alternative minimum tax

The AMT was designed to prevent wealthy taxpayers from using tax loopholes to avoid paying taxes. Because historically the exemption from the AMT had not been automatically adjusted for inflation and certain common deductions were not allowed in computing the AMT, millions of middle class taxpayers were finding themselves subject to the AMT. However, Congress provided some annual relief in the recent past by installing "AMT patches" which increased the AMT exemption.

ATRA permanently increased the AMT exemption beginning in 2012 and provided for indexing of the exemption for 2013 and beyond. Since ATRA increased income tax rates for certain taxpayers beginning in 2013, fewer people may be subject to the AMT while paying a higher overall rate. Proper planning requires a two-year analysis in order to determine the true benefits you can achieve.

The Tax Cuts and Jobs Act of 2017 has also impacted the AMT.

EisnerAmper

WHAT TRIGGERS THE AMT?

The AMT is computed separately from your regular tax. Using your regular taxable income as a starting point, adjustments are made to arrive at your alternative minimum taxable income ("AMTI"). Many deductions and tax credits that are used to calculate your regular tax are not deductible or allowable in computing AMTI. So, even though the AMT maximum tax rate is less than the regular maximum tax rate, your AMT liability may be higher than your regular tax. You will pay the higher of the regular tax or the AMT.

Chart 3 shows most of the adjustments necessary to calculate your AMTI. As the chart illustrates, certain deductions, such as state and local income taxes and real estate taxes (for 2017), are not deductible when computing your AMTI. Other deductions, such as depreciation on business property, may be different for regular tax and AMT purposes. And some forms of income are exempt for regular tax purposes but taxable for AMT purposes. One example is the exercise of incentive stock options to the extent the fair market value exceeds the exercise price.

Tax Tip 5 demonstrates the high cost of being in the AMT.

Tax Tip 6 explains how state taxes on long-term capital gains and qualified dividends may trigger the AMT.

PRIVATE ACTIVITY BOND INTEREST

Tax-exempt interest on specified private activity bonds issued in 2009 and 2010 are no longer an item of tax preference and, therefore, not subject to the AMT. However, the interest on such bonds issued before 2009 and after 2010 is still subject to the AMT.

AMT RATES

The AMT is taxed at two rates: 26% and 28%. For 2017, the 28% maximum tax rate applies to ordinary AMTI in excess of $187,800 for joint returns and unmarried individuals and $93,900 if married filing separately net of any allowable exclusion. Ordinary AMTI of $187,800 or less is subject to a tax rate of 26% for married joint filers and unmarried individuals, whereas the 26% tax rate applies to married filing separately with ordinary AMTI of $93,900 or less. Net long-term capital gains and qualified dividends are taxed at the same maximum 20% rate for both the AMT and regular tax.

AMT EXEMPTION

Beginning in 2013, the exemption amount is indexed for inflation. For 2017, you are allowed an AMT exemption of up to $84,500 if married filing jointly, $54,300 if filing single or head of household or $42,250 if married filing separately. The exemption begins to phase out at $160,900 for married filing jointly, $120,700 for single or head of household, or $80,450 for married filing separately. Exemptions are fully phased out for taxpayers when their AMTI reaches $498,900 (married filing jointly), $337,900 (single or head of household) or $249,450 (married filing separately) for 2017. The AMT exemption amount is reduced 25% for every dollar of AMTI above the threshold amount for the taxpayer's filing status.

Be advised that while you are in the AMT exemption phase out range, your marginal AMT tax rate can be as high as 35% for 2017. For 2018, the Tax Cuts and Jobs Act further closes the gap between the regular tax and the AMT. The AMT exemption amounts are increased for individuals effective 2018 through 2025: $109,400 for married filing jointly or surviving spouses; $70,300 for single or head of household filers; and $54,700 for married filing separately.

In addition, for tax years beginning after December 31, 2017 and before January 1, 2026, the phase-out exemptions amounts are as follows: $1 million for married filing jointly and surviving spouses; and $500,000 for all other filers (single, head of household or married filing separately). The AMT exemption and phase out amounts are subject to inflation adjustment annually.

The 2018 exemption amounts are completely phased-out when the AMTI reaches $1,437,600 for married filing jointly or surviving spouses; $781,200 for single or head of household filers; and $718,800 for married filing separately. The exemption continues to phase-out 25% of every $1 for AMTI over the threshold amount.

