



Giving Credit Where Credit is Due-Holiday AMT Gift  
Podcast of December 9, 2006



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## A Gift in the Extenders Bill

In the final hours of the lame duck session of the 109<sup>th</sup> Congress, the *Tax Relief and Health Care Act of 2006* emerged from Congress. The bill contains a number of extenders that were popular but had been held hostage to political maneuvering during the year, but has a few surprise items in it. For this podcast we are going to look at one interesting provision that could have applicability to certain clients who ended up with “lifetime” supplies of AMT credit carryover due to the dot com bust in the early part of this decade.

Also of interest for AMT purposes is an item that is apparently *not* in this bill. The extension of the AMT exemption increase that expired at the end of 2006 after having been temporarily extended after leaving the law in 2005 is not in this bill. As such, we

are going to be facing uncertainty in projecting 2007 taxes and perhaps having some issues doing AMT planning when looking at the timing of taking certain deductions or receiving certain items of income around the end of 2006. It will be up to the 110<sup>th</sup> Congress to decide if relief will be extended on this item.

## The Law

For this podcast, I am going to give you the law and explanation in this document. The relevant provisions are Sections 402 and 403 of the Act, as reproduced below from the House bill (for now that's the version we have, but be sure to check that the nothing changed in the wee hours of the morning as the Senate passed the final conference bill):

**SEC. 402. CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY MADE REFUNDABLE AFTER PERIOD OF YEARS.**

(a) IN GENERAL. -- Section 53 (relating to credit for prior year minimum tax liability) is amended by adding at the end the following new subsection:

"(e) SPECIAL RULE FOR INDIVIDUALS WITH LONGTERM UNUSED CREDITS. --

"(1) IN GENERAL. -- If an individual has a longterm unused minimum tax credit for any taxable year beginning before January 1, 2013, the amount determined under subsection (c) for such taxable year shall not be less than the AMT refundable credit amount for such taxable year.

"(2) AMT REFUNDABLE CREDIT AMOUNT. -- For purposes of paragraph (1) --

"(A) IN GENERAL. -- The term 'AMT refundable credit amount' means, with respect to any taxable year, the amount equal to the greater of --

"(i) the lesser of --

"(I) \$5,000, or

"(II) the amount of long-term unused minimum tax credit for such taxable year, or

"(ii) 20 percent of the amount of such credit.

"(B) PHASEOUT OF AMT REFUNDABLE CREDIT AMOUNT. --

"(i) IN GENERAL. -- In the case of an individual whose adjusted gross income for any taxable year exceeds the threshold amount (within the meaning of section 151(d)(3)(C)), the AMT refundable credit amount determined under subparagraph (A) for such taxable year shall be reduced by the applicable percentage (within the meaning of section 151(d)(3)(B)).

"(ii) ADJUSTED GROSS INCOME. -- For purposes of clause (i), adjusted gross income shall be determined without regard to sections 911, 931, and 933.

"(3) LONG-TERM UNUSED MINIMUM TAX CREDIT. --

"(A) IN GENERAL. -- For purposes of this subsection, the term 'long-term unused minimum tax credit' means, with respect to any taxable year, the portion of the minimum tax credit determined under subsection (b) attributable to the adjusted net minimum tax for taxable years before the 3rd taxable year immediately preceding such taxable year.

"(B) FIRST-IN, FIRST-OUT ORDERING RULE. -- For purposes of subparagraph (A), credits shall be treated as allowed under subsection (a) on a first-in, first-out basis.

"(4) CREDIT REFUNDABLE. -- For purposes of this title (other than this section), the credit allowed by reason of this subsection shall be treated as if it were allowed under subpart C."

(b) CONFORMING AMENDMENTS. --

(1) Section 6211(b)(4)(A) is amended by striking "and 34" and inserting "34, and 53(e)".

(2) Paragraph (2) of section 1324(b) of title 31, United States Code, is amended by inserting "or 53(e)" after "section 35".

(c) EFFECTIVE DATE. -- The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

**SEC. 403. RETURNS REQUIRED IN CONNECTION WITH CERTAIN OPTIONS.**

(a) IN GENERAL. -- So much of section 6039(a) as follows paragraph (2) is amended to read as follows: "shall, for such calendar year, make a return at such time and in such manner, and setting forth such information, as the Secretary may by regulations prescribe."

