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*By George R. Goodman*

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# Regular Tax vs. AMT Bracketology: AMT Upsets Regular Tax for Many

By George R. Goodman


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George R. Goodman is of counsel with Foley & Lardner LLP, Chicago.

In this article, Goodman examines how the alternative minimum tax has overtaken regular tax for many individuals, and he discusses the resulting implications for tax policy and individual tax planning.



## Introduction

Much has been said about the fact that so many taxpayers are now paying alternative minimum tax, which is often attributed to the AMT thresholds not being indexed for inflation. However, it is worth delving deeply into the changed relationship between the regular tax and AMT. Now, for moderately high-income individuals, the AMT has nearly supplanted the regular tax system altogether by imposing relatively high rates with no allowance for specified tax preferences. Moreover, although qualified dividends and capital gains are ostensibly taxed at the same favorable rates under the AMT as under the regular tax system, that income can effectively be taxed at higher AMT rates by reducing the AMT exemption.

This article explores those concepts further. The focus is on the AMT for individuals only (not corporations), and specifically on comparing the basic rate brackets, standard deduction or itemized deductions, and exemptions under the regular tax and AMT systems. Understanding the now-distorted, cattywampus relationship between the regular tax and AMT systems will help individuals minimize their overall regular and AMT tax liabilities while avoiding expending resources on regular tax planning that yields no benefits under the AMT. It will also help inform the tax reform debate.

## The Regular and AMT Tax Systems

The regular and AMT tax systems resemble Amtrak's Lake Shore Limited from Chicago to New York City/Boston. For either destination, the same train leaves out of Chicago, but it splits around Albany, New York, into two trains that diverge to New York City and Boston. Similarly, both the regular and AMT tax systems start with the determination of adjusted gross income (Albany, if you will). This determination rests largely on fundamental notions of income. AGI represents the excess of gross income over specific priority ''above-the-line'' deductions, generally for expenses incurred in earning that gross income. Then the two tax systems diverge.

Under the regular tax system, once a taxpayer has determined AGI, he subtracts either the standard deduction or his itemized deductions, and finally his personal exemptions, to arrive at regular taxable income (RTI). Itemized deductions and personal exemptions, but not the standard deduction, are subject to specific limitations and phaseouts depending on the taxpayer's AGI.[1] RTI is divided between ordinary income taxed in the regular income tax brackets ranging from 10 to 39.6 percent, and preferential qualified dividend and net capital gain income taxed at maximum rates of 15 or 20 percent. The total tax is the taxpayer's regular income tax liability (which may be reduced by credits).

The AMT system tweaks AGI differently to instead arrive at alternative minimum taxable income (AMTI).[2] The AMT disallows or adjusts some of the

[1]Itemized deductions that are considered ''miscellaneous itemized deductions'' as defined in section 67 are allowed only to the extent they exceed a floor of 2 percent of AGI. Under an overall limitation, almost all itemized deductions are reduced by 3 percent of the excess, if any, of AGI over the applicable amount under section 68(b), but not less than 20 percent of the itemized deductions otherwise allowable. Significantly, the standard deduction is not considered an itemized deduction subject to these restrictions and is allowed in full regardless of AGI. Personal exemptions are phased out over AGI ranges beginning with the same section 68(b) applicable amounts.

[2]Although section 55, which imposes the AMT, technically starts with RTI, addback of the standard deduction, personal exemptions, and some itemized deductions effectively gets back to AGI, which is the starting point (less itemized deductions) for computing AMTI on IRS Form 6251, ''Alternative Minimum Tax — Individuals.'' As defined, preference items include both adjustments under section 56 and preferences under section 57,

(Footnote continued on next page.)

deductions, credits, or exclusions that are allowed for regular tax purposes (preference items). In particular, the standard deduction and many itemized deductions, as well as personal exemptions, are preference items; these are disallowed — and no benefit is derived from them — under the AMT.

Instead, the AMT has its own exemption, which phases out when AMTI reaches specific levels. The first $179,500 of AMTI that exceeds the exemption is taxed at 26 percent, and any remaining AMTI is taxed at 28 percent, except that the tax rate on qualified dividend income and net capital gain income is capped at 15 or 20 percent. The total tax is the tentative minimum tax (TMT) (which may be reduced by credits). Technically, a taxpayer only pays AMT to the extent TMT exceeds his regular income tax computed under the regular income tax system above. But the AMT system can be thought of as imposing tax equal to the TMT, because the TMT is the total tax that must be paid (although part may technically overlap with and be paid as regular income tax).[3]

In short, the regular and AMT tax systems start out along the same path to reach AGI, then diverge to produce two different tax figures, regular income tax and TMT. One can be thought of as New York and the other Boston, depending on one's view of the taxes and the cities. Regardless, the taxpayer must pay the greater of regular tax or TMT.

This article focuses on how the regular tax and AMT systems diverge after AGI.

