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The alternative minimum tax jargon is littered with abbreviations. Many of the following abbreviations are used in this outline:

• ACE = Adjusted current earnings.
• AMT = Alternative minimum tax.
• AMTFTC = Alternative minimum tax foreign tax credit.
• AMTI = Alternative minimum taxable income.
• AMTNOL = Alternative minimum tax net operating loss (referred to by some as the “ATNOL”).
• ANBI = Adjusted net book income.
• BURP = Book unreported profits.
• MTC = Minimum tax credit.
• TMT = Tentative minimum tax.

This outline also uses the term “regular AMTI” to refer to AMTI computed without regard to the BURP adjustment, the ACE adjustment, or any deduction for net operating losses.
§ 4.02 SITUATIONS IN WHICH THE TAXPAYER MUST TAKE AMT CALCULATIONS INTO ACCOUNT

[1] Taxpayer Is Currently Subject to AMT
This is self-explanatory.

[2] Taxpayer May Be Subject to AMT in the Future
If a taxpayer first becomes subject to the AMT in year x, the determination of the taxpayer's AMT liability in year x often will involve AMT calculations with respect to pre-x years beginning after 1986. For example, the AMT basis of certain depreciable assets in year x will reflect the AMT depreciation (rather than the regular tax depreciation) allowed or allowable with respect to those assets in pre-x years beginning after 1986. (Section 56(a)(7).)

[3] Superfund Calculation
The environmental tax imposed by section 59A is based on alternative minimum taxable income ("AMTI"). A corporation (other than a RIC or REIT) with AMTI in excess of $2 million (determined without regard to any deduction for net operating losses) must compute AMTI for this purpose even if the corporation is not subject to the AMT for any taxable year. The environmental tax is not imposed for taxable years beginning after 1995. (Note that the environmental tax originally was scheduled to terminate at the end of 1991 and was extended by the Omnibus Budget Reconciliation Act of 1990, P.L. 101-508 ("OBRA 1990"), section 11231.)
The AMT is technically a tax imposed in addition to the regular tax. Therefore, the actual AMT liability imposed by section 55 is equal to a tentative minimum tax liability (“TMT”) reduced by the regular tax liability. The TMT is determined by (i) multiplying AMTI (reduced by an exemption amount) by 20 percent and (ii) reducing the product by the alternative foreign tax credit (“AMTFTC”).

[1] Computation of AMTI

[a] Starting Point—Regular Taxable Income
AMTI generally is calculated by making adjustments to regular taxable income. (Section 55(b)(2).) However, in the case of a taxpayer whose regular tax base is something other than taxable income (e.g., unrelated business taxable income, life insurance company taxable income, or income effectively connected with a U.S. trade or business), that regular tax base is used as a starting point instead of taxable income. (Section 55(b) (flush language); section 882(a)(1); see H. Rep. No. 795, 100th Cong., 2d Sess, 87-88.)

[b] Line-Item Adjustments
In calculating AMTI, taxable income is recomputed by taking into account the “adjustments” provided in sections 56 and 58. (Section 55(b)(2)(A).) Most of the AMT “adjustments” are methods of accounting for specified types of expenditures or transactions and are used, for AMT purposes, as complete substitutes for the regular-tax methods of accounting for those expenditures or transactions. These “line-item adjustments” can either increase or decrease AMTI relative to taxable income.

[c] Preferences
The sum of all items of “tax preference,” computed under section 57, is added to taxable income in computing AMTI. (Section 55(b)(2)(B).) Note that items of tax preference simply generate “amounts” that increase bottom-line AMTI. Thus, for example, the fact that AMTI is increased by reason of a tax preference attributable to accelerated depreciation does not appear to affect the amount of depreciation that is considered to be “allowed or allowable” for purposes of either the regular tax or the AMT. This may be contrasted with the line-item “adjustments,” discussed in § 4.03[a][b] above. See, however, § 4.07[a][b] below.

[d] Bottom-Line Adjustments

[i] BURP Adjustment
The adjustment for “book unreported profits” (“BURP”) applies only for taxable years beginning before 1990. (Section 56(c)(1)(A), as in effect before its amendment by OBRA 1990.)¹ The adjustment is equal to 50 percent of the excess of (i) adjusted net book income (“ANBI”) for the taxable year over (ii) regular AMTI for the taxable year (i.e., AMTI determined without regard to the BURP adjustment or the net operating loss deduction). (Section 56(f)(1), as in effect before its repeal by OBRA 1990.) The BURP adjustment is computed separately for each taxable year and never reduces AMTI, even if ANBI is less than regular AMTI.

[ii] ACE Adjustment

The adjustment for “adjusted current earnings” (“ACE”) applies for all taxable years beginning after 1989. (Section 56(c)(1).) The ACE adjustment is equal to 75 percent of the difference between (i) ACE for the taxable year and (ii) regular AMTI for the taxable year. (Section 56(g)(1).) When ACE exceeds regular AMTI, the adjustment is positive. When regular AMTI exceeds ACE, the adjustment is negative. A negative ACE adjustment is allowed for a taxable year, however, only to the extent of the taxpayer’s net cumulative positive ACE adjustments for all prior taxable years. (Section 56(g)(2).)

[e] AMTNOL Adjustment

For purposes of computing AMTI, an “alternative tax net operating loss deduction” (the “AMTNOL” deduction) is allowed in lieu of the regular tax NOL deduction. (Section 56(a)(4).) In general, the AMTNOL deduction is the deduction that would be allowed under section 172 if the NOL carryover to the taxable year were computed by taking into account all AMT adjustments and preferences for all taxable years beginning after 1986. The AMTNOL deduction for a taxable year is limited, however, generally to 90 percent of AMTI determined without regard to the AMTNOL deduction. Any amount of the AMTNOL deduction that is disallowed under this limitation is added to the AMTNOL carryover determined under section 172(b). (Section 56(d).)

[f] Exemption Amount and Phase-Out

AMTI is reduced by a $40,000 “exemption amount.” The exemption amount is reduced, however, by 25 cents for each dollar by which AMTI (determined without regard to the exemption amount) exceeds $150,000. Therefore, if a taxpayer’s pre-exemption AMTI is at least $310,000, the taxpayer’s exemption amount is zero.² (Section 55(d).)

[2] Computation of Net AMT

[a] Tax Rate

The corporate AMT rate is 20 percent. Thus, the first step in computing the net AMT liability is the multiplication of AMTI by 20 percent. (Section 55(b)(1)(B)(i).)

[b] Application of AMTFTC

¹ Section 11801 of OBRA 1990 repealed certain “expired or obsolete provisions” of the Internal Revenue Code, including the provisions relating to the BURP adjustment. Thus, Code section 56(f) is repealed, and Code section 56(c)(1) no longer refers to the BURP adjustment. See OBRA 1990, sections 11801(a)(3) and (c)(2). A “savings provision” in OBRA 1990, however, ensures that these amendments do not affect the treatment of transactions occurring, property acquired, or items of income, loss, deduction, and credit taken into account before November 5, 1990, the date of enactment of OBRA 1990. See OBRA 1990, section 11821(b). Accordingly, sections 56(c)(1)(A) and 56(f), as in effect prior to their repeal or amendment by OBRA 1990, are fully effective for all purposes.

² The remainder of this outline will ignore the AMT exemption amount and will use the term “AMTI” to mean “alternative minimum taxable income reduced by the exemption amount.”
The product of AMTI and the 20 percent AMT rate is then reduced by the alternative minimum tax foreign tax credit ("AMTFTC"). (Section 55(b)(1)(B)(ii).) The resulting net amount is referred to as the "tentative minimum tax" ("TMT"). Like the AMTNOL deduction, the AMTFTC generally is computed by applying the foreign tax credit rules taking AMT adjustments and preferences into account. (Section 59(a)(1).) In addition, the AMTFTC cannot be used to reduce the TMT to less than 10 percent of what it would be if neither the AMTFTC or the AMTNOL were taken into account. (Section 59(a)(2).) (For a further limitation on the AMTFTC in the case of certain oil and gas producers, see § 4.08[1] below.)

[c] Excess of TMT Over Regular Tax
Finally, the TMT is reduced by the regular tax liability for the taxable year (determined after taking into account the regular tax foreign tax credit and the section 936 credit). (Section 55(a).) The excess, if any, is the AMT liability for the taxable year.

[3] Interaction With Regular Tax

[a] Minimum Tax Credit
A taxpayer’s AMT liability for a taxable year may be applied as a credit in a subsequent taxable year to the extent that the regular tax liability for such subsequent year (determined after taking into account all other allowable nonrefundable credits) exceeds the TMT for such year. (Section 53.) The taxpayer’s store of minimum tax credits ("MTCs") is reduced as such credits are used. (Section 53(b)(2).) The store of MTCs available for use in a taxable year is increased by the amount of certain credits that (i) were not allowed for prior taxable years because of limitations that prevented such credits from reducing the tax liability below the TMT and (ii) were not allowed to carry over by reason of the rules generally applicable to such credits. These credits are the orphan drug credit (see section 28), and the credit for producing fuel from nonconventional sources (see section 29). (Section 53(d)(1)(B)(iv).)

[b] Investment Credit Limitation
The amount of the TMT generally establishes a floor below which business tax credits may not reduce the tax liability under chapter 1 of the Internal Revenue Code. (Section 38(c)(1).) However, in the case of property placed in service before 1991 and certain transition property, the “regular” investment credit (i.e., the credit attributable to the regular percentage under section 46(a)(1)) may be used, after other credits are taken into account, to reduce the net tax liability to 75 percent of the TMT. (Section 38(c)(2).) The extra limitation for regular investment credits may not be used, however, in excess of an amount that would cause the taxpayer’s net tax liability to be less than ten percent of what the taxpayer’s TMT would be if the AMTNOL deduction and the AMTFTC were disregarded (i.e., 2 percent of pre-NOL AMTI). (Section 38(c)(2)(C).) In general, for property placed in service after 1990, section 38(c)(2) is repealed. See P.L. 101-508, §§ 11813(b)(2)(B) and 11813(c).
§ 4.04 COMPUTATION OF “REGULAR” AMTI AND THE AMTNOL DEDUCTION

[1] Line-Item Adjustments

[a] Introduction to “Adjustment” Concept
In computing AMTI, taxable income is recomputed by taking into account the “adjustments” provided in sections 56 and 58. (Section 55(b)(2)(A).) In general, an AMT “adjustment” is an accounting method, applicable to a particular type of expenditure or transaction, that must be used for AMT purposes in lieu of the accounting method applicable to that expenditure or transaction for regular-tax purposes. In other words, the regular-tax effects of the expenditure or transaction are eliminated from taxable income, and the effects of the prescribed AMT accounting treatment are substituted therefor. (The substitution is required because the regular-tax method of accounting for the expenditure or transaction is considered to be more generous than the “normative” method of accounting for such items.) The application of an AMT adjustment may result, for a given taxable year, in either an increase or a decrease in AMTI relative to taxable income. The purpose of the positive-or-negative “adjustment” approach is to ensure that adjustments relating only to the timing of income or expense do not cause AMTI over a period of years to be overstated. (Compare the effect of preferences, discussed in § 4.04[2][a] below.)