Fewer taxpayers will be subject to the AMT due to the increase of the AMT exemption and threshold amounts for tax years after 2017 and before 2026, as well as the elimination or scaling back of certain itemized deductions.

PLANNING FOR AMT SCENARIOS

Tax planning can help you determine whether or not you will be subject to the AMT. This can enable you to take steps to reduce your overall tax liability. Using Chart 3 to guide you, here are three possible AMT scenarios to plan for:

You are subject to the AMT in the current year, but don't expect to be next year:

- Defer until the following year any deductions that are not deductible for AMT purposes. Note that state and local income taxes and property taxes are no longer deductible for AMT purposes and only deductible up to $10,000 for regular tax purposes.

tax tip

5 THE HIGH COST OF THE AMT

Failing to consider the AMT and incorrectly timing the payment of some of your deductions can be costly. Let's say that before December 31, 2017, you paid the following expenses:

- $15,000 state estimated fourth quarter 2017 tax payment (due January 15, 2018),
- $10,000 in real estate taxes (tax was assessed due in January, 2018), and
- $20,000 in charitable contributions that you could have delayed until 2018.

Income	Regular Tax After Year-End Payments	AMT
Earned income	$ 200,000	$ 200,000
Qualifying dividends	25,000	25,000
Long-term capital gains	175,000	175,000
Total Income	**$ 400,000**	**$ 400,000**
Deductions		
State & local income taxes	$ 100,000	$ 0
Real estate taxes	20,000	0
Mortgage interest	50,000	50,000
Contributions	40,000	40,000
Investment advisory fees	25,000	0
Disallowance of advisory fees (2% of AGI)	(8,000)	0
3% AGI Floor	(2,586)	0
Net Itemized Deductions	**$ 224,414**	**$ 90,000**
Personal exemptions (married with 2 children) (after phaseouts)	4,860	0
Taxable Income	**$ 170,726**	**$ 310,000**
Federal Tax	**$ 14,224**	**$ 34,937**
Medicare Contribution Tax on net investment income	5,054	5,054
Total federal tax (including Medicare Contribution Tax on net investment income)	**$ 19,278**	**$ 39,991**

Because you must pay the higher of the two taxes, your tax will be $39,991 — that's $20,713 of AMT tax in excess of your regular tax. Therefore, you lost the full benefit from the prepayment of your state estimated tax and real estate taxes, as well as some of the benefit of prepaying charitable contributions.

Caveat: *Keep in mind changes in law under the Tax Cuts and Jobs Act that are effective for the 2018-2025 tax years, and how that could impact the AMT calculation.*

- Taxpayers with large itemized deductions that are disallowed for AMT but considered a direct expense that can be deducted when computing net investment income may want to consider taking such deductions in the current year, even if in the AMT. Expenses such as state and local taxes paid, investment fees, etc. are directly allocable to net investment income and can be used to lower the 3.8% surtax even if the deductions are not allowed for AMT purposes.

- Accelerate ordinary income into the current year to benefit from the lower AMT rate.

- Realize net short-term capital gains this year to benefit from the lower AMT rates, unless these gains will offset short-term losses next year or would otherwise be held long term.

- Delay exercising any incentive stock options ("ISOs") since you could wind up paying the AMT on the spread between the fair market value and the exercise price. If you already exercised the options, consider a disqualifying disposition as discussed in the chapter on stock options. Also, see the rule discussed later in this chapter that may offer some credit relief for the AMT resulting from the exercise of ISOs.

- Take IRA or retirement plan distributions if in AMT; tax paid may be at a lower rate.

You are not subject to the AMT in the current year and will be taxed at the regular tax rate of 37% (2018) but expect to be subject to the AMT next year:

- Prepay deductions that are not deductible for AMT purposes to get the full tax benefit in the current year rather than lose the tax benefit next year.

- Prepay deductions that are deductible against the AMT, such as charitable contributions, to gain the benefit of the higher ordinary tax rate in the current year.

- Defer ordinary income, such as bonuses if possible, to the following year to take advantage of the lower AMT rate.

- Review your ISO awards to determine if you can exercise any shares before the end of the year. The exercise will be tax-free this year up to the extent of the break-even point between your regular tax and the AMT. In the following year, any exercises will result in an AMT liability based on the fair market value of the shares at the time of exercise over the exercise price.

