Business point

AMT's silver lining

In recent years, more taxpayers regrettably have become familiar with Alternative Minimum Tax (AMT). This tax has caused a lot of confusion. More taxpayers are asking, "What is Alternative Minimum Tax and why do I have to pay it?"

There isn't enough space in this article (or even this issue) to explain everything about AMT. Instead, we'll explain the theory of AMT, how it's calculated and how to claim an AMT credit. This should give you an idea of when and how it may affect you. This article focuses on AMT as it applies to an individual taxpayer, not to entities (corporations, partnerships, etc.). Different forms, rules and calculations may apply.

Let's start by explaining the term Alternative Minimum Tax. AMT uses an alternative set of tax rules that (in theory) calculates the minimum tax liability, given a certain income. If you're already paying more than this minimum amount under the regular tax calculation, you don't owe any AMT. However, if your regular tax calculation is less than the AMT calculation, you must add the difference to your tax liability on line 46 of the 1040 form, making your actual federal tax liability equal to the AMT liability.

The theory of AMT

Congress enacted the AMT law in 1969 after learning 155 taxpayers with incomes greater than $200,000 in 1966 paid no federal tax. The concept was to prevent very high-income individuals from exploiting special tax benefits to pay either little or no federal tax.

With the Tax Reform Act of 1986, the Alternative Minimum Tax calculations became "parallel" to the regular federal tax calculation. As a result, your federal tax liability is now calculated twice — first using the regular federal tax method and then using the AMT method.

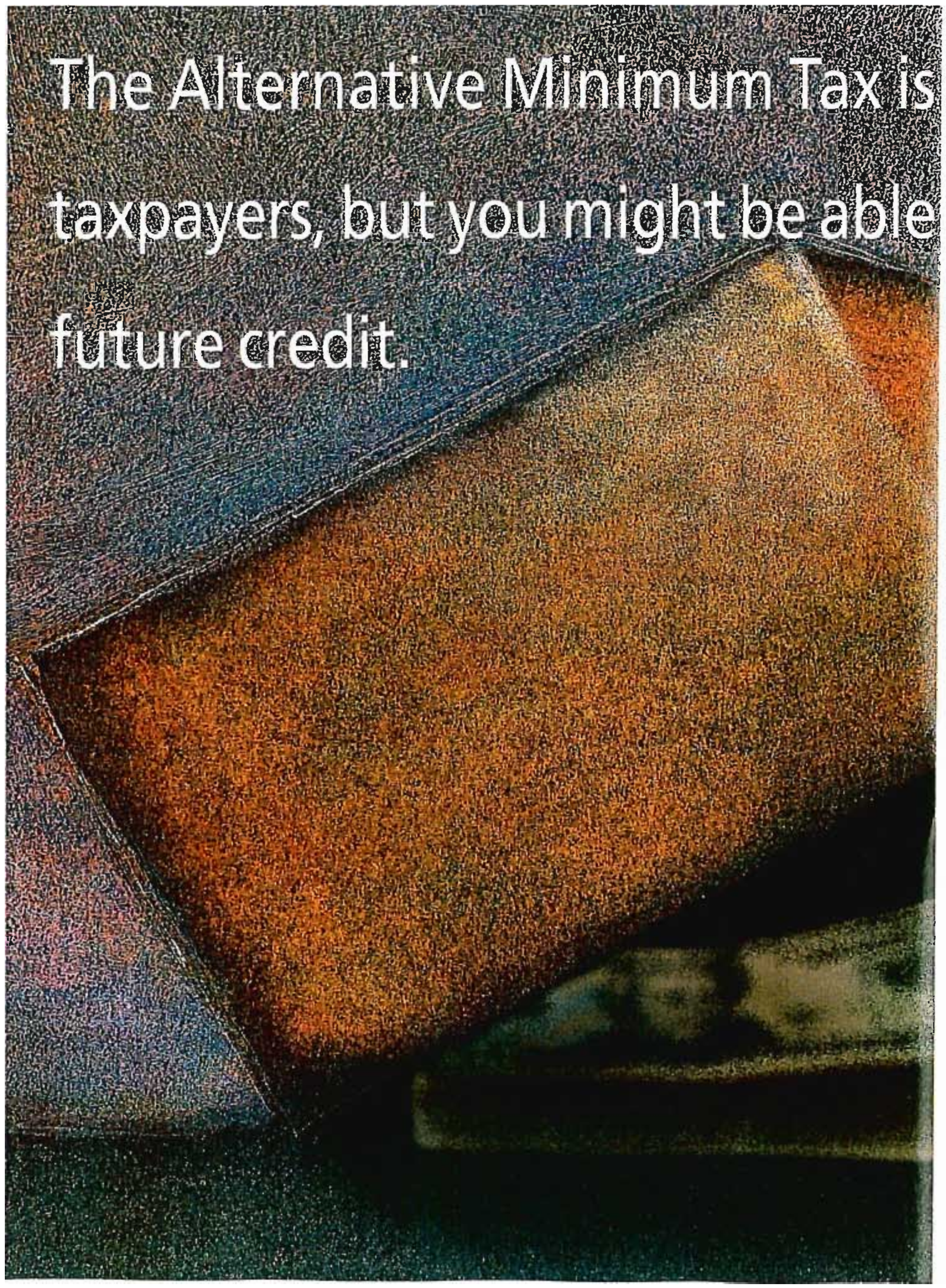
Because AMT affected few taxpayers until recent years, the ruling received little attention. But AMT is not indexed to inflation, and with the lowering of regular federal tax rates in recent years, an increasing number of middle-income taxpayers are finding themselves subject to this tax.

