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Reduce the Impact of the Alternative Minimum Tax

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Taxpayers who focus only on the regular tax system can end up with an unexpected AMT liability—but by balancing regular tax and AMT concerns, they can improve their overall tax situation.

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The goals of income tax planning, including planning for the alternative minimum tax (AMT), generally are to reduce tax liability to the greatest extent possible and to incur tax liability at the most opportune time from the taxpayer's perspective. These goals are achieved by taking advantage of:

1. The varying tax rates applicable to different forms of income and different tax years.
2. The time value of money.

A taxpayer can obtain the income tax benefits of lower tax rates and improve the timing of tax liability through a variety of strategies. For example, the timing of transactions with income tax consequences may be altered. Income may be deferred, deductions may be accelerated, or transactions may be shifted to years in which the taxpayer enjoys more favorable tax rates. A taxpayer should also make business and investment decisions to obtain the greatest financial rewards on an after-tax basis. Thus, business and investment alternatives should be analyzed to take into account tax rate differentials (for example, whether the income is tax-exempt or tax-preferred) and the timing of income flows.

The mismatching of deductions and related income from an investment may also provide tax rate or timing advantages. For example, depreciation deductions or deductions incurred in connection with certain mining or oil exploration activities may be deductible for regular tax purposes in advance of the related income produced by the expenditure. The advanced tax savings from the deduction produces a timing advantage that improves the after-tax return of the investment. A tax rate advantage may also be obtained if the subsequent income produced by the investment is taxed at a rate lower than the rate of tax saved by the earlier deduction (although the Code's various recapture provisions limit the effectiveness of this strategy).

Finally, tax rate and timing differences may be maximized by shifting income and deductions between taxpayers to obtain optimum results. Thus, a taxpayer may opt for a lease financing arrangement to acquire an asset rather than debt financing in order to shift the tax benefits of ownership to the lessor.[1]

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The AMT potentially affects every income tax planning strategy. If applicable, the AMT imposes tax rates that vary significantly from regular tax marginal rates. The AMT also significantly affects the timing of a taxpayer's tax liability. Frequently, the AMT reduces or eliminates timing advantages available in the regular tax and is, in effect, a prepayment of regular tax liability. At other times, the AMT is a permanent increase in the taxpayer's overall tax liability. Thus, successful AMT planning may reduce overall tax liability or it may produce more favorable timing of tax liability.

PLANNING TIP

The goal of AMT planning must be to reach the optimum tax result taking into account both regular tax and AMT considerations. The goal is *not* simply to avoid or reduce AMT liability. Strategies to avoid or reduce the AMT in many instances produce a corresponding and larger increase in regular tax liability. Consequently, in many instances proper management of the AMT, rather than its avoidance, is the better planning strategy.

AMT crossover point

AMT liability is triggered only when a taxpayer's tentative minimum tax exceeds regular tax liability for the tax year.[2] Therefore, a taxpayer may recognize AMT adjustments and preferences up to the point where tentative minimum tax is equal to regular tax and not be liable for any AMT. For noncorporate taxpayers, this AMT crossover point generally occurs when (1) 26% of the first $175,000 of taxable excess (alternative minimum taxable income (AMTI) less exemption amount), plus 28% of the taxable excess over $175,000, reduced by the AMT foreign tax credit (AMT FTC), is greater than (2) regular tax.[3] For married taxpayers filing separate returns, the 28% rate begins with $87,500 of taxable excess.[4] For corporate taxpayers, the AMT crossover point is reached when 20% of the AMTI in excess of the exemption amount, reduced by the AMT FTC, exceeds regular tax.[5] Thus, the AMT crossover point and AMT liability depend on a comparison of both:

1. The regular tax rate with the AMT tax rate.
2. The tax base for the regular tax with the tax base for the AMT.

Tax rate considerations. The likelihood of AMT liability depends, in part, on the differential between a taxpayer's regular tax marginal rate and AMT marginal rate. When the difference between those rates is smaller, a taxpayer's tentative minimum tax is more likely to exceed the taxpayer's regular tax.

Individual taxpayers. For individual taxpayers in 2000, the top marginal regular tax rate in Section 1 generally is 39.6% for taxable income in excess of $288,350 ($144,175 in the case of a married taxpayer filing a separate return).[6] Taxable income below $288,350 is taxed at rates varying from 15% to 36%. The 36% rate applies to taxable income in the $161,450 to $266,350 range in the case of married taxpayers filing jointly, and $132,600 to $288,350 in the case of unmarried taxpayers other than surviving spouses and heads of households.[7] Marginal regular tax rates higher than the Section 1 rates may apply as the result of the Section 67 floor on miscellaneous itemized deductions, the Section 68 limitation on itemized deductions, the phaseout of personal exemptions, or the phaseout of other tax benefits for high-income taxpayers.[8] For a noncorporate taxpayer with a net capital gain, Section 1(h) provides that the net capital gain generally may not be taxed at higher than 20%.

