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MEMORANDUM

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TO: Interested Persons

FROM: Ron Kirk, Economics Section, 303-866-4785

SUBJECT: Alternative Minimum Tax

This memorandum provides information on the alternative minimum tax (AMT) imposed at the federal and state levels.

Summary

The federal individual income tax system consists of two parallel tax systems: the standard income tax familiar to most taxpayers and an alternative minimum tax (AMT). The purpose of the AMT was to keep taxpayers with high incomes from paying little or no income tax by taking advantage of various preferences in the federal tax code. Prior to the federal income tax reform that began in 2000, the AMT affected less than 1 percent of all taxpayers in the nation. Because the AMT is not indexed for inflation, the Congressional Budget Office (CBO) expects it to affect about one-fifth of all taxpayers in tax year 2010 under current law.

Recently, the federal Congress enacted an AMT "patch" that increased the exemption amounts and certain credits that resulted in a one-year fix. The effect of this change means that if a taxpayer did not owe an AMT in tax year 2008, the person would not owe an AMT in tax year 2009.

Colorado imposes an AMT that piggybacks on the federal AMT and was put in place in 1987 when the state reformed its individual income tax system to conform to the federal tax reform that took place during the mid-1980s. The Colorado AMT is only applied to individual taxpayers, not corporations. Colorado and 11 other states have an AMT for individual filers. Seven states have an AMT that affects corporations. In FY 2008-09, \$5.5 million was paid by Colorado taxpayers who had state AMT liability.

Alternative Minimum Tax

Background and history. For more than 30 years, the federal individual income tax has consisted of two parallel tax systems: the standard income tax familiar to most taxpayers and an alternative minimum tax (AMT) that was initially intended to impose taxes on high-income individuals who have no tax liability under the regular system. The purpose of the AMT was to keep taxpayers with high incomes from paying little or no income tax by taking advantage of various preferences in the federal tax code. Prior to the federal income tax reform that began in 2000, the AMT affected less than 1 percent of all taxpayers in the nation.

Because the AMT is not indexed for inflation, the Congressional Budget Office (CBO) expects it to affect about one-fifth of all taxpayers by 2010. In 2009, the federal Congress enacted an AMT "patch" (through the American Recovery and Reinvestment Act (ARRA)) that increased the exemption amounts and certain credits that have the effect of a one-year fix in 2009. Thus, if a taxpayer did not own an AMT in 2008, the person would not owe an AMT in 2009. The CBO estimates that the repeal of the AMT would reduce federal tax revenue by \$600 billion through tax year 2014.

Federal AMT

The process for determining whether a taxpayer owes a federal AMT is determined by calculating taxes owed under the regular tax system and calculating alternative minimum taxable income (AMTI) under the AMT system. If the AMT is larger than the tax bill under the regular system, the taxpayer owes the amount of the AMT in excess of that owed in regular taxes, plus the regular taxes owed.

Regular and AMT tax systems. When a filer first calculates income for federal tax purposes under the regular system, the taxpayer may receive preferred treatment for certain types of income and be able to claim certain exemptions, deductions, exclusions, and credits. When a filer calculates AMTI under the AMT system, the filer is not allowed to claim dependency exemptions, the standard deduction, and certain itemized deductions for medical and dental expenses, state and local taxes, and miscellaneous deductions. After these modifications adjust taxable income, the filer determines federal taxable income (FTI) under the regular system, and if applicable, the alternative minimum taxable income under the AMT system. Table 1 lists a *small sample* of some of the differences between the federal regular and AMT systems for single filers in 2009.

Table 1
Federal Regular and AMT Systems

Federal System:	Regular	AMT
Dependency exemption	\$3,650 per exemption	none
Standard deduction (if not itemizing)	\$5,700	none
Certain itemized deductions (Schedule A)	medical and dental expenses, state and local taxes, and miscellaneous deductions	limited deductions
Equals	Federal Taxable Income	Alternative Minimum Tax Income

**Note: This table is not inclusive of all of the differences between the regular and AMT tax systems in terms of allowable exemptions, deductions, exclusions, and credits.*

Once FTI is calculated, the regular federal tax rates are applied to determine taxes owed under the regular system. Before the taxpayer knows whether an AMT is owed, the taxpayer must first subtract an AMT exemption amount from AMTI to determine the taxable excess. The AMT exemption for single filers is \$46,700 and \$70,950 for joint filers (Table 2). After the exemption is subtracted from AMTI, the excess is taxed at up to 28 percent depending on the amount of AMTI. The result is the tentative minimum tax under the AMT system. Table 2 shows the federal tax rates that apply under each system.

Table 2
2009 Federal Tax Rates

Federal System:	Regular		AMT	
Starting point	FTI		AMTI	
AMT exemption	NA		\$46,700 single filers; and \$70,950 joint filers.	
Equals	FTI		taxable excess	
Taxes owed	(single filers in 2009)	(joint filers in 2009)	(single filers in 2009)	(joint filers in 2009)
FTI or AMTI multiplied by tax rate	\$0 - \$8,350 @ 10% \$8,351 - \$33,950 @ 15% \$33,951 - \$82,250 @ 25% \$82,251 - \$171,550 @ 28% \$171,551 - \$372,950 @ 33% Over \$372,950 @ 35%	\$0 - \$16,700 @ 10% \$16,701 - \$67,900 @ 15% \$67,901 - \$137,050 @ 25% \$137,051 - \$208,850 @ 28% \$208,851 - \$372,950 @ 33% Over \$372,950 @ 35%	\$0 - \$87,500 @ 26% Over \$87,500, total amount taxed at 28%	\$0 - \$175,000 @ 26% Over \$175,000, total amount taxed at 28%
Taxes owed	federal taxes owed under regular system		tentative minimum tax owed under the AMT	

The AMT equals the amount of the excess of the tentative minimum tax owed, if any, over the regular federal taxes owed. Thus, if the result is a negative number, no AMT is owed. If the taxpayer owes an AMT, the final tax liability is the sum of the regular federal taxes owed and the AMT liability. Table 3 shows an example of when an AMT liability is incurred, and the amount of final tax liability owed.