[b] Depreciation
The depreciation adjustment (section 56(a)(1)) applies to tangible property placed in service after December 31, 1986 (other than property grandfathered from application of section 201 of the Tax Reform Act of 1986), and to property with respect to which an election was made under section 203(a)(1)(B) of the 1986 Act. In lieu of the regular-tax depreciation deduction for such property, the AMT depreciation deduction is determined as follows:

- Section 1250 property that is rental real property is depreciated over 40 years using the straight-line method.
- Section 1250 property that is not rental real property is depreciated over its class life using the straight-line method.
- Property that is depreciated using the straight-line method for regular-tax purposes (e.g., foreign-use property) is depreciated over its class life using the straight-line method.
- All other property is depreciated over its class life using the 150-percent declining balance method (switching to straight-line).

The depreciation adjustment does not apply to property that is excluded from application of section 168 by reason of (i) section 168(f)(1) (property not depreciated using a method expressed in terms of years, if the taxpayer elects to exclude the property from application of MACRS), (ii) 168(f)(2) (public utility property,
where the taxpayer does not use a normalization method of accounting), (iii) 168(f)(3) (films and video
tapes), or (iv) 168(f)(4) (sound recordings). AMT depreciation for such property therefore is computed using
regular-tax rules.

[c] **Mining Exploration and Development Costs**

Mining exploration and development costs incurred after December 31, 1986, must be capitalized and
amortized over the ten-year period beginning with the year in which the expenditures were made. (Section
56(a)(2).)

[d] **Pollution Control Facilities**

Depreciation with respect to pollution control facilities placed in service after December 31, 1986, is
determined under section 168(g). (Section 56(a)(5).) Generally, this means that depreciation will be
determined on the basis of the class life of the property using the straight-line method.

[e] **Circulation Expenditures of a Personal Holding Company**

The adjustment for circulation expenditures applies to such expenditures made after December 31, 1986,
and does not apply to corporations other than personal holding companies (as defined in section 542).
(Section 56(b)(2)(C).) Such expenditures must be capitalized and amortized over the three-year period
beginning with the year in which the expenditures were made. (Section 56(b)(2)(A)(i).)

[f] **Installment Sales**

(Section 56(a)(6).) The adjustment for installment sales applies to sales made after March 1, 1986, and
applies only to sales of property described in section 1221(1) (i.e., property includable in inventory, and
other property held primarily for sale to customers in the ordinary course of business). The adjustment does
not apply to sales of timeshares and residential lots with respect to which an interest charge is elected
under section 453(l)(2)(B).

3 In the case of any installment sale to which the adjustment applies, income is determined without regard to
section 453.

Section 453 generally does not apply for regular-tax purposes to any sale, occurring after December 31,
1987, of (a) property includable in inventory (section 453(b)(2)(B)), (b) personal property sold by a person
who regularly sells such property on the installment method (sections 453(b)(2)(A) and (l)(1)(A)), or (c) real
property held for sale to customers in the ordinary course of business (sections 453(b)(2)(A) and (l)(1)(B)).

Thus, no AMT adjustment is made with respect to such sales. Under an exception in section 453(l)(2)(A),
however, section 453 continues to apply to sales of property used or produced in the business of farming.
Accordingly, the AMT adjustment for installment sales has continuing effect with respect to such sales.

[g] **Long-Term Contracts**

The adjustment for long-term contracts applies to contracts entered into on or after March 1, 1986, other
than (a) certain small home construction contracts entered into after June 21, 1988, and (b) all home
construction contracts entered into in taxable years beginning after September 30, 1990. (Section 55(a)(3).)

In the case of any contract to which the adjustment applies, taxable income from the contract is determined
under the percentage-of-completion method. Since the percentage-of-completion method generally must be
used for regular-tax purposes for all long-term contracts entered into on or after July 11, 1989 (see P.L.
101-239, § 7621), this adjustment will have little continuing effect.

3 The adjustment also applies to sales of property, in taxable years beginning before January 1, 1987, to which the “proportional
disallowance rule” contained in section 453C (as in effect prior to its repeal by P.L. 100-203) applied.
[h] Alcohol Fuel Credit Exclusion
Section 87, which causes the alcohol fuel credit determined under section 40(a) to be included in gross income, does not apply for AMT purposes. (Section 56(a)(8).)

In the case of amounts contributed to a capital construction fund after December 31, 1986, and amounts earned by such funds after December 31, 1986, the income-reduction and correlative basis-reduction provisions of section 7518 do not apply for AMT purposes. (Section 56(c)(2).)

[j] Blue Cross/Blue Shield Deduction
The deduction provided by section 833(b) is not allowed for AMT purposes. (Section 56(c)(3).)

[2] Preferences

[a] Introduction to “Preference” Concept
The amount of all items of “tax preference,” computed under section 57, is added to taxable income in computing AMTI. (Section 55(b)(2)(B).) Like the line-item “adjustments,” AMT preferences relate to specified regular-tax methods of accounting for particular items of income or expenditure that are more generous than the “normative” method of accounting for such items. For any given taxable year, any reduction in regular taxable income caused by one of the specified preferential methods of accounting (relative to the normative method of accounting for the item in question) is simply added to bottom-line AMTI. AMTI is not reduced, however, if the use of the preferential method rather than the normative method increases regular taxable income for the taxable year (e.g., because the normative method takes an item of deduction into account in the current year, while the preferential method took the item into account in a prior year). As a result, if a preferential method of accounting is used to account for the recovery a capital expenditure for regular-tax purposes, less than 100 percent of the expenditure will be recovered for AMT purposes—in effect, the normative deduction will be allowed for taxable years in which it is smaller than the preferential deduction, while the preferential deduction will be allowed for taxable years in which it is smaller than the normative deduction (i.e., taxable years after the “cross-over point”). In addition, the fact that AMTI is increased by reason of a tax preference attributable to accelerated depreciation does not affect the amount of depreciation that is considered to be “allowed or allowable” for purposes of either the regular tax or the AMT.

[b] Accelerated Depreciation and Amortization on Pre-1987 Property
Prior to the establishment of the corporate AMT by the Tax Reform Act of 1986, accelerated depreciation with respect to certain types of property was treated as a tax preference for purposes of the corporate “add-on” minimum tax. These types of property included real property and (in the case of section 542 personal holding companies only) leased personal property. The amounts that would have been treated as preference amounts with respect to the taxpayer had the 1986 Act not been enacted are treated as preferences for AMT purposes. (Section 57(a)(7).) These amounts are computed on a property-by-property basis and are equal to the excess (if any) of the regular-tax depreciation deduction for the year over the deduction that would have been allowed for the year under the straight-line method over periods specified in section 57 as in effect prior to the enactment of the 1986 Act.

[c] Percentage Depletion in Excess of Basis
The excess of (i) the section 611 depletion deduction for the taxable year with respect to a property over (ii) the adjusted basis of the property as of the end of the year (determined without regard to the depletion deduction) is an AMT preference. For taxable years beginning after 1992, this preference does not apply to oil and gas depletion deductions determined under section 613A(c) (relating to so-called “independent
producers and royalty owners”). (Section 57(a)(1).) Note that this preference is separately determined for each property (identified under section 614).

[d] **Intangible Drilling and Development Costs (“IDCs”)**
For regular-tax purposes, a taxpayer generally may elect to deduct IDCs for oil and gas wells and geothermal wells as current expenses. (Section 263(c).) In the case of an “integrated oil company” that makes such an election, however, only 70 percent of such costs may be deducted currently; the remaining 30 percent must be capitalized and deducted ratably over the 60-month period beginning with the month in which the costs are incurred. (Section 291(b).)

For AMT purposes, the normative method of recovering IDCs is (i) ten-year amortization beginning with the month in which production begins or, if the taxpayer elects, (ii) cost depletion. (Section 57(b).) The AMT preference for IDCs is not simply the excess of the regular-tax deduction over the normative AMT deduction, however. Instead, that excess is computed, on a pooled basis, for all of the taxpayer’s oil and gas properties, and, on a separate pooled basis, for all of the taxpayer’s geothermal properties. The excess amount for the year for each type of property is then treated as an AMT preference only to the extent that that amount exceeds 65 percent of the taxpayer’s net income for the year from that type of property (disregarding the excess IDC amount in computing net income). (Section 57(a)(2).)

For taxable years beginning after 1992, the IDC preference generally is not taken into account by a taxpayer that is not an integrated oil company (within the meaning of section 291(b)(4)). However, the foregoing exception may reduce the taxpayer’s AMTI (determined by including the IDC preference and by disregarding the AMTNOL deduction) by only 40 percent (30 percent for taxable years beginning in 1993).

[e] **Bad Debts of Financial Institutions**
For regular-tax purposes, financial institutions described in sections 585 and 593 are permitted to deduct reasonable additions to reserves for losses on bad debts, computed under rules set forth in those sections. For any taxable year, the excess of (i) the deduction allowed under one of the foregoing provisions (reduced to the extent such deduction is disallowed by section 291(a)(3)) over (ii) the amount that would have been allowed had the taxpayer’s bad debt reserve for all taxable years been maintained on the basis of actual experience, is treated as an AMT preference. (Section 57(a)(4).)

[f] **Interest on Post-8/7/86 Specified Private Activity Bonds**
Interest on a specified private activity bond (generally, a private activity bond issued after August 7, 1986) is an AMT preference. (Section 57(a)(5).) The amount of the preference is reduced by any disallowed interest deduction that would have been allowable if the interest on the bond were includable in regular taxable income, but the preference may not be reduced below zero by the related interest expense. (See H. Rep. No. 426, 99th Cong., 2d Sess. 313.)

[g] **Charitable Contributions of Appreciated Property**

[i] **Pre-1993 Contributions**
Prior to the repeal of this preference, in the case of a charitable contribution of appreciated property on or after August 16, 1986, the amount by which the regular-tax deduction attributable to the contribution exceeded the basis of the property generally was an AMT preference. (Section 57(a)(6).) Since the preference applied only to “capital gain property,” the preference effectively applied on a property-by-property basis. Thus, no AMT benefit resulted from a contribution of property with a basis higher than its fair market value; the deduction was limited to fair market value for both regular-tax and AMT
purposes. Under OBRA 1990, section 11344, as amended by the Tax Extension Act of 1991, section 112, this preference was made inapplicable to tangible personal property "in the case of any taxable year beginning in 1991" or to personal property contributed "before July 1, 1992, in a taxable year beginning in 1992." The OBRA 1990 Conference Report states that this exception applied to "contributions made during taxable years beginning in 1991." (H. Rep. No. 101-964, p. 1033.) It is arguable, however, that the statutory effective date rule made section 57(a)(6) inapplicable to deductions that were taken into account in 1991 (and not to other deductions), rather than to contributions that were made in 1991. Under this view, (i) deductions that were carried to 1991 under section 170(d)(2) and were attributable to the appreciation element in tangible personal property contributed in a pre-1991 year would escape preference treatment under the statutory language, but (ii) deductions that were carried from 1991 and were attributable to the appreciation element in tangible personal property contributed in 1991 would not escape preference treatment. In this regard, note that, according to the 1986 Act Bluebook, at 444-45, the “basis” portion of an appreciated-property contribution is treated as deducted first for regular-tax purposes. Thus, if an appreciated-property contribution was made in 1991, and the basis of the property was at least equal to the section 170(b)(2) limitation in 1991, it is possible that the entire appreciation element was carried to subsequent years and became subject to section 57(a)(6) in such years. In Rev. Rul. 90-111, 1990-2 C.B. 30, the Service ruled that, in the case of an individual taxpayer, the exception to section 57(a)(6) applied to carryovers attributable to contributions made in 1991 and did not apply to carryovers from pre-1991 years. It is not known whether the Service believes the same result is required for corporations. In any event, even if section 57(a)(6) did not apply to a contribution of appreciated property, the appreciation element may not have significantly reduced current tax liability for a taxpayer subject to the ACE adjustment for the taxable year, since, in the IRS’ view, current E&P is reduced only by the adjusted basis of the contributed property. Rev. Rul. 78-123, 1978-1 C.B. 87; contra, Kaplan v. Commissioner, 43 T.C. 580 (1965), nonacq., 1978-1 C.B. 2.