(b) STATEMENTS TO PERSONS WITH RESPECT TO WHOM INFORMATION IS FURNISHED. -- Section 6039 is amended by redesignating subsections (b) and (c) as subsection (c) and (d), respectively, and by inserting after subsection (a) the following new subsection:

"(b) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REPORTED. -- Every corporation making a return under subsection (a) shall furnish to each person whose name is set forth in such return a written statement setting forth such information as the Secretary may by regulations prescribe. The written statement required under the preceding sentence shall be furnished to such person on or before January 31 of the year following the calendar year for which the return under subsection (a) was made."

(c) CONFORMING AMENDMENTS. --

- (1) Section 6724(d)(1)(B) is amended by striking "or" at the end of clause (xvii), by striking "and" at the end of clause (xviii) and inserting "or", and by adding at the end the following new clause:
- "(xix) section 6039(a) (relating to returns required with respect to certain options), and".
- (2) Section 6724(d)(2)(B) is amended by striking "section 6039(a)" and inserting "section 6039(b)".
- (3) The heading of section 6039 and the item relating to such section in the table of sections of subpart A of part III of subchapter A of chapter 61 of such Code are each amended by striking "Information" and inserting "Returns".
- (4) The heading of subsection (a) of section 6039 is amended by striking "FURNISHING OF INFORMATION" and inserting "REQUIREMENT OF REPORTING".
- (d) EFFECTIVE DATE -- The amendments made by this section shall apply to calendar years beginning after the date of the enactment of this Act.

The provision references §151(d)(3)(B) and (C) for its phase outs. So you have the reference, here is that provision of the IRC:

- (B) Applicable percentage
- For purposes of subparagraph (A), the term "applicable percentage" means 2 percentage points for each \$2,500 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds the threshold amount. In the case of a married individual filing a separate return, the preceding sentence shall be applied by substituting "\$1,250" for "\$2,500". In no event shall the applicable percentage exceed 100 percent.
- (C) Threshold amount
- For purposes of this paragraph, the term "threshold amount" means --
- (i) \$150,000 in the case of a joint return or a surviving spouse (as defined in section 2(a),
  - (ii) \$125,000 in the case of a head of a household (as defined in section 2(b)),
  - (iii) \$100,000 in the case of an individual who is not married and who is not a surviving spouse or head of a household, and
  - (iv) \$75,000 in the case of a married individual filing a separate return.
- For purposes of this paragraph, marital status shall be determined under section 7703.

## Technical Explanation of the Provisions

Below is the technical explanation of the provisions as prepared by the Joint Committee on Taxation:

### **2. Alternative minimum tax credit relief for individuals; returns required for certain options** (secs. 402 and 403 of the bill and secs. 53 and 6039 of the Code)

#### **Present Law**

##### **In general**

Present law imposes an alternative minimum tax ("AMT") on an individual taxpayer to the extent the taxpayer's tentative minimum tax liability exceeds his or her regular income tax liability. An individual's tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed \$175,000 (\$87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is the amount by which the alternative minimum taxable income ("AMTI") exceeds an exemption amount.

An individual's AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

The individual AMT attributable to deferral adjustments generates a minimum tax credit that is allowable to the extent the regular tax (reduced by other nonrefundable credits) exceeds the tentative minimum tax in a future taxable year. Unused minimum tax credits are carried forward indefinitely.

##### **AMT treatment of incentive stock options**

One of the adjustments in computing AMTI is the tax treatment of the exercise of an incentive stock option. An incentive stock option is an option granted by a corporation in connection with an individual's employment, so long as the option meets certain specified requirements.<sup>84</sup> Under the regular tax, the exercise of an incentive stock option is tax-free if the stock is not disposed of within one year of exercise of the option or within two years of the grant of the option.<sup>85</sup> The individual then computes the long-term capital gain or loss on the sale of the stock using the amount paid for the stock as the cost basis. If the holding period requirements are not satisfied, the individual generally takes into account at the exercise of the option an amount of ordinary income equal to the excess of the fair market value of the stock on the date of exercise over the amount paid for the stock. The cost basis of the stock is increased by the amount taken into account.<sup>86</sup>

Under the individual alternative minimum tax, the exercise of an incentive stock option is treated as the exercise of an option other than an incentive stock option.

