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# AMT Relief: If Not too Little, Definitely too Late |

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Had the members of Congress been any slower in passing the alternative minimum tax (AMT) patch for individuals, they might have entered the record books as the slowest mammals on the planet. As it turns out, they merely appear to be apathetic to the needs of taxpayers. Luckily the IRS has come to the rescue by doing its best to mitigate delays.

## The Problem that Won't Go Away

The National Taxpayer Advocate's 2006 report to Congress listed the complexity of the current Tax Code as first among the most serious problems faced by taxpayers. The AMT was cited as the primary example of this complexity. The report states, "While the AMT was originally designed to prevent wealthy taxpayers from escaping tax liability through the use of tax-avoidance transactions, most of the significant tax loopholes that enabled taxpayers to escape tax at the time the AMT was written have long since been closed. Today, the AMT is left to punish taxpayers for engaging in such 'classic tax-avoidance behavior' as having children or living in a high-tax state."

Unlike Congress, the Taxpayer

Advocate apparently remembered the second of Adam Smith's four maxims of general taxation—certainty. In *The Wealth of Nations*, Smith pointed out the problem of uncertainty when he stated, "The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty" (Modern Library Edition, 1994, p. 889). In fairness to Congress, Smith's focus was on tax collectors having the ability to collect "arbitrary" amounts. While he had surely never encountered anything resembling the modern income tax system or the AMT, the idea of certainty is clearly critical to any business or investment decision.

Smith's other three maxims are equality, convenience of payment, and economy of collection. In light of the frequent practice of bashing the IRS these days, it's important to note that those of us who have dealt with the Service in an objective manner would argue that it has been relatively successful at accomplishing the goals of convenience of payment and economy of collection, which are the two it can control.

Most politicians would prefer to repeal the AMT and ease this complexity and certainty burden. The problem is the cost. The past decade has witnessed substantial reductions in the regular tax rates, including the creation of a 10% bracket range for regular income and the lowering of the rates on capital gains and dividends to 15% for most taxpayers. While the capital gains and dividend rate of 15% applies for AMT purposes as well, the inclusion of these amounts can force other income of the taxpayer into AMT.

## The Patch Passes Congress

On December 19, 2007, the House passed the individual AMT patch for 2007 that the Senate had passed earlier in the month. President Bush

signed the bill into law on December 26, 2007. The patch doesn't include the revenue offsets that had proven to be too contentious, so its approximate \$50 billion cost will be passed on to future generations of taxpayers. The patch will bring the individual AMT exemption amount up to \$66,250 for joint filers and \$44,350 for unmarried individuals for 2007. It will also provide for the use of nonrefundable personal credits against AMT. The patch essentially adjusts the AMT for inflation so that taxpayers in the same economic position in 2007 as they were in 2006 will not fall farther into the AMT trap.

For readers of *Strategic Finance*, this patch probably comes as welcome relief since we represent those most likely to fall into the AMT trap: members of a one- or two-professional-income household that pays significant state taxes along with miscellaneous itemized deductions and claims exemptions for children.

### The Effects of the Delay

The delay by Congress in passing the patch causes some problems. The IRS couldn't program its primary system based on what it felt the law would be. It must maintain its system based on what the law is currently. The Service has stated that it has done everything possible to be ready to implement the patch. In an IRS Oversight Board Issue Paper from November 2007, the IRS originally anticipated that it would require seven weeks after enactment before it could begin to process returns. This report also discussed three scenarios to illustrate the consequences of delayed passage of the patch. On December 28, 2007, the IRS announced in Release 2007-209 that it expected filing season to be

delayed until approximately February 11, 2008, for AMT-related filings that involve five specific forms:

- ◆ Form 8863, Education Credits;
- ◆ Form 5695, Residential Energy Credits;
- ◆ Form 1040A's Schedule 2, Child and Dependent Care Expenses for Form 1040A;
- ◆ Form 8396, Mortgage Interest Credit; and
- ◆ Form 8859, District of Columbia First-Time Homebuyer Credit.

The IRS said it should be able to process filings that don't use the five affected forms beginning January 14, 2008. Had it been forced to delay the filing season for all returns until February 18, the result would have been a delay in processing 37.7 million returns and in issuing 31.8 million refunds totaling \$86.9 billion, the Oversight Board report estimated.

Release 2007-209 notes that up to 13.5 million taxpayers may still be affected by the delayed filing date, but typically only three million to four million of the affected taxpayers file during the early part of the season. Most of the AMT-affected taxpayers aren't likely to be in refund situations. On the contrary, these taxpayers typically owe additional tax, having based their payments on 100% (or 110%) of the prior year's tax or 90% of the current year's tax.

Fortunately, lower-income taxpayers who don't use the five affected forms should be able to receive their refunds in a timely manner due to the Service's foresight. For the early filers who will face delays, the only satisfaction available may be to reprimand their senators and representatives for not providing a remedy for the AMT in a timely manner.

Printed forms were prepared prior to the passage of the patch. As a result, those preparing manual

returns will need to make adjustments to the forms to reflect the increased exemption amount for AMT and the use of personal credits against AMT. If you use software, the key is to make sure the proper update to the software has been downloaded before the final running of the return.

### More Changes Ahead

The real "beauty" of the patch is that it only covers the year 2007. In the absence of a repeal of the AMT or a major overhaul of the system—both of which are unlikely—we can all look forward to a repeat of this exercise in the closing months of 2008. At least there's one bright spot on the horizon: It's an election year. Perhaps we should all count ourselves lucky that the election takes place before the Thanksgiving recess, giving us ample opportunity to penalize those who choose not to work together toward a solution prior to election day.

We would like to thank the IRS for doing everything in its power to minimize the impact of the delay. We hope Congress will realize how much the Service bailed it out. On the practical side, remember to make sure your software has been updated to include the adjusted AMT numbers prior to final processing and filing. ■

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