The statutory AMT rates in Section 55 for noncorporate taxpayers to compute tentative minimum tax generally are 26% for the taxpayer's first $175,000 of taxable excess and 28% thereafter; for married taxpayers filing separately, the 28% rate begins when taxable excess exceeds $87,500.[9] Thus, the differential between the highest Section 1 rate for noncorporate taxpayers and the highest AMT rate is 11.6% (39.6% compared with 28%). For noncorporate taxpayers, the regular tax and AMT rates on capital gain are the same (discussed below).

Corporations. The top marginal tax rate in Section 11 for corporate taxpayers is 35% on taxable income in excess of $10 million. Taxable income below $10 million is taxed at 15%, 25%, and 34% rates, with the 34% rate applicable to taxable income over $75,000 to $10 million.[10] The benefit of the 15% and 25% rates is phased out for corporations with taxable incomes between $100,000 and $335,000. The benefit of the 34% rate is phased out by an additional 3% tax on taxable income in excess of $15 million. The additional tax, however, cannot exceed $100,000.[11]

For corporate taxpayers, the AMT rate for computing tentative minimum tax is 20%.[12] The difference between the highest Section 11 rate for corporate taxpayers and the corporate AMT rate is 15% (35% compared with 20%).

Other AMT rates. In addition to the Section 55 tax rates applicable in computing tentative minimum tax, the AMT imposes a variety of tax rates on different forms of income through the special treatment of various AMT adjustments and preferences. For example:

- The adjustment for corporate taxpayers for adjusted current earnings (ACE) may increase a corporation's AMTI by 75% of a particular item included in ACE. The effective AMT tax rate on an item included in AMTI under the ACE adjustment is, therefore, 15% (75% of the 20% Section 55 rate).
- Under the AMT a taxpayer generally may not use the alternative tax net operating loss (AT NOL) deduction to reduce AMTI below 10% of the amount it would be without that deduction.[13] A corporate taxpayer subject to that limitation, in effect, incurs a 2% AMT tax rate (10% of the 20% Section 55 rate) on its AT NOL. A noncorporate taxpayer subject to this limit generally would incur either a 2.6% or 2.8% AMT tax rate (i.e., 10% of the 26% or 28% Section 55 rates) on an AT NOL.

FREQUENTLY, THE AMT REDUCES OR ELIMINATES TIMING ADVANTAGES AVAILABLE IN THE REGULAR TAX AND IS, IN EFFECT, A PREPAYMENT OF REGULAR TAX LIABILITY.

Effect of exemption phaseout. The exemption amount allowed a taxpayer in computing tentative minimum tax is phased out by 25% of AMTI in excess of certain established limits. For individuals filing jointly or as a surviving spouse and for corporate taxpayers, the phaseout begins with AMTI in excess of $150,000. For single taxpayers who are not surviving spouses, the phaseout begins with AMTI in excess of $112,500. For married taxpayers filing separately and for estates and trusts, the phaseout begins with AMTI in excess of $75,000.[14]

The effect of this phaseout is to increase the taxpayer's marginal AMT rate by 25% in the phaseout range.[15] For example, a corporation's $40,000 exemption amount is phased out between $150,000 and $310,000 of AMTI. Thus, the corporation's marginal AMT rate on each dollar of AMTI in that range is 25%, rather than 20%.

Example. X Co. has $150,000 of AMTI and no AMT FTC. Therefore, its tentative minimum tax is $22,000 ($150,000 of AMTI less $40,000 exemption amount, multiplied by 20%). On the other hand, if X Co. has $160,000 of AMTI, its tentative minimum tax is $24,500 ($160,000 of AMTI less $37,500 exemption amount after phaseout, multiplied by 20%). Thus, the additional $10,000 of AMTI produces a $2,500 increase (25%) in tax as a result of the phaseout of the exemption amount.

For noncorporate taxpayers, the phaseout of the exemption amount increases the 26% and 28% AMT rates by 25% to 32.5% and 35%, respectively, in the phaseout range.

Capital gains. For regular tax purposes, if a noncorporate taxpayer has a net capital gain, the maximum tax rate on such gain generally is 20%.[16] Thus, net capital gain potentially is taxed at a rate that is 19.6% below the highest tax rate paid by individual taxpayers (20% compared with 39.6%). In addition to the rate preference for net capital gain, under Section 1202 a noncorporate taxpayer may exclude 50% of any gain from the sale or exchange of qualified small business stock held for more than five years.[17] Section 55(b)(3) conforms the AMT rates on capital gain with the regular capital gain tax rates. Thus, there is no rate differential between the two tax systems with respect to an individual's capital gain.

