary dividends
6b Qualified dividends
7 Royalties
8 Net short-term capital gain (loss)
9a Net long-term capital gain (loss)
9b Collectibles (28%) gain (loss)
9c Unrecaptured section 1250 gain
10 Net section 1231 gain (loss)
11 Other income (loss)
12 Section 179 deduction
13 Other deductions
14 Self-employment earnings (loss)
15 Credits & credit recapture
16 Foreign transactions
17 Alternative minimum tax (AMT) items
18 Tax-exempt income and nondeductible expenses
19 Distributions
20 Other information

*See attached statement for additional information.

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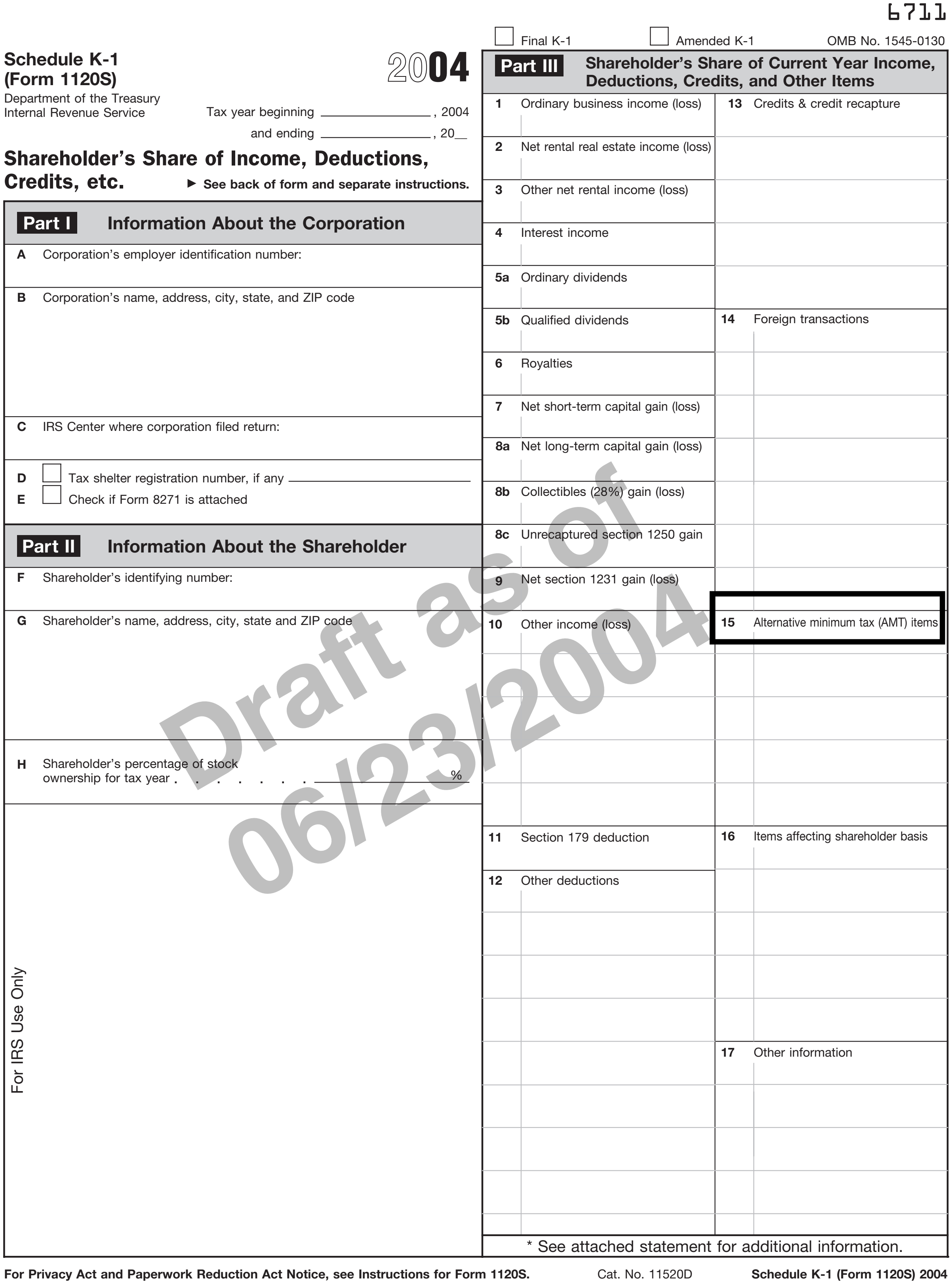
The AMT adjustments from an **S corporation** are listed on line 15.



