CHAPTER OF CONTENTS:

8500 ALTERNATIVE MINIMUM TAX

Congress enacted the alternative minimum tax (AMT) as a response to perceived abuses of the tax system. Congress believes that many wealthy taxpayers avoided paying income tax by using exclusions, deductions, and tax credits. The federal AMT addresses this perceived problem by applying a single rate of tax to a tax base, which intends to represent "true economic income." AMT is entirely distinct from, and runs parallel to, the regular tax system.

For tax years beginning 2018 and after, corporations are no longer subject to federal AMT.

The Tax Cuts and Jobs Act (TCJA) signed into law on December 22, 2017, repealed the federal corporate Alternative Minimum Tax (AMT) and made changes to the rules for Net Operating Losses and the AMT Credit. California law does not conform to the repeal of the federal corporate AMT or to the changes to the NOL and AMT Credit provisions. California taxpayers continue to compute AMT, NOLs, and AMT Credit, in conformity to federal rules as of the specified date of January 1, 2015, with modifications.

Effective for taxable years beginning on or after January 1, 1988, California substantially conformed to the federal AMT by incorporating with modifications IRC sections 55 - 59. These are contained in R&TC sections 23400-23459.

When considering issues in this area, you should always refer to the law for the particular year you are examining to determine the applicable rules for that year. Since the rules are very specific, the manual discussion only provides a general overview of the major AMT provisions and points out significant federal/state differences.

8510 Overview of the AMT Mechanics

The AMT provisions create an entire parallel system of taxation that generally targets corporations with Alternative Minimum Taxable Income (AMTI) over $40,000.

The AMT is based on AMTI. The basic calculation of the AMT is:

Basic AMT Calculation	**Discussion:**
Net Income After State Adjustments ± Adjustments + Preference Items = Pre-Adjustment AMTI before ACE Adjustment and AMT NOL	The computation starts with regular California net income after state adjustments. Net income is then reduced or increased by AMT adjustments, and increased by tax preference items to arrive at "pre-adjustment AMTI."
Apportionment provisions are applied. = California pre-adjustment AMTI	At this point, the separate AMTI amounts of the members of a unitary group are combined, and apportionment and allocation procedures are applied to arrive at the California AMTI.
± ACE Adjustment = AMTI before NOL	The ACE Adjustment and AMT NOL are applied on an individual taxpayer basis as explained in MATM 8540.

- AMT NOL Deduction	
= AMTI before Exemption	
- Exemption	A maximum exemption of $40,000 is allowed for each taxpayer.
= AMTI	
x 6.65% Tax Rate (8.65% for financial corporations) = Tentative Minimum Tax (TMT)	After being reduced by the exemption amount, AMTI is taxed at a 6.65% (8.65% for financials) rate to determine TMT.
- California Regular Tax	If the TMT exceeds the regular tax, the excess is the alternative minimum tax (AMT).
= Alternative Minimum Tax	

The AMT for general and financial corporations represents the incremental portion of the tentative minimum tax (TMT) that exceeds the regular tax. If the regular tax exceeds the TMT, no AMT exists. This concept can be illustrated as follows:

Since AMT represents the excess of TMT over the regular tax liability, an increase to regular tax may decrease or possibly eliminate AMT. You need to consider this factor when determining the materiality of an audit issue.

Before surveying a return on the assumption that the AMT effect will result in insufficient tax potential, you and your supervisor should consider the fact that the AMT is generally considered a prepayment of tax. In years when the TMT exceeds the regular tax, a minimum tax credit is generated because AMT was paid. See MATM 8580. That credit can be carried forward to offset the regular tax in years when the regular tax exceeds TMT. Although increasing the regular tax and reducing AMT may not result in a material tax effect in the current year, the minimum tax credit carried over to subsequent years will be reduced. This may have a substantial effect in future years. By the time that the minimum tax credit is used, the SOL for the year of the income adjustments may have expired. If an NPA or NPACA (see MAP 7.7) has not been issued, we may be barred from revising the amount of the minimum tax credit carryover. See MATM 9010.

8520 AMT Adjustments

IRC §56, which California incorporates with modifications in R&TC §23456, requires taxpayers to treat certain items differently in the calculation of alternative minimum taxable income (AMTI) than those items would be treated in the calculation of regular taxable income.

