Chapter 3: Advanced Individual Issues

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

In 1987, the current AMT model was adopted. Under the AMT rules, a second method of calculating a taxpayer’s income tax 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. Unfortunately, the 1987 model did not incorporate any adjustments for inflation.

With the lack of inflation adjustments and Congress’s tendency to lower regular taxes without adjusting the AMT calculation, the AMT began to affect more and more middle class taxpayers. In the Taxpayer Advocate’s 2003 Annual Report to Congress, Nina E. Olson stated 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.”

Between 2003 and 2013, Congress repeatedly passed temporary “fixes” to AMT, which provided higher AMT exemption amounts and allowed certain tax credits to apply to both regular tax and AMT. However, each of these fixes expired within one or two years of enactment, making it difficult for taxpayers to plan appropriately.

Finally, on January 1, 2013, Congress passed the American Taxpayer Relief Act of 2012 (ATRA), which permanently fixes the AMT problem for most taxpayers. Besides permanently increasing the AMT provisions, ATRA also permanently indexes for inflation the following AMT components.

- Exemptions
- Brackets
- Phaseout provisions

In addition, ATRA extends certain tax credits for both AMT and regular tax purposes and allows certain other tax credits to apply permanently to both types of income tax.

Unlike regular income tax, the AMT calculation does not include any personal exemptions. The AMT exemption is applied to a tax return. The phaseout of personal exemptions reinstated by ATRA for regular tax purposes does not affect the calculation of AMT. Previously, the difference in the exemption amounts caused some taxpayers with large families to owe AMT even though every other item of income or deduction was treated the same for both taxes.

**2013 AMT TABLES**

The following table shows the exemption amounts and phaseout floors for 2013.

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>2013 AMT Exemption</th>
<th>2013 AMT Exemption Phaseout (25% of AMTI Above...)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Married filing jointly (MFJ) or qualified widow(er) (QW)</td>
<td>$80,800</td>
<td>$153,900</td>
</tr>
<tr>
<td>Single</td>
<td>51,900</td>
<td>115,400</td>
</tr>
<tr>
<td>Married filing separately (MFS)</td>
<td>40,400</td>
<td>76,950</td>
</tr>
<tr>
<td>Estates and trusts</td>
<td>23,100</td>
<td>76,950</td>
</tr>
</tbody>
</table>

The following table summarizes the tax brackets for AMT income (AMTI).

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>26% Bracket AMTI Between...</th>
<th>28% Bracket AMTI Above...</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFJ or QW</td>
<td>$0–$179,500</td>
<td>$179,500</td>
</tr>
<tr>
<td>Single</td>
<td>0–179,500</td>
<td>179,500</td>
</tr>
<tr>
<td>MFS</td>
<td>0–89,750</td>
<td>89,750</td>
</tr>
<tr>
<td>Estates and trusts</td>
<td>0–179,500</td>
<td>179,500</td>
</tr>
</tbody>
</table>

**THE MECHANICS OF AMT**

The calculation of a taxpayer’s AMT starts with the taxpayer’s AGI. If the taxpayer uses the standard deduction for regular tax purposes, all of this deduction is lost for AMT purposes. If the taxpayer itemizes, the total amount of the itemized deductions is subtracted from AGI, but the taxpayer may be required to add some of these deductions back into income for AMT purposes.

The following itemized deductions may be reduced or eliminated in the calculation of AMT income.

1. Medical and dental expenses (For AMT purposes, allowable medical expenses must exceed 10% of AGI. In 2013, the 10% floor applies for both types of taxes to taxpayers under age 65. Therefore, only taxpayers age 65 or older who are allowed to use the 7.5% floor are subject to this add-back.)
2. Taxes (100% add-back for most taxes)
3. Home mortgage interest (add-back based on use of mortgage proceeds)
4. Miscellaneous itemized deductions subject to the 2% floor (100% add-back)

Starting in 2013, itemized deductions for regular tax purposes are phased out for taxpayers whose income exceeds certain thresholds. However, the amount of the phaseout applied in the calculation of regular taxable income is ignored for AMT purposes.\(^3\)

**Note.** For more information about the phaseout of itemized deductions for higher-income taxpayers, see the 2013 University of Illinois Federal Tax Workbook, Volume A, Chapter 1: New Legislation.

\(^3\) IRC §56(b)(1)(F).
In addition to the modifications related to itemized deductions, there are approximately 20 other additions and subtractions that may be required, depending on the nature of the taxpayer’s income and losses. These modifications are reported on lines 7 through 27 of Form 6251, *Alternative Minimum Tax — Individuals.*

**Depreciation** can cause multiple entries for AMT purposes. Depreciation rules vary for regular tax and AMT purposes. In the early years of an asset’s life, regular depreciation may be more than AMT depreciation, so the excess is added back into AMT income. However, in later years, AMT depreciation may be more than regular depreciation, so the taxpayer is allowed to deduct the difference from AMT income.

If a taxpayer sells an asset for which the accumulated regular depreciation is different from the accumulated AMT depreciation, the taxpayer must modify AMT income for the difference in the gain or loss on the sale. If a taxpayer has a net operating loss (NOL) that includes depreciation, the taxpayer must make entries on Form 6251 for the NOL calculated under each tax system.

The items subject to modification for AMT purposes are called preferences and adjustments. Each has specific rules applicable to items in this category. Modifications resulting from timing differences may qualify the taxpayer for a credit in future years. This credit is calculated on Form 8801, *Credit for Prior Year Minimum Tax — Individuals, Estates, and Trusts.*

**AMT AND CAPITAL GAIN TAX RATES**

For noncorporate taxpayers the Code allows the same tax rates that apply to qualified dividends, long-term capital gains, and unrecaptured IRC §1250 gains under regular tax to apply to AMT income. However, because of the AMT exemption phaseouts, taxpayers with large capital gains may be forced to pay AMT on their other income that is subject to ordinary tax rates.

**Example 1.** Marvin and Jessica are retired television stars. In 2013, both are 63 years old. They receive $12,000 from social security, and their combined pension income is $30,000. They also have interest income of $4,800. They file jointly and do not itemize.

Marvin owns 1,000 shares of stock in Iludiam Q-36, Inc., which he purchased in 1999 for a total of $30,000. (The stock is not qualified IRC §1202 small business stock.) Due to increased interest in space modulators as possible defense shields against rogue asteroids, the price of the shares has skyrocketed to $400 per share. Marvin consults with his tax advisor, Chuck, about the tax consequences of selling all the shares in 2013. Chuck makes the following calculations and concludes that the 2013 federal taxes due if Marvin sells all the shares will total $63,385. This includes $3,730 of AMT and $6,270 of Medicare tax on net investment income (NII).

**Note.** For a thorough explanation of the Medicare tax on NII, see the 2013 *University of Illinois Federal Tax Workbook, Volume A, Chapter 2: Affordable Care Act Update.*

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4. IRC §57.
5. IRC §§56 and 58.
6. IRC §55(b)(3).