A net capital gain, however, may have regular tax consequences in addition to the tax rate preference. Because a net capital gain and the includable portion of a gain from the sale or exchange of qualified small business stock will increase adjusted gross income, such gains may:

1. Increase the Section 67 floor for deduction of miscellaneous itemized deductions.
2. Increase the Section 68 regular tax limitation on itemized deductions.
3. Accelerate the phaseout of exemption amounts or other tax benefits.[18]

Realization of a long-term capital gain may affect the taxpayer's AMT liability in several ways. Under Section 57(a)(7), if the gain is from the sale or exchange of qualified small business stock held for more than five years, 42% (28% if the stock's holding period begins after 2000) of the amount excluded under Section 1202 is an item of tax preference. Realization of a gain also increases both taxable income and AMTI. Taxable income will increase by more than the includable gain if the gain reduces the deduction for miscellaneous itemized deductions under Section 67, reduces itemized deductions under Section 68, or accelerates the phaseout of exemption amounts. AMTI will increase only by the gain plus any Section 57(a)(7) preference, because miscellaneous itemized deductions and exemption amounts are not allowed in computing AMTI, and Section 68 does not apply to the AMT.[19]

For planning purposes, the critical aspect of a net capital gain is that the regular tax rate for the gain and the AMT rate are equal. The rate preference for a net capital gain reduces regular tax liability, thereby increasing the likelihood of AMT liability from AMT adjustments and preferences, such as high state taxes, depreciation, and the bargain element on the exercise of an incentive stock optiou. This problem has arisen for taxpayers who have accelerated ordinary income into a regular tax year and then recognized a significant capital gain in the next year when substantial state tax liability is owed on the first year's tax liability.

Example. Tom is an individual taxpayer. In Year 1, Tom has low income and no AMT liability. In Year 2, Tom is not subject to the AMT, but he accelerates Year 3 income into Year 2 because tax rates will increase in Year 3. Because his Year 1 tax liability was low, Tom does not make state estimated tax payments in Year 2. In Year 3, Tom realizes a significant net capital gain and must pay the state income tax bill for Year 2. Tom also must make state estimated tax payments in Year 3. In this situation, Tom is likely to have AMT liability in Year 3 when the net capital gain is realized and significant state taxes are paid.

Because the state taxes are exclusion preferences, no minimum tax credit (MTC) is produced by this AMT liability. If Tom had anticipated the Year 3 net capital gain, state taxes on the Year 2 income should have been paid before the end of that year. Deferral of Year 3 estimate tax payments is another option, but that will likely produce a state tax penalty.

AMT base

"Tentative minimum tax" is generally defined as the AMT rate multiplied by the difference between the taxpayer's AMTI and the exemption amount.[20] AMTI is the taxpayer's taxable income for the year determined with the various AMT adjustments in Sections 56 and 58, and increased by the items of tax preference in Section 57.[21]

For planning purposes, it is important to recognize that the relationships among a taxpayer's taxable income, AMTI, regular tax rate, and AMT rate determine AMT liability. All must be considered to anticipate exposure to the AMT.

Example. Y Co. has no AMT FTC, and its AMT exemption amount is phased out. If Y Co. pays regular tax at a flat 34% rate, its AMTI must be more than 170% (i.e., 34% divided by 20%) of its taxable income before its tentative minimum tax exceeds regular tax.

In the case of a noncorporate taxpayer, the relationship among taxable income, AMTI, the regular tax rate, and the AMT rate is more complex because the regular tax and AMT rates vary more.

Effect of exemption amount. Because the AMT exemption amount reduces AMTI in computing teutative minimum tax, the exemption amount after any phaseout, in effect, shelters AMT adjustments and preferences from AMT liability.

Minimum tax credit

The MTC generally allows a taxpayer's AMT liability to be credited against regular tax liability in subsequent years.[22] The credit, however, may not reduce regular tax liability below tentative minimum tax.[23] In the case of noncorporate taxpayers (and corporations for tax years beginning before 1990), an MTC arises only with respect to AMT liability from certain AMT adjustments and preferences ("deferral preferences"), such as accelerated depreciation, that increase AMTI because of the timing, rather than the amount, of a deduction or inclusion.[24]

THE AMT IMPOSES A VARIETY OF TAX RATES ON DIFFERENT FORMS OF INCOME THROUGH THE SPECIAL TREATMENT OF VARIOUS AMT ADJUSTMENTS AND PREFERENCES.

For noncorporate taxpayers, the MTC for any tax year is generally defined as the AMT liability reduced by the amount that would be the taxpayer's AMT if only certain AMT adjustments and preferences ("exclusion preferences") were taken into account.[25] The calculation is made so that AMT liability is treated as being first generated by deferral preferences. This rule helps to preserve the MTC to the greatest extent possible. The exclusion preferences are defined as the AMT adjustments in Section 56(b)(1) (limitations on deductions of noncorporate taxpayers), and the preference items in Sections 57(a)(1) (depletion), 57(a)(5) (tax-exempt interest on specified private activity bonds), and 57(a)(7) (exclusion for gains on certain small business stock).[26] Thus, noncorporate taxpayers with significant amounts of these preferences are the most likely to incur AMT liability that does not produce an MTC.

