Chapter 9 *
ALTERNATIVE MINIMUM TAX

Introduction

Congress imposed the alternative minimum tax (AMT) to prevent taxpayers with significant income from combining specified tax exclusions, deductions, and credits to pay very little or no federal income tax. When it was first enacted in 1969, the AMT affected only a few very high-income taxpayers. But since it was first imposed, changes to the regular tax rules have 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 be affected.

> **Cross-Reference**
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> ***More Detailed Information***
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> For more detailed information about the AMT for individual taxpayers, see the 2-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.

This chapter gives a basic explanation of the AMT, some examples of situations that cause taxpayers to pay it, and some planning techniques to minimize the AMT's impact.

The terminology of the AMT tax is a little confusing because the tax is technically an add-on tax (added on to the regular tax liability), rather than an alternative to the regular income 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.

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 taxpayer's 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. The effect of these rules is that taxpayers must pay the higher of the regular tax or the tentative minimum tax.

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This chapter focuses on the AMT imposed on individual taxpayers. The AMT imposed on C corporations (CAMT) is discussed briefly at the end of the fact sheet.

Basic AMT Calculation

To determine if you should compute AMT, you can refer to the instructions for Form 1040 which includes a worksheet and information regarding Form 6251, AMT – Individuals. Some of the common reasons for filing Form 6251 include: accelerated depreciation, investment interest expense, NOL deduction, foreign tax credits and electric vehicle tax credits. Just because the form must be completed does not mean you will owe AMT.

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. The resulting income 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).

AMT Adjustments

To calculate AMTI, taxpayers start with their taxable income and then add back in 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 differences between the deductions that are allowed for the regular income tax and those that are allowed for the AMT.

Example 9.1: AMT Adjustments

Andy and Mary Thompson are married and have four children. In calculating their $315,000 taxable income for 2022, they included the following deductions that affect AMTI:

1. $80,000 depreciation on new farm equipment (bought in 2022 for $400,000; depreciated over 5 years using the 200% declining balance method, half-year convention)
2. $25,900 standard deduction

The AMT rules require Andy and Mary to add the following amounts 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

Adding the $45,900 total of these adjustments to their $315,000 taxable income results in $360,900 AMTI.

AMT Exemption Amounts

Figure 9.1 shows the maximum AMT exemption amounts provided in the Internal Revenue Code (I.R.C.) for any year that the Congress does not temporarily increase them. However, each year beginning in 2001, Congress has temporarily increased these exemption amounts for individual returns, and it is likely to continue to increase them or otherwise change the AMT rules to reduce the impact of the AMT. Figure 9.1 also shows the temporary increase in the exemption amounts for 2022 and 2023. The examples in this chapter use the amounts shown in Figure 9.1 for 2022.

Figure 9.1. AMT Exemption Amounts

Filing Status	I.R.C. 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
Head of household	33,750	75,900	81,300
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 9.2: Basic AMT Calculation

Andy and Mary Thompson from Example 9.1 compute their AMT as shown in Figure 9.2.

Figure 9.2. AMT Calculation

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 x 0.28
Tentative minimum tax	$ 63,862
Regular tax on $315,000	– 63,271
AMT	$ 591

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 taxpayers pay the higher of their regular tax liability or their tentative minimum tax.

AMT Credit

The AMT caused by some adjustments can create a credit that reduces regular income tax liability in subsequent tax years. In effect, these adjustments do not increase a taxpayer's total tax liability; they simply accelerate income tax liability by imposing the AMT in one year and reducing income taxes in a later year. Because taxpayers must pay the higher of their regular tax or their tentative minimum tax each year, a subsequent-year reduction of AMTI does not in itself produce the offsetting benefit that the credit provides.

Adjustments That Create an AMT Credit

The adjustments that can create an AMT credit are those that defer deductions rather than permanently prohibit them. 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 an addition 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 subtracted in calculating AMTI. By the end of the assets' recovery period, the total regular tax depreciation and the AMT depreciation are the same. Therefore, the AMT rules simply deferred the depreciation deduction—they did not reduce the total depreciation deduction.