- **Depreciation:** For AMT purposes, most property placed in service after 1986 must be depreciated using the methods described in IRC section 56(a). Generally, real property is depreciated using the straight-line method over a specified life. Personal property that has not been depreciated under the straight-line method for regular tax purposes must generally use the 150 percent declining balance method for AMT purposes, changing to the straight-line method in the first year in which the straight-line method yields a higher deduction. The AMT adjustment is the difference between the depreciation deduction computed under the AMT method and the depreciation computed for regular tax purposes.

Although California adopts this provision without modification, there will usually be federal/state differences in the amount of the adjustment because of differing depreciation methods used for regular tax purposes. Unless the taxpayer uses the straight-line or 150 percent declining balance method for regular tax, you should verify the depreciation adjustment for AMT.

- **Basis adjustments in determining gain or loss from sale or exchange of property:** For AMT purposes, the adjusted basis of property is equal to the cost of the asset less accumulated AMT depreciation. Obviously, if the adjusted basis is different for AMT purposes than for regular tax purposes, there will be a different gain or loss on disposition. In years where the corporation sells an asset, there should be two adjustments to AMTI, the depreciation adjustment and the gain adjustment (IRC §56(a)(6)).

- **Mining and exploration and development costs:** The federal requirement that certain mining exploration and development costs be amortized for AMT purposes over a ten-year period, applies in California only to expenses incurred during taxable years beginning on or after January 1, 1988. Under federal law, the requirement applies to costs incurred after December 31, 1986. (See IRC §56(a)(2) and R&TC §23456(a)(1).)

- **Long-term contracts:** The percentage-of-completion method must be substituted for the completed-contract method in the determination of AMTI for any long-term contracts entered into on or after March 1, 1986. For certain small construction contracts, simplified procedures for allocation of costs must be used. See IRC §56(a)(3). California conforms to this provision without modification. You may find federal/state differences in the amount of the AMT adjustment because of the effective dates of long-term contract rules for regular tax purposes.

- **Pollution control facilities:** The five-year depreciation method available under IRC section 169 for such facilities must be replaced for AMT purposes by the alternative depreciation system specified under IRC section 168(g) (straight-line method, without regard to salvage value). (See IRC §56(a)(5).) Unlike federal law, California law allows the use of the five-year depreciation provision only if the facility is located in California and certified by the State Air Resources Board, in the case of air pollution, or the State Water Resources Control Board, in the case of water pollution. (See R&TC §24372.3.) Federal/state differences may arise in connection with facilities located outside the state. (See R&TC §23456(a)(2).)

- **Installment accounting method:** Generally, there is no adjustment for taxpayers using the installment method for regular tax purposes. In tax years beginning prior to 1997, certain taxpayers were not allowed to report income on the installment method for purposes of alternative minimum tax even though such method was allowable for regular tax purposes. These taxpayers may have a negative adjustment to alternative minimum taxable income when they receive payments for such installment sales. Negative adjustments after tax year 1996 are only available related to sales made between 8/16/1986 and 1/1/1990 for which the taxpayer was subject to the proportionate disallowance rule. (Former IRC §§ 56(a)(6), 453C; IRC § 453(l)(2)(B); RTC §§ 23456(a)(3), 24467.)

- **Merchant Marine capital construction funds:** For AMT purposes, amounts deposited in these funds are not deductible and the earnings on these funds are not excludable from AMTI. The AMT adjustment is the amount deposited into the fund and the earnings excluded for regular tax purposes.

- **Blue Cross and Blue Shield Organizations:** California law does not provide for this deduction. There is no adjustment for California AMT purposes.

8530 Tax Preference Items

California incorporates, with modifications described below, IRC section 57, which designates as tax preference items (TPIs) certain items that are accorded favorable tax treatment. Because TPIs have the effect of reducing regular taxable income, the amounts described below must be added back in the computation of alternative minimum taxable income (AMTI):

In the calculation of the AMTI, the following items are tax preference items:

- **Depletion:** The excess of the percentage depletion deduction over the adjusted basis of the property at the end of the taxable year is a tax preference item for both federal and state purposes. (See IRC § 57(a)(1) and R&TC §23457.)

- **Intangible drilling costs:** For both federal and state purposes, tax preference items include the amount by which "excess intangible drilling costs" (as defined in IRC § 57(a)(2)(B)) exceed 65 percent of the taxpayer's net income from oil, gas, and geothermal properties. (See IRC §57(a)(2) and R&TC §23457.)

