Income Tax Planning

I. INCOME TAX AND FORM 1040 - IMPORTANT TOPICS

A. Alternative Minimum Tax.

1. Alternative minimum tax.
   a. Backup to the income tax designed to ensure that no taxpayer with substantial economic income can avoid significant tax liability using deductions, exclusions, and credit.
   b. A separate but parallel tax system.
   c. American Recovery and Reinvestment Act of 2009 (Recovery Act of 2009).
      i. One-year patch for tax year 2009.
      ii. Does not apply to other tax year exemption amounts.
      iii. Exemption amounts for 2010 revert to 2000 levels unless Congress passes new legislation.
   d. May have to pay if AMTI (alternative <u>minimum</u> taxable income) exceeds for 2009:
      i. $70,950 if married filing a joint return.
      ii. $46,700 if single or head of household.
      iii. $35,475 for married filing separately.
   e. Preferences—add backs.
      i. The AMT is designed to take back all or part of the tax benefits derived through the use of these tax preferences.
         A) Percentage depletion in excess of adjusted basis.
         B) Interest on certain private activity bonds (sports stadium) except those issued in 2009 and 2010.
         C) Excess of accelerated depreciation over SL on real property placed in service before 1987.
         D) Seven percent of excluded amount of gain (3.5% of total gain) on sale of Section 1202 stock (for stock acquired 2-18-09 to 12-31-10, only 1.75% of total gain is an add back).
         E) Intangible drilling costs.
      ii. Tax preferences are always positive.
   f. Adjustments
      i. Adjustments made to taxable income in the formula can be either positive or negative.
      ii. Most adjustments relate to timing differences because of separate income tax and AMT calculation procedures/rules. A positive adjustment is made when the deduction allowed for income tax purposes exceeds the deduction allowed for AMT purposes. The opposite is true for a negative adjustment.

g. Calculating alternative minimum taxable income (AMTI):

	Regular taxable income
+	Positive AMT adjustments
–	Negative AMT adjustments
+	Tax preferences
=	Alternative Minimum Taxable Income

h. Calculating alternative minimum tax (AMT):

	AMTI
–	AMT exemption
=	Minimum tax base
×	AMT rate
=	Tentative AMT
–	Regular income tax on taxable income
=	AMT

i. Postponing or avoiding AMT
   i. Items that increase regular income tax liability can help the taxpayer postpone or avoid AMT in a given year by increasing regular income tax.
      A) Accelerate regular income to same year as AMT income is expected.
      B) Postpone payment of some deductible expenses to the next year (medical payments, state income and property taxes, charitable giving).

Adjustments to Taxable Income

Adjustment	Regular Tax	AMT	Positive/Negative
Personal and dependency exemptions	Allowed	Disallowed	Positive
Standard deduction	Allowed	Disallowed	Positive
Itemized deduction—medical	Allowed in excess of 7.5% of AGI	Allowed in excess of 10% of AGI	Positive[3]
Itemized deduction—taxes (state income taxes and property taxes)	Allowed	Disallowed	Positive
Miscellaneous itemized deductions	Allowed >2% of AGI	Disallowed	Positive
Interest on student loans	Allowed	Disallowed	Positive
Difference between qualified-residence interest and home equity loan interest[1]	Allowed	Disallowed	Positive
Investment interest expense as limited for AMT purposes (related to qualified-residence interest and private-activity-bond interest)	Allowed	Disallowed	Positive
Exercise of incentive stock options	Not taxed	Bargain element (spread) is an addback	Positive
Tax benefit rule for state income tax refund	Included in income	Not included in income	Negative
Reduction of itemized deductions	Some deductions disallowed	No reduction	Negative
Depreciation of post-1986 property	MACRS allowed	ADS allowed	Both[2]
Mining exploration and development costs		Both[2]	
Pollution control facilities		Both[2]	
Research and experimental expenses		Both[2]	
Completed contract method	Small businesses can use the completed contract method	Small businesses must use the percentage-of-completion method	Both[2]
Passive activity losses		Both[2]	
Adjusted gain/loss		Both[2]	

[1] Home equity loan interest that is not used for home improvements is not considered qualified residence interest for the purposes of AMT.

[2] Both means the adjustment could be positive or negative depending on circumstances.

[3] The impact of a higher threshold, 10%, is an add-back of 2.5% (10% – 7.5%) of the taxpayer's AGI for purposes of calculating AMTI.