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Alternative Minimum Tax*

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Introduction

Congress imposes the alternative minimum tax (AMT) on taxpayers to prevent them from combining tax exclusions, deductions, and credits to pay very little or no federal income tax when they have significant income. When it was first enacted in 1969, the AMT affected only a few, very high-income taxpayers. Since it was first imposed, changes to the regular tax rules caused many more taxpayers to pay the AMT. Following the passage of the Tax Cuts and Jobs Act (TCJA), increased AMT phaseouts and exemption amounts have significantly reduced the number of taxpayers required to calculate and pay AMT. If no other legislation is enacted these provisions will expire at the end of 2025, and significantly more taxpayers will again be affected by these provisions. This article gives a basic explanation of the AMT and some examples of situations that cause taxpayers to pay the AMT.

The terminology of the AMT tax can be confusing because the tax that Congress calls the AMT is technically an add-on tax rather than an alternative to the regular income tax—the AMT is added on to the regular tax liability. The IRS follows the Congressional labeling and calls the amount of tax added on to the regular tax the "alternative minimum tax." Therefore, taxpayers report their regular income tax on their income tax return and then add on the AMT to find their total income tax liability for a respective tax year.

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While the AMT is technically an add-on tax, it has the effect of an alternative tax because taxpayers calculate their AMT by subtracting regular tax liability from a "tentative minimum tax." If the tentative minimum tax is less than the regular tax, there is no AMT. If the tentative minimum tax is greater than the regular tax, the AMT is the difference between the tentative minimum tax and the regular tax. Because the AMT is added to the regular tax, the effect of these rules is that taxpayers pay the higher of the regular tax or the tentative minimum tax. Therefore, the tentative minimum tax is, in effect, an alternative tax that taxpayers must pay if it exceeds their regular tax obligation.

Because the owners of partnerships, S corporations, and limited liability companies (LLCs) that are taxed as disregarded entities, are taxed on the income of those entities (the entities do not pay tax on the income), the individual AMT is the focus of this fact sheet. The AMT imposed on C corporations (CAMT) is discussed briefly at the end of the article.

Basic AMT Calculation

Taxpayers compute their tentative minimum tax by first computing their alternative minimum taxable income (AMTI), which is their taxable income for regular tax purposes adjusted by the difference between deductions that are allowed for the regular tax and those that are allowed for the AMT. The AMTI is then reduced by an exemption amount and the result is multiplied by 26% for the first $206,100 ($103,050 for married filing separately) and 28% for the amount over $206,100 ($103,050) to find the tentative minimum tax.

AMT Adjustments

To calculate AMTI, taxpayers start with their taxable income and then add back some of the deductions they claimed to compute their taxable income. They also make some adjustments that reduce their taxable income. These adjustments account for the difference between the deductions that are allowed for the regular income tax and those that are allowed for the AMT.

Example 1

Andy and Mary Thompson are married and have 4 children. To calculate their $315,000 of taxable income for 2022, they included the following deductions:

- $80,000 of depreciation on new farm equipment (bought in 2022 for $400,000, depreciated over 5 years using the 200% declining balance method, half-year convention).
- $25,900 standard deduction

The AMT rules require Andy and Mary to add the following to their taxable income to compute their AMTI.

1. $20,000 of the farm equipment depreciation (this is the excess over the $60,000 of depreciation that could be claimed using the 150% declining balance method over 5 years assuming half-year convention)
2. $25,900 standard deduction

Andy and Mary must add the $45,900 total of these adjustments to their $315,000 taxable income to compute their $360,900 AMTI.

AMT Exemption Amounts

Taxpayers reduce the AMTI by an exemption amount and multiply the result by the 26% (for the first $206,100) and 28% (for any amount over $206,100) AMT rates. Figure 1 shows the AMT exemption amounts provided in Internal Revenue Code Section 55(d)(1). However, Congress has increased these exemption amounts for taxpayers filing an individual return each year beginning in 2001. To illustrate the increases, Figure 1 also shows the exemption amounts that are in effect for 2022 and 2023. The examples in this article use the rates shown in Figure 1 for 2022.