- **Tax-exempt interest:** Although interest from specified private activity bonds is added back as a tax preference item for federal purposes, California does not incorporate that federal provision. This is not a tax preference item for California purposes. (See R&TC §23457(a).)

8540 Apportionment & Allocation of Pre-adjustment AMTI

The result of adjusting net income or loss after state adjustments by AMT adjustments and tax preference items is the Pre-Adjustment AMTI before ACE adjustments and AMT NOL.

Generally, the AMT calculation must incorporate the same concepts used in the calculation of regular California taxable income. AMTI may consist of both business and non-business amounts. The pre-adjustment AMTI of the members of a combined group must be combined, allocated or apportioned to California, and intrastate apportioned to each member in the same manner as is regular taxable income. You should perform these computations by running pre-adjustment AMTI through the PASS Principal Schedules (Schedules Ie & If). You may find an example of the computations in FTB Publication 1061, *Guidelines for Corporations Filing a Combined Report.*

The apportionment factors used to apportion pre-adjustment AMTI should reflect the AMT rules. This may create factor differences if the taxpayer has significant long-term contracts, installment sales, or intangible drilling costs.

When you perform the allocation and apportionment computations, remember that the amount of any non-business income or loss for AMT purposes should include any increases or decreases for tax preference or AMT adjustment items, such as accelerated depreciation directly related to such income. For regular tax purposes, non-business income or loss allocable outside California is not included in the tax base. The same holds true for AMT purposes. Once you perform the apportionment and allocation computations, only the California AMTI will remain.

In addition to apportioning and allocating AMTI to California, you must intrastate apportion AMTI among each of the California taxpayers using the computations described in MATM 7900 and in FTB Publication 1061. From this point on, you must calculate the ACE adjustment, AMT NOL, exemption amount, AMT liability, and tax credits separately for each taxpayer in the combined group.

8550 Adjusted Current Earnings (ACE) Adjustment

For taxable years beginning on or after January 1, 1990, the Adjusted Current Earnings provision began and it was intended to make AMTI more representative of economic income. The ACE adjustment is 75 percent of the difference between "adjusted current earnings" and pre-adjustment AMTI. The adjustment follows this formula:

	Adjusted Current Earnings
-	Pre-adjustment AMTI
=	Difference
X	75%
=	ACE adjustment

An ACE adjustment can either be positive or negative. If the adjusted current earnings is greater than pre-adjustment AMTI, a positive adjustment will result. If the adjusted current earnings is less than pre-adjustment AMTI, the adjustment will be negative. Negative ACE adjustments are limited. They will only be allowed to the extent that the corporation's total positive ACE adjustments in prior years exceeded that corporation's total negative adjustments in prior years. Negative adjustments that are not allowed in one year due to this limitation cannot be carried over to any other taxable year.

The ACE adjustment must be made on a post-apportionment basis, and is calculated for each taxpayer in a combined group. To perform this calculation, pre-adjustment AMTI is combined, apportioned or allocated to California, and intrastate apportioned to each taxpayer as described in MATM 8540. Adjusted current earnings is also combined, apportioned or allocated to California, and intrastate apportioned to each taxpayer in the same manner. Each taxpayer in the combined group then calculates its ACE adjustment by comparing its share of California pre-adjustment AMTI with its share of California adjusted current earnings. You can find an example of this computation in FTB Publication 1061, *Guidelines for Corporations Filing a Combined Report*.

Adjusted Current Earnings

To derive "adjusted current earnings," pre-adjustment AMTI is modified by the adjustments listed in IRC §56(g)(4) and R&TC §23456. The adjustments necessary to compute adjusted current earnings are as follows:

- **Depreciation**

California adopted the federal ACE depreciation adjustments specified in IRC §56(g)(4)(A), with certain modifications. These modifications are detailed in R&TC §23456(f). Generally, the straight-line method must be used to compute depreciation for ACE purposes. The depreciable basis and the recovery period will vary depending upon when property was placed in service. The adjustment required is the difference between the depreciation allowable for ACE purposes and the depreciation allowable for AMTI purposes.

For property placed in service on or after January1, 1998, the California ACE depreciation is the same as the depreciation allowable for AMTI. Therefore, there is no ACE depreciation adjustment for this property. For federal purposes, this provision applies to property placed in service after 1993.