For a corporate taxpayer, the MTC generally is the AMT imposed for the year without any reduction for AMT attributable to exclusion preferences.[27]

The effect of the MTC is to make AMT paid by corporate taxpayers and AMT paid by noncorporate taxpayers attributable to deferral preferences a prepayment of regular tax after the effect of the MTC is taken into account. In comparison, AMT paid by a noncorporate taxpayer attributable to exclusion preferences that do not produce an MTC results in an increase in total taxes paid over time. Thus, if possible, a taxpayer should plan so that any AMT incurred produces an MTC.[28] Also, it is important to plan so that the MTC offsets regular tax liability as quickly as possible. For a taxpayer continually subject to the AMT and with little prospect of using the MTC in the near future, all AMT liability begins to resemble a permanent tax increase.[29] The MTC also makes it critical that the AMT consequences of an item be evaluated over time so that the effect of the MTC in later years is considered.[30]

> BECAUSE STATE TAXES ARE EXCLUSION PREFERENCES, NO MINIMUM TAX CREDIT IS PRODUCED BY THIS AMT LIABILITY.

Income and deduction categories

The AMT, in effect, creates three broad general categories of income and deduction. The different categories need to be distinguished because their effect on regular tax and AMT varies. Thus, understanding the differences between the categories is important for AMT planning.[31] The categories are as follows:

1. Items of income and deduction that affect both taxable income and AMTI equally at the same time ("nonpreference items"). Examples of nonpreference items are items of gross income (e.g., compensation for services) or deductions (e.g., interest incurred in a trade or business) that are treated identically for both regular tax and AMT purposes.
2. Items of income and deduction that affect taxable income and AMTI equally over time, but not simultaneously ("deferral preferences"). For example, a taxpayer is permitted to fully depreciate an asset's basis for both regular tax and AMT purposes, but the timing of those deductions in the two tax systems may be vastly different.
3. Certain items either are included in AMTI or are not deductible in computing AMTI, but are never included or fully deductible in calculating taxable income ("exclusion preferences"). For example, interest from specified private activity bonds is included in AMTI and excluded from taxable income.[32] Another exclusion preference is state and local property taxes, which are deductible in computing taxable income but not in computing AMTI.[33]

AMT planning strategies

Planning for the AMT must be part of a taxpayer's overall long-term income tax planning strategy.[34] In many instances, the AMT denies or limits regular tax benefits that a taxpayer would otherwise be entitled to. Thus, regular tax planning strategies that do not consider the effect of the AMT either may be ineffective or may produce unanticipated adverse tax consequences.

Tax planning for the AMT requires a taxpayer to determine the impact of any proposed strategy on both regular tax liability and tentative minimum tax. Because each tax system has a vast array of variables, generalized tax planning strategies for the AMT are not feasible. Instead, each taxpayer must examine the effect of an AMT adjustment or preference in the context of that particular taxpayer's overall tax situation. That examination must include careful consideration of the impact on the taxpayer's tax results of the various planning options for the particular adjustment or preference.

Simple AMT planning strategies are not easily constructed; a planner must be careful for several reasons:

- The AMT may make traditional regular tax planning inappropriate. Acceleration of deductions and deferral of income may not always be a wise strategy for a taxpayer subject to the AMT.

- Planning for the AMT must be done on a multiyear basis because certain AMT adjustments and preferences have an effect over multiple years, and the MTC frequently makes the AMT a prepayment of regular tax. Long-term projections of regular tax and AMT liability must, therefore, be made in order to project the overall tax consequences of various alternative strategies.
- The complexity of the AMT makes the use of computer projections particularly appropriate for planning. Many tax planning software programs are available to do multiyear regular tax and AMT projections, and are well worth the cost for professionals who do extensive AMT planning. The programming also can often determine the state tax consequences of "what if" scenarios.

When AMT should be avoided. The answer to the question, "When should AMT be avoided?" is not obvious. When AMT liability produces an MTC, planning strategies that reduce AMT are often inappropriate because they result in an increase in total current tax liability. Consequently, the best planning strategy may be to pay AMT or even incur additional AMT and use the resulting MTC as quickly as possible.

For example, acceleration of nonpreference income or deferral of nonpreference deductions reduce AMT liability for a taxpayer subject to the AMT, but increase total tax liability. Thus, if such a strategy reduces AMT that produces an MTC, it is not appropriate.[35]

Example. X Co. has $500,000 of taxable income in 2000 and $400,000 of AMT adjustments and preferences. X's regular tax liability is $170,000 (34% of $500,000), and its tentative minimum tax is $180,000 (20% of $900,000 of AMTI). Thus, X's AMT is $10,000. X could reduce its AMT liability by accelerating nonpreference income or deferring nonpreference deductions, but those strategies would increase X's total tax. For example, if X accelerated $20,000 of income into 2000, its regular tax liability would be $176,800 (34% of $520,000) and its tentative minimum tax would be $184,000 (20% of $920,000). By accelerating $20,000 of income, X's AMT is reduced to $7,200 but its total tax liability is increased by $4,000 (from $180,000 to $184,000).

