You are receiving this message from the Saboo e-Solutions Resource Center. If you do not wish to receive future issues of Resource Center Learning please reply with the subject UNSUBSCRIBE. Further, if you know of others who would be interested in receiving the Saboo e-Solutions' Newsletter, please forward this email or send their names and email addresses to resources@sabooe-solutions.com.

In our last month's Newsletter we discussed the basics of Alternative Minimum Tax (AMT). We take up from there to discuss some significant critical issues and planning tools relating to AMT.

Dual Basis Assets and Capital Gains:

In some cases, an asset may have one basis for regular income tax purposes and a different basis (usually higher) for AMT purposes. (Generally, but not always, your "basis" in an asset is what you paid for it, plus or minus certain adjustments. Your adjusted basis is the portion of the asset that shouldn't be taxed when you sell the asset.) When there's a tax basis difference, the AMT capital gain or loss won't be the same as the regular capital gain or loss.

For instance, exercising an incentive stock option isn't usually a taxable event for regular income tax purposes. However, you may have to report income for AMT purposes when you exercise an incentive stock option. The difference between your exercise price and the fair market value of the stock on the exercise date is considered an adjustment for AMT purposes. So, you might have to pay AMT in the year you exercise an incentive stock option. However, your AMT basis in the stock is increased by the amount of the adjustment. This could create a smaller capital gain when you sell the stock. If you overlook this basis adjustment, you might end up paying too much tax.

> ***Example 1:*** At a time when your company's stock was trading at $80 per share, you exercised an incentive stock option to purchase 500 shares at $24 per share. For AMT purposes you report an adjustment of $28,000 ($56 per share). The result is that you hold stock with a basis of $24 per share for regular tax purposes and $80 per share for AMT purposes.

When you sell a dual basis asset, you report the difference between the regular tax gain or loss and the AMT gain or loss as an adjustment. If your AMT basis is higher (as is usually the case), you report this item as a negative adjustment. The result may be to reduce the amount of AMT you pay or increase the amount of AMT credit you can use.

> ***Example 2:*** In *Example 1*, you held stock with a basis of $24 per share for regular tax purposes and $80 per share for AMT purposes. If you sell the stock for $100 per share and have no other capital gains or losses, you should report a negative adjustment of $56 per share on your AMT calculation. If you have to pay AMT in the year of the sale, this adjustment will reduce your alternative minimum tax liability.

What is the AMT credit for prior year Alternative Minimum Tax?

Here's good news: a portion of your AMT liability, perhaps all, may reduce the tax you pay on future tax returns. Working with this AMT credit is a two-step process.

First you find out how much credit is available, then you find out how much of the credit you can use.

Find the Available Credit: AMT preferences and adjustments can be divided into two categories: permanent differences ("exclusion items") and timing differences.

- ***Permanent differences*** involve items that can be deducted for regular income tax purposes, but not for AMT purposes. Miscellaneous itemized deductions fall into this category.
- ***Timing differences*** involve items, such as depreciation, that are deducted differently for AMT and regular tax purposes. Usually, timing items allow you to delay reporting income.

If you paid AMT last year because of timing differences, you can claim a credit against your regular income tax this year for the amount of AMT attributable to those timing differences. If you're lucky, your entire AMT will be available as a credit in future years. But some people find that only a small portion, or none at all, is available for use as a credit.

Determine How Much AMT Credit You Can Use: If you have some AMT credit available from a prior year, you have to determine how much of the credit you can use in the current year. You can only use the AMT credit in a year when you're not paying alternative minimum tax.

The amount of credit you can use is based on the difference between your regular tax and the tax calculated under the AMT rules.

> ***Example 3:*** Suppose you have $8,000 of AMT credit available from 2005. In 2006 your regular tax is $37,000. Your tax calculated under the AMT rules is $32,000. You don't have to pay AMT because your regular tax is higher than the tax calculated under the AMT rules. Better still, you're allowed to claim $5,000 of AMT credit, reducing your regular tax to $32,000.

In this example, you would still have $3,000 of AMT credit you haven't used. That amount will be available in 2007. In tax lingo, it's *carried forward*.

Of course, you can't claim more than the amount of the available credit. In the *Example 3*, if the AMT credit available from 2005 was $2,700, then you would use the full amount of the credit in 2006. You would reduce your regular tax to $34,300 — not all the way to $32,000.

AMT Relief-Personal Credits:

For taxable years beginning in 2005, the nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular tax and alternative minimum tax.

For taxable years beginning after 2005, the nonrefundable personal credits (other than the adoption credit, child credit and saver's credit) are allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The adoption credit, child credit, and saver's credit are allowed to the full extent of the individual's regular tax and alternative minimum tax.

TIPRA (Tax Increase Prevention and Reconciliation Act of 2005) extends the nonrefundable personal credits to the full extent of the individual's regular tax and AMT for 2006.

Few strategies:

- Postpone (or prepay) some itemized deductions. If there are regular tax deductions that will be added back for AMT purposes and that a taxpayer has flexibility in paying (for example, state and local taxes), delay paying these taxes until next year to avoid a current-year AMT liability. Likewise, if a taxpayer is not subject to AMT in the current year but likely will owe AMT next year, he or she might try to manage that AMT liability and consider prepaying some of next year's state and local taxes.

- Some employees may be able to negotiate with their employers for earlier payments of income that would normally be paid shortly after year-end (such as bonuses). By doing this, a taxpayer may be able to have this income taxed at whichever rate (AMT or regular tax) is lower for a given year.

- Pay off home-equity loans where the proceeds were not used to improve the home. The only mortgage interest eligible for AMT purposes is from a mortgage whose proceeds were actually used to build, buy or substantially improve a taxpayer's main or second home.

- Dispose of investments in private activity bonds as the interest from private activity bonds issued by state or local governments after August 7,1986 must be included for the purpose of calculation of AMT. Income may be reduced by allocable expenses that were not deductible on form 1040.

Disclaimer:

We appreciate and value your feedback very much. Let us know how we can help make this communication vehicle and the learning resource more valuable to you.

You can always e-mail us at resources@sabooe-solutions.com or call at 1-646-435-7887(USA) or 020 7993 8870(UK) or 91 33 2236 5173 (India).

Sincerely,

Editorial Board, Resource Center
Saboo e-Solutions Pvt. Ltd.
6, Ganesh Chandra Avenue
Kolkata-700013, India
www.sabooe-solutions.com