Under this treatment, generally the individual takes into account as ordinary income for purposes of computing AMTI the excess of the fair market value of the stock at the date of exercise over the amount paid for the stock.<sup>87</sup> When the stock is later sold, for purposes of computing capital gain or loss for purposes of AMTI, the adjusted basis of the stock includes the amount taken into account as AMTI.

The adjustment relating to incentive stock options is a deferral adjustment and therefore generates an AMT credit in the year the stock is sold.<sup>88</sup>

### **Furnishing of information**

Under present law,<sup>89</sup> employers are required to provide to employees information regarding the transfer of stock pursuant to the exercise of an incentive stock option and to transfers of stock under an employee stock purchase plan where the option price is between 85 percent and 100 percent of the value of the stock.<sup>90</sup>

### **Explanation of Provision**

#### **Allowance of credit**

Under the provision, an individual's minimum tax credit allowable for any taxable year beginning before January 1, 2013, is not less than the "AMT refundable credit amount". The "AMT refundable credit amount" is the greater of (1) the lesser of \$5,000 or the long-term unused minimum tax credit, or (2) 20 percent of the long-term unused minimum tax credit. The long-term unused minimum tax credit for any taxable year means the portion of the minimum tax credit attributable to the adjusted net minimum tax for taxable years before the 3rd taxable year immediately preceding the taxable year (assuming the credits are used on a first-in, first-out basis). In the case of an individual whose adjusted gross income for a taxable year exceeds the threshold amount (within the meaning of section 151(d)(3)(C)), the AMT refundable credit amount is reduced by the applicable percentage (within the meaning of section 151(d)(3)(B)). The additional credit allowable by reason of this provision is refundable.

*Example.* -- Assume in 2010 an individual has an adjusted gross income that results in an applicable percentage of 50 percent under section 151(d)(3)(B), a regular tax of \$45,000, a tentative minimum tax of \$40,000, no other credits allowable, and a minimum tax credit for the taxable year (before limitation under section 53(c)) of \$1.1 million of which \$1 million is a long-term unused minimum tax credit.

The AMT refundable credit amount for the taxable year is \$100,000 (20 percent of the \$1 million long-term unused minimum tax credit reduced by an applicable percentage of 50 percent). The minimum tax credit allowable for the taxable year is \$100,000 (the greater of the AMT refundable credit amount or the amount of the credit otherwise allowable). The \$5,000 credit allowable without regard to this

provision is nonrefundable and the additional \$95,000 of credit allowable by reason of this provision is treated as a refundable credit. Thus, the taxpayer has an overpayment of \$55,000 (\$45,000 regular tax less \$5,000 nonrefundable AMT credit less \$95,000 refundable AMT credit). The \$55,000 overpayment is allowed as a refund or credit to the taxpayer. The remaining \$1 million minimum tax credit is carried forward to future taxable years.

If, in the above example, the adjusted gross income did not exceed the threshold amount under section 151(d)(3)(C), the AMT refundable credit amount for the taxable year would be \$200,000, and the overpayment would be \$155,000.

### **Information returns**

The provision requires an employer to make an information return with the IRS, in addition to providing information to the employee, regarding the transfer of stock pursuant to exercise of an incentive stock option, and to certain stock transfers regarding employee stock purchase plans.

### **Effective Date**

The provision relating to the minimum tax credit applies to taxable years beginning after the date of enactment.

The provision relating to returns applies to calendar years beginning after the date of enactment.

### **Notes**

<sup>84</sup> Sec. 422.

<sup>85</sup> Sec. 421.

<sup>86</sup> If the stock is sold at a loss before the required holding periods are met, the amount taken into account may not exceed the amount realized on the sale over the adjusted basis of the stock. If the stock is sold after the taxable year in which the option was exercised but before the required holding periods are met, the required inclusion is made in the year the stock is sold.

<sup>87</sup> If the stock is sold in the same taxable year the option is exercised, no adjustment in computing AMTI is required.

<sup>88</sup> If the stock is sold for less than the amount paid for the stock, the loss may not be allowed in full in computing AMTI by reason of the \$3,000 limit on the deductibility of net capital losses. Thus, the excess of the regular tax over the tentative minimum tax may not reflect the full amount of the loss.

<sup>89</sup> Sec. 6039.

<sup>90</sup> Sec. 423(c).