How AMT is calculated

The easiest way to understand AMT is to view it as a separate tax system. This system has different tax rates, tax brackets, exemptions and rules for determining deductible expenses. They generally are less favorable to taxpayers than the regular tax rules.

Because of all the inconsistencies between regular tax and AMT tax calculations, the only way to see whether it affects you is to calculate the AMT using the IRS Form 6251 "Alternative Minimum Tax." This form will walk you step by step through the process. In overview, you will:

1. **Make a tax preference adjustment to your regular income.** Some of the



most common adjustments to your income for AMT calculations are:

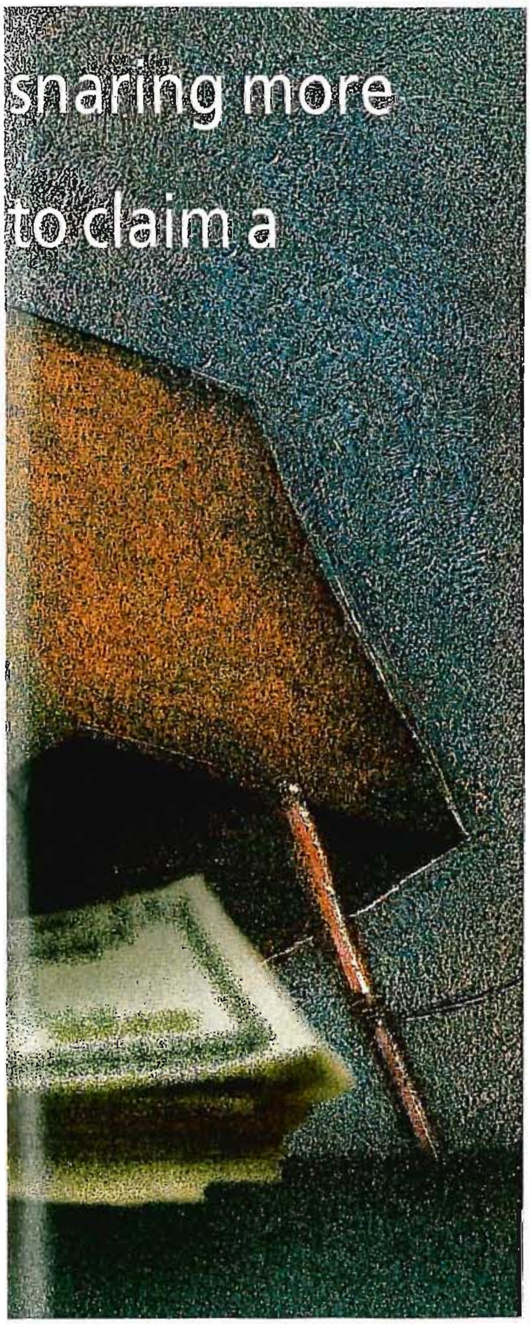
a. Personal exemptions
b. Standard deductions (assuming you did not itemize)
c. State and local taxes (assuming you did itemize)
d. Percentage of medical expense (assuming you did itemize)
e. Depreciation adjustment (for most farmers this is probably the most common adjustment)
f. Stock options