Avoidance of AMT liability may also not be an appropriate strategy in other situations. For example, a tax deduction that produces an AMT adjustment may still reduce total tax liability even though AMT is incurred as a result of the deduction.

Example. Y Co. has $500,000 of taxable income in 2000 and $350,000 of AMT adjustments and preferences. Thus, Y Co. is at the AMT crossover point where its taxable income (34% of $500,000, or $170,000) equals its tentative minimum tax (20% of $850,000 of AMTI, or $170,000). Assume Y Co. is considering placing machinery in service during 2000. The machinery has a $100,000 basis, a seven-year class life, and is five-year property. If Y Co. places the machinery in service, it will have a $20,000 regular tax depreciation deduction for the property in 2000 and a $5,000 AMT adjustment for depreciation.[36] Y's taxable income will be reduced to $480,000, and its regular tax liability will be $163,200 (34% of $480,000). Y's AMTI will be $835,000 ($480,000 of taxable income plus $350,000 of AMT adjustments and preferences plus $5,000 AMT depreciation adjustment); its tentative minimum tax will be $167,000 (20% of $835,000).

THE MTC ALSO MAKES IT CRITICAL THAT THE AMT CONSEQUENCES OF AN ITEM BE EVALUATED OVER TIME SO THAT THE EFFECT OF THE MTC IN LATER YEARS IS CONSIDERED.

Thus, by putting the machinery in service in 2000, Y incurs $3,800 of AMT, but its total tax liability is reduced by $3,000 (20% of the $15,000 of depreciation allowed for AMT purposes). Also, the $3,800 of AMT produces an MTC to offset future tax liability.

Likewise, acceleration of nonpreference deductions or deferral of nonpreference income may produce or increase AMT liability, but that is good planning if total tax liability is reduced.

Example. The facts are the same as in the preceding example, except Y Co. has $500,000 of taxable income in 2000, $350,000 of AMT adjustments and preferences, and is at the AMT crossover point. If Y defers $20,000 of nonpreference income or accelerates that amount of nonpreference deductions into 2000, its taxable income will be $480,000 and its regular tax liability will be $163,200. Y's AMTI will be $830,000 and its tentative minimum tax will be $166,000 (20% of $830,000). Thus, it will incur $2,800 of AMT that will produce an MTC. Y's total taxes, however, are reduced by $4,000.

These two examples illustrate one other important planning point. In the first example, Y Co. placed depreciable property in service, and an AMT adjustment was produced. If Y Co. could have obtained the machinery under a lease arrangement, the rental obligation would have been deductible like the nonpreference deduction in the second example. Thus, substitution of a nonpreference deduction for a deduction that produces an AMT adjustment or preference may reduce tax liability. The comparison, however, has to be analyzed on an after-tax basis and must take into account time-value-of-money considerations.

Exclusion preferences. Exclusion preferences that produce AMT liability and no MTC for a noncorporate taxpayer result in an increase in the taxpayer's total taxes. Thus, such AMT liability should be avoided if possible. Strategies to avoid such AMT liability include eliminating the preference item, shifting the preference item to a regular tax year, and accelerating income or deferring deductions to avoid the AMT.

WHEN AMT LIABILITY PRODUCES AN MTC, PLANNING STRATEGIES THAT REDUCE AMT ARE OFTEN INAPPROPRIATE BECAUSE THEY RESULT IN AN INCREASE IN TOTAL CURRENT TAX LIABILITY.

Taxpayers subject to AMT. Planning strategies for noncorporate taxpayers subject to the AMT vary depending on whether the AMT results from deferral preferences and produces an MTC or whether it results from exclusion preferences and does not produce an MTC. That is because AMT produced by deferral preferences is, in effect, a prepayment of regular tax liability, whereas AMT from exclusion preferences is an increase in the taxpayer's total tax liability. For corporate taxpayers, the MTC is the AMT imposed for the year without any reduction for AMT attributable to exclusion preferences. Thus, all corporate AMT produces an MTC.

AMT from deferral preferences. For regular tax purposes, a taxpayer normally prefers to defer recognition of income and accelerate the use of deductions in order to defer tax liability. For AMT purposes, this general strategy applies when AMT liability produces an MTC. Any income deferral strategy must also consider the effect of expiring tax benefits, such as net operating loss or charitable deduction carryovers, and rate changes. Income should not be accelerated into an AMT year to take advantage of the AMT tax rate where the AMT is attributable to deferral preferences. In such a case, acceleration of income or deferral of deductions merely accelerates taxes into the AMT year and reduces the MTC.

