TEMPORARY AMT RELIEF

The recently enacted Tax Increase Prevention Act of 2007 extended partial relief to individual taxpayers from the alternative minimum tax (AMT). Earlier temporary measures to deal with the AMT expired at the end of 2006, meaning that more than 20 million projected additional taxpayers would have faced paying the tax on their 2007 returns without the new relief. Please keep in mind this is only a summary of this important tax relief provision

- **Brief overview of the AMT.**

  The AMT is a parallel tax system which does not permit several of the deductions permissible under the regular tax system, such as state, local and property taxes. Taxpayers who may be subject to the AMT must calculate their tax liability under the regular Federal tax system and under the AMT system taking into account certain "preferences" and "adjustments." If their liability is found to be greater under the AMT system, that's what they owe the Federal government. Originally enacted to make sure wealthy Americans did not escape paying taxes, the AMT has started to apply to more middle-income taxpayers, due in part to the fact that the AMT parameters are not indexed for inflation.

  In recent years, Congress has provided a measure of relief from the AMT by raising the AMT "exemption amounts" - allowances which reduce the amount of alternative minimum taxable income (AMTI), reducing or eliminating AMT liability. (However, these exemption amounts are phased out for taxpayers whose AMTI exceeds specified amounts.) For 2006, the AMT exemption amounts were $62,550 for married couples filing jointly and surviving spouses; $42,500 for single taxpayers; and $31,275 for married filing separately. However, for 2007, those amounts were scheduled to fall back to the amounts which applied in 2000: $45,000, $33,750, and $22,500, respectively. This would have brought millions of additional middle-income Americans under the AMT system, resulting in higher Federal tax bills for many of them, along with higher compliance costs associated with filling out and filing the complicated AMT tax form.

- **New law provides one-year stopgap fix.**

  To prevent the unintended result of having millions of middle-income taxpayers fall prey to the AMT, Congress has once again relied on a temporary "patch" to the problem, this time a one-year extension of the 2006 AMT exemption amounts, increased slightly. Under the new law, for tax years beginning in 2007, the AMT exemption amounts are increased to: (1) $66,250 in the case of married individuals filing a joint return and surviving spouses; (2) $44,350 in the case of unmarried individuals other than surviving spouses; and (3) $33,125 in the case of married individuals filing a separate return.

- **Personal credits may be used to offset AMT through 2007.**

  Another provision in the new law provides AMT relief for taxpayers claiming personal tax credits. The tax liability limitation rules generally provide that certain nonrefundable personal credits (including the dependent care credit, the elderly and disabled credit and the Hope Scholarship and Lifetime Learning credits) are allowed only to the extent a taxpayer has regular income tax liability in excess of the tentative minimum tax, which has the effect of disallowing these credits against AMT. Temporary provisions had been enacted which permitted these credits to offset the entire regular and AMT liability through the end of 2006. The new law extends this temporary provision to tax years beginning in 2007.

- **AMT refundable credit amount liberalized.**

You should also note, in a technical correction, the AMT refundable credit amount was liberalized. To understand this change, you need to go back to 2006, when, in an effort to help taxpayers who were stung by the AMT as a result of exercising incentive stock options (ISOs), legislation was enacted that increased the amount of the minimum tax credit ("MTC" or "AMT credit") and made it partially refundable. For tax years starting in 2007 and before 2013, individuals with unused MTCs that are long-term (i.e., more than three years old) are entitled to an AMT refundable credit, subject to a phase-out based on adjusted gross income (AGI). As originally enacted, the AMT refundable credit for a tax year could be as much as 20% of the taxpayer's long-term unused MTC for the year. The taxpayer's long-term unused MTC is reduced by the amount of the AMT refundable credit. Before the technical correction, if the taxpayer had no additional long-term unused MTCs, his credit would decrease in later years.

Under the technical correction, the taxpayer's AMT refundable credit for a tax year is the amount (not exceeding long-term unused MTC for the year) equal to the greater of:

(1) $5,000;
(2) 20% of the long-term unused MTC; or
(3) the AMT refundable credit amount (if any) for the prior tax year - the preceding year's credit amount (before any AGI-based reduction).

Thus, a taxpayer who doesn't have additional unused long-term MTCs uses the preceding year's credit amount (or $5,000, if greater) as his AMT refundable credit, provided he has sufficient long-term unused MTC. This allows taxpayers to claim the full 20% amount they claimed in the first year (e.g., 2007) per year for five years, provided their AGI does not reach the phase-out range.