Figure 1. AMT Exemption Amounts

Filing Status	I.R.C. § 55(d)(1) Exemption Amount	2022 Exemption Amount	2023 Exemption Amount
Married individuals filing jointly	$ 45,000	118,100	126,500
Surviving spouses	45,000	118,100	126,500
Single individuals	33,750	75,900	81,300
Married individuals filing separately	22,500	59,050	63,250
Estates and trusts	22,500	26,500	28,400

Example 2

Andy and Mary Thompson (from the previous example) compute their AMT as shown below.

AMTI	$360,900
Exemption	- 118,100
AMT tax base	$ 242,800
AMT tax rate on first $206,100 of AMTI AMT tax rate on remaining $36,700	0.26 0.28
Tentative minimum tax	$ 63,862
Regular tax on $315,000	63,271
AMT	$ 591

The AMT caused by some of the AMT adjustments can be used to reduce regular income tax liability in the tax years after the year they paid an AMT. In effect, these adjustments do not increase a taxpayer's total tax liability; they simply accelerate income tax liability by requiring the taxpayer to pay the AMT in one year and then reducing income taxes by that amount in a later year. Note that Andy and Mary pay the $63,271 regular tax plus the $591 AMT for a total tax of $63,862, which is equal to the tentative minimum tax. Therefore, the effect of the AMT is to make Andy and Mary pay the higher of their regular tax liability or their tentative minimum tax.

Adjustments that Create an AMT Credit

The AMT adjustments that just defer deductions rather than permanently prohibit a deduction are the adjustments that can create an AMT credit. For example, some assets can be depreciated at a faster rate for regular tax purposes than for AMT purposes. In the early years of depreciating those assets, the regular tax depreciation exceeds the AMT depreciation, and the excess is a positive adjustment to AMTI that can cause an AMT liability. In the later years of depreciating those assets, the regular tax depreciation is less than the AMT depreciation and the deficit is a negative adjustment to AMTI. By the end of the recovery period for those assets, the total regular tax depreciation and AMT depreciation are the same. Therefore, the AMT rules simply deferred the depreciation deduction—they did not reduce the total depreciation deduction.

The most common AMT adjustments that **do not** create an AMT credit because they cause a permanent difference in regular taxable income and AMTI (i.e., they are **not** deferral items) are:

- The standard deduction
- Itemized deductions, including any investment interest expense reported on Schedule E.

Example 3

In the previous example, Andy and Mary Thompson's AMT for 2022 was $591.

One of their two AMT adjustments – the $25,900 standard deduction – is not a deferral adjustment. The AMT caused by those permanent adjustments does not create an AMT credit.

However, their $20,000 depreciation adjustment is a deferral adjustment that creates a $591 AMT credit. (Without the $20,000 depreciation adjustment, their 2022 AMT would be zero). The credit can be subtracted from their regular tax liability in 2023, but a limit applies: It can reduce their regular tax liability only to their tentative minimum tax for 2023. Any excess is carried forward to reduce regular income taxes in future years, subject to each year's tentative minimum tax limit.

Note. Because Andy and Mary get a $591 credit in 2023 for the AMT they paid in 2022, the AMT has not increased their income tax, it has only accelerated it from 2023 to 2022.

AMT Management and Planning Issues

This section provides examples that show how the AMT affects taxpayers with large capital gains, itemized deductions that are limited for the AMT calculation, and high personal exemption deductions.

Taxpayers with Large Capital Gains

The AMT calculation allows taxpayers to use the same tax rate on capital gains as they use for regular tax liability. Although this provision appears to not trigger the AMT, taxpayers with large capital gains may be subject to AMT because of the loss of the AMT exemption. The tax on the capital gain does not change, but the tax on the ordinary income increases because the capital gains reduce the AMT exemption, which increases the ordinary income that is subject to the AMT rates. For 2022, the phase-out begins when AMTI exceeds $539,900 for taxpayers filing as single, head of household, or married filing separately. The phase-out begins at $1,079,800 for joint returns and surviving spouses.