Table 3
Is a Federal AMT Owed?

Federal Taxes Owed (regular system) (A)	Tentative Minimum Tax (AMT) (B)	AMT (B minus A) (C)	Final Liability (D)
\$50,000	\$48,000	none owed (\$2,000)	\$50,000
\$50,000	\$58,000	AMT owed \$8,000	\$58,000

Complex computation. For most taxpayers, the first step toward determining whether an AMT is owed, is known after completing the 55-line *Form 6251, Alternative Minimum Tax — Individuals*. Given the form's complexity, and the number of potential scenarios that could trigger an AMT (or refundable credit), many filers choose to seek professional help to determine if an AMT is owed or a refundable credit is captured.

Colorado's AMT

Colorado imposes an AMT that piggybacks on the federal AMT and was put in place in 1987 when the state reformed its individual income tax system to conform to the federal tax reform. The Colorado AMT is only applied to individual taxpayers, not corporations, and is equal to the amount by which 3.47 percent of the Colorado alternative minimum taxable income exceeds the standard, Colorado income tax (Section 39-22-105 (1.5) (a), C.R.S.). Colorado and 11 other states have an AMT for individual filers. These states include: California; Connecticut; Iowa; Maine; Maryland; Minnesota; Nebraska; New York; Rhode Island; West Virginia; and Wisconsin. Seven states (excluding Colorado) have an AMT that affects corporations.

Computation. The starting point for determining when a state AMT is owed is federal AMTI. If a taxpayer owes a federal AMT, the filer may owe a Colorado AMT. Federal AMT income is first modified by certain Colorado additions and deductions to arrive at Colorado AMTI. For example, some modifications may include an addition for non-Colorado state and local bond interest not included in federal AMT income and deductions that may include the federal alternative minimum tax exemption. Once additions and deductions are used to modify AMTI, the Colorado AMTI is multiplied by 3.47 percent to determine the "tentative" Colorado AMT. If this amount exceeds the Colorado normal tax, the difference is the amount of Colorado AMT owed. Table 4 shows a hypothetical computation that shows when a state AMT is owed. In the Table, the amount of Colorado AMT owed, or \$2,537 is due in addition to the normal Colorado income tax. Thus, the final tax liability is \$7,287 (Colorado AMT plus Colorado normal tax).

Table 4
Is a Colorado AMT Owed?

Federal alternative minimum taxable income (AMTI)	\$200,000
<i>plus:</i> additions to income — (for example) non-Colorado state and local bond interest	60,000
<i>minus:</i> federal alternative minimum tax exemption — (single filer, Table 2)	46,700
<i>minus:</i> subtractions to income — (for example) federal bond interest	3,300
<i>equals:</i> Colorado alternative minimum taxable income (AMTI)	\$210,000
Colorado AMTI multiplied by 3.47 percent equals "tentative Colorado AMT	\$7,287
If tentative Colorado AMT > normal Colorado tax, the difference is the Colorado AMT owed.	
Tentative Colorado AMT	\$7,287
Normal Colorado tax	\$4,750
Colorado (AMT)	\$2,537
Final tax liability (Colorado AMT plus Normal Colorado Tax)	\$7,287

Colorado alternative minimum taxes paid. In FY 2008-09, \$5.5 million was paid by Colorado taxpayers who had state AMT liability. Table 5 provides a 10-year history of AMT taxes paid from FY 1999-00 through FY 2008-09.

Table 5
Colorado Alternative Minimum Taxes Paid
(in millions)

Fiscal Year	Taxes Paid	Fiscal Year	Taxes Paid
FY 1999-00	\$5.2	FY 2004-05	\$2.5
FY 2000-01	\$7.8	FY 2005-06	\$2.7
FY 2001-02	\$4.0	FY 2006-07	\$3.0
FY 2002-03	\$2.8	FY 2007-08	\$2.8
FY 2003-04	\$2.5	FY 2008-09	\$5.5

Source: Colorado Department of Revenue, 2009 Annual Report, P. 30.

Credit for the prior year AMT. A taxpayer who has a federal AMT tax liability is eligible for AMT credits under the federal tax code. The federal AMT credit is refundable for tax years 2007 through 2012.¹ Colorado has a state income tax credit that is calculated using the federal AMT credits that accrue to the taxpayer. For example, taxpayers in Colorado may claim a state income

¹ The federal tax system allows for a refundable AMT credit. The AMT credit was enacted to give relief to individuals who exercised incentive stock options that later lost a significant portion of, or all of, their value in later years.

tax credit of 12 percent of the federal tax credit claimed in the prior year. The state credit is limited to the tax due and is nonrefundable.

Tracking the credit. The Colorado Department of Revenue did not track the AMT credit with the old legacy information system. However, department estimates for 2006 found that the credit's General Fund revenue impact ranged between \$2.0 million and \$3.0 million. The department expects that the new computer income tax system, or the Colorado Integrated Tax Architecture system, will provide data on the state AMT credits claimed for the 2009 income tax year. Thus, data on the AMT credit's impact may be available by October 2010.