## Rise of the AMT

After the Tax Reform Act of 1986 reformed the Internal Revenue Code, almost all individuals started off as regular taxpayers. The intended purpose of the AMT was ''to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits.''[4] Initially, in line with that limited purpose, the AMT ensnared only a few high-income taxpayers otherwise benefiting from large preference items.

For 1988, the first year for which the new tax rates under TRA 1986 were fully in effect, individuals filed 109,708,280 returns and paid taxes of $412.9 billion; of these, only 113,562 returns reported AMT, totaling just $1 billion.[5]

Boy, how things have changed. In 2012 individuals filed 144,948,385 returns and paid taxes of $1,191.6 billion; of these, a whopping 4,250,567 reported AMT totaling $29.1 billion.[6] Both the percentage of returns reflecting AMT and the amount of AMT have increased nearly 30-fold since 1988.

Why the big increase in AMT? The items designated as preference items have changed little since TRA 1986. While shifts in taxpayer behavior may be responsible for some of the AMT, the real change seems to be in the basic rate brackets.

Under TRA 1986, the regular tax had two nominal rate brackets: 15 percent and 28 percent. In 1988 the standard deduction was $3,000 for a single taxpayer ($5,000 if married filing jointly), and the personal exemption was $1,950. To phase out and recapture the benefit of the 15 percent tax bracket and personal exemptions, there was an additional 5 percent surtax on income in specific ranges. Factoring in this 5 percent surtax, the resulting rate brackets on RTI of single or married joint returns claiming only the standard deduction and one or two personal exemptions, respectively, were as follows:

**Table 1. 1988 Rates**

| Tax Rates | Single RTI | Married Joint RTI |
|---|---|---|
| 15% | $0-$17,850 | $0-$29,750 |
| 28% | $17,851-$43,150 | $29,751-$71,900 |
| 33% | $43,151-$100,480 | $71,901-$171,090 |
| 28% | $100,481 and up | $171,091 and up |

For 1988, AMT was imposed on individuals at a flat rate of 21 percent on AMTI in excess of the allowable AMT exemption, which was $30,000 for a single taxpayer or $40,000 for a joint return. The

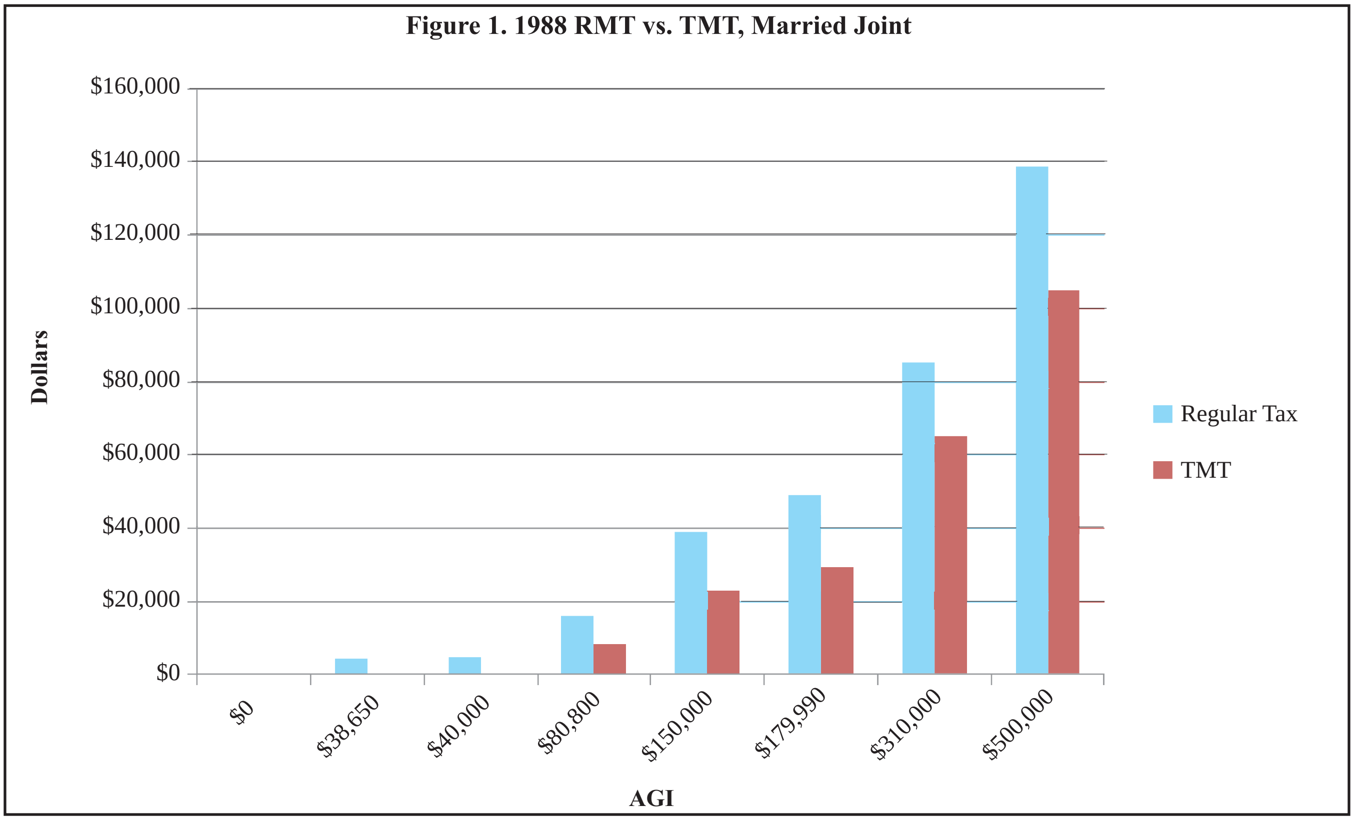
some of which are reflected ''above-the-line'' in AGI. This article does not focus on above-the-line preference items.