Example 4

Tommy Hawk is single with no dependents. In 2022, Tommy decided to get out of farming, so he sold his 150 acres of farmland but kept the home, outbuildings, and machinery. He had $55,000 of farm income for 2022 and $50,000 of wages from a new job. He sold the 150 acres of farmland for $710,000. His income tax basis in the land was $10,000, so he had a $700,000 capital gain from the sale of the land.

(Continued below)

Example 4 ***(continued)***

Tommy elected the $12,950 standard deduction. If Tommy had not sold the farmland in 2022, he would not owe any AMT. His AMTI would be $101,114 ($55,000 farm income – $3,886 SE tax deduction + $50,000 wages). His income subject to the AMT after subtracting his $75,900 AMT exemption would be $25,214, and he would have a $6,556 tentative minimum tax ($25,214 × 26% = $6,556), which is less than the $15,013 regular tax on his $88,164 taxable income.

The capital gains from the sale of the farmland increase his AMTI to $801,114, and cause his $75,900 AMT exemption to be reduced to $10,594. The calculation of his $788,164 taxable income is below.

Farm income	$55,000
Wages	50,000
Less: Deduction for 50% of SE Tax	3,886
Long-term capital gain	700,000
($810,000 – 10,000 basis)	
Adjusted gross income (line 38 Form 1040)	$801,114
Less: Standard deduction	-12,950
Taxable income	$788,164

Tommy's regular income tax on his $788,164 of taxable income is $136,433 because of ordinary rates and capital gains rates at 15% and 20%. His AMT calculation is shown below.

Taxable income	$788,164
Standard deduction	+ 12,950
AMTI	801,114
Exemption*	- 10,594
Tentative minimum tax base	$790,520
Tentative minimum tax**	$144,955
Regular tax	-136,433
AMT	$ 8,522

* Tommy's AMT exemption is $10,594 because his $801,114 AMTI – $539,900 phase-out causes his exemption amount, $75,900, to be reduced by $65,306 ($261,214 x .25).

** Tommy's tentative minimum tax is $23,535 (26% of the $90,520) plus $121,421 ($328,414 of his $700,000-capital gain at 20% = $65,683 + $371,586 of his $700,000 capital gain at 15% = $55,738)

Planning Pointer

If capital gains cause you to pay the AMT, spreading them over more than one year can reduce or eliminate the AMT. Spreading capital gains can keep your AMTI below the threshold for reducing the AMT exemption amount, and therefore allow the exemption to offset the regular income.

Capital gains can be spread over more than one year by making an installment sale or by selling part of the assets in each of two or more years. Be sure to compare the tax savings with the risk of not getting paid on an installment contract or the risk of a price decrease if you delay selling part of the assets.

Example 5

Tommy Hawk (from the previous examples) sold his farmland for $710,000, but instead of getting one payment, he entered an installment contract that requires the buyer to pay $355,000 down in 2022, and a $355,000 payment in 2023. After subtracting $5,000 of basis from each of those payments, Tommy has $350,000 of long-term capital gain to report in both 2022 and 2023. He had $101,114 of ordinary income each year and claims the standard deduction. Tommy's AMT for 2022 is zero as shown below.

Taxable income ($101,114+$350,000)	$451,114
Standard deduction	+ 12,950
AMTI	464,064
Exemption*	- 75,900
Tentative minimum tax base	$388,164
Tentative minimum tax**	$61,922
Regular tax	- 70,602
AMT	$ 0

* Tommy's AMT exemption is $75,900 as he gets the full amount.
**Tommy's tentative minimum tax is $61,922 (26% of the $38,164 because his $101,114 ordinary income is reduced by the AMT exemption) plus $52,000 (15% of his $350,000 capital gain).

Because of the AMT exemption amounts, tax rates, and standard deductions for 2023, Tommy will owe no AMT for 2023.

Spreading the capital gain over the two years reduces his total AMT for the two years from $8,522 to zero.