AMT from exclusion preferences. If a noncorporate taxpayer has AMT liability attributable to exclusion preferences, that AMT is an increase in the taxpayer's total tax liability because no MTC is produced. Thus, it is important for a noncorporate taxpayer to avoid AMT attributable to exclusion preferences. Any remaining AMT exemption amount offsets exclusion preferences before AMT liability is produced, and the MTC is calculated as if AMT liability occurs first from deferral preferences. Thus, a taxpayer may have exclusion preferences that do not produce AMT liability.

One strategy to avoid AMT liability from an exclusion preference that does not produce an MTC is to shift the preferences into (1) a regular tax year or (2) an AMT year when no AMT is produced by the exclusion preference so that an MTC is created.

Example. Ted, an individual, owes state and local property taxes that are exclusion preferences. Ted is subject to the AMT for the current year and will not receive an MTC. If the next year is a regular tax year for him, he should defer any year-end property tax payments to the next tax year.

Another strategy to avoid AMT liability from an exclusion preference that does not produce an MTC is to arrange financial affairs to avoid the preference.

Example. Alice and Bruce are married and file jointly. During 2000, they have $200,000 of tax-exempt interest from private activity bonds and consequently owe AMT. No MTC is created by the AMT because the interest on the private activity bonds is an exclusion preference under Sections 53(d)(1)(B)(ii)(II) and 57(a)(5). If Alice and Bruce rearranged their investments early in the year so that they held tax-exempt bonds that were not private activity bonds, they would not incur AMT. The decision to make that change in investments would have to consider the after-tax return on the different bonds.

Because AMT attributable to exclusion preferences that do not produce an MTC is an increase in total tax liability, such AMT liability should be minimized. If a taxpayer's regular tax marginal rate exceeds his or her AMT marginal tax rate, deferral of income from the year will reduce regular tax more than tentative minimum tax. Thus, deferral of income from a year when AMT is attributable to exclusion preferences may increase such AMT and may increase total taxes paid over time. The time value of money savings from the deferral of tax has to be balanced against the increased AMT liability.

PLANNING TIPS

The following are general rules for timing considerations involving the AMT:

1. **Strategies that reduce AMT, which would produce an MTC, and increase total current tax liability, are not advisable.**
2. **Strategies that replace a deduction that produces a deferral preference with a nonpreference deduction (e.g., leasing depreciable property) may be advisable, but they must be analyzed on an after-tax basis and must take into account time-value-of-money considerations.**
3. **Taxpayers with AMT from deferral preferences generally should defer income and accelerate deductions to defer tax liability. Income, including capital gains, should not be accelerated into an AMT yeer where the AMT is attributable to deferral preferences. Such acceleration of income merely accelerates tax liability. The tax rate on the accelerated income is not reduced to the AMT rate, because the MTC is reduced.**
4. **Noncorporate taxpayers should avoid AMT attributable to exclusion preferences where no MTC is produced.**
5. **If a noncorporate taxpayer has AMT attributable to exclusion preferences where no MTC is produced, the taxpayer should consider accelerating income into the year to eliminate the AMT liability. Income should not be deferred from, or deductions accelerated into, such a year.**
6. **A taxpayer with an MTC should plan to use the credit as soon as possible to reduce regular tax liability.**

Conversely, acceleration of income into such a year when AMT liability is attributable to exclusion preferences will increase regular tax more than tentative minimum tax and reduce total tax liability over time to the extent AMT on exclusion preferences is eliminated. In this situation, the time value of money cost from accelerating tax liability has to be balanced against the reduced AMT liability.

Use of minimum tax credit. A taxpayer with an MTC will want to use the credit as soon as possible to reduce regular tax liability. Thus, a taxpayer with an MTC will want to accelerate income into a regular tax year to fully use the credit to offset regular tax liability.

Conforming elections

The Code allows a taxpayer to elect to conform the regular tax and AMT treatment of several items that otherwise would produce an AMT adjustment or preference. For example, a taxpayer may make an election when property is placed in service so that regular tax and AMT depreciation on the property will be identical and no Section 56(a)(1) adjustment will result.

Section 59(e) also permits a taxpayer to elect for regular tax purposes to deduct ratably certain qualified expenditures over prescribed periods. Most important for AMT purposes, any portion of a qualified expenditure subject to a Section 59(e) election is not treated as either an item of tax preference under Section 57 or an AMT adjustment under Section 56.[37] The Section 59(e) election applies to:

1. Section 173 circulation expenditures (which may be deducted over three years).
2. Section 174(a) research and experimentation expenditures (which may be deducted over ten years).
3. Section 263(c) intangible drilling and development costs (which may be deducted over the 60-month period beginning in the month the expenditure was paid or incurred).
4. Section 616(a) development expenditures (which may be deducted over ten years).
5. Section 617(a) mining exploration expenditures (which may be deducted over ten years).[38] The Section 291(b) cutbacks of intangible drilling costs for an integrated oil company and mining development and exploration expenditures for corporate taxpayers apply before the Section 59(e) election, as provided in Section 59(f). Amounts deducted ratably under the Section 59(e) election are subject to recapture under the Code's recapture provisions on a disposition of the property.