You are not subject to the AMT in either year:

- You have avoided the AMT, but you still want to reduce your regular tax liability in the current year. Turn to the chapter on tax planning strategies for year-end planning ideas that can minimize your tax exposure.

AMT CREDIT CAN REDUCE FUTURE TAXES

If you pay the AMT, you may be entitled to a tax credit against your regular tax in a subsequent year. You qualify for an AMT credit based on "deferral items" that contributed to your AMT liability. The most common deferral items are depreciation adjustments, passive activity adjustments and the tax preference on the exercise of ISOs. Other deductions, such as state and local income taxes and investment fees, are called exclusion items. You cannot get an AMT credit from these deductions. The AMT illustration in Tax Tip 5 would not create an AMT credit since none of the adjustments are deferral items.

tax tip 6

LONG-TERM CAPITAL GAINS AND QUALIFYING DIVIDEND INCOME NO LONGER WILL PUT YOU INTO THE AMT STARTING IN 2018

In prior years, long-term capital gains and qualifying dividend income may have resulted in the taxpayer being subject to the AMT, even though both were taxed at the maximum tax rate of 20% for regular tax purposes and for the AMT. The reason for this is that when the taxpayer paid the state and local taxes on the income, it reduced the regular tax liability, but did not reduce the AMTI. Therefore, the AMT taxable income was higher than the regular taxable income.

This is no longer the case as a result of the Tax Cuts and Jobs Act. Because state and local taxes are no longer a deduction in computing the regular income tax (except for the election to deduct $10,000), it will most likely not cause a taxpayer to be subject to the AMT. This provision is in effect for the tax years 2018 through 2025.

Keep in mind that if you are subject to the Medicare Contribution Tax on net investment income, consideration should be given to paying expenses that are allocable in arriving at net investment income even if they are not deductible for regular tax and AMT purposes. State and local taxes on net investment income can be deducted in the computation of the Medicare Contribution Tax.

The reason a deduction is classified as a deferral item is because over time you will end up with the same total deductions for both regular tax and AMT purposes. As an example, a depreciation difference is a deferral item if it is calculated using a different asset life and method for AMT purposes then used for regular tax purposes. However, over the life of the asset, the total depreciation will be the same under either tax computation. Special rules apply for bonus depreciation. See the chapter on business owner issues and depreciation deductions.

chart 3

AMT VS. REGULAR TAX— STARTING IN 2018

Description	Deductible in Computing: Regular Tax	Deductible in Computing: AMT	Taxable for AMT Only	Other AMT Differences
State and local income taxes (non-business); can elect up to $10,000 ($5,000 MFS) for combined state and local income and real estate taxes	•			
Real estate taxes (personal); can elect up to $10,000 ($5,000 MFS) for combined state and local income and real estate taxes	•			
Qualified Motor Vehicle Tax (state or local sales tax or excise tax on purchase)	•			
Investment interest expense	•	•		
Charitable contributions	•	•		
Investment advisory fees (no longer deductible for either AMT or regular tax purposes)				
Employee business expenses (W-2) (no longer deductible for either AMT or regular tax purposes)				
Mortgage interest on: • Qualified acquisition and equity debt up to $750,000 used to buy, build, or improve your residence • Equity debt not used to buy, build or substantially improve your residence (no longer deductible for either AMT or regular tax purposes) **Note:** *Interest on acquisition debt in excess of $750,000 entered into after December 15, 2017 is not deductible as mortgage interest, but the debt is subject to the interest tracing rules to determine if deductible as interest on other debt, such as investment interest.* **Note:** *Equity debt used to buy, build or substantially improve the residence that secures the loan is still deductible.*	•	•		
Medical expenses in excess of 7.5% of AGI*	•	•		
Exercise of ISOS (to the extent the fair market value exceeds the exercise price)			•	
Depreciation (subject to different AMT rules)				•
Gain or loss on disposition of certain assets, including sale of small business stock				•
Passive activity adjustments				•
Interest on private activity bonds issued before 2009 and after 2010				•
Net operating losses (subject to different AMT rules)				•

**For regular and alternative minimum tax purposes, the medical expense threshold is 7.5% for any tax year beginning after December 31, 2016 and before January 1, 2019.*