Office of Chief Counsel
Internal Revenue Service

# memorandum

CC:NER:BRK:TL-N-3515-99
AJMandell

date: AUG - 5 1999

to: Chief, Examination Division, Brooklyn
Attn: Group Manager, Steven Townsend
Revenue Agent, Josephine Chiofalo

from: District Counsel, Brooklyn

subject: [redacted]
U.I.L. 59.07-00

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**Issue:**

Whether an alternative minimum tax (AMT) depreciation adjustment should be included in the alternative minimum taxable income (AMTI) when the ordinary loss is disallowed because the taxpayer was not at risk for the loss?

**Facts:**

The facts, as we understand them from the information you provided, are as follows:

[redacted] (hereafter "[redacted]") is a limited liability company with [redacted] members. Its only business activity is its interest in a related limited partnership, [redacted] holds a [redacted]% limited partnership interest in [redacted].

In the [redacted] year the taxpayer received a Form K-1 from [redacted] which showed an ordinary flow thru loss in the amount of $[redacted] and an AMT depreciation adjustment of $[redacted]. The revenue agent determined that the taxpayer was not at risk for the loss, and on October 20, 1998 our office rendered advice agreeing

that the taxpayer was not at risk under I.R.C. section 465.[1]

The revenue agent, in addition to disallowing the $[redacted] ordinary loss, proposes to include the AMT depreciation adjustment of $[redacted] on line 14(h) of Form 6251 (Alternative Minimum Tax-Individuals).

It is the taxpayer's position that since the revenue agent disallowed the flow-thru K-1 loss because he was not at risk, the AMT depreciation adjustment should not be included in computing the AMTI. The taxpayer believes that the AMT depreciation adjustment should be suspended and included in the AMTI when the taxpayer is at risk for the loss.

**Discussion:**

Since 1969, the Internal Revenue Code has included minimum tax provisions for both corporate and individual taxpayers. Congress enacted the minimum tax to prevent corporate and individual taxpayers from aggregating deductions to the point where they pay either no tax or a "shockingly low" tax. First Chicago Corp. v. Commissioner, 842 F.2d 180, 181 (7th Cir. 1988), aff'd 88 T.C. 663 (1987).

The post 1986 AMT rules, I.R.C. sections 55-59, were enacted to achieve one overriding objective; to establish a floor for tax liability, so that a taxpayer pays some tax regardless of the tax breaks otherwise available to him under the regular income tax (hereafter RIT). Day v. Commissioner, 108 T.C. 11 (1997). The AMT rules accomplish this goal by eliminating favorable treatment to certain items that are treated favorably for purposes of the RIT (tax preference items). See I.R.C. sections 55(b)(2)(B) and 57(a). The AMT is paid only if, and to the extent that, it exceeds the taxpayer's RIT. See I.R.C. section 55(a).

Since Congress recognized that it could not envision all of the possible inequities of the minimum tax, in 1976 it incorporated section 58(h), which provided a so-called tax benefit rule, as part of the add-on minimum tax system. See Tax Reform Act of 1976, Pub. L. 94-455. The section 58(h) tax benefit rule mandated that the Secretary of the Treasury prescribe regulations under which items of tax preference shall be properly adjusted where the tax

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[1]The National Office post reviewed and concurred with our advice. It is our understanding that the taxpayer has now agreed that he was not at risk, and therefore was not entitled to the partnership loss in the [redacted] year.

treatment giving rise to such items will not result in the reduction of the taxpayer's tax for any taxable years.

Although section 58(h) was repealed by the Tax Reform Act of 1986, that Congress affirmatively chose to retain the tax benefit rule is demonstrated by the fact that the provision was renumbered as section 59(g) and its language was changed. Effective for taxable years after 1986, section 59(g) provides that the Secretary may prescribe regulations under which differently treated items shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer's regular tax for the taxable year for which the item is taken into account or for any other taxable year.

The substitution of the word "may" for "shall" renders the tax benefit rule discretionary. Section 59(g) was added to the code to give the Secretary the flexibility to provide relief in the event a taxpayer would not get a reduction in regular tax liability from an item that was not includable in the AMT base. Day v. Commissioner, 108 T.C. 11 (1997).

As discussed below, we do not believe that the tax benefit rule, specifically section 59(g), should be applied in the instant case, and do not believe that there should be any AMT depreciation adjustment in the [redacted] year.

The AMT is a tax system that is separate from, but parallel to, the regular tax system. For most purposes the tax base for the new alternative minimum tax is determined as though the alternative minimum tax were a separate and independent income tax system. Thus, for example, where a Code provision refers to a "loss" of the taxpayer from an activity, for purposes of the alternative minimum tax, the existence of a loss is determined with regard to the items that are includable and deductible for minimum tax, not regular tax, purposes. Staff of the Joint Committee on Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986 (Comm. Print 1987) (the Bluebook).[2]

Post 1986 AMT rules are provided with respect to the application of Code sections suspending losses, such as sections 465, 704(d) and 1366(d). Since deductions, or the basis of property, relevant to the application of these sections may differ

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[2]Although the Bluebook does not technically rise to the level of legislative history because it is authored by the congressional staff and not by Congress, such explanations are entitled to great respect. Rivera v. Commissioner, 89 T.C. 343, 349 (1987).

for regular and minimum tax purposes, respectively, it is necessary to recompute, for minimum tax purposes, the amounts that are suspended and carried forward. Staff of the Joint Committee on Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986 472 (Comm. Print 1987).

In the instant case, the taxpayer had a $[redacted] loss disallowed because he was not at risk under the provisions of section 465(b)(3)(A). Therefore, for regular tax purposes he had a $[redacted] suspended loss. The AMT loss must then be independently recomputed. The depreciation adjustment was in the amount of $[redacted]. For AMT purposes there would be no depreciation adjustment in the [redacted] year, and there would be a suspended AMT loss in the amount of $[redacted] ($[redacted] - $[redacted].

This opinion is based upon the facts set forth herein. You should be aware that, under routine procedures which have been established for opinions of this type, we have referred this memorandum to the Office of Chief Counsel for review. That review might result in modifications to the conclusions herein. We will inform you of the result of the review as soon as we hear from that office. In the meantime, the conclusions reached in this opinion should be considered to be only preliminary.

If you have any additional questions, please call the undersigned at (516) 688-1701.

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By: _____
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