- **Items Included in Earnings & Profits**

Generally, IRC §56(g)(4)(B) provides that adjusted current earnings shall include all income items which are not taken into account in determining pre-adjustment AMTI but which are taken into account for Earnings & Profits purposes. Remember that the computation of pre-adjustment AMTI begins with the amount of the regular taxable income, so when we say that the income item is not taken into account in determining pre-adjustment AMTI, then it is also excluded from regular taxable income. See Treasury Regulation § 1.56(g)-1(c)(6) for a partial list of these items.

The phrase "Earnings & Profits" is a tax accounting concept used to determine tax consequences of corporate distributions to shareholders. Earnings and profits is not the same as taxable income or earnings as determined by normal accounting practices.

Federal/state differences may occur due to differences in the way that items are reported for regular tax purposes. For example, interest on state and local bonds is generally excluded from federal pre-adjustment AMTI, but it is an adjustment for federal ACE purposes because it is included in earnings and profits. For California purposes, only interest from California obligations is excluded from pre-adjustment AMTI. Therefore, the California ACE add back may differ from the federal add back. In addition, if a corporation is subject to the corporate income tax rather than the franchise tax, R&TC §23456(g)(3) provides that the amount of interest income included in adjusted current earnings may not exceed the amount included for purposes of the regular tax.

- **Disallowance of Items not Deductible in Computing Earnings and Profits**

IRC §56(g)(4)(C) provides that adjusted current earnings may not be reduced by deductions not allowable against Earnings & Profits, even if the deductions were taken into account in determining pre-adjustment AMTI. California law modifies the federal provisions as follows:

California does not follow the federal provisions relating to dividend deductions. Instead, California allows dividends to be deducted from earnings and profits in accordance with the dividend deductions allowed for regular tax purposes under R&TC sections 24402, 24410, 24411, and 25106. (See R&TC §23456(g)(1)(A)(i).)

California's interest offset rules in R&TC §24344 must be applied in determining the amount of interest deductible for purposes of adjusted current earnings. In addition, no deduction from adjusted current earnings will be allowed for interest expense allocable to income that has not been included in the measure of tax as per R&TC §24425. (See R&TC § 23456(g)(1)(D)(4).)

- **Intangible Drilling Costs**

When you determine ACE, the adjustments for intangible drilling costs provide that those costs are amortized on a straight-line basis over 60 months beginning with the month in which the expenses were paid or incurred.

- **Circulation & Organizational Expenditures**

For ACE purposes:

Circulation expenses are amortized over 3 years.

Organizational expenses are charged to a capital account and are not taken into account until the corporation is sold or disposed of.

- **LIFO Inventory Adjustments**

The LIFO inventory adjustment requires an increase or decrease in earnings and profits by the amount of any increase or decrease in LIFO recapture amounts.

- **Installment Sales**

In the case of installment sales, ACE is computed as if the corporation did not use the installment method.

- **Disallowance of Loss on Exchange of Debt Pools**

For ACE purposes, no loss will be recognized on the exchange of any pool of debt obligations for another pool having substantially the same effective interest rates and maturities.

- **Acquisition Expenses of Life Insurance Companies for Qualified Foreign Contracts**

Acquisition expenses of life insurance companies should be capitalized and amortized for ACE purposes in accordance with generally accepted accounting principles.

- **Depletion**

For any property placed in service in a taxable year beginning after 1989, the depletion deduction for ACE purposes must be computed under the cost depletion method. An exception is made for independent oil and gas producers and royalty owners.

- **Basis Adjustment**

ACE should be adjusted for the gains or losses on the disposition of assets due to changes to the adjusted basis of assets caused by any other ACE changes, such as the depreciation adjustments.

8560 AMT NOL Deduction

The two key features you should remember about AMT net operating losses (NOLs) are:

- AMT NOLs must be computed on the basis of AMTI
- AMT NOL deduction may not offset more than 90 percent of the AMTI for any taxable year.

In some respects, the computation of the AMT NOL is subject to the same rules and limitations as regular tax NOLs (the 50 percent limitation, water's-edge NOL limitations and, IRC §382 limitations; See MATM 8000). As with regular tax NOLs, each taxpayer in a combined group must apply its separately apportioned or allocated share of California AMT NOL to its apportioned or allocated share of AMTI.