[ii] Post-1992 Contributions
Section 57(a)(6) is repealed for contributions made after December 31, 1992. In the case of contributions of tangible personal property, the preference is repealed for contributions made after June 30, 1992. (Revenue Reconciliation Act of 1993, P.L. 103-66, § 13171(a).)


An “alternative” net operating loss deduction (“AMTNOL deduction”) is allowed for AMT purposes in lieu of the regular-tax NOL deduction. In other words, in computing AMTI, the regular-tax NOL deduction is added back to taxable income, and the AMTNOL deduction is then subtracted. (Section 56(a)(4).)

[a] 90-percent Limitation
The allowable AMTNOL deduction for a taxable year is limited to 90 percent of pre-AMTNOL AMTI for the year. (Section 56(d)(1)(A).)

[b] Alternative Computation
The AMTNOL deduction for a taxable year is the amount that would be allowable as a deduction for the year under section 172 if the section 172 computations reflected AMT accounting methods (including both

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4 See, however, H. Rep. No. 99-426 (December 7, 1985), at 313, which incorrectly states that unrealized losses on contributed property would reduce the preference under the House version of the 1986 Act.

5 See section 56(h), as in effect before its repeal by P.L. 102-486, § 1915(c)(1).
adjustments and preferences) for all years during which the AMT was in effect (i.e., all post-1986 years). Thus:

- The net operating loss (if any) for each year beginning after 1986 is determined by taking into account all AMT adjustments and preferences. (Section 56(d)(2)(A).)

- For purposes of determining the amount of an AMTNOL carryover, section 172(b)(2) is applied for each post-1986 year by substituting “90 percent of pre-AMTNOL AMTI” for “taxable income.” (Section 56(d)(1)(B)(ii).)

[c] Treatment of NOL Carryforwards From Pre-1987 Years
The amount of any regular-tax NOL carryforward from a year beginning before 1987 generally is taken into account as an AMTNOL carryforward for years beginning after 1986. If, however, the taxpayer had a deferred add-on minimum tax liability at the end of 1986 under section 56(b) (as in effect prior to its repeal by the Tax Reform Act of 1986), the AMTNOL carryover to the first year beginning after 1986 must be reduced by the amount of the preferences that gave rise to the deferred add-on tax liability. (1986 Act, section 701(f)(2)(B).)

[d] Treatment of AMTNOL Where Regular-Tax NOL Is Carried Back to Pre-1987 Years
Since, for AMT purposes, section 172(b)(2) is applied for pre-1987 years without regard to AMT adjustments and preferences, an AMTNOL arising in a post-1986 year probably must be reduced by regular taxable income in pre-1987 carryback years unless the carryback period is relinquished by an election under section 172(b)(3)(C). (See 1986 Act Bluebook at 469.) Such an election may not be made for AMT purposes only. If the election is made, it applies for both regular-tax and AMT purposes. (Rev. Rul. 87-44, 1987-1 C.B. 3.)
§ 4.05 “PARALLEL SYSTEM” CONCEPT

[1] Statement of Concept
The “parallel system” theory posits that, when the Internal Revenue Code defines an alternative tax base (such as AMTI) by explicitly modifying the regular-tax accounting rule for an item (e.g., a type of transaction, a type of expenditure, or a type of income), all regular-tax accounting methods and other rules that take the results of the explicitly modified rule into account should be deemed to be implicitly modified, so that, for purposes of determining the amount of the alternative tax base, the unmodified methods and rules are applied by taking into account the results of the modified rule.

[2] Examples Illustrating “Parallel System” Issues

Example (1):
The taxpayer acquires an asset that is used to produce inventory. For the taxable year, the regular-tax depreciation allowance for the asset is $100, and, due to an AMT adjustment, the AMT depreciation allowance for the asset is $60. For regular-tax purposes, section 263A requires the $100 of depreciation to be included in the cost of inventory. The Internal Revenue Code does not expressly provide that, for AMT purposes, the cost of goods sold shall be computed by inventorying depreciation allowable for AMT, rather than regular-tax, purposes. How is the taxpayer’s cost of goods computed for AMT purposes? Example (2): The facts are the same as in Example (1), except that the asset is not subject to the depreciation adjustment rules. Instead, the regular-tax depreciation allowance for the asset generates a $40 preference, which is added to the taxpayer’s AMTI.

Example (3).
The taxpayer owns an asset with a regular-tax basis of $100 and an AMT basis of $150. The taxpayer contributes the asset to a corporation in a transaction to which section 351 applies. What is the corporation’s basis in the asset for AMT purposes?

• The use of modified accounting rules for some but not all purposes may result in a duplication or omission of income in computing AMTI.
The use of modified accounting rules for some but not all purposes may result in distortions in the timing of income and deductions in computing AMTI.

If the alternative tax base’s modified accounting rules are assumed to yield a better measurement of economic income than the unmodified rules they replace, they should be taken into account for all purposes that relate to the measurement of income derived during an accounting period for AMT purposes.

If the alternative tax base’s modified accounting rules are assumed to yield a better measurement of economic income than the unmodified rules they replace, they must provide better measures of, e.g., the taxpayer’s ability to pay tax, or, e.g., the appropriateness of applying an income-based de minimis rule.

Once an accounting rule is modified for purposes of the alternative tax base, it is conceptually simpler, as a starting point, to assume that the modified rule applies for all purposes that relate to that base than to assume that it applies only where necessary to avoid results that are considered to be inappropriate under one or more of the foregoing arguments.

Arguments Against the “Parallel System” Approach

The “parallel system” approach is not systematically adopted by the statute.

The specific “parallel system” provisions in the statute (see §§ 4.05[7][b] through 4.05[7][f] below) imply that the “parallel system” approach is not intended to be applied across the board.

The “parallel system” approach adds complexity to the tax system by requiring taxpayers to maintain a complete set of accounting records for purposes of the parallel system only.

Statutory Authority for “Parallel System” Approach

Implication of “Adjustment” Concept

The basic statutory rule for adjustments states: “In determining the amount of the [AMTI] for any taxable year the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax).” (Section 56(a).) (Similar language appears in section 56(c), applicable to corporations only.)

This may be read to mean that each accounting rule embodied in an “adjustment” must be taken into account for all tax purposes in lieu of the regular tax rule replaced by the adjustment. Is any other interpretation plausible?

Broad Authority Granted to the Treasury

Authority for the Treasury to implement a parallel system approach on an across-the-board basis is hidden in section 59(h), which reads:

The limitations of sections 704(d), 465, and 1366(d) (and such other provisions as may be specified in regulations) shall be applied for purposes of computing the alternative minimum taxable income of the taxpayer for the taxable year with the adjustments of sections 56, 57, and 58.

This provision permits, but does not require, the Treasury to implement the “parallel system” approach as broadly as it chooses. In the absence of regulations, does this provision carry a negative implication? Why does it refer to the “adjustments” of section 57 (which relates only to “preferences”)?

1986 Act Bluebook

The following passage in the nonauthoritative 1986 Act Bluebook (at p.438) states that Congress generally intended the AMT to be applied on a “parallel system” basis:

Structure of minimum tax as an alternative system. For most purposes, the tax base for the new alternative minimum tax is determined as though the alternative minimum tax were a separate and
The use of modified accounting rules for some but not all purposes may result in distortions in the timing of income and deductions in computing AMTI.

If the alternative tax base’s modified accounting rules are assumed to yield a better measurement of economic income than the unmodified rules they replace, they should be taken into account for all purposes that relate to the measurement of income derived during an accounting period for AMT purposes.

If the alternative tax base’s modified accounting rules are assumed to yield a better measurement of economic income than the unmodified rules they replace, they must provide better measures of, e.g., the taxpayer’s ability to pay tax, or, e.g., the appropriateness of applying an income-based _de minimis_ rule.

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### 4 Arguments Against the “Parallel System” Approach

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- The “parallel system” approach adds complexity to the tax system by requiring taxpayers to maintain a complete set of accounting records for purposes of the parallel system only.

### 5 Statutory Authority for “Parallel System” Approach

#### [a] Implication of “Adjustment” Concept

The basic statutory rule for adjustments states: “In determining the amount of the [AMTI] for any taxable year the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax).” (Section 56(a).) (Similar language appears in section 56(c), applicable to corporations only.) This may be read to mean that each accounting rule embodied in an “adjustment” must be taken into account for all tax purposes in lieu of the regular tax rule replaced by the adjustment. Is any other interpretation plausible?

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Authority for the Treasury to implement a parallel system approach on an across-the-board basis is hidden in section 59(h), which reads:

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This provision permits, but does not require, the Treasury to implement the “parallel system” approach as broadly as it chooses. In the absence of regulations, does this provision carry a negative implication? Why does it refer to the “adjustments” of section 57 (which relates only to “preferences”)?

#### [c] 1986 Act Bluebook

The following passage in the nonauthoritative 1986 Act Bluebook (at p.438) states that Congress generally intended the AMT to be applied on a “parallel system” basis:

*Structure of minimum tax as an alternative system.* For most purposes, the tax base for the new alternative minimum tax is determined as though the alternative minimum tax were a separate and
independent income tax system. In certain instances, the operation of the alternative minimum tax as a separate and independent tax system is set forth expressly in the Code. In other instances, however, where no such express statement is made, Congress did not intend to imply that similar adjustments were not necessary.


[a] Avoiding Duplications and Omissions of Income on a Taxpayer’s Return Within the AMT Accounting System

The most obvious need for “parallel system” accounting arises when failure to implement such a system would cause duplications or omissions of income. For example, if depreciation with respect to an asset is computed on a straight-line basis for AMT purposes, but the AMT basis of the asset is adjusted by accelerated regular-tax depreciation, AMTI will be duplicated when the asset is sold. On the other hand, if the AMT basis of the asset is adjusted by straight-line depreciation, but the taxpayer’s regular-tax NOL carryover (taking into account regular-tax accelerated depreciation) is allowed for AMT purposes, AMTI will be omitted in some circumstances. In order to avoid problems such as the foregoing, it is necessary to account for any item of income or expense in a manner that causes the item to be measured in the same way whenever it is taken into account in computing taxable income in the AMT system. Following are examples of rules that must be applied on a parallel basis for the foregoing reason:

- Computation of adjusted basis. (See sections 56(a)(7) and 56(g)(4)(I).)
- Computation of NOL deduction. (See sections 56(a)(4) and 56(d).)