[3]Section 53 allows AMT attributable to deferral preference items (timing items that defer RTI to future years, as opposed to exclusions that exempt items from regular tax altogether) to be credited against regular tax in future years. This ameliorates the problem of taxpayers losing altogether the benefit of timing preference items, as when a regular tax timing deduction in one year is disallowed under the AMT, while regular tax would otherwise be incurred in a later year when no deduction is allowed for regular tax purposes because it was already allowed for regular tax purposes in the prior year.

[4]Joint Committee on Taxation, ''General Explanation of the Tax Reform Act of 1986,'' at 432 (May 4, 1987).

[5]Charles Day and Michael Strudler, ''Individual Income Tax Rates and Tax Shares, 1988-1989,'' *Statistics of Income Bulletin* (Spring 1993). References herein to TRA 1986 include technical corrections.

[6]Michael Parisi, ''Individual Income Tax Returns, Preliminary Data, 2012,'' *Statistics of Income Bulletin* (Winter 2014). The AMT figure appears to represent just the technical AMT, the excess of TMT over regular tax. But one could view the AMT system as imposing tax equal to TMT. Under that view, the AMT would account for much more than the $29.1 billion technical AMT. In the 2012 tax year, returns with AGI exceeding $200,000 reported total income tax of $657 billion, and their total TMT is probably at least two-thirds of that.




exemption phased out for singles with AMTI between $112,500-$232,500 and for joint returns with AMTI between $150,000-$310,000.

Given the relatively low 21 percent AMT tax rate, in the absence of large preference items, regular tax significantly outpaced TMT at all income levels. The only cause for incurrence of AMT was large preference items, in keeping with the AMT's intended scope and purpose.

To more precisely compare the regular tax and AMT systems, it is helpful to conceive of the regular maximum tax (RMT) that could be incurred for a given level of AGI. For any given AGI, RMT is the regular tax computed assuming the taxpayer has only ordinary income and claims only the bare minimum in preference items, that is, the standard deduction and either one or two personal exemptions for a single or joint return, respectively. The excess of RMT over TMT represents how much regular tax could be saved through preference items before the AMT takes hold. The smaller the excess, the more likely the AMT will apply.

To illustrate the gap between regular tax and AMT in 1988, Figure 1 depicts the 1988 RMT and TMT of a married couple at various AGI levels.

At any AGI level, the RMT substantially exceeds TMT. The same was true for single taxpayers as well. AMT only applied to the few taxpayers with enough preference items to reduce the regular tax below TMT.

Since 1988 the regular tax bracket thresholds and rates, the standard deduction and personal exemption, and the AMT rates and exemption have all increased. These changes cut in different directions regarding the scope of the AMT. The changes that decrease regular tax (higher regular bracket thresholds, standard deduction, and personal exemption) or increase TMT (higher AMT tax rates) narrow the RMT versus TMT gap, while changes that increase regular tax (higher regular tax rates) or reduce TMT (higher AMT exemption) widen the gap.

On balance, the changes have virtually eliminated the gap between RMT and TMT for moderately high-AGI individuals. The gap for them is now so small their preference items typically push regular tax below TMT.[7] The AMT is no longer just a tax safety net to capture only large preference items and prevent high-income taxpayers from avoiding significant tax. It has become the governing tax regime for most moderately high-AGI individuals simply because of their income level, and even if their computed regular tax is substantial.

[7]In 2012, of 3,423,477 taxable returns reporting AGI exceeding $250,000, 2,661,084, or 78 percent, reported AMT. Out of 1,822,172 taxable returns reporting AGI between $200,000 and $250,000, nearly 45 percent, or 811,912, reported AMT. *See* Parisi, *supra* note 6.

This transformation is apparent from comparing the 2014 regular and AMT tax rate brackets. The 2014 regular tax brackets applicable to RTI begin with low rates but are quite progressive, as follows:

| Table 2. 2014 Rates | | |
|---|---|---|
| Tax Rates | Single RTI | Married Joint RTI |
| 10% | $0-$9,075 | $0-$18,150 |
| 15% | $9,076-$36,900 | $18,151-$73,800 |
| 25% | $36,901-$89,350 | $73,801-$148,850 |
| 28% | $89,351-$186,350 | $148,851-$226,850 |
| 33% | $186,351-$405,100 | $226,851-$405,100 |
| 35% | $405,101-$406,750 | $405,101-$457,600 |
| 39.6% | $406,751 and up | $457,601 and up |

The standard deduction is $6,200 for singles and $12,400 for joint returns. The personal exemption is $3,950 but phases out for singles with AGI between $254,200-$376,701 and joint returns with AGI between $305,050-$427,551.

