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AMT AND INCOME AVERAGING  
— by Neil E. Harl*  

For almost everyone involved with farm income tax, the repeal of the alternative minimum tax provision impacting deferred and installment contracts for the sale of commodities¹ was greeted with a sigh of relief. Now, AMT has reared its head again, this time with income averaging.²

The problem

Income averaging for those “engaged in a farming business” was enacted in 1997³ for a three year trial period (1998 through 2000) and was made permanent in 1998.⁴ Income averaging is accomplished by calculating the tax as though one-third of the “elected farm income” was included in income of the three prior years.⁵ “Elected farm income” is income attributable to a farming business and includes gains from the sale or other disposition of property (other than land) regularly used by the taxpayer in the farming business “for a substantial period.”⁶

Although there are numerous problems in applying income averaging, most of which are expected to be addressed in long-awaited regulations (which have not yet been issued), a matter of major concern is that the benefit “window” of income averaging is relatively narrow because of alternative minimum tax liability.⁷ That was almost certainly not anticipated by the Congress in enacting the income averaging provision.

It is quite clear that income averaging applies only for purposes of calculating the regular income tax—the “tax imposed by section 1.”⁸ The “Blue Book” of the Joint Committee on Taxation states:

“Further, the provision does not apply for purposes of the alternative minimum tax under Section 55.”⁹

An identical provision appears in the conference committee report.¹⁰

It is not completely clear from that statement whether the alternative minimum tax is increased by the decrease in regular income tax caused by income averaging but that appears to be the IRS position. Therefore, it appears that taxpayers must take AMT into account in making decisions about income averaging. AMT can negate much of the tax saving benefit from income averaging.

Example:¹¹ Whitney, who is single, had a $35,000 tentative minimum tax (line 26 of Form 6251) for 1998. She had a $30,000 regular tax (line 40 of form 1040 and line 26 of Form 6251) before income averaging, which resulted in a $5,000 alternative minimum tax (line 27 of Form 6251).

Whitney has enough of her 15 percent bracket available in 1995, 1996 and 1997 so that if she elects income averaging for $51,000 of her 1998 farm income, her regular tax liability would decrease by $8,160. However, her alternative minimum tax would increase by $8,160 if the statute is interpreted as requiring an increase in AMT in the amount of the decrease in regular tax from income averaging. Therefore, her total tax

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liability for the year would not change.

The obvious question is whether the AMT credit\textsuperscript{12} would provide any relief against the regular tax in future years.

**The AMT credit**

The credit for prior year minimum tax is designed to reduce the regular tax liability by part or all of the AMT paid in previous years.\textsuperscript{13} The credit can be carried forward indefinitely to offset regular tax in future years; therefore, it is not necessary to determine which prior year’s minimum tax credit is being used in a particular year.\textsuperscript{14} The minimum credit cannot be carried back.\textsuperscript{15} The rules are different for individuals (using Form 8801) and for corporations (using Form 8827).\textsuperscript{16}

**Individuals.** The alternative minimum tax credit is limited to the extent that regular tax liability (reduced by the other nonrefundable credits) exceeds the tentative minimum tax for the year.\textsuperscript{17} The prior year minimum tax credit for individuals generally arises only in connection with deferral-type preferences and adjustments.\textsuperscript{18} Exclusion-type adjustments include—(1) the standard deduction, (2) personal exemptions, (3) medical and dental expenses, (4) miscellaneous itemized deductions and (5) interest expense.\textsuperscript{19} Real and personal property taxes and state, local and foreign income, war profits and excess profits taxes are also in that category\textsuperscript{20} unless allowable in computing adjusted gross income.\textsuperscript{21} Exclusion-type preference items include depletion, tax-exempt interest and gains from small business stock.\textsuperscript{22} “Adjusted minimum tax” is the net minimum tax reduced by the amount that would have been the net minimum tax if only the exclusion-type preferences and adjustments had been considered.\textsuperscript{23}

**Corporations.** A corporation AMT credit is limited to the amount the regular tax (reduced by the other credits) exceeds 25 percent of the excess of the corporation’s regular tax over $25,000.\textsuperscript{24} That limitation was added by the Tax Reform Act of 1997.

Example: The committee report contains an example of married taxpayers, filing a joint return with—(1) no regular taxable income, (2) deferral preferences in the amount of $300,000 and (3) exclusion preferences (including disallowed itemized deductions) of $240,000. Under the 25 percent alternative minimum tax rate and the $40,000 exemption amount (which were in effect at that time), minimum tax liability would total $125,000. However, if the taxpayers had only exclusion preferences, the minimum tax liability would have been $50,000 (25 percent of $240,000 as reduced by the $40,000 exemption). Thus, the amount of minimum tax available as a carryforward credit would be $75,000 ($125,000 less $50,000).\textsuperscript{25}

**In conclusion**

Unless and until changed by Congress, those using income averaging will need to watch closely to see if AMT diminishes or eliminates the benefits from the averaging election.

**FOOTNOTES**

\begin{itemize}
  \item[2] 4 Harl *supra* n. 1, § 26.08; Harl, *supra* n. 1, § 4.01[4].
  \item[6] I.R.C. § 1301(b).
  \item[7] See I.R.C. § 55.
  \item[8] I.R.C. § 1301(a).
  \item[12] I.R.C. § 53.
  \item[14] See I.R.C. § 53.
  \item[15] Id.
  \item[17] I.R.C. § 53(c).
  \item[20] I.R.C. §§ 56(b)(1)(A), 164(a)(1), (2), (3).
\end{itemize}

**CASES, REGULATIONS AND STATUTES**

by Robert P. Achenbach, Jr.

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**BANKRUPTCY**

**FEDERAL TAXATION-ALM § 13.03[7].**\textsuperscript{*}  
**DISCHARGE.** The debtors filed a previous Chapter 13 case in August 1990 and the IRS filed claims for unpaid taxes for 1987, 1988 and 1989. The Chapter 13 plan provided for payment of the taxes but the debtor failed to fully pay the tax claims before the case was dismissed in October 1994. The current case was filed in January 1995 and the IRS again filed its claim for the 1987 through 1989 taxes. The debtors argued that the tax claims were no longer entitled to a priority because the taxes were due more than three years before the petition was filed. The IRS argued, as several courts have held, that the three year period of Section 523(a)(2) was tolled during the first bankruptcy case. The court, however, held that the statute provided no authority for any tolling of the three year period. Instead, the court held that the Bankruptcy Court could give the tax claims priority based on the court’s equity power under Section 105 and remanded the case.

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\*Agricultural Law Manual (ALM).