ESSAY

HOW DID A ROGUE 2011 IRS INSTRUCTION PRODUCE A NONSENSICAL AND PUNITIVE AMT INVESTMENT INTEREST EXPENSE DEDUCTION COMPUTATIONAL FORMULA AND NOBODY KNOWS IT?

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INTRODUCTION

Meaningful compliance with tax law enacted by Congress requires taxpayers to file income tax returns (Form 1040) that accurately calculate their tax liability to be paid to the Internal Revenue Service ("IRS"). It is presumed that this will be accomplished by dutifully following IRS instructions in making numeric or percentage entries on the appropriate line items on the myriad of forms and schedules interconnected with Form 1040. Often, those entries are components of preset tax significant formulas—all of which are necessary to calculate a taxpayer's tax liability.

Years ago, tax preparation was done manually without the assistance of tax software. Those days of preparing a Form 1040 by hand are long gone. According to a recent study, 84 percent of returns were prepared by taxpayers or their hired tax preparers using tax preparation software.[1] Significantly, all tax preparation software used in the preparation of electronically