For 2014 the AMT exemption is $52,800 for singles and $82,100 for joint returns, but phases out for singles with AMTI between $117,300-$328,500, and joint returns with AMTI between $156,500-$484,900. The first $182,500 of AMTI in excess of the exemption is taxed at 26 percent, and the remaining AMTI is taxed at 28 percent.

After the relatively large exemption, the AMT kicks in at nominal rates on par with the regular rates. But the phaseout of the AMT exemption over higher income levels then pushes the AMT rates well above the regular rates over much of the phaseout range. As a result, TMT nearly equals RMT for moderately high-AGI taxpayers.

Two examples illustrate this convergence. The first is a married couple. Factoring in the regular tax personal exemption and AMT exemption phaseouts, the couple's RMT and TMT, in relation to AGI, are shown in Table 3.

A few general observations can be made. Regular tax clearly exceeds the $0 TMT for AGI up to $82,100. Thereafter TMT should catch up quickly given AMT's significantly higher marginal tax rates for AGI from $82,101-$305,051. Once AGI reaches $305,051, regular tax will again outpace the AMT.

Figure 2 shows the couple's RMT and TMT at the various AGI bracket thresholds.

As can be seen (or computed from the above table), the couple's RMT exceeds TMT by less than about $2,000 for AGI between around $243,000 and $485,000. And this is the couple's maximum regular tax, computed assuming the couple has only ordinary income and claims only the bare minimum preference items of the standard deduction and two personal exemptions. Little additional preference items, or as shown in the next section below, even just dividend or capital gain income, would push the couple into AMT.

The second example is a single individual. Factoring in the personal and AMT exemption phaseouts, the individual's RMT and AMT in relation to AGI are shown in Table 4.

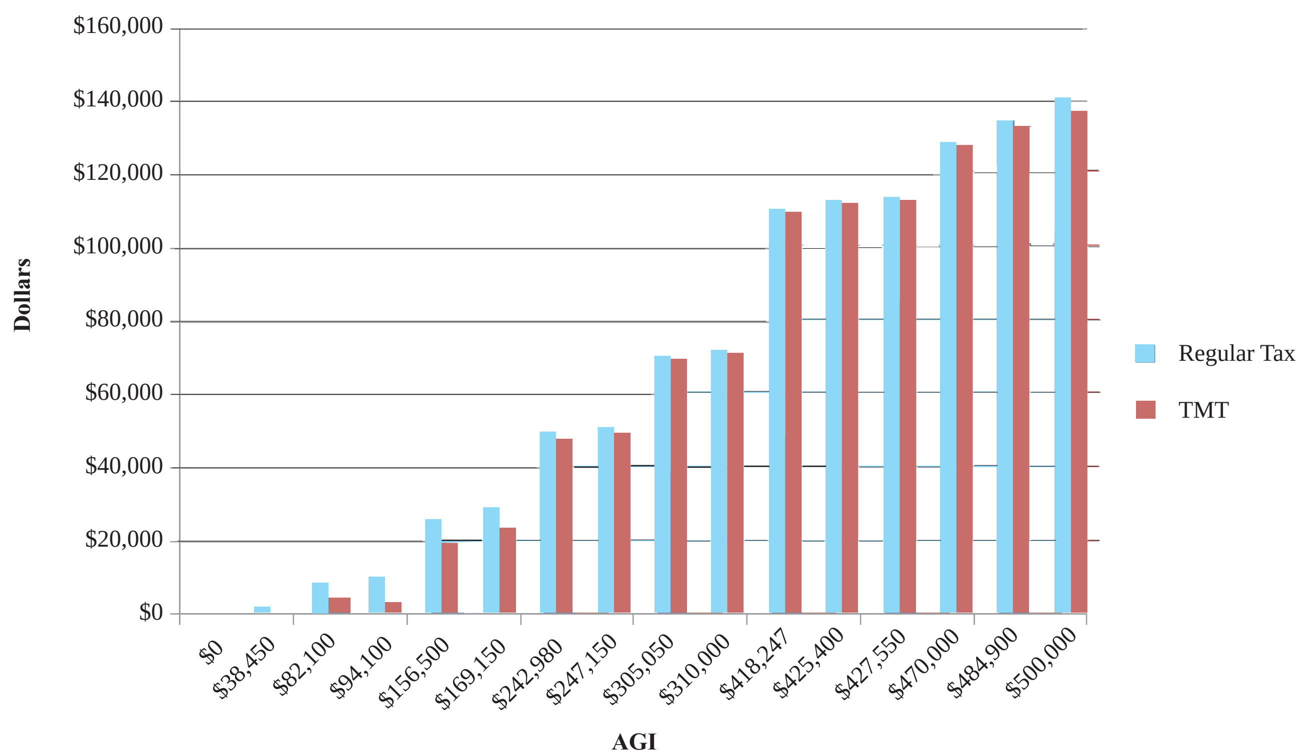
Regular tax exceeds $0 TMT for AGI up to $52,800. Thereafter, in the AGI ranges of $52,801-$99,501, $117,301-$196,501, and $211,701-$328,500, marginal AMT rates exceed regular tax rates and TMT will narrow the gap. Ultimately, AMT approaches but never quite catches up with regular tax, which begins pulling away again at $328,500. Figure 3 shows the individual's RMT and TMT at the various AGI bracket thresholds.

