

AMT relief in the 2008 Extenders Act

Following are details regarding three key provisions in the "Tax Extenders and Alternative Minimum Tax Relief Act of 2008" (the 2008 Extenders Act), which was enacted on Oct. 3, 2008. The provisions extend partial relief to individual taxpayers from the alternative minimum tax, or AMT. Earlier temporary measures to deal with the unintended creep of the AMT's reach expired at the end of 2007, meaning that more than 20 million additional taxpayers would have faced paying the tax on their 2008 returns without the new relief.

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 Originally enacted to make sure that wealthy Americans did not escape paying taxes, the AMT has started to apply to more middle-income taxpayers, due in part to the fact that the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 that 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 2007, the AMT exemption amounts were \$66,250 for married couples filing jointly and surviving spouses; \$44,350 for single taxpayers; and \$33,125 for married filing separately. However, for 2008, those amounts were scheduled to fall back to the amounts that 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 2007 exemption amounts, increased slightly. Under the new law, for tax years beginning in 2008, the AMT exemption amounts are increased to: (1) \$69,950 in the case of married individuals filing a joint return and surviving spouses; (2) \$46,200 in the case of unmarried individuals other than surviving spouses; and (3) \$34,975 in the case of married individuals filing a separate return.

Personal credits may be used to offset AMT through 2008

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 that 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 2007. The new law extends this temporary provision to tax years beginning in 2008.

Extension and modification of AMT credit allowance against incentive stock options (ISOs)

A further provision in the new law liberalizes the AMT refundable credit amount that was first enacted in 2006 to help taxpayers who were stung by the AMT as a result of exercising incentive stock options (ISOs). Under the regular tax, ISOs are not taxed upon exercise. Under the AMT, however, a taxpayer must pay tax on the stock value when the option is exercised. The economic downturn in 2000 resulted in many individuals having to pay tax on "phantom income" because the stock prices dropped dramatically after the date of exercise. In 2006, Congress provided relief for these situations but did not correct the problem entirely. The new law provides additional relief to affected taxpayers by accelerating the refund of taxes paid on the phantom income and by stopping further IRS efforts to collect those taxes. Specifically, the new law allows 50% of long-term unused minimum tax credits to be refunded over each of two years (instead of 20% over each of five years as was allowed under pre-2008 Extenders Act law), eliminates a rule that limited the relief available to higher-income taxpayers, and abates any underpayment of tax outstanding on the date of enactment related to ISOs and the AMT including interest.