[b] Internally Consistent Timing Rules

It is not necessary for AMT accounting rules to control all timing of income and expense items in order to avoid duplications and omissions of income. However, in some cases, even if duplications and omissions are not at issue, it may be necessary to follow a “parallel system” approach in order to avoid distortions during a single taxable year. For example, if a zero-basis depreciable asset is sold in a deferred intercompany transaction, the purchasing member’s contribution to consolidated AMTI will be computed by taking AMT depreciation into account. If the selling member’s deferred gain is restored on the basis of faster regular-tax depreciation, consolidated taxable income will be overstated in the early years of the asset’s use by the purchasing member and understated in the later years.

[c] Timing Rules Faithful to Purpose of AMT

In some cases, failure to adopt AMT timing rules on a parallel basis will cause neither duplications nor omissions of income nor absurdly distorted results, but will simply permit the taxpayer to avoid the income-accelerating effect of the AMT rules. For example, if AMT inventory amounts are computed by capitalizing regular-tax depreciation rather than AMT depreciation, cost of goods sold will be accelerated in a manner that does not reflect an assumption that depreciable assets used to generate inventories are depreciating at the rate specified in the AMT depreciation provisions rather than the regular-tax depreciation provisions. (See Reg. § 1.56(g)-1(a)(5). Note that this regulation applies for ACE purposes only; it is likely, however, that a similar rule, generally applicable for regular AMT purposes, will be included in future regulations.)

[d] Income-Based Limitations

Some tax deductions are limited, not for income-measurement reasons, but for policy reasons, by reference to some measure of the taxpayer’s taxable income. For example, a corporate taxpayer’s charitable

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6 In fact, if a depreciable asset used to produce inventory is sold before it is fully depreciated for AMT purposes, a permanent omission of AMTI will occur if regular tax depreciation is capitalized, since the capitalized depreciation will exceed the cumulative reductions of the asset’s AMT basis (which will be equal to cumulative AMT depreciation).
contribution deduction generally is limited to ten percent of taxable income (as modified) (section 170(b)(2)), and an independent producer’s deduction for percentage depletion on oil and gas wells generally is limited to 65 percent of taxable income (as modified) (section 613A(d)(1)). Arguably, for AMT purposes, these limitations should be determined by reference to modified AMTI, rather than modified regular taxable income. These limitations are inherently arbitrary, however, and the deductions to which they relate are unrelated to the measurement of economic income; therefore, failure to apply them on a parallel basis will not result in duplications, omissions, distortions, or improper timing of income. (Note that, in TAM 9320003, the Service determined that both the charitable contribution limitation and the percentage depletion limitation should be recomputed for AMT purposes on a parallel basis.)

[e] Rules Triggered by Adjusted-Basis Computations

Some income-tax rules may be triggered by computations involving the adjusted basis of the taxpayer’s assets. For example, under section 382(h)(3)(B), a taxpayer is treated as having a net unrealized built-in gain or loss only if the fair market value and aggregate adjusted basis of the taxpayer’s assets differ by more than a specified threshold amount. In addition, under the section 861 regulations, interest expense may be apportioned among classes of income by reference to the respective adjusted bases of the assets generating those classes of income. (Reg. § 1.861-9T(g).) In applying the foregoing rules for AMT purposes, it is not necessary to take AMT adjusted bases into account, in the sense that failure to do so will not result in duplications, omissions, distortions, or improper timing of income.

[f] Status Issues

Some income-tax rules may be triggered by a determination that a taxpayer has a particular status. For example, under Reg. § 1.382-2T(a)(1), an ownership change may occur with respect to a corporation for section 382 purposes only if the corporation is a “loss corporation.” In applying this status-determination rule for AMT purposes, it is not necessary to take AMTNOLs, rather than regular-tax NOLs, into account, in the sense that failure to do so will not result in duplications, omissions, distortions, or improper timing of income. (In fact, for purposes of the ACE “pushdown” rule provided in section 56(g)(4)(G), the regulations take the position that the determination of whether a corporation is a loss corporation is made solely by reference to the corporation’s regular-tax attributes. See Reg. § 1.56(g)-1(k)(2).

[g] Transactions Involving More Than One Taxpayer

[i] Section 381 Transactions

When the assets of a target corporation are acquired in a transaction to which section 381 applies, the target corporation’s AMT attributes (e.g., its AMTNOL, the AMT bases of its assets, etc.) should be taken into account by the acquiring corporation to the extent provided in section 381 with respect to the regular-tax counterparts of those attributes. Otherwise, AMTI attributable to the target’s operations may be duplicated or omitted.

[ii] Carryover Basis Transactions

When one taxpayer transfers an asset to another taxpayer in a carryover basis transaction (e.g., a section 351 contribution), a question arises as to whether the transferee should take separate regular-tax and AMT bases in the transferred asset. Unlike property transferred in a section 381 transaction, the transferred basis property (see section 7701(a)(43)) in a carryover basis transaction need not be accounted for in a parallel manner in order to avoid duplication or omission of at least one level of AMTI, since the transferor should have an exchanged AMT basis in the asset received in exchange for the transferred asset (e.g., stock in the transferee, in the case of a section 351 contribution).

[iii] Incentive Stock Options
In general, when a corporation issues an incentive stock option to an employee, the employee recognizes no income when the option is exercised, and the employer is allowed no deduction with respect to the transfer of the stock to the employee. (Section 421(a).) For AMT purposes, section 56(b)(3) provides: “In determining the [AMTI] of any taxpayer (other than a corporation) … section 421 shall not apply to the transfer of stock acquired pursuant to the exercise of an incentive stock option …” Although section 56(b)(3) does not, by its terms, apply to the corporate employer, does the parallel-system approach permit the employer to claim a deduction under section 83(h) for AMT purposes?

[h] Interaction of Regular-Tax System and “Parallel System”

In some (hopefully rare) cases, the regular-tax system and the parallel system collide. For example, the limitation taken into account under section 383(a) for a “post-change year” is equal to “the section 382 limitation for such post-change year to the extent available after application of [the section 382 limitation on NOLs and recognized built-in losses, the section 383(b) limitation on net capital loss carryovers, and the section 383(c) limitation on foreign tax credit carryovers].” Under a pure parallel system, a single section 382 limitation should be computed for a loss corporation in the event of an ownership change, and that limitation should be separately applied to (i) the corporation’s regular-tax NOLs, recognized built-in losses, net capital loss carryovers, and foreign tax credit carryovers, and (ii) the corporation’s AMTNOLs, recognized built-in AMT losses, net AMT capital loss carryovers, and AMTFTC carryovers. Since the amounts of the regular-tax and AMT counterparts of those attributes will differ, the corporation’s unused section 382 limitation should differ for regular-tax and AMT purposes. In this light, how should the section 383(a) limitation be computed? There is no authority on this point.7


[a] Use of “Adjustments.”

As mentioned above, the basic statutory rule for adjustments states: “In determining the amount of the [AMTI] for any taxable year the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax).” (Section 56(a).) (Similar language appears in section 56(c), applicable to corporations only.) This may be read to mean that each accounting rule embodied in an “adjustment” must be taken into account for all tax purposes in lieu of the regular tax rule replaced by the adjustment. Is any other interpretation plausible? (Note that this analysis does not apply to non-normative items treated as section 57 preferences. Also note, however, that Reg. § 1.56(g)-1(f)(3) (relating to the LIFO recapture rule under ACE) and Reg. § 1.56(g)-1(r) (providing an election to use regular-tax inventory amounts for purposes of computing pre-ACE AMTI and ACE) suggest that section 57 preferences are not simply added to AMTI but, instead, are taken into account in computing inventory amounts.)


[c] Basis of Property

The basis of property for AMT purposes is determined by taking into account the adjustments relating to depreciation, mining exploration and development costs, pollution control facilities, and circulation expenditures. (Section 55(a)(7).) The statute does not, however, provide that the AMT basis of property is determined by taking into account preference items that relate to deductions that affect basis (e.g., the preference for accelerated depreciation on certain pre-1987 property). Does this suggest that preference items generally are not intended to be taken into account in a “parallel” manner?

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7 A similar conundrum arises under section 108(b), since an amount of excluded cancellation of indebtedness income first reduces net operating losses (the regular tax and AMT versions of which are likely to differ) and then reduces the general business credit (which exists independently of the parallel regular tax and AMT systems).
[d] **Partnership Basis Limitation; At-Risk Limitation**
The limitations of section 704(d) (limiting a partner’s share of partnership losses to the partner’s basis in its partnership interest) and 465 (the at-risk limitation) are applied for AMT purposes by taking into account all “adjustments” provided in sections 56, 57, and 58. (Section 59(h).) (Note: Since section 57 describes only “preferences,” the term “adjustments” may be intended to include preferences. There is currently no authority on this point.)

[e] **Passive Activity Loss Limitation**
The passive activity loss limitation, set forth in section 469, is applied for AMT purposes by taking into account all “adjustments” provided in sections 56 and 57. (Section 58(b).) (Note: Since section 57 describes only “preferences,” the term “adjustments” may be intended to include preferences. There is currently no authority on this point.)

[f] **Application of Subchapter J to Estates and Trusts and Their Beneficiaries**
Section 59(c) provides that the AMTI of estates and trusts and their beneficiaries is computed by applying part I of subchapter J (i.e., sections 641 through 683) taking into account the “adjustments” provided in part VI of subchapter A (i.e., sections 55 through 59).
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§ 4.07 ACE ADJUSTMENT

[1] Structure
Application of the ACE adjustment involves a two-step process. First, ACE itself is computed. (Note: Since ACE applies only for purposes of computing current AMTI (i.e., AMTI without regard to NOL carryovers), ACE itself should not involve any carryover computations.) Second, regular AMTI (i.e., AMTI without regard to the ACE adjustment or the net operating loss deduction) is adjusted to take the ACE computation into account.

[a] Computation of ACE.
ACE represents yet another attempt by Congress to approximate a corporate taxpayer’s current “economic income.” The starting point for calculating ACE is regular AMTI (i.e., AMTI without regard to the ACE adjustment or the net operating loss deduction). Regular AMTI is then adjusted as provided in section 56(g)(4). The adjustments provided in section 56(g)(4) include (i) certain specified adjustments adopted by Congress for ACE purposes only, and (ii) two residual categories of adjustments that are based on the rules for determining earnings and profits (“E&P”) for purposes of subchapter C.

[b] Adjustment of Pre-ACE AMTI
Before taking the AMTNOL deduction into account, regular AMTI is adjusted by 75 percent of the difference between ACE and regular AMTI. If ACE is greater than regular AMTI, 75 percent of the difference is added to regular AMTI. (Section 56(g)(1).) If ACE is less than regular AMTI, 75 percent of the difference generally is subtracted from regular AMTI. (Section 56(g)(2)(A).) A negative adjustment is allowed, however, only to the extent of net cumulative positive adjustments in prior taxable years. (Section 56(g)(2)(B).) For purposes of computing the adjustment, an amount of loss is considered to be “greater” than a larger amount of loss, and any amount of income is considered to be “greater” than any amount of loss. (See Reg. § 1.56(g)-1(a)(3).)