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☐ Final K-1 ☐ Amended K-1 OMB No. 1545-0130

Schedule K-1
(Form 1120S)
Department of the Treasury
Internal Revenue Service

2004

Tax year beginning ____________, 2004
and ending ____________, 20__

Shareholder's Share of Income, Deductions, Credits, etc.

▶ **See back of form and separate instructions.**

Part I Information About the Corporation

A Corporation's employer identification number:

B Corporation's name, address, city, state, and ZIP code

C IRS Center where corporation filed return:

D ☐ Tax shelter registration number, if any ____________

E ☐ Check if Form 8271 is attached

Part II Information About the Shareholder

F Shareholder's identifying number:

G Shareholder's name, address, city, state and ZIP code

H Shareholder's percentage of stock ownership for tax year . . . . ____________ %

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Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items

1 Ordinary business income (loss)

2 Net rental real estate income (loss)

3 Other net rental income (loss)

4 Interest income

5a Ordinary dividends

5b Qualified dividends

6 Royalties

7 Net short-term capital gain (loss)

8a Net long-term capital gain (loss)

8b Collectibles (28%) gain (loss)

8c Unrecaptured section 1250 gain

9 Net section 1231 gain (loss)

10 Other income (loss)

11 Section 179 deduction

12 Other deductions

13 Credits & credit recapture

14 Foreign transactions

15 Alternative minimum tax (AMT) items

16 Items affecting shareholder basis

17 Other information

* See attached statement for additional information.

For Privacy Act and Paperwork Reduction Act Notice, see Instructions for Form 1120S. Cat. No. 11520D **Schedule K-1 (Form 1120S) 2004**

CALCULATING AMT FOR C CORPORATIONS

Corporations are subject to the AMT. The adjustment/preferences and computation are similar to those calculated for the individual. The following are the major differences between corporate AMT and individual AMT.

EXEMPTION [14]

A corporation may be exempt from AMT based on the following:

1. If the tax year being filed is the first tax year of the corporation,[15] the AMT for that corporation is zero.
2. If the corporation was treated as a small corporation, it must meet the $7.5 million gross receipts test. This test requires the corporation's prior three-year average gross receipts to fall below $7.5 million. The limit is $5 million if the corporation had only one prior year,[16] and the corporation was exempt from AMT for all prior years beginning after 1997.
3. If the corporation was exempt from the AMT for all prior years beginning after 1997.

ADJUSTMENTS AND PREFERENCE ITEMS

Merchant Marine Capital Construction Funds.[17] This deduction is not allowed for the AMT. If the corporation took this deduction for regular tax, it must be added back.

Tax Shelter Farm Activities.[18] If the corporation is a personal service corporation (PSC) and it has a gain or loss from a tax shelter farm activity that is not a passive activity, all gains and losses reported for the regular tax from tax shelter farm activities by taking into account any AMT adjustments and preferences must be recalculated. The AMT gain/loss is determined using the rules for the regular tax. No loss is allowed unless the PSC is insolvent.

Adjusted Current Earnings (ACE) Adjustment. ACE is the pretax book income used for financial statement reporting purposes. A portion of the difference between the AMTI and the adjusted current earnings of corporations (other than S corporations, regulated investment companies, real estate investment trusts, or real estate mortgage investment conduits) is treated as a tax preference item for years beginning after 1989. It is aimed at recapturing some of the overall tax savings enjoyed by corporations that report large earnings to their shareholders and creditors but, due to a variety of tax benefits, pay little or no tax. To achieve this recapture, a corporation's AMTI must be increased by 75% of the amount by which its ACE exceeds its AMTI, computed without the adjustments for either the ACE preference or alternative tax NOL.[19]

EXEMPTION AMOUNT

The exemption amount for corporate AMT is $40,000. The exemption is phased out for corporate AMTI beginning at $150,000, and is fully phased out by $310,000.

CORPORATE AMT RATE

There is only one rate for corporate AMT. The rate is 20%.

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[14] IRC §55(e)

[15] IRC §55(e)(1)(C)

[16] IRC §55(e)(1)(A)

[17] IRC §56(c)(2)

[18] IRC §58(a)

[19] IRC §56(c)(1) and 56(g)

APPENDIX

Exclusion: an adjustment for AMT which **will not** result in AMT credit in future years.

Deferral: an adjustment for AMT which **will** possibly result in AMT Credit in future years.