The individual's TMT is within about $3,000 of the RMT over AGI between roughly $195,000 and $330,000.

| Table 3. 2014 RMT vs. TMT, Married Joint | | |
|---|---|---|
| AGI | RMT | TMT |
| $\$0 \le AGI \le \$38,450$ | (10% * AGI) - $2,030 | $0 |
| $\$38,451 \le AGI \le \$82,100$ | (15% * AGI) - $3,953 | $0 |
| $\$82,101 \le AGI \le \$94,100$ | (15% * AGI) - $3,953 | (26% * AGI) - $21,346 |
| $\$94,101 \le AGI \le \$156,500$ | (25% * AGI) - $13,363 | (26% * AGI) - $21,346 |
| $\$156,501 \le AGI \le \$169,150$ | (25% * AGI) - $13,363 | (32.5% * AGI) - $31,519 |
| $\$169,151 \le AGI \le \$242,980$ | (28% * AGI) - $18,437 | (32.5% * AGI) - $31,519 |
| $\$242,981 \le AGI \le \$247,150$ | (28% * AGI) - $18,437 | (35% * AGI) - $37,593 |
| $\$247,151 \le AGI \le \$305,050$ | (33% * AGI) - $30,795 | (35% * AGI) - $37,593 |
| $\$305,051 \le AGI \le \$418,247$ | (35.1% * AGI) - $37,157[a] | (35% * AGI) - $37,593 |
| $\$418,248 \le AGI \le \$427,550$ | (37.2% * AGI) - $46,050 | (35% * AGI) - $37,593 |
| $\$427,551 \le AGI \le \$470,000$ | (35% * AGI) - $36,538 | (35% * AGI) - $37,593 |
| $\$470,001 \le AGI \le \$484,900$ | (39.6% * AGI) - $58,158 | (35% * AGI) - $37,593 |
| $\$484,901 \le AGI$ | (39.6% * AGI) - $58,158 | (28% * AGI) - $3,650 |

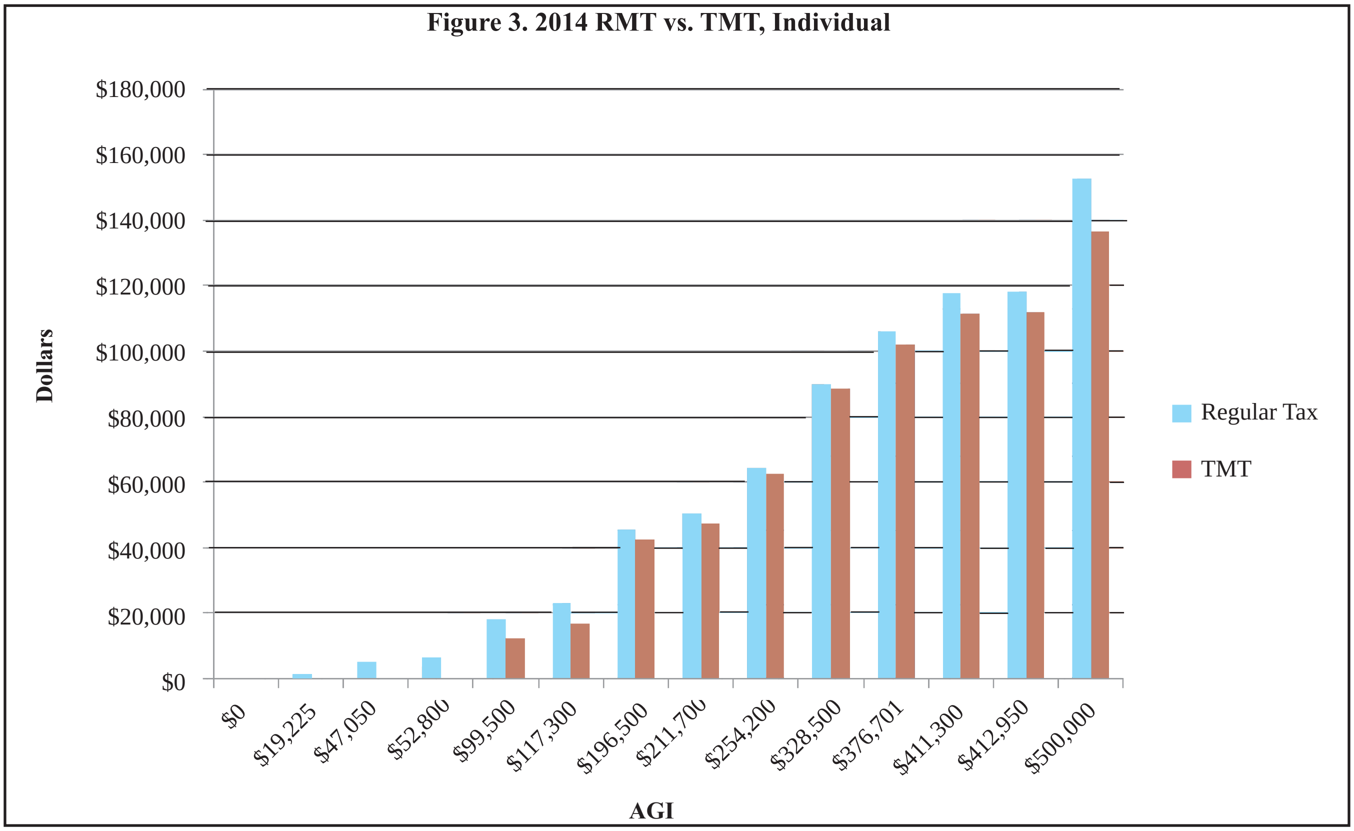
[a]Technically, the personal exemptions are phased out over the $305,051-$427,550 AGI range in a more discrete manner, by 2 percent for each $2,500 (or fraction thereof) that AGI exceeds $305,050. The bracket formulae shown approximate this result by assuming the phase-out to be continuous over that range. The same approach is used in the single individual brackets in Table 4.