[2] Section 56(g)(4) Adjustments
Section 56(g)(3)(A) states that ACE is “determined with the adjustments provided in paragraph (4).” Like the AMT adjustments discussed in § 4.04[1][a] above, an ACE adjustment is an accounting method, applicable to a particular type of expenditure or transaction, that must be used for ACE purposes in lieu of the accounting method applicable to that expenditure or transaction for regular-AMT purposes. In other words, solely for purposes of computing ACE, the regular-AMT effects of the expenditure or transaction are eliminated from the computation of regular AMTI, and the effects of the prescribed ACE accounting treatment are substituted therefor. This may result, for a given taxable year, in either an increase or a decrease in ACE relative to regular AMTI.
Note that, in the case of an ACE adjustment that relates to an item that gives rise to regular-AMT preferences, the amount of the preference may be included in ACE twice. This may occur because (i) the starting point for computing ACE is pre-ACE AMTI (including preferences added to bottom-line AMTI), and (ii) ACE is computed by replacing the regular-AMT treatment of the item giving rise to the preference (which arguably is the same as the regular-tax treatment of the item) with the ACE treatment of the item. To the extent the regular-tax benefit of the item exceeds the ACE benefit of the item (or the regular-tax detriment of the item is less than the ACE detriment of the item) by an amount that equals or exceeds the preference amount generated by the item, the preference amount is effectively included in ACE twice. In some cases, it may be argued that the ACE “adjustment” requires a recomputation of the preference item for ACE purposes only. A provision in the ACE regulations attempts to deal with this problem in a nontechnical manner simply by stating that items included or deducted in computing regular AMTI are not included or deducted again in computing ACE. See Reg. § 1.56(g)-1(a)(6)(ii). This provision is not terribly clear, however, and may cause some confusion.

[a] Enumerated Adjustments

[i] Depreciation
(Section 56(g)(4)(A) and Reg. § 1.56(g)-1(b).) For property placed in service before 1994, an ACE adjustment for depreciation must be made with respect to all property for which accelerated depreciation under ACRS or MACRS is allowed, regardless of when the property was placed in service, as long as the property has a positive adjusted basis as of the beginning of the first taxable year for which the ACE adjustment is in effect (i.e., the first taxable year beginning after 1989). In general, the ACE depreciation method is the straight-line “alternative” depreciation method specified in section 168(g). Note that the rules applicable to certain property placed in service after 1980 but before 1990 may cause annual ACE depreciation for such property to be significantly less than economic depreciation. The following table sets forth the method for determining ACE depreciation for each class of property:

[See original source for omitted material. For further information please call the editorial contact for this publication.]

[ii] Inside Build-Up on Life Insurance Contracts
(Section 56(g)(4)(B)(ii) and Reg. § 1.56(g)-1(c)(5).) In general, for purposes of computing ACE, gross income includes (i) the increase in the net surrender value of a life insurance contract during the taxable year, plus (ii) the cost of life insurance protection provided under the contract during the year, minus (iii) premiums paid under the contract during the year.

[iii] Intangible Drilling and Development Costs
Section 56(g)(4)(D)(i) and Reg. § 1.56(g)-1(f)(1).) For purposes of computing ACE, IDCs paid or incurred with respect to a well (other than a dry hole) in taxable years beginning after 1989 are capitalized and recovered ratably over the 60-month period beginning with the month in which production from the well begins. (See section 312(n)(2)(A).) Arguably, such IDCs still must be taken into account in computing the preference under section 57(a)(2) to the extent they are “allowable under section 263(c) or 291(b) for the taxable year.” (See the second paragraph of § 4.07[2] above for a discussion of this “double inclusion” problem.) For taxable years beginning after 1992, this rule applies only to “integrated oil companies” (within the meaning of section 291(b)(4).)

[iv] Circulation Expenditures and Organizational Expenditures
(Section 56(g)(4)(D)(ii) and Reg. § 1.56(g)-1(f)(2).) Sections 173 and 248 do not apply for purposes of computing ACE. In general, this means that organizational expenditures are permanently capitalized,
while circulation expenditures may be recovered to the extent permitted by general principles of law. Thus, the distinction between expenditures to increase circulation and expenditures to maintain circulation must be addressed in determining the ACE deduction for circulation expenditures. Note that, if an election under section 59(e) is made with respect to a circulation expenditure, the expenditure is amortized ratably over the three-year period beginning with the year in which the expenditure is made, and section 56 does not apply to the expenditure. (Reg. § 1.56(g)-1(f)(2).) Presumably, a taxpayer may elect to amortize only those expenditures that arguably have been made to increase circulation.

[v] LIFO Inventory Adjustment

(Section 56(g)(4)(D)(iii) and Reg. § 1.56(g)-1(f)(3).) ACE is increased or decreased by the amount of any increase or decrease in the LIFO recapture amount as of the close of the taxable year, in the manner provided in section 312(n)(4). For purposes of computing the LIFO recapture amount for ACE purposes, inventory amounts should be determined using ACE accounting principles. (E.g., inventorable ACE depreciation, rather than regular-tax depreciation, regular-AMT depreciation, or E&P depreciation, should be taken into account.) As of the beginning of the first taxable year beginning after 1989, of course, ACE inventory amounts and regular-AMT inventory amounts should be the same.

Note that, under Reg. § 1.56(g)-1(r), a taxpayer may elect to use regular-tax inventory amounts for pre-ACE AMT purposes and ACE purposes. If the election is made, (i) the preferences and adjustments that relate to inventorable costs must be taken into account in the computation of AMTI and ACE as though the costs were not inventorable, and (ii) the LIFO recapture amount is computed using regular-tax inventory amounts for purposes of section 56(g)(4)(D)(iii). This regulation implies that, if an election under the regulation is not made, section 57 preferences that relate to inventories are not added to AMTI but are taken into account in computing AMT inventory amounts. Such a result is not required by the statute, however.

[vi] Installment Sales

(Section 56(g)(4)(D)(iv) and Reg. § 1.56(g)-1(f)(4).) For purposes of computing ACE, the installment method generally does not apply with respect to any sale occurring in a taxable year beginning after 1989. (Note that, even before this rule is taken into account, the regular AMT rules prohibit use of the installment method for many sales. See § 4.04[1][f] above.) The installment method may be used, however, with respect to a portion of the gain from an installment sale if an interest charge with respect to the sale is paid under section 453A. The portion of the gain eligible for installment reporting under ACE is the gain from the sale multiplied by the “applicable percentage” determined with respect to the installment obligation under section 453A(c)(4).

[vii] Loss on Exchanges of Debt Pools

(Section 56(g)(4)(E) and Reg. § 1.56(g)-1(g) (reserved).) For purposes of computing ACE, no loss is allowed on the exchange of a pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

[viii] Amortization of Acquisition Expenses of Life Insurance Companies

(Section 56(g)(4)(F) (as in effect prior to its repeal by OBRA 1990, section 11301(b)) and Reg. § 1.56(g)-1(h).) Under the foregoing provisions, for purposes of computing ACE, a life insurance company (within the meaning of section 816(a) must capitalize policy acquisition expenses and amortize those expenses over the reasonably estimated life of the policy using a method that provides a reasonable allowance for amortization. This adjustment applies to expenditures incurred in all taxable years, including taxable years beginning before 1990.

The ACE adjustment for policy acquisition expenses was repealed by OBRA 1990. For “small insurance companies” (generally, within the meaning of Code section 806(a)(3)), the repeal is effective for taxable years beginning after 1989. Therefore, the adjustment need never be taken into account by
such companies. (OBRA 1990, section 11301(d)(2)(A).) For other companies, however, the repeal is effective for taxable years beginning on or after September 30, 1990. (Id.) In the case of any taxable year including September 30, 1990, the amount required to be capitalized under section 56(g)(4)(F) and the amount amortized under that section are equal to (i) the corresponding amounts determined as if section 56(g)(4)(F) had not been repealed, multiplied by (ii) the fraction of the taxable year occurring before September 30, 1990. (OBRA 1990, section 11301(d)(2)(B).)

[ix] Depletion

(Section 56(g)(4)(F) (as renumbered by OBRA 1990, section 11301(b)) and Reg. §1.56(g)-1(j).) For purposes of computing ACE, depletion with respect to any property placed in service in a taxable year beginning after 1989 is determined under the cost depletion method of section 611. For taxable years beginning after 1992, this rule does not apply with respect to oil and gas depletion deductions determined under section 613A(c) (relating to so-called “independent producers and royalty owners”). The “residual exclusion rule,” discussed in §4.07[2][c] below, also is expressly made inapplicable to such depletion deductions.

Note that, to the extent the adjusted basis of a depletable property has been reduced to zero for regular-tax purposes due to the allowance of percentage depletion, an AMT preference in the amount of any additional percentage depletion must be taken into account under section 57(a)(1) in computing ACE even though the taxpayer does not deduct percentage depletion for ACE purposes. Arguably, in the case of post-1989 properties, the depletion preference should be subtracted from AMTI for purposes of computing ACE on the ground that the section 56(g)(4)(F) adjustment prevents any depletion deduction in excess of basis from being “allowable” for ACE purposes, and section 57(a)(1) therefore does not apply within the ACE system. (See the second paragraph of §4.07[2] above for a discussion of this “double inclusion” problem.)

[x] Ownership Changes

Section 56(g)(4)(G) (as renumbered by OBRA 1990, section 11301(b)) and Reg. §1.56(g)-1(k).) If a section 382 “ownership change” occurs in a taxable year beginning after 1989 with respect to a loss corporation, and the corporation has a net unrealized built-in loss immediately before the ownership change, the adjusted basis of each asset of the corporation must be adjusted, for ACE purposes only, to reflect its proportionate share of the fair market value of all of the corporation’s assets. This adjustment is referred to as the “pushdown” rule. A corporation is considered to have a net unrealized built-in loss only if the amount by which the aggregate adjusted basis of its assets exceeds the fair market value of those assets is greater than the lesser of (i) $10 million and (ii) 15 percent of the fair market value of the assets. (Section 382(h)(3)(B).)

Identification of “loss corporation.” For purposes of the pushdown rule, the determination of whether a corporation is a “loss corporation” (and therefore may have an “ownership change” for purposes of section 382) is made on the basis of regular-tax accounting rules only (rather than AMT or ACE accounting rules). Thus, a corporation is a loss corporation if it has an NOL for regular-tax purposes, regardless of whether it has an NOL for AMT purposes. Similarly, a corporation is not a loss corporation merely because it has a net unrealized built-in loss in excess of the section 382(h)(3)(B) threshold for AMT or ACE purposes, unless it is otherwise a loss corporation for regular-tax purposes. (Reg. §1.56(g)-1(k)(2).)

Identification of “net unrealized built-in loss.” Once it is determined that a corporation is a loss corporation, the additional determination of whether the corporation has a net unrealized built-in loss, and therefore is subject to the pushdown rule, is made by comparing the fair market value of the corporation’s assets to the aggregate adjusted basis of those assets for ACE purposes. (Reg. §1.56(g)-1(k)(3).)

[xi] Adjusted Basis
For purposes of computing ACE, the adjusted basis of any property with respect to which an adjustment under section 56(g)(4) applies is determined by taking that adjustment into account. Thus, for example, the ACE adjusted basis of depreciable property is reduced by ACE depreciation rather than regular-tax or regular-AMT depreciation. Unlike the statute, the regulations do not contain an express provision relating to ACE adjusted basis. The drafters preferred to provide an across-the-board parallel-system rule that affects adjusted basis implicitly.