Taxpayers often forget to apply the California NOL limitation to AMT NOLs, or forget to limit the AMT NOL to 90 percent of AMTI. Since these are fairly common mistakes, you should be especially careful to review taxpayers' AMT computations for these issues.

The federal AMT NOL provisions are IRC §56(a)(4) and IRC §56(d). California conforms to those provisions, but modifies the applicable dates pursuant to R&TC §23456(b). Legislation in 1994 added R&TC §23456(c) to clarify how California's NOL rules for apportioning taxpayers interact with the AMT rules.

Since NOLs arising from taxable years beginning before January 1, 1988 cannot be based upon AMTI, former R&TC §23456(c)(2) provided rules for determining the amount of AMT NOL to carry forward from those years.

8565 Exemption Amount

California incorporates IRC §55(d)(2), which exempts the first $40,000 of alternative minimum taxable income from the alternative minimum tax. The exemption amount is reduced (but not below zero) by an amount equal to 25 percent of the amount by which the AMTI of a corporate taxpayer exceeds $150,000. The exemption is zero if the AMTI is greater than or equal to $310,000. (See R&TC §23455.)

Each California taxpayer in a combined group has its own $40,000 exemption, and applies its own $150,000 limitation. The exemption and limitation are applied against the California AMTI apportioned and allocated to that taxpayer.

8570 Tentative Minimum Tax

For general corporations, the tentative minimum tax is 6.65 percent and 8.65 percent for financial corporations of the excess AMTI of the exemption amount. (See R&TC §23455(a) and R&TC §23455(d).) Corporations with valid S-Corporation elections are not subject to the AMT.

The tentative minimum tax (TMT) is compared to the taxpayer's regular tax. For purposes of this comparison, the "regular tax" is defined as the corporation franchise tax, the corporation income tax, or the tax on the unrelated business income of an exempt corporation. You should make the comparison before the application of any tax credits.

If the TMT exceeds the regular tax, the difference is the Alternative Minimum Tax. Without considering tax credits, the taxpayer is effectively required to pay the higher of the TMT or the regular tax for the taxable year.

8575 Interaction With Tax Credits

Once the tentative minimum tax (TMT) and alternative minimum tax (AMT) have been determined, then any available tax credits may be applied. Most tax credits are not allowed to reduce the regular tax below the TMT amount. Only certain credits may reduce the regular tax below the TMT amount. In the *Appeal of NASSCO*, 2010-SBE-001 (November 17, 2010), the Board of Equalization allowed the Enterprise Zone credit (EZ) and the Manufacturers' Investment Credit (MIC) to reduce the AMT. (See FTB Notice 2011-02.) Therefore, the EZ, MIC, and carryovers from certain repealed versions of the solar energy credit are allowed to offset the AMT.

R&TC §23036(d)(1) lists those credits that can reduce the regular tax below the TMT. R&TC §23036(c) provides the ordering rules for applying credits. Those rules are also discussed in MATM 9010.

8580 Minimum Tax Credit

When a taxpayer's TMT exceeds the regular tax, a Minimum Tax Credit (MTC) is generated. The MTC may be carried forward and applied against the regular tax in a year when regular tax exceeds TMT. The amount of MTC that can be applied in any taxable year is limited because the MTC cannot reduce regular tax below the TMT, but any unused MTC can be carried forward indefinitely. (See IRC §53 and R&TC §23453.)

The MTC reflects the intent of Congress for the alternative minimum tax system to be largely a pre-payment of tax. Many AMT adjustments are timing adjustments or deferrals that will turn around in subsequent years. The theory is that if taxpayers pay AMT on an item, they will be allowed a benefit in the subsequent year when the item results in a smaller deduction for regular tax purposes than for AMTI.

Application of MTC carryover:

The following example will illustrate how the MTC carryover is applied:

Example: The first year in which the taxpayer's tentative minimum tax exceeded its regular tax was 2010. Assume the following facts for 2010 and 2011:

	2010	**2011**
Tentative Minimum Tax	147,856	120,000
Regular Tax	54,928	140,000
AMT	92,928	--

Since the TMT exceeded the regular tax, a minimum tax credit of $92,928 was generated in 2010.

In 2011, regular tax exceeded TMT by $20,000. Assuming that the taxpayer has no other tax credits, $20,000 of the MTC may be applied in 2011 to reduce the regular tax liability to $120,000. The remaining $72,928 MTC will be carried forward to subsequent years.

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