Figure 2. 2014 RMT vs. TMT, Married Joint




| Table 4. 2014 RMT vs. TMT, Individual | | |
|---|---|---|
| **AGI** | **RMT Tax** | **TMT** |
| $0 ≤ AGI ≤ $19,225 | (10% * AGI) - $1,015 | $0 |
| $19,226 ≤ AGI ≤ $47,050 | (15% * AGI) - $1,976 | $0 |
| $47,051 ≤ AGI ≤ $52,800 | (25% * AGI) - $6,681 | $0 |
| $52,801 ≤ AGI ≤ $99,500 | (25% * AGI) - $6,681 | (26% * AGI) - $13,728 |
| $99,501 ≤ AGI ≤ $117,300 | (28% * AGI) - $9,666 | (26% * AGI) - $13,728 |
| $117,301 ≤ AGI ≤ $196,500 | (28% * AGI) - $9,666 | (32.5% * AGI) - $21,353 |
| $196,501 ≤ AGI ≤ $211,700 | (33% * AGI) - $19,481 | (32.5% * AGI) - $21,353 |
| $211,701 ≤ AGI ≤ $254,200 | (33% * AGI) - $19,481 | (35% * AGI) - $26,645 |
| $254,201 ≤ AGI ≤ $328,500 | (34% * AGI) - $22,142 | (35% * AGI) - $26,645 |
| $328,501 ≤ AGI ≤ $376,701 | (34% * AGI) - $22,142 | (28% * AGI) - $3,650 |
| $376,702 ≤ AGI ≤ $411,300 | (33% * AGI) - $18,188 | (28% * AGI) - $3,650 |
| $411,301 ≤ AGI ≤ $412,950 | (35% * AGI) - $26,414 | (28% * AGI) - $3,650 |
| $412,951 ≤ AGI | (39.6% * AGI) - $45,409 | (28% * AGI) - $3,650 |

The two examples show that in the moderately high-AGI ranges identified above (roughly $243,000-$480,000 AGI for joint returns, $195,000-$330,000 AGI for singles), TMT is within a few thousand dollars of RMT. That differential represents the greatest tax reduction and savings that could be achieved by claiming more preference items than the bare minimum reflected in RMT. The AMT is setting a high TMT tax floor, very close to RMT. AMT is not just preventing these taxpayers from avoiding significant tax liability, as was its stated purpose, but from paying practically anything less than their maximum regular tax liability. This result stems simply from the basic current regular tax and AMT rate brackets. The rate-bracket convergence for moderately high-AGI taxpayers has caused the AMT to largely supplant the regular tax system for these taxpayers because they typically have sufficient additional preference items to reduce their regular tax below TMT. Moreover, as discussed next, even dividends and capital gains, which are normally not considered preference items, can push these taxpayers into AMT.




## Dividends and Capital Gains

Qualified dividend income and net capital gains are ostensibly taxed at the same favorable rates for regular tax and AMT purposes, generally 15 percent (or 20 percent to the extent the taxpayer's income exceeds the 39.6 percent regular tax bracket threshold). This might suggest such income is neutral insofar as applicability of AMT is concerned and gets taxed at the same 15 percent rate under AMT as under regular tax.