[b] Additional Income Items Included in ACE: Current E&P Items Permanently Excluded From Regular AMTI

In General
ACE includes income items that are excluded from gross income for purposes of computing regular AMTI but are included in computing E&P. Such items are included in ACE for the taxable year in which they are included in current E&P. This adjustment (referred to herein as the “residual inclusion rule”) applies only to “permanent” differences between regular AMTI and E&P. Following is a nonexclusive list of income items that are included in ACE by reason of the residual inclusion rule (see Reg. § 1.56(g)-1(c)(6)):

- Tax-exempt interest excluded from gross income under section 103.
- Interest on ESOP loans excluded from gross income under section 133.
- Proceeds of life insurance excluded from gross income under section 101. (The amount included under the residual inclusion rule does not include amounts already included by reason of the “inside build-up” adjustment provided in section 56(g)(4)(B)(ii) and Reg. § 1.56(g)-1(c)(5).)
- Amounts received as compensation for injuries or sickness that are excluded from gross income under section 104.
- Amounts of financial assistance excluded from gross income under section 597. (Presumably, such amounts should not be included in ACE to the extent they are offset by reductions in tax attributes under section 597(c).)
- Income attributable to a recovery that is excluded from gross income under section 111, if the item recovered was deducted in computing earnings and profits in a prior year.
- A cost-sharing payment excluded from gross income under section 126, except to the extent a basis increase attributable to the excluded amount is denied under section 126(e).

The regulations expressly state that the residual inclusion rule does not require inclusion in ACE of either (i) lessee improvements that are excluded from the lessor’s income under section 109 or (ii) non-shareholder contributions to capital that are excluded from income under section 118. (Reg. § 1.56(g)-1(c)(7).)

[ii] Allowance of Offsetting Deductions
If an income item is included in ACE under the residual inclusion rule, ACE is reduced by any deduction, not allowed for regular-AMT purposes, that would have been allowed for regular-AMT purposes if the income item had been included in gross income for regular-AMT purposes. (Section 56(g)(4)(B)(i)(II) and Reg. § 1.56(g)-1(c)(3).)

[iii] Special Rule for Discharge-of-Indebtedness Income
Notwithstanding the residual inclusion rule, any amount that is excluded from gross income under section 108 (or corresponding provisions of prior law, including case law, regulations, and
In general, for purposes of computing ACE, an amount that is not deductible in computing current E&P for any taxable year is not allowed as a deduction. (The adjustment is referred to herein as the “residual disallowance rule.”) Following is a nonexclusive list of deductions that are disallowed for ACE purposes by reason of the residual disallowance rule (see Reg. § 1.56(g)-1(d)(3)):

- Dividends-received deductions allowable for regular-tax purposes under section 243, 244, or 245 (except to the extent allowed for ACE purposes under section 56(g)(4)(C)(ii) and Reg. § 1.56(g)-1(d)(2)).
- Dividends-paid deductions allowable for regular-tax purposes under section 404(k) (relating to dividends paid to ESOPs).
- Nonpatronage cooperative dividends paid by an “exempt” agricultural cooperative and deductible for regular-tax purposes under section 1382(c)(1).
- The deduction for small life insurance companies allowed for regular-tax purposes under section 806.

Special Rules for Dividends-Received Deduction

Although the residual disallowance rule generally denies any ACE deduction for dividends received, section 56(g)(4)(C)(ii) generally reverses this treatment for most dividends other than dividends on portfolio stock. Following is the treatment of each class of dividends:

70-percent-deductible dividends. For purposes of computing ACE, no deduction is allowed for a dividend received that is 70-percent-deductible for regular-tax purposes.

100-percent-deductible and 80-percent-deductible dividends. For purposes of computing ACE, a deduction is allowed for a dividend received that is 100-percent-deductible or 80-percent-deductible for regular-tax purposes, but only to the extent the dividend is attributable to earnings of the paying corporation that are subject to federal income tax. (Section 56(g)(4)(C)(ii)(I) and Reg. § 1.56(g)-1(d)(2)(i).)

Dividends received from section 936 corporations. Earnings of a section 936 corporation are treated as not subject to federal income tax if they are eligible for the section 936 credit (i.e., if they are described in section 936(a)(1)(A) or (B)), but the amount of earnings so treated is reduced to reflect the effect of the credit-reduction required by section 936(a)(4)). If, during a taxable year of the parent corporation, a section 936 corporation distributes less than 100 percent of its earnings for the current taxable year or for any prior taxable year, the distribution is considered to consist of ratable portions of the corporation’s eligible and ineligible earnings. (Reg. § 1.56(g)-1(d)(2)(ii)(B).) (Note that, for purposes of computing the AMTFTC, special rules apply to dividends from a section 936 company. See § 4.08[6] below.)

Dividends received from FSCs. Non-exempt foreign trade income of a FSC (determined under either of the administrative pricing methods of sections 925(a)(1) and (2)) is considered to be subject to federal income tax. The ordering rules in Reg. § 1.926(a)-1(b)(1) are used to identify the earnings out of which a distribution is made. (Reg. § 1.56(g)-1(d)(2)(ii)(A).)

Section 245(c) dividends received from a FSC by a cooperative. For purposes of computing ACE of an agricultural cooperative, the deduction allowed under section 245(c) for a dividend received from a FSC is allowed. (Section 56(g)(4)(C)(iv) and Prop. Reg. § 1.56(g)-1T(d)(2)(iii).)
[3] “Parallel System” Concept Expressly Adopted in ACE Regulations

The Preamble to the ACE regulations states:

[T]he Internal Revenue Service believes Congress intended that ACE (and the alternative minimum tax (AMT) in general) be a separate tax system. The Service specifically requested comments when it published the [ACE proposed regulations] on whether the statute and the legislative history required ACE to be a separate tax system, and if so, whether there were ways in which the Service could mitigate the resulting complexity without deviating from the substantive results Congress intended. The Service received no comments on these issues.

Consistent with this declaration, Reg. § 1.56(g)-1(a)(5) expressly provides that, except as otherwise provided by regulations or other administrative guidance,

[All Internal Revenue Code provisions that apply in determining the regular taxable income of a taxpayer also apply in determining adjusted current earnings. … In applying Code provisions, however, the adjustments of [Reg. § 1.56(g)-1] and section 56(g) are also taken into account. For example, in applying the capitalization provisions of section 263A, the amount of depreciation to be capitalized is based on the amount of depreciation allowed in computing adjusted current earnings.

Probably, this provision would work better if it referred to “provisions that apply in determining regular AMTI” rather than “provisions that apply in determining the regular taxable income.” Such a change would be extremely helpful in avoiding inadvertent discontinuities between ACE and the pre-ACE AMT system, such as the double-counting problem discussed in the second paragraph of § 4.07[2] above.


In general, the final ACE Regulations provide that the ACE adjustment for a consolidated group is computed on a consolidated basis. In other words, consolidated regular AMTI is first calculated by adjusting consolidated taxable income (without regard to the NOL deduction) in accordance with sections 56 (other than subsection (g)), 57, and 58. Next, consolidated ACE is calculated by adjusting consolidated regular AMTI in accordance with section 56(g). Finally consolidated regular AMTI is adjusted by 75 percent of the difference between the two amounts. (Reg. § 1.56(g)-1(n).) A negative ACE adjustment, however, may not exceed the group’s cumulative net positive ACE adjustments in prior years.

These rules are proposed to be superseded by Prop. Reg. § 1.1502-55, which covers the application of the alternative minimum tax to consolidated groups. The proposed consolidated return regulations are discussed in § 4.10 below.

[5] Transitional Rule for Partnership and Partner with Different Taxable Years

Reg. § 1.56(g)-1(p)(1) provides that, if a corporation is a partner in a partnership, ACE applies to items of partnership income and expense that are taken into account by the partner in the partner’s taxable year beginning after 1989, even if those items were taken into account by the partnership in a partnership taxable year beginning before 1990.

Reg. § 1.56(g)-1(p)(2) provides that, for purposes of the ACE effective-date provisions, partnership events (such as incurring expenditures or placing property in service) are deemed to occur on the last day of the partnership’s taxable year. Therefore, if the last day of a partnership’s taxable year falls within a corporate partner’s taxable year beginning after 1989, all ACE adjustments that would apply if those events occurred in a taxable year beginning after 1989 will apply with respect to that partner.
§ 4.08 ALTERNATIVE FOREIGN TAX CREDIT

As noted above, the net AMT liability is equal to the excess of the tentative minimum tax (“TMT”) over the regular tax. (Section 55(a).) For this purpose, the “regular tax” is the regular tax liability, as defined in section 26(b), reduced by the foreign tax credit and the section 936 credit. (Section 56(c).) The TMT is determined by multiplying AMTI by 20 percent and reducing the product by the alternative foreign tax credit (“AMTFTC”). The AMTFTC is determined under the following rules, which are provided in section 59(a).

[1] 90-Percent Limitation
The AMTFTC cannot be used to reduce the TMT to less than 10 percent of what the TMT would be if the AMTNOL deduction and the AMTFTC were disregarded (i.e., less than two percent of pre-AMTNOL AMTI). (In the case of a so-called “independent producer or royalty owner” eligible for the Section 708(b)(2)(A) reduction of the depletion preference, that reduction also is disregarded in computing the hypothetical TMT for purposes of the 90-percent limitation.) (Section 59(a)(2).)

[2] Parallel Computation
The allowable AMTFTC for a taxable year (before taking the 90-percent limitation into account) is computed on a parallel basis with respect to all taxable years beginning after 1986. The parallel computation entails the following modifications of the computation of the regular foreign tax credit:

• For purposes of section 904(a), the “tax against which [the foreign tax] credit is taken” is the TMT, rather than the tax liability described in section 901. (Section 59(a)(1)(A).)

• For purposes of section 904(a), the ratio of foreign source income to worldwide income is computed by reference to AMTI rather than taxable income. (Section 59(a)(1)(B).) This entails an item-by-item sourcing of AMTI. (H. Rep. No. 841, 99th Cong., 2d Sess. II-282 (1986).)

• For purposes of section 904(d)(2), the determination of whether income is “high-taxed” income is made on the basis of the 20-percent AMT rate rather than the regular-tax rate. (Section 59(a)(1)(C).) Section 708(b)(2)(B)

• For taxable years beginning after 1986 but before 1990 (i.e., taxable years during which the BURP adjustment, rather than the ACE adjustment, is in effect), the BURP adjustment is treated as having the same proportionate “source and character” as AMTI determined without regard to the BURP

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8 It is not necessary to take the section 936 credit into account in determining a section 936 corporation’s TMT, because income eligible for the section 936 credit is excluded from the corporation's AMTI. (Section 59(b).)

9 Section 59(a) does not actually provide that this treatment applies only for years beginning after 1986. Probably, this omission was unintended.
The amount of AMTFTC that is disallowed for a taxable year by reason of the 90-percent limitation is carried over under the rules provided in section 708(b)(2)(B). (section 708(b)(2)(A).) (Note, however, that the AMT foreign tax credit limitation that is unused due to the 90-percent limitation does not carry over. Therefore, when the 90-percent limitation applies, the allowable AMTFTC for all taxable years is irremediably reduced to less than 20 percent of foreign source AMTI.)

[3] Treatment of ACE Adjustment

[a] Source
The Code contains no express rule for determining the portions of the ACE adjustment that are deemed to adjust AMTI derived from U.S. and foreign sources, respectively. The 1986 Act Conference Report, however, states that “items included in [AMTI] by reason of the preference for earnings and profits are sourced, for purposes of the section 904 limitation, on an item-by-item basis.” (H. Rep. No. 841, at II-282.) It is not clear what this entails when the ACE adjustment is negative, or when, e.g., a positive ACE/AMTI differential from foreign sources offsets a negative ACE/AMTI differential from U.S. sources. Possibly, future regulations will treat ACE as altering the ratio of foreign source AMTI to worldwide AMTI even when there is no ACE adjustment for the taxable year.