Itemized Deduction Limitations for AMT Calculation

The AMT calculation limits the Schedule A (Form 1040) itemized deductions. The common itemized deductions subject to AMT limitations are:

1. State and local taxes, including property taxes, income taxes, and sales taxes. These are not deductible in calculating AMT. Taxpayers with high state and local taxes are more likely to have an AMT liability. This itemized deduction has been capped at $10,000, following the passage of the Tax Cuts and Jobs Act.
2. Home mortgage interest on indebtedness not used in acquiring, constructing, or substantially improving any property that is the taxpayer's main home or second home that is a qualified dwelling. It is not deductible for AMT.
3. Medical and dental expense deductions. For the AMT calculation, they are limited to a 10% of AGI floor instead of the 7.5% of AGI floor that applies to the regular tax liability calculation.

Because of the increased standard deduction and phaseout amounts for the AMT after TJCA, a small percentage of taxpayers will be itemizing and, with the increased phaseouts for AMT, many of those will not be subject to AMT.

Example 6

Dana Miller, a single taxpayer with no dependents, has $45,000 of wages for 2022. She raises horses and the IRS treats her horse activities as a hobby because she has not made a profit in the first seven years of raising horses. In 2022, Dana had $40,000 of revenue from her horse activity. The calculation of her taxable income and regular tax liability for 2022 is shown below.

Wages			$ 45,000
Revenue from horse activity			40,000
Adjusted gross income			$ 85,000
Itemized deductions			
State income taxes		1,500	
Real property taxes		2,500	
Home mortgage interest		10,000	
Charitable contributions		2,000	
Miscellaneous deductions			
Medical Expenses*	25,000		
	8,500		
Excess over 10% of AGI		17,000	
Total Itemized deductions			- 33,000
Taxable income			$ 52,000
Regular income tax			$ 7,063

The miscellaneous itemized deductions are disallowed for the AMT calculation, as shown below.

Taxable income	$52,000
State income taxes	1,500
Real property taxes	2,500
Miscellaneous deduction	17,000
Personal exemption deduction	
AMTI	$73,000
AMT exemption	- 75,900
Tentative minimum tax base	$0
Tentative minimum tax ($0× 26%)	$ 0
Regular tax	- 6,700
AMT	$ 0

The AMT is not triggered because of the increased exemption amounts, but the table above shows the calculations for adding back itemized deduction items.

AMT for Corporations

The Tax Cuts and Jobs Act had repealed the Corporate AMT. However, the Inflation Reduction Act of 2022 reinstituted the corporate AMT for tax years 2023 and beyond. This rule does not apply to S-corporations, REITs, investment companies and private equity funds.

Corporations with average annual book income exceeding $1 billion for three consecutive years are subject to CAMT. CAMT will be 15% of corporate income. Corporations that are subject to CAMT will calculate their taxes under regular corporate tax rules and the CAMT, and be responsible for paying the higher amount.

It is important to note that the calculation is based on the book income, and not taxable income, of the corporation. This is referred to as adjusted financial statement income, AFSI. This was seen as a way to avoid corporate tax incentives that reduce taxable income resulting in no or low tax liability.

The Future of the AMT

AMT was becoming a concern for a growing number of taxpayers. AMT rates had been temporarily increased but not indexed for inflation like regular income tax rates. Following the passage of the Tax Cuts and Jobs Act, increased AMT phaseouts and exemption amounts have significantly reduced the number of taxpayers required to calculate and pay AMT. If no other legislation is enacted these provisions will expire at the end of 2025, causing significantly more taxpayers to fall under these provisions starting in 2026.

With the passage of the Inflation Reduction Act, the CAMT will start to impact C Corporations in 2023 and beyond. It is expected to impact a small number of corporations, perhaps especially so for agriculture. More guidance is expected on these provisions.

IRS Publications

For more detailed information about the AMT for individual taxpayers see the two-page Form 6251, Alternative Minimum Tax--Individuals, and the 12 pages of instructions for it. Form 6251 and its instructions can be accessed at www.irs.gov. Enter “Alternative Minimum Tax Form 6251” in the search box in the upper right-hand corner.

Additional Topics

This fact sheet was written as part of Rural Tax Education, a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.