In fact, however, such income can attract AMT at higher rates. This is because, for taxpayers in the AMT exemption phaseout range, dividends and capital gain reduce the AMT exemption just like any other income. The AMT exemption phaseout equates to an additional tax equal to the 25 percent exemption phaseout percentage times the applicable AMT rate. For a taxpayer with ordinary income subject to a 26 or 28 percent AMT rate, the phaseout results in an additional 6.5 or 7 percent tax rate. This would be on top of the basic 15 percent tax on the dividend or capital gain. Combined, the dividend or capital gain can be effectively taxed at a 21.5 or 22 percent rate under AMT. Thus, that income can produce AMT even though it is not a preference item.

A simple example illustrates that effect. Suppose a single individual has AGI of $250,000, consisting of $180,000 ordinary income and $70,000 in qualified dividends and net capital gain; claims only the minimum standard deduction and one personal exemption; and has no other preference items. Her TMT of $52,198 would exceed her regular tax of $51,234. She incurs AMT simply by having dividend and capital gain income.

To see the AMT tax rate on the dividends and capital gains, suppose she realizes an additional $1,000 in qualified dividend income and net capital gain, bringing her AGI to $251,000. Her regular income tax would increase by only 15 percent of the additional income to $51,384. But her TMT would increase to $52,412.50, a $215 increase representing 21.5 percent of the additional $1,000 income. The additional qualified dividend income and net capital gain is effectively taxed at 21.5 percent. Fifteen percent, or $150 of the tax increase, is the basic 15 percent rate on such income. The remaining 6.5 percent, or $65.50, is from the reduction in her AMT exemption (25 percent, or $250 reduction in her exemption, times her 26 percent AMT rate).

At higher income levels, qualified dividend income and net capital gain can also reduce personal exemptions and itemized deductions under the regular tax system. But these phaseouts would only increase the regular tax rate by roughly 1 percent for each personal exemption and 1 percent for the itemized deduction phaseout. Generally the rate effect of these phaseouts is smaller than the AMT exemption phaseout. Suppose the woman above had $220,000 of qualified dividend income or net capital gain, giving her AGI of $400,000. That additional income would fully phase out her $3,950 regular tax personal exemption, and her regular tax would be $74,840. But her AMT exemption would also be fully phased out, and her TMT would be $79,800, about $5,000 more than her regular tax.

This analysis illustrates how the AMT has displaced the regular tax for many moderately high-AGI taxpayers solely because they have dividends or capital gains. Again, this stems from the basic rate structures of the AMT and regular tax systems. Far from AMT's basic purpose, these taxpayers are not availing themselves of preference items and would be paying significant regular tax in the absence of the AMT.

**Tax Reform**

Much consideration has been given in recent years to reforming the Internal Revenue Code. The AMT plays a role in that debate. It adds significant complexity and compliance burdens, and its scope has expanded dramatically since its inception. It is no longer limited to its original purpose of preventing high economic income taxpayers from using exclusions, deductions, and credits to avoid paying significant tax. A corollary to its expanded scope is that it has become a significant revenue raiser.

A fundamental question is whether it is good to have two parallel tax systems. This may depend on whether it is possible to get the tax system right the first time. One seemingly fair, straightforward, economically efficient, and pro-growth approach would be to measure ''true'' economic income (taking into account basic tax principles), tax it all the same (in whatever rate brackets are desired and needed to raise the necessary revenue), and leave it at that. In that case, there would be no place for a second, AMT tax system.[8]

The justification for an AMT must lie in purposeful distortion of taxable income away from ''true'' income, often in an attempt to influence behavior. In that context, the AMT could serve its purpose of preventing use of the distortive exclusions, preferences, and credits to avoid too much tax. One justification stated for the AMT was that it is unfair and undermines the tax system if ''high-income'' taxpayers can use preference items to pay little or no tax.[9] That concern, combined with the need for revenue, could reasonably override the specific policies underlying particular distortive provisions. The AMT could effectively impose a negative synergism on preference items to achieve this balance.

As it is, the current convergence of TMT with RMT for moderately high-AGI individuals may undermine the code. One rationale for the AMT recognized the code's attempt to encourage behavior: ''Although these provisions may provide incentives for worthy goals, they become counterproductive when taxpayers are allowed to use them to avoid virtually all tax liability.''[10] It is unclear why this would be the case, but be that as it may, offering incentives is not even possible (or is severely diminished) for taxpayers already subject to AMT simply because of the regular and AMT rate structures. For them, the AMT in its current broad scope precludes those incentives altogether.

The AMT can also increase taxes on dividends and capital gains, thereby undermining the policies behind their generally lower tax rates.

Finally, contrary to the purpose stated for the AMT in 1986, it now applies to most moderately high-AGI taxpayers, even if they would otherwise pay significant regular tax almost equaling the maximum regular tax. This can seemingly undermine confidence and respect for the tax code. Also, it can call into question why some items that arguably reduce income, such as state income taxes, are designated as preference items or are even allowed in the first place.