The Section 59(e) election may be made with respect to any portion of a qualified expenditure.[39] Once made, the election is revocable only with the consent of the government.[40] In TAM 9607001, a taxpayer sought to modify the amount capitalized and amortized under

Section 59(e) by filing an amended return. The ruling concludes that a taxpayer may not simply file an amended return modifying the Section 59(e) amount after the due date of the original return, because such a change requires a revocation of the original election with IRS consent.

Partners and shareholders in an S corporation make the election individually with respect to their shares of the qualified expenditure.[41] A Section 59(e) election must be made by the due date (including extensions) of the taxpayer's income tax return for the year of the election. To make the election, a taxpayer attaches to the return a statement that includes:

1. The taxpayer's name, address, and Social Security or employer identification number.
2. The specific write-off chosen.
3. A notation that the election is made under Section 59(e).
4. The year for which the choice is made.
5. The tax preference item to which the election applies.

A taxpayer can use Form 4562, Depreciation and Amortization, to choose the optional write-off method under Section 59(e).

The elections permitted by the Code conform the regular tax treatment of the item with the AMT treatment and have the advantage of reducing recordkeeping costs, since separate regular tax and AMT records do not have to be kept. The elections, however, will seldom reduce a taxpayer's total tax liability (regular and AMT), and using them is generally an unwise tax planning strategy. Although these regular tax elections reduce AMT liability, they produce an offsetting or greater increase in regular tax liability. Thus, a conforming election will seldom reduce overall tax liability and may increase it. One situation where such an election could be beneficial is where the taxpayer has an expiring regular tax benefit that would otherwise be lost. Also, a conforming election may have the effect of preserving some or all of the AMT exemption amount.

Corporate strategies

The AMT timing considerations for corporate taxpayers are generally the same as those for noncorporate taxpayers with AMT attributable to deferral preferences. Corporate AMT planning is different from AMT planning for noncorporate taxpayers in other respects. The most significant difference is the Section 56(g) adjustment for corporate taxpayers based on ACE (i.e., the ACE adjustment). This adjustment is a complex provision requiring computation of an additional tax base—ACE—when the AMT liability of a corporation is calculated. Consequently, the ACE adjustment presents its own distinctive planning opportunities and challenges.

In addition, corporate AMT planning may focus primarily on the use of MTCs. Many capital-intensive corporations have been subject to the AMT for a number of years and have extensive nnused MTCs. Finally, changes in corporate composition, through mergers or acquisitions, may present AMT planning opportunities.

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Mergers and acquisitions. Corporations and their tax advisors began developing strategies for dealing with the AMT early on when the extension of the tax to corporate taxpayers was proposed as part of TRA '86. Corporate mergers were quickly recognized as a strategy for coping with the AMT. The merger of a corporation with high AMT liability with a corporation with little or no AMT has been described as "a marriage made in the Internal Revenue Code." Such a union would save tax because the total regular tax of the merged corporations generally would exceed the one corporation's AMT liability. Capital-intensive companies with large AMT adjustments and service companies with no AMT exposure are particularly good candidates for an "AMT marriage." Acquisitions to acquire corporations with AT NOLs or unused MTCs are also promising candidates.

Example. Capital Corp. has $500,000 of taxable income and $400,000 of AMT adjustments and preferences. Service Co. has $400,000 of taxable income and no AMT adjustments and preferences. As separate corporations, Capital owes $170,000 of regular tax (34% of $500,000 of taxable income), has $180,000 of tentative minimum tax (20% of $900,000 of AMTI), and owes $10,000 of AMT. Service owes $136,000 of regular tax (34% of $400,000 of taxable income).

If Capital and Service merged, their taxable income would be $900,000, and they would owe $306,000 of regular tax (34% of $900,000 of taxable income). The AMTI of the merged corporation would be $1.3 million ($900,000 of taxable income plus $400,000 of AMT adjustments and preferences). Tentative minimum tax of the merged corporation would be $260,000 (20% of $1.3 million of AMTI), and no AMT would be owed. As separate corporations, Capital and Service paid $316,000 of tax liability ($180,000 by Capital and $136,000 by Service). As a merged corporation, $306,000 of total tax liability would be owed. Thus, the merger would eliminate the $10,000 of AMT owed by Capital as a separate corporation.

The disposition of a business may have adverse AMT consequences. For example, if Capital and Service were a consolidated group and a decision had been made to dispose of Service, the additional AMT exposure to Capital following the transaction must be considered a cost of the transaction.[42]

The decision concerning whether to structure a taxable acquisition as a sale of stock or a sale of assets must also factor in the AMT consequences. On a sale of assets, a selling corporation subject to the AMT will be taxed immediately at the 20% AMT rate and its MTC will be reduced, assuming its regular tax liability is increased by the sale more than the tentative minimum tax. Also, the seller's AMT bases in its assets may vary significantly from their regular tax bases, and AMT losses may be produced by the sale.