For a complete list of adjustments, review IRS Form 6251 and the instructions.

2. Deduct the AMT exemption. This varies depending on your filing status and income phaseouts. For 2006, the "married filing joint" deduction is $62,550.

3. Calculate the AMT. Again, rates and brackets vary depending on your filing status. For 2006, the brackets for a "married filing joint" taxpayer are 26 percent on the first $175,000 then 28 percent on any excess.

Because of the complexity and rise in number of taxpayers affected by AMT recently, the IRS has developed an online tool called the "AMT Assistant." This tool asks you specific questions and tells you if you do not need to file the 6251 Alternative Minimum Tax Form. The AMT Assistant is available at http://apps.irs.gov/app/amt2006.



How to claim an AMT credit

Here comes the possible good news: You may be able to claim a credit in future years for some (possibly all) of the additional taxes you paid resulting from AMT. You'll need to file IRS Form 8801 to calculate your Minimum Tax Credit (MTC) each year. In general, here are several steps to help you understand what is required.

1. Calculate the available credit. This involves calculating the AMT again using *yet another* set of rules. (It's an alternative to the alternative.) Only some of the AMT adjustment items are eligible for use in the credit calculation. To determine eligibility, the adjustments are classified as:
   a. Deferral (timing) adjustments are eligible for the MTC credit. This typically would include an item like depreciation adjustments.
   b. Exclusion (permanent) adjustments are not eligible for the MTC credit. These include items such as state and local taxes, medical and dental adjustments.

If you're lucky, all your AMT adjustments are deferral and your entire MTC credit can be carried forward. Unfortunately, this is not usually the situation.

2. Determine how much of the MTC you can claim as a credit in the following year. On Dec. 20, 2006, during the final days of the 109th Congress, a new AMT law passed. It separates MTC into short-term (three years or less) and long-term (greater than three years) for tax years 2007-2012.

Nothing changes for the short-term MTC. It's still limited to the extent that regular tax exceeds AMT. For example, if John has a MTC of $4,000, a regular federal tax of $23,000 and an AMT liability of $22,000, he will be able to claim $1,000 in carried-over MTC.

However, the new law makes the long-term MTC credit refundable. You receive the lesser of:

1. $5,000
2. Actual MTC
3. 20 percent of the carried-over MTC (limited to income phaseouts)

IRS currently has no form or publication to refer to on this change. However, this long-term credit is subject to income phaseouts and FIFO (first-in, first-out) rules, so ask your tax preparer for details about this new credit.

Remember, this new MTC ruling applies to 2007 returns to be filed in 2008, so if you have an MTC carried over, be sure to file Form 8801 to take advantage of this change. ■

Editor's note: *Kent Vickre and Chuck Cagley author a tax and finance column for each issue of Pioneer* GrowingPoint® *magazine. Vickre is state coordinator of the Iowa Farm Business Association. Cagley is state coordinator of Illinois Farm Business Farm Management. They address issues that influence agribusiness success.*

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