In sum, there are broad policy questions about whether there is a need for an AMT at all and narrower questions about scaling the AMT back to its original intended scope. But the political reality may be that the Internal Revenue Code cannot be reformed at all at this time.

**Tax Planning With the AMT**

So how should taxpayers factor the current AMT into their tax planning? First, it should be determined whether the AMT is relevant. The AMT would generally be irrelevant for lower-income taxpayers whose AGI does not materially exceed the AMT exemption, or for very high-income taxpayers incurring high regular tax rates. In other cases, it may be necessary to do a rough calculation of both regular and TMT tax, or to use the IRS's AMT Assistant, or to consult the instructions to IRS Form 6251, ''Alternative Minimum Tax — Individual,'' to ascertain if AMT may apply.

Assuming AMT is relevant, a taxpayer should generally claim sufficient available preference items to reduce regular tax to TMT. From a regular tax standpoint, itemizing deductions is generally better than the standard deduction if the allowed amount

[8]Former House Ways and Means Committee Chair Dave Camp's tax reform proposal would have eliminated the AMT in overhauling the code.

[9]*See supra* note 4, at 433.

[10]*Id.* at 432.

of itemized deductions (taking into account the 2 percent AGI floor on some deductions and section 68 phasedown) exceeds the standard deduction. A taxpayer may need to arrange or time his affairs, investments, and payments to make sufficient preference items available.

Assuming regular tax is or will be at or below TMT, additional preference items would not yield any federal tax savings. They would only reduce regular tax, not TMT. For example, a taxpayer already in AMT does not benefit from claiming additional personal exemptions or state income tax deductions, which do not reduce AMT. It is generally not worth it for an AMT payer to spend time and resources on securing preference items beyond what is needed to get regular tax down to TMT. A possible exception is that some preference items such as personal exemptions may still be allowed for state tax purposes and could produce a small state tax savings.

What does save federal taxes in those circumstances are deductions, credits, or exclusions that are not preference items and are allowed for both regular and AMT purposes — those are items on which to focus. An example is the deduction for charitable donations. If a taxpayer is in AMT regardless of whether he itemizes or takes the standard deduction, it may make sense to itemize to claim non-preference item deductions that are allowable for both AMT and regular tax purposes.[11] This is so even if the itemized deductions are less than the standard deduction.

For example, suppose an individual made charitable contributions of $3,000 and state income tax payments of $2,000 during 2014, and will be in AMT for 2014 regardless of whether he itemizes or not. His total $5,000 itemized deduction is less than the $6,200 standard deduction, so one might think he should take the standard deduction. However, as he is assumed to be an AMT payer and the standard deduction is disallowed for AMT purposes, the standard deduction would do nothing. If he itemizes, he would be allowed to deduct the $3,000 charitable contributions for AMT purposes (the state income tax deduction is a disallowed preference item). The $3,000 charitable deduction would reduce TMT by $780 at the 26 percent AMT rate or by $840 at the 28 percent rate. He should itemize even though his regular tax is slightly higher than if he claimed the standard deduction because that is irrelevant given that he is an assumed AMT payer.

If a taxpayer is on the bubble between regular and AMT tax, it would likely be necessary to look at it both ways, that is, compute both regular tax and AMT with itemization and with the standard deduction, and adopt whichever approach produces the lesser of regular tax or TMT liability.

When a deduction, credit, or exclusion could affect a future tax year, additional considerations may come into play. If a taxpayer is a current-year AMT payer but expects to be a higher-marginal-rate regular taxpayer next year, or vice versa, he may want to time items to fall in the optimum year. Another consideration is that a future recovery of a deduction is generally taxable, unless no tax benefit was received for the deduction. Claiming an itemized deduction could cause later recovery of that item to be taxable, whereas future recovery may not be taxable if only the standard deduction is claimed. But if the itemized deduction is disallowed under the AMT, a later recovery may not be includable in AMTI. Section 56 specifically excludes from AMTI recoveries of state, local, and foreign taxes the prior regular tax deduction of which was disallowed under AMT. Finally, AMT incurred regarding timing preference items may be allowed as a credit against future regular tax.

In sum, the presence of the regular and AMT systems requires taxpayers to plan for consequences under both systems, not only in the current year but also in future years. Some strategies are outlined above. However, ultimately, the taxpayer may need to compute regular tax and AMT under the various available approaches and adopt the approach that yields the least overall tax.

## Conclusion

The AMT has supplanted the regular tax system for most moderately high-AGI taxpayers because of the current rate structures rather than the claiming of large preference items. This raises fundamental questions about the need for two tax systems, and more narrowly whether the AMT should be scaled back to its original, more limited purposes. As it is, taxpayers must factor the broad AMT into their tax planning. Generally, potential AMT payers should claim preference items to the extent regular tax would otherwise exceed TMT, and then focus on non-preference deductions, credits, and exemptions that reduce both regular tax and TMT.

[11] Also, the regular tax overall limitation on itemized deductions under section 68 does not apply for AMT purposes. *See* section 56(b)(1)(F).