AMT Exclusions and Deferral Reference Chart

Description	Alternative Minimum Tax, Form 6251	Adjustment Type	AMT Credit
Medical and dental expenses	Limited to the amount in excess of 10% of AGI instead of 7.5%. The form requires the add-back of 2.5% of AGI or the actual amount deducted, whichever is less.	+	Exclusion
Taxes from Schedule A	No deduction is allowed for taxes. Add back the entire amount deducted for taxes on Schedule A.	+	Exclusion
Home mortgage interest	The only mortgage interest deductible for AMT is interest incurred to buy, build, or improve the primary residence or second home. Interest paid on refinanced amounts in excess of the original mortgage is not allowed. Add back disallowed interest.	+	Exclusion
Miscellaneous deductions from Schedule A	No deductions are allowed for deductions which exceed 2% of AGI. The amount deducted as miscellaneous expense on Schedule A is added back.	+	Exclusion
Itemized deductions subject to income limitations	Enter the amount from line 9 of the worksheet for Schedule A, the amount itemized deductions have been reduced based on the taxpayer's income.	–	Exclusion
Tax refund	Not included in AMT income.	–	Exclusion
Investment interest expense	Must be recalculated for various adjustments; private activity bonds treated as taxable investment interest; disallowed mortgage interest such as a home equity loan used to purchase stock should be added to investment interest expense.	+/–	Exclusion
Depletion	Must be recalculated using AMT rules. Basis must also be recalculated.	+/–	Exclusion
Net operating loss	The net operating loss deducted on the other income line must be added back.	+	Recalculated to determine allowable AMTNOL
Private activity bond interest	Add to AMT income any private activity bond interest exempt from regular income tax, reduced by any allocable expenses not deductible under regular tax, but not below zero.	+	Exclusion
Qualified small business stock	If the exclusion was claimed under IRC §1202 for gain on qualified small business stock, multiply the pre-May 6, 2003, excluded gain by 42% and the post-May 5, 2003, gain by 7%.	+	Exclusion

AMT Exclusions and Deferral Reference Chart (continued)

Description	Alternative Minimum Tax, Form 6251	Adjustment Type	AMT Credit
Incentive stock options	If the employee executes a cashless transaction (exercises option and sells stock the same day), no adjustment. However if the employee exercises the option but does not sell the stock within the same tax year, the difference between the execution price and the FMV on the date of execution is added.	+	Deferral
Estates and trusts	Enter AMT amounts from Schedule K-1	+/–	Deferral
Electing large partnerships	Enter AMT amounts from Schedule K-1	+/–	Deferral
Disposition of property	Enter the difference between the regular taxable gain or loss and the gain or loss computed using AMT rules. Generally there is a basis difference due to depreciable methods or as in the case of ISOs, recognized gain upon exercise of the option.	+/–	Deferral
Depreciation of assets (post 1986)	The difference between regular tax depreciation and applicable AMT method of depreciation.	+/–	Deferral
Passive activities	Recalculate Form 8582 using applicable AMT rules for depreciation, gains and losses, etc.	+/–	Deferral
Loss limitations	Gains and losses must be recalculated using AMT adjustments and preferences.	+/–	Deferral
Circulation costs	Expenses incurred to increase circulation are currently deductible for regular tax. For AMT they must be amortized over 3 years and the difference between the amortization expense and current deduction entered as an adjustment.	+/–	Deferral
Long-term contracts	Generally requires the use of the percentage of completion (POC) method. The difference between this method and the method used for regular tax must be entered as an adjustment.	+/–	Deferral
Mining costs	Deductible for regular tax (can elect to amortize over 10 years). AMT requires these costs to be amortized over 10 years with the difference between the current deduction under regular tax and the amortized costs entered as an adjustment.	+/–	Deferral
Research and experimental costs	For regular tax these costs can be expensed, amortized or capitalized. For AMT they must be amortized over a 10-year period with the difference between the current deduction and the amortized amount entered as an adjustment.	+/–	Deferral

AMT Exclusions and Deferral Reference Chart (continued)

Description	Alternative Minimum Tax, Form 6251	Adjustment Type	AMT Credit
Certain installment sales	The installment method does not apply for the AMT to any nondealer disposition of property after August 16, 1986, but before January 1, 1987, if an installment obligation to which the proportionate disallowance rule applied arose from the disposition.	−	Deferral
Intangible drilling costs	For regular tax currently deductible or amortized over 60 months. AMT requires 60-month amortization of these costs. If for regular tax these costs were expensed, AMT then requires costs in excess of 65% of the net income of the well to be amortized over 120 months.	+	Deferral
Other adjustments including income-based adjustments	For regular tax items affected by "net income" or "business income" limitations (IRC §179, business use of home, pension contributions, SE health insurance deduction) these deductions must be recomputed based on the revised AMT income after all adjustments.	+/−	Must be allocated