CR-742
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OSU Current Report

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ALTERNATIVE MINIMUM TAX AND INVESTMENT CREDIT

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The "new alternative minimum tax" imposed by the Revenue Act of 1978 caught many taxpayers by surprise. Many taxpayers with large capital gain deductions and/or large itemized deductions did not realize until they prepared their 1979 income tax returns that they would have to pay additional tax because of the "alternative minimum tax". Also, they discovered that they could not receive the full benefit of their "Investment Credit" on their 1979 income tax.

The following information regarding the alternative minimum tax is taken from the IRS Publication 225 - Farmers Tax Guide.

"For individuals there are two different minimum tax computations, the regular minimum tax and the alternative minimum tax. The alternative minimum tax is a separate minimum tax and not a substitute for the regular minimum tax. You compute the alternative minimum tax on Form 6251, Alternative Minimum Tax Computation.

The tax preference items (discussed later) used in figuring the alternative minimum tax are different than those used in figuring the regular minimum tax. The capital gain deduction and adjusted itemized deductions are the preference items for the alternative minimum tax. However, the alternative minimum tax may apply even if you have no tax preference items.

TAX COMPUTATION

The alternative minimum tax rates are applied to your alternative minimum taxable income. Your alternative minimum taxable income is computed by subtracting from your adjusted gross income the sum of any excess itemized deductions, your zero bracket amount, and $1,000 for each exemption claimed. To this amount you must add the tax preference items, if any, for the capital gain deduction and adjusted itemized deductions. If the amount from multiplying the alternative minimum tax rates and your alternative minimum taxable income is more than your regular tax, the excess is your alternative minimum tax and you must add it to your liability. The alternative minimum tax does not apply unless it is more than your regular tax.

RATE OF TAX

Your alternative minimum tax rate is zero on the first $20,000 of alternative minimum taxable income; 10% on the next

$40,000; 20% on the next $40,000; and 25% on the amount over $100,000.

IF YOU ARE MARRIED FILING SEPARATELY, to figure your alternative minimum tax you must divide in half all the dollar amounts in the preceding discussion.

COMPUTATION OF REGULAR TAX. After figuring your alternative minimum tax, you subtract your regular income tax from your alternative minimum tax to arrive at the amount to add to your tax liability. To figure your regular tax begin with the net tax from line 47, Form 1040.

THE TAX PREFERENCE ITEMS for the alternative minimum tax are your capital gain deduction and your adjusted itemized deductions.

CAPITAL GAIN DEDUCTION is the untaxed part of your long-term capital gain. This is 60% of the excess of net long-term capital gain over net short-term capital loss for the year. Do not include as a tax preference item the capital gain deduction attributable to a sale of your main home after July 26, 1978.

ADJUSTED ITEMIZED DEDUCTIONS is generally the amount of your itemized deductions that exceeds 60% of your adjusted gross income. In figuring your adjusted itemized deductions you must subtract from your total itemized deductions and from your adjusted gross income your deductions for:

1) Medical and dental expenses;
2) State, local, and foreign taxes;
3) Casualty and theft losses; and
4) Any deduction for estate tax paid on income in respect of a decedent.

EXAMPLE OF ALTERNATIVE MINIMUM TAX

Frank Jones is married with two children. He and his wife, Jane, file a joint return on which they claim four exemptions. Frank and Jane operate a farm and have a net farm profit of $30,000. They also have a gain of $50,000 on the sale of land held 20 years and raised dairy cattle held 3 years. They deducted the costs of raising the dairy cattle over the 3 years. They have $7,000 of investment credit on farm equipment purchased this year. Their total itemized deductions are $4,000.

On their Form 1040 from these facts Frank and Jane figure their adjusted gross income to be $50,000 and their tax before subtraction of their $7,000 investment credit to be $12,548. They figure their regular tax to be $5,548 by subtracting the $7,000 investment credit from their tax of $12,548.

Now Frank and Jane figure their alternative minimum tax on Form 6251. They do this in the following manner.

FIRST, REDUCING ADJUSTED GROSS INCOME. They reduce their adjusted gross income of $50,000 by $8,000 which is the sum of; their excess itemized deductions of $600 ($4,000 total itemized deductions minus $3,400 zero bracket amount), their zero bracket maount of $3,400, and their personal exemptions of $4,000 ($1,000 X 4). The result is $42,000 ($50,000 - $8,000).

SECOND, FIGURING TOTAL TAX PREFERENCE ITEMS. Because their adjusted itemized deductions are not more than 60% of their adjusted gross income, Frank and Jane do not include them as tax preference items. They do include their capital gain deduction of $30,000 (60% X $50,000) as a tax preference item. Their total of tax preference items is $30,000.

THIRD, FIGURING THE ALTERNATIVE MINIMUM TAXABLE INCOME, Frank and Jane figure their alternative minimum taxable income to be $72,000 by adding their total tax preference items of $30,000 to their income of $42,000, as determined in the first step.

FOURTH, FIGURING THE ALTERNATIVE MINIMUM TAX. Frank and Jane multiply their alternative minimum taxable income of $72,000 by the tax rates discussed earlier. The result is $6,400. They figure their alternative minimum tax to be $852 by subtracting the regular tax of $5,548 from $6,400. They add the $852 to their tax liability.