AMT adjustments that cause a permanent difference in regular taxable income and AMTI do not create an AMT credit. These adjustments include:

- itemized deductions, including any investment interest expense reported on Schedule E,
- the standard deduction

Example 9.3: AMT Credit

In Example 9.2, 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 that permanent adjustment 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.

Observation

AMT on Deferral Items Only Accelerates Tax Liability

Because Andy and Mary receive a $591 credit in 2023 for the $591 AMT they paid in 2022, the AMT did not permanently increase their income tax. The AMT only accelerated the $591 liability from 2023 to 2022.

AMT Management and Planning Issues

The examples in this section show how the AMT affects taxpayers with large capital gains or itemized deductions that are limited for the AMT calculation.

Taxpayers with Large Capital Gains

The same capital gains tax rates that are used for regular tax liability apply in calculating the AMT. Although these rates do not trigger the AMT, taxpayers with large capital gains nevertheless may be subject to the AMT as a result of a reduction of the AMT exemption. The AMT exemption amounts shown in Figure 9.1 are maximums; the exemption is phased out for higher income taxpayers. (The phase-out begins when AMTI exceeds $539,900 for taxpayers filing as single or head of household, $1,079,800 for joint returns and surviving spouses, and $539,900 for married taxpayers filing separate returns.) Thus, while the tax rate on capital gains is still capped at 20%, the tentative minimum tax increases because the reduced AMT exemption increases the total income that is subject to the AMT rates.

Example 9.4: Taxpayer with Large Capital Gains

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.

Tommy claims the $12,950 standard deduction. If Tommy had not sold the land, 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 ($25,921 × 26% = $6,556), which is less than the $15,013 regular tax on his $88,164 taxable income.

However, the capital gain from the farmland sale increases his taxable income to $788,164 and his regular tax to $136,433. The capital gain is still taxed at the 15% and 20% rate, but its inclusion in his $801,114 AMTI reduces his $75,900 AMT exemption to $10,594 causing his AMT to increase to $144,955. Therefore, Tommy owes an additional $8,522 after triggering the AMT.

Planning Pointer

Spread Capital Gains to More Than One Year

If large capital gains would cause the AMT, spreading them over more than one year can reduce or eliminate the additional liability. Spreading the gains can keep AMTI below the threshold for reducing the AMT exemption amount.

Capital gains can be spread out 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 being paid on an installment contract or the risk of a price decrease if you delay selling part of the assets.

Example 9.5: Spreading Capital Gains

Tommy Hawk from Example 9.4 sold his farmland for $710,000, but he entered into an installment contract that required the buyer to pay $355,000 in 2022 and $355,000 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 each year. He has $101,821 of ordinary income and claims the standard deduction for 2022. Tommy's AMT for 2022 is zero.

If his income is similar in 2023, and the AMT exemption amounts, tax rates, standard deduction, and personal exemption deduction are the same for 2023 as they are for 2022, Tommy also will owe no AMT for 2023.

Itemized Deduction Limitations

The AMT calculation eliminates or limits several of the Schedule A (Form 1040) itemized deductions. They include the following common itemized deductions.

1. State and local taxes (including property taxes, income taxes, and sales taxes) are not deductible at all in calculating AMT. Taxpayers with high state and local taxes are more likely to have an AMT liability. This deduction however is capped at $10,000, following the passage of TCJA.
2. Home mortgage interest on indebtedness that is not used to acquire, construct, or substantially improve the taxpayer's main home or second home is not deductible for AMT.
3. Medical and dental expense deductions are limited to a 10%-of-AGI floor instead of the 7.5%-of-AGI floor that applies to the regular tax liability calculation.

Planning Pointer

Prepayment of Taxes

Taxpayers who prepay property taxes or state income taxes for the following year (doubling the current-year deduction) to maximize the use of the standard deduction the following year may find themselves with an AMT liability that reduces or eliminates the intended tax benefit.

AMT for Corporations

The Tax Cuts and Jobs Act 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 were 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 a significant number of taxpayers to once again be subject to AMT starting in 2026.