On the purchaser's side of an asset acquisition, the possibility of future AMT liability resulting from deductions attributable to the acquired assets must be considered. The same considerations for the seller and purchaser are relevant when there is a sale of a subsidiary's stock and a Section 338(h)(10) election is made.

Limitations on merger and acquisition strategies. The Code contains an array of provisions that determine the effect of an acquisition on the target corporation's tax attributes. In general, such attributes carry over to the acquiring corporation when the target's assets are acquired in a Section 332 liquidation or certain reorganizations.[43] Carryovers of the target's tax attributes, however, are limited by provisions designed to prevent a profitable corporation from acquiring a loss corporation in order to employ the favorable tax attributes of the loss corporation. Each of these regular tax limitations potentially applies in an AMT context under the principle that the AMT is a separate and parallel tax system. The limitations potentially limiting the carryover of tax attributes include:

1. Section 381 limitation on carryovers of a target corporation's tax attributes.
2. Section 382 limitation on net operating loss carryforwards following ownership changes.
3. Section 383 limitation on the use of unused MTCs following an ownership change.
4. Section 384 limitation on use of preacquisition losses to offset built-in gains.
5. Section 269 limitation on tax attributes following an acquisition whose principal purpose is to evade or avoid federal income tax.
6. The limitations on carryovers of tax attributes in the consolidated return regulations.
7. The Section 56(g)(4)(G) adjustment in computing ACE to the basis of assets when there is a Section 382 ownership change and the corporation has a net unrealized built-in loss.

Conclusion

The AMT is affecting an increasing number of taxpayers each year. This heightens the need for AMT planning. By implementing certain strategies, taxpayers can reduce or eliminate their AMT liability. Before taking steps to reduce AMT, however, taxpayers should be sure that they will not increase their regular tax by more than the AMT savings. ■

NOTES

1 See generally Gallagher, "Financing Real Estate Projects," ¶ 57 (CCH Tax Transactions Lib.).

2 Section 55(a).

3 Sections 55(a) and (b)(1)(A).

4 Section 55(b)(1)(A)(iii).

5 Sections 55(a) and (b)(1)(B).

6 Sections 1(a), (b), (c), and (d).

7 Sections 1(a) and (c); Rev. Proc. 99-42, 1999-46 IRB 568.

8 Sections 68 and 151(d)(3).

9 Section 55(b)(1)(A).

10 Sections 11(a) and (b)(1).

11 Section 11(b)(1).

12 Section 55(b)(1)(B)(i).

13 Section 56(d)(1)(A).

14 Section 55(d)(3).

15 See generally Hartwell, "The Individual Alternative Minimum Tax: A Road Map," 14 Rev. Tax'n Individuals 195 (1990); Klein and Grevengoed, "Individual Alternative Minimum Tax," 48 NYU Inst. on Fed. Tax'n 6 (1990).

16 Section 1(h).

17 Section 1202(a).

18 Sections 67(a), 68(a), 151(d)(3), and 469(i)(3).

19 Sections 56(b)(1)(A)(i), (E), and (F).

20 Sections 55(b)(1)(A) and (B).

21 Section 55(b)(2).

22 Section 53(a).

23 Section 53(c).

24 Sections 53(b) and 53(d)(1)(B); see generally Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (Blue Book), page 437.

25 Sections 53(d)(1)(A) and (B)(i).

26 Section 53(d)(1)(B)(ii).

27 Section 53(d)(1)(B)(iv)(I).

28 Klein and Grevengoed, *supra* note 15.

29 Sanders, "The Corporate Minimum Tax Credit After RRA '89," 68 Taxes 540 (1990); Zimbler, "The Corporate Alternative Minimum Tax: Another Look," 65 Taxes 846 (1987).

30 Stern, "Planning With the New Minimum Tax Credit," 12 Rev. Tax'n Individuals 129 (1988).

31 See generally Zimbler, *supra* note 29.

32 Sections 57(a)(5), and 103(a) and (b)(1).

33 Sections 56(b)(1)(A)(ii) and 164(a)(1).

34 Kepniss, "Alternative Minimum Tax for Individuals," 47 NYU Inst. on Fed. Tax'n 7 (1989); Klein and Grevengoed, *supra* note 15; Kozub and Bunn, "Planning Strategies to Minimize the Effects of the Individual Alternative Minimum Tax," 16 Tax'n Law. 236 (1988); Sanders, *supra* note 29; Streer and Holland, "Working With the Revised Alternative Minimum Tax for Individuals," 18 Tax Adviser 150 (1987).

35 Zimbler, *supra* note 29.

36 Section 56(a)(1)(A).

37 Section 59(e)(6).

38 Sections 59(e)(1) and (2).

39 Section 59(e)(4)(A).

40 Section 59(e)(4)(B).

41 Section 59(e)(4)(C).

42 Zimbler, *supra* note 29.

43 Sections 381(a) and (c).