COMPUTATION OF INVESTMENT CREDIT FOR CARRYBACK AND CARRYOVER PURPOSES.
If the alternative minimum tax applies, you may not receive the full tax benefit of the investment credit claimed during the year. If so, any tax benefit lost is eligible for carryback and carryover purposes.

You compute your investment credit carryback and carryover by reducing the amount of your allowable investment credit by the lesser of:

1) The amount of investment credit allowable; or

2) The alternative minimum tax (line 49B Form 1040) reduced by an amount based on the targeted jobs credit and work incentive program credit.

In the previous example, Frank and Jane have an allowable investment credit of $7,000 and no targeted jobs credit or work incentive program credit. However, because of their alternative minimum tax of $852, they received a tax benefit from their investment credit of only $6,148 ($7,000 minus $852). Therefore, they have an amount available for investment credit carryback and carryover purposes of $852 ($7,000 minus $6,148).

As previously mentioned the target jobs credit and work incentive program credit are factors in determining the carryback and carryover, but since the previous example does not illustrate them, they are not discussed here. For more information, see IRS Publication 525.

IRS Publication 225 - Farmers' Tax Guide points out that the alternative minimum tax may apply even if you have no tax preference items.

Since you cannot apply any credits other than the foreign tax credit to reduce your alternative minimum tax, you in effect lose the benefit of these credits to the extent of the alternative minimum tax. However, in the case of three credits - the targeted jobs credit, the work incentive program (WIN) credit, and the investment credit - you may carry the lost benefit back for up to 3 tax years and then forward for up to 7 tax years until you recover it.

TABLE 1

Regular and Alternative Minimum Tax at Varying Levels of Income

(Joint Return - 4 Exemptions)

A/ Taxable Income	Column 1 Regular Tax	Column 2 B/ Alternative Minimum Tax Computation
$30,000	$4,945	$470.00
40,000	8,495	1,470.00
50,000	12,818	2,470.00

A/ Figure assumes $3,500 capital sales, 60% or $2,100 added to Alternative Taxable Income. Figure needs to be adjusted for greater or lesser capital gains.

B/ Regular tax subtracted from this figure to determine amount to be added to regular tax.

Summary -

Taxpayer may use this table to determine approximately when the amount of investment credit used will trigger the alternative minimum tax. For example, with a $30,000 taxable income, the use of investment credit that reduces the regular tax liability in column 1 below $470 will result in alternative minimum tax being paid.

TABLE 2

How Varying Amount of Capital Gains Effect Regular Tax and Alternative Minimum Tax with $35,000 Regular Ordinary Taxable Income (Joint Return - 4 exemptions)

Capital Gain	Regular Tax	Alternative Minimum Tax. Comp.
$20,000	$9,796	$2,760
40,000	13,308	5,520
60,000	17,228	9,520
80,000	21,298	13,900
100,000	25,618	18,900
200,000	48,568	43,900

Summary -

Taxpayer may use this table to visualize how capital gains effect both regular tax and the alternative minimum tax. Note that as the capital gain increases from 60 to $80,000 a 33 percent increase, the alternative minimum tax increases from $9,520 to $13,950, a 46 percent increase. Note with the 80,000 capital gain that as long as the regular tax is greater than $13,900 after the deduction for investment credit no alternative minimum tax is due.

TABLE 3

How Varying Amounts of Capital Gain Effect Regular Tax and Alternative Minimum Tax with $20,000 Regular Ordinary Taxable Income (Joint Return - 4 exemptions)

Capital Gain	Column 1 Regular Tax	Column 2 Alternative Minimum Tax Computation
$20,000	$4,330	$1,260
40,000	6,969	3,260
60,000	10,226	6,520
80,000	13,798	10,520
100,000	17,718	15,150
200,000	39,638	40,150

TABLE 4

How Varying Amounts of Capital Gain Effect Regular Tax and Alternative Minimum Tax with $10,000 Regular Ordinary Taxable Income (Joint Return - 4 exemptions)

Capital Gain	Column 1 Regular Tax	Column 2 Alternative Minimum Tax Computation
$20,000	$1,840	260
40,000	3,770	2,260
60,000	6,229	4,520
80,000	9,366	8,520
100,000	12,818	12,650
200,000	33,738	37,650

Comparing the Regular Tax and Alternative Minimum Tax in Tables 3 and 4 with the same amount of Capital Gain, the effect of smaller Regular Taxable Income can be seen. The use of investment credit that reduces the regular tax liability in column 1 below the alternative minimum tax in Column 2 will result in alternative minimum tax being paid.

Strategies for avoiding or minimizing the alternative minimum tax would include the following:

a) Use of installment sales of capital items to reduce the size of capital gains deductions.

b) Time purchases of items eligible for investment credit to years with high regular tax or not to exceed amount which triggers alternative minimum tax.

c) Avoid having allowable investment credit and alternative minimum tax preference items in same tax year.

d) Excess itemized deductions such as large charitable gifts or donations will, also, result in alternative minimum tax.

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