[b] Section 904(d)(1) Category
Since the ACE adjustment is not described in sections 904(d)(1)(A) through 904(d)(1)(H), and section 904(d)(1)(I) expressly includes all “income other than income described in any of the preceding subparagraphs,” the ACE adjustment arguably is included in the category described by section 904(d)(1)(I), frequently referred to as the “general basket.” Reg. § 1.904-4(k) states, however: “For purposes of computing the [AMTFTC], items included in [AMTI] by reason of [the ACE adjustment] shall be characterized as income described in a separate category under section 904(d) … based on the character of the underlying items of income.”

[4] Treatment of Foreign Tax Credit Carryovers From Pre-1987 Years

The 1986 Act Conference Report states that an AMTFTC arising in a post-1986 year must be reduced by foreign tax credits carried back to pre-1987 years for regular tax purposes. (H./Rep. No. 841, 99th Cong., 2d Sess. II-282 (1986).) This is a reasonable interpretation of the statute in the case of an AMTFTC that carries over due to insufficient AMTFTC limitation in the year in which the AMTFTC arises, since the amount of the remaining AMTFTC carryover is the same as the regular tax FTC carryover but for the AMT recomputations as per section 59(a)(1)(B). The Conference Report appears to be technically incorrect, however, in the case of a taxpayer that (i) pays foreign taxes during a post-1986 taxable year, (ii) has insufficient regular tax FTC limitation and therefore carries the regular tax FTC back to a pre-1987 year, and (iii) has sufficient AMTFTC limitation to credit the taxes in the year in which they are paid. In such a case, there is no Code provision that suggests the currently utilized AMTFTC must be reduced.

[6] Treatment of Dividends Received from a Section 936 Corporation

10 See note 9 above.
[a] Treatment Under BURP Adjustment

Under section 901(g), taxes paid to a possession with respect to dividends received from a section 936 corporation are not treated as creditable foreign taxes if a dividends-received deduction is allowed with respect to the dividends. Since no dividends-received deduction is allowed in computing adjusted net book income, and 50 percent of the amount of dividends received from a section 936 corporation therefore may be included in AMTI for taxable years during which the BURP adjustment is in effect, it is appropriate to treat the tax paid to possessions with respect to such dividends as a creditable foreign tax for AMT purposes to the extent the dividends received increase the recipient’s AMTI. Section 56(f)(2)(F) (as in effect before its repeal by OBRA 1990) provides, in effect, that a fraction of such tax is treated as a creditable foreign tax for AMT purposes; the numerator of the fraction is the increase in AMTI attributable to dividends received from section 936 corporations, and the denominator is the total amount of such dividends. Since the BURP adjustment is equal to 50 percent of the excess of adjusted net book income over regular AMTI, the fraction can never be greater than 50 percent; the fraction is less than 50 percent when adjusted net book income (without regard to the dividends) is less than regular AMTI.\(^\text{11}\)

Section 56(f)(2)(F) (as in effect before its repeal) also provides that a dividend received from a section 936 subsidiary is grossed up by taxes paid by the subsidiary to the possession, and the gross-up amount is treated as a withholding tax eligible for the treatment described in the preceding paragraph. The amount of the gross-up is determined under rules similar to the rules of section 902.

Importantly, since the BURP adjustment is sourced and characterized in the same proportion as regular AMTI (see section 59(a)(1)(C)), an increase in AMTI attributable to dividends received from a section 936 subsidiary generally will not be reflected by a corresponding increase in the AMT foreign tax credit limitation unless the taxpayer has foreign source income other than section 936 dividends. Accordingly, some corporations receiving dividends from section 936 subsidiaries may not be able to credit possession taxes against TAMT.

[b] Treatment Under ACE Adjustment

Possessions taxes attributable to dividends received from section 936 corporations are effectively treated the same for years during which the ACE adjustment is in effect as they are treated for years during which the BURP adjustment is in effect, except that 75 percent of the possessions taxes (rather than 50 percent) are taken into account. (Section 56(g)(4)(C)(iii), as amended by OBRA 1990, section 11801(c)(2)(C).)

Since the 1986 Act Conference Report, however, states that “items included in [AMTI] by reason of the preference for earnings and profits are sourced, for purposes of the section 904 limitation, on an item-by-item basis,” (H. Rep. No. 841, at II-282), any increase in AMTI attributable to dividends received from section 936 corporations in a taxable year beginning after 1989 should increase the recipient’s foreign source AMTI. Moreover, as noted in § 4.08[3][b] above, although it could be argued that the entire ACE adjustment technically is included in the “general basket” described by section 904(d)(1)(l), Reg. § 1.904-4(k) categorizes the ACE adjustment by reference to the separate components of ACE. Assuming that this regulation is valid, section 56(f)(4)(C)(iii)(IV) causes the portion of the ACE adjustment attributable to section 936 dividends to be treated as if it were described in a “separate category” under section 904(d)(1).

\(^\text{11}\) For similar reasons, if a taxpayer chooses to deduct foreign taxes, the last clause of section 901(g)(1) should not apply to an appropriate fraction of the taxes paid to possessions with respect to dividends from possessions corporations. Congress, however, omitted (presumably inadvertently) a protective provision for taxpayers deducting foreign taxes.
[1] **Background**

For any taxable year beginning after 1989, a corporate taxpayer’s net AMT liability for the year may be carried forward and used as a credit against the regular tax liability in a subsequent year. For taxable years beginning in 1987, 1988, and 1989, however, the amount that could be carried forward as a credit was limited to the taxpayer’s cumulative “adjusted net minimum tax.” The adjusted net minimum tax for a taxable year was defined as (i) the tax imposed by section 55 for the year, reduced by (ii) the tax that would have been imposed by section 55 for the taxable year if only “exclusion preferences” had been taken into account (herein, the “exclusion-only AMT”). The purpose of this rule (which continues to apply to individual taxpayers) was to allow the AMT to be treated, in effect, as a prepayment of the regular tax only to the extent the AMT was generated by timing differences between AMTI and regular taxable income.


(This issue arises in computing adjusted net AMT for 1987, 1988, and 1989 only.) As a technical matter, the exclusion-only AMT for a taxable year is equal to the amount that would be the net AMT liability for the year if the only adjustments and preferences taken into account were certain specified “exclusion” items. As a technical matter, since the AMTNOL adjustment provided in sections 56(a)(4) and 56(d) is not one of the specified items, it appears that the exclusion-only AMT is computed by taking into account the regular-tax NOL deduction. On the other hand, it also could be argued that an alternative NOL computation would be required even in the absence of the statutory AMTNOL provisions, by virtue of the “alternative” nature of the AMT system. Under the latter approach, one might argue that a third NOL deduction (an exclusion-only AMTNOL deduction) should be used.

[3] **Is There a “Disappearing Minimum Tax Credit?”**

(This issue arises in computing adjusted net AMT for 1988 and 1989 only.) The 1986 Act Bluebook states (at 464):

In some cases, a taxpayer’s accumulated minimum tax credits from prior taxable years may be reduced even though such credits are not used to reduce regular tax liability (or may be reduced to a greater extent than such credits are used to reduce such liability). This occurs in years where both of the following circumstances are present: (1) taking into account solely the deferral items, alternative minimum taxable income is less than regular taxable income, and (2) due to the exclusion items, the taxpayer would incur minimum tax liability for the taxable year if alternative minimum taxable income were treated as equal to regular taxable income with respect to deferral items.
Presumably, this conclusion is correct only if (i) the adjusted net minimum tax for a taxable year may, as a technical matter, be negative, and (ii) the negative amount is subtracted from positive amounts attributable to prior years in determining “the adjusted net minimum tax imposed for all prior taxable years beginning after 1986.” (See section 53(b)(1).)
APPLICATION OF AMT RULES TO CORPORATIONS FILING A CONSOLIDATED RETURN

[1] Rules Are Set Forth in Proposed Consolidated Return Regulations
Aside from a cryptic statement in Reg. § 1.56(g)-1(n) to the effect that the ACE adjustment is computed on a consolidated basis (see § 4.07[4] above), issues relating to the application of AMT provisions in a consolidated return environment are dealt with in proposed regulations issued on December 29, 1992. (See Prop. Reg. § 1.1502-55 ("Computation of alternative minimum tax of consolidated groups"), and proposed amendments to Reg. §§ 1.1502-1 (relating to the definition of "tax liability"), 1.1502-2 (relating to the definition of "consolidated tax liability"), 1.1502-5 (relating to estimated tax), 1.1502-33 (relating to E&P treatment of federal income tax liability), and 1.1552-1 (relating to allocation of consolidated tax liability).)

Prop. Reg. § 1.1502-55(a)(2) simply states: “The consolidated AMT is determined under an approach that generally parallels the determination of the group’s consolidated regular tax liability.” The Preamble to the proposed consolidated return regulations elaborates: “[T]he Service believes that Congress generally intended the AMT and adjusted current earnings (‘ACE’) systems to be separate from, and parallel to, the regular tax system. See, e.g., § 1.56(g)-1(a)(5)… The proposed regulations apply the separate and parallel principle to consolidated groups. They do not, however, illustrate how this principle applies in all cases…. Unless an exception to the separate and parallel principle is provided, the separate and parallel principle governs the treatment of all consolidated AMT and ACE items.” (IA-57-89, 57 Fed. Reg. 62251.) Thus, except to the extent modified in the regulations, all of the rules in Reg. § 1.1502 are to be applied within the AMT system (and within the ACE system), taking into account the applicable adjustments and preferences.

[3] Consolidated Computations

[a] Consolidated AMT
Prop. Reg. § 1.1502-55(a)(2) provides (albeit indirectly) that AMT is computed on a consolidated basis. According to section I.A. of Preamble to IA-57-89, this means that consolidated AMT is determined by:

• Computing consolidated AMTI,
• Subtracting the consolidated exemption amount,
• Multiplying the resulting amount by 20 percent,
• Subtracting the consolidated AMT foreign tax credit (yielding consolidated TMT), and
• Subtracting the consolidated regular tax liability.
[b] **Consolidated AMTI**

Under Prop. Reg. § 1.1502-55(b)(2), consolidated AMTI generally is computed under Reg. §§ 1.1502-11 and 1.1502-12 in the same manner as consolidated regular taxable income, i.e., based on separate company (pre-NOL) AMTI, consolidating adjustments, and a consolidated AMTNOL deduction. However, the ACE adjustment is applied on a consolidated basis before application of the consolidated AMTNOL deduction. (Prop. Reg. § 1.1502-55(b)(1)(i).)

[i] **Consolidated IDC Preference**

In order to allow the 65-percent income offset to be applied on a group-wide basis, Prop. Reg. § 1.1502-55(b)(2)(ii)(B) provides that the IDC preference determined under section 57(a)(2) is computed on a consolidated basis and then allocated among the members.

[ii] **Effect of Separate-Company LIFO Adjustment**

Under Prop. Reg. § 1.1502-55, the LIFO adjustment determined under section 56(g)(4)(D)(iii) and section 312(n)(4) is computed on a separate company basis. Note, however, that, since Reg. § 1.56(g)-1(f)(3) eliminates the 1990 LIFO reserve baseline, one member's negative LIFO adjustment may, in all cases, offset another member’s positive LIFO adjustment (or other positive ACE adjustments).

[c] **Consolidated ACE Adjustment**

Under Reg. § 1.56(g) and Prop. Reg. § 1.1502-55(b)(3), consolidated ACE is computed under Reg. §§ 1.1502-11 and 1.1502-12 in the same manner as consolidated regular taxable income, i.e., based on separate company ACE and consolidating adjustments. The consolidated ACE adjustment is 75 percent of the difference between consolidated ACE and consolidated “pre-adjustment AMTI.” As noted above, a negative ACE adjustment may not exceed the taxpayer’s cumulative prior positive ACE adjustments. Prop. Reg. § 1.1502-55(b)(3)(iii) permits a consolidated group to take into account both prior consolidated positive ACE adjustments and members’ prior separate return year positive ACE adjustments. No SRLY limitation is imposed.

**Technical ACE issue for members of consolidated groups.** As discussed in § 4.07[2][b][i] above, the “residual inclusion rule” (see section 56(g)(4)(B)(i)) provides that ACE includes the amount of income items that are excluded from gross income for purposes of computing regular AMTI but are taken into account in computing E&P. Query: Are amounts included in a member’s E&P under Reg. § 1.1502-33(c)(4)(ii)(a) included in ACE? The “correct” answer is clearly “no.” Note that Reg. § 1.1502-33(c)(4)(ii)(a) says that these amounts are “reflected” in the member’s E&P, while the residual inclusion rule refers to amounts “taken into account in determining” E&P. Is this distinction sufficient the correct result? This issue is not addressed in either Reg. § 1.56(g) or Prop. Reg. § 1.1502-55.

[d] **Consolidated AMTFTC**

Prop. Reg. § 1.1502-55(c), entitled “Consolidated alternative minimum tax foreign tax credit,” is reserved, but Prop. Reg. § 1.1502-55(b)(1) and section I.A. of the Preamble to the proposed regulations, suggest that the consolidated AMTFTC is determined by applying Reg. § 1.1502-4 in the same manner as it is applied for regular tax purposes.

[4] **Treatment of Gain and Loss From Deferred Intercompany Transactions**

Prop. Reg. § 1.1502-55(f) makes it clear that Reg. §§ 1.1502-13 and -14 are applied on a parallel basis for both AMT and ACE purposes. Thus, for example, AMT deferred gain from an intercompany sale of a depreciable asset is restored on the basis of the purchasing member’s AMT depreciation, and ACE deferred gain from the sale is restored on the basis of the purchasing member’s ACE depreciation.
[5] Application of SRLY Limitations to AMT Attributes

Prop. Reg. § 1.1502-55(d), entitled “Separate return limitation years,” is reserved. Under the separate and parallel principle, however, it should be assumed that the SRLY limitations applicable to regular-tax built-in deductions, net operating loss carryovers, capital loss carryovers, and foreign tax credit carryovers (see Reg. § 1.1502-15, Reg. § 1.1502-21(c), Reg. § 1.1502-22(c), and Reg. § 1.1502-4(f), respectively) apply to their AMT counterparts.

No SRLY limitation on the MTC is provided in the final regulations or in Prop. Reg. § 1.1502-55, and the MTC has no regular-tax counterpart, but the Tax Court has previously applied SRLY “general principles” to the add-on minimum tax in *Wegman’s Properties, 78 T.C. 786 (1982)*, so it is possible that an implicit SRLY limitation applies to the MTC.

Prop. Reg. § 1.1502-55(b)(3)(iii) makes it clear that SRLY limitations not apply to prior positive ACE adjustments.


[a] General Rule for Attributes With Regular-Tax Counterparts

Prop. Reg. § 1.1502-55(e)(1) generally provides: “The apportionment of consolidated AMT attributes that have regular tax counterparts is based on the principles applicable to the regular tax counterparts.” This rule properly implements the separate and parallel principle but may give rise to distortions if the regular-tax attribute-apportionment rules are not consistent with the allocation of the MTC, discussed in § 4.10[6][b] below.

[b] Allocation of Consolidated MTC

A group’s consolidated MTC is allocated to a member on the basis of that member’s cumulative contribution to the group’s consolidated AMT, net of the member’s cumulative contribution to consolidated MTC used by the group. (Prop. Reg. § 1.1502-55(h)(6).)

A member’s contribution to the group’s consolidated AMT is measured by comparing (i) actual consolidated AMT with (ii) consolidated AMT determined without the member’s items. (Prop. Reg. § 1.1502-55(h)(6)(iv).)

A member’s contribution to the consolidated MTC used by the group is in proportion to the member’s contribution to the consolidated AMT that gave rise to the MTC used (Prop. Reg. § 1.1502-55(h)(6)(vi)), treating the earliest-generated MTC as used first. (Prop. Reg. § 1.1502-55(h)(7).) Note that this rule may cause distortions when a consolidated MTC is used by the group because of a consolidated regular tax liability that is attributable to members that did not contribute to the consolidated AMT that gave rise to the MTC.

For taxable years for which returns are filed earlier than 60 days after final regulations are published, any reasonable method may be used to allocate consolidated MTC. (See Prop. Reg. §§ 1.1502-55(h)(3)(i)(B)(2) and (h)(4)(ii).) It is not entirely clear whether this rule applies when a member leaves a group in a taxable year before the effective date of the regulations but either the member or the group proposes to use the MTC in a taxable year after the effective date of the regulations. The better reading of the regulations is that the “reasonable method” rule applies in such a situation.

[c] Allocation of Prior Consolidated Positive ACE Adjustments

This amount is allocated among the members in proportion to their proportionate shares of all of the members’ separate cumulative positive ACE adjustments. (Prop. Reg. § 1.1502-55(e)(2).)

[d] Theoretical Problem Raised by Charitable Contribution Carryover

Under Prop. Reg. § 1.1502-55(e)(1), Reg. § 1.1502-79(e) applies on a parallel basis for AMT purposes. Since section 57(a)(6) (for taxable years prior to its repeal in 1993) operates as a preference, rather than an adjustment, this creates potential distortions. Suppose that, in consolidated group AB, A contributes $25 of
cash, B contributes $75 of zero-basis property, and the group’s deduction for the year is limited to $20. The $75 preference determined under section 57(a)(6) is deferred, so the group’s AMT deduction is $20 and no preference is taken into account. (See 1986 Act Bluebook at 444-45.) Thus, at the end of the year, the group has an $80 deduction carryover and a $75 deferred preference. Since A contributed cash, A should be entitled to a net AMT carryover (i.e., a carryover net of deferred preference) of $5, and B should get zero. Under Reg. § 1.1502-79(e), however, AB’s $80 carryover is allocated $20 to A and $60 to B. This allocation produces the right result only if (i) the deferred preference is allocated to members who contributed appreciated property, in proportion to the amounts of appreciation in their respective contributions, to the extent of the carryovers allocated to them, and (ii) the remaining deferred preferences are allocated to the other members, in proportion to ratio of their contributions. There are, however, no rules in Prop. Reg. § 1.1502-55 for allocating the deferred charitable contribution preference. In any event, section 57(a)(6) is now repealed. Since Prop. Reg. § 1.1502-55 will not be effective for any year prior to the repeal, this issue should not arise.

[7] Investment Adjustments and Excess Loss Accounts

Traditionally, the consolidated return regulations have required the adjustment of a member’s basis in a subsidiary (and the restoration to income of negative basis upon the occurrence of certain events) to be made on the basis of the member’s share of the subsidiary’s positive or negative earnings and profits. Under Prop. Reg. §§ 1.1502-19 and 1.1502-32, however, such adjustments are to be made on the basis of taxable income and loss. (See CO-30-92, published November 12, 1992.) Following the “separate and parallel” principle, Prop. Reg. § 1.1502-55(g) provides that the principles of Prop. Reg. §§ 1.1502-19 and 1.1502-32 are applied for purposes of determining AMT basis and excess loss accounts and ACE basis and excess loss accounts. Although the proposed regulations do not say so explicitly, the adjustments should be made by taking into account the member’s share of the subsidiary’s positive or negative AMTI and ACE, respectively. Section 57 preference items, however, are not taken into account. (Prop. Reg. § 1.1502-55(g)(2)(iii)) The exclusion of preference items can cause the double counting of preference “income” in a consolidated group’s AMTI and is not explained.


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§ 4.11 APPLICATION OF AMT TO RICs AND REITs

[1] In General
Since the AMT applies to all corporations other than S corporations, it applies to regulated investment companies described in section 851 (“RICs”), and real estate investment trusts described in section 856 (“REITs”).

[2] Special Statutory Rules
Under section 59(d)(1)(A), “differently treated items” of a RIC are apportioned between the RIC and its shareholders, and “differently treated items” of a REIT are apportioned between the REIT and holders of beneficial interests in the REIT, “in accordance with regulations.” A “differently treated item” is an item that is treated differently for AMT and regular tax purposes. (Section 59(d)(2).) At present, no regulations have been published or proposed.

Regarding the apportionment of “differently treated items,” the nonauthoritative 1986 Act Bluebook (at p. 472, n. 33) says:

[I]f a RIC or REIT distributes all its pre-dividend taxable income in each taxable year, it is intended that the minimum tax adjustments and preferences be apportioned to the shareholders and beneficiaries since the adjustments and preferences either reduced or increased the entity’s taxable income and therefore the amount of the dividend. Where any shareholder or beneficiary incurs a minimum tax attributable to deferral items, that shareholder or beneficiary may use the minimum tax credit in future years to offset regular tax under usual rules. Where the RIC or REIT distributes more or less than its taxable income in a taxable year, the Treasury Department is to prescribe regulations providing rules for apportioning the preferences and adjustments.

This discussion is problematic. First, it is not based on any authoritative discussion in any of the official committee reports. Second, it is not clear why the Bluebook drafters assumed that items that affect an investment company’s taxable income also affect the amount of dividends paid by the investment company.

[4] “Parallel System” Treatment
Under the “separate and parallel” principle adopted in final regulations relating to the ACE adjustment (see Reg. § 1.56(g)-1) and in proposed regulations relating to the application of the AMT to consolidated groups (see Prop. Reg. § 1.1502-55), all of the rules in the Code and regulations that are applicable to RICs, REITs, and their shareholders also should be applicable for AMT purposes, taking into account the AMT adjustments and preferences. This would be comparable to the AMT regime expressly adopted for trusts and estates by section 59(c).
Potential Risks for RICs and REITs

If the “separate and parallel” principle is applied to RICs and REITs, adverse consequences could result for a RIC or REIT with AMTI that exceeds regular taxable income. The least important consequence would be the potential imposition of the AMT on a RIC or REIT that pays dividends equal to its regular taxable income and therefore expects to have no tax liability. The most serious consequence would be the effective loss of RIC or REIT status for AMT purposes if the entity does not distribute a sufficient percentage of its AMTI. (See section 852(a)(1) (in the case of RICs) and section 857(a)(1) (in the case of REITs).) The latter risk probably is not a concern for RICs, which must distribute the same percentage of their taxable income and tax-exempt interest and are unlikely to have “differently treated items” other than tax-exempt interest.