



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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The Honorable Bill Nelson
United States Senator
Landmark Two, 225 East Robinson Street
Suite 410
Orlando, FL 32801

Dear Senator Nelson:

I am responding to your inquiry dated December 4, 2008, on behalf of your constituent, _____, expressed concern about paying the alternative minimum tax (AMT) despite having paid full taxes and capital gain taxes. Although _____ did not clearly explain his situation, we hope the following general information about the AMT will be helpful.

To determine whether a taxpayer is liable for the AMT, the taxpayer must first calculate his or her regular tax liability, taking into account appropriate deductions, credits, and exclusions. The taxpayer then makes a separate calculation to determine an alternative amount of taxable income (AMTI). A taxpayer calculates the AMTI by taking into account a number of adjustments and preferences, which generally are income and deduction items treated less favorably in computing AMTI than when calculating regular taxable income. After the taxpayer has computed AMTI, he or she determines tentative minimum tax (TMT), which is the excess of AMTI over an AMT exemption amount, multiplied by the applicable AMT tax rate. If TMT is greater than the regular tax liability, the taxpayer has an AMT liability. If TMT is the same as or less than the taxpayer's regular tax liability, the taxpayer has no AMT liability.

As stated above, the AMT is a separately figured tax that eliminates many deductions, thus increasing the tax liability for a taxpayer, who would otherwise pay less tax. Some common examples of deductions not allowed in computing the alternative minimum taxable income are miscellaneous itemized deductions, the standard deduction, and the deductions for state and local taxes and for personal exemptions. Examples of common preference items not allowed in computing AMTI are exclusions for gains on

sale of certain small business stock and interest on certain state and local bonds. The capital gains tax, however, does not create AMT liability, because the tax on capital gains for individuals is the same for both regular tax and alternative minimum tax.

To illustrate, assume that in 2008 a married filing jointly taxpayer who takes the standard deduction and two personal exemptions has ordinary income of \$45,000 and capital gains income of \$355,000, arriving at an adjusted gross income of \$400,000. After taking the standard deduction (\$10,900) and a deduction for two personal exemptions (\$4,666), the taxable income is \$384,434. The regular tax is \$51,511 (including the capital gains portion) and the tentative minimum tax is \$57,663 (including the capital gains portion). Thus, this taxpayer owes an AMT of \$6,152. This occurs for two reasons. First, the standard deduction and personal exemptions are eliminated in the minimum tax calculation. Second, the AMT rate is 26 percent while the effective regular tax rate under this example is about 12 percent.

Congress enacted the AMT to “serve on overriding objective: to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits.” Congress believed that it was “inherently unfair for high-income taxpayers to pay little or no tax due to their ability to use tax preferences.” (See H. R. Rep. No. 99-426 at 305-306 (1985)).

If you have any additional questions, please contact me or _____ at
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Sincerely,

Michael J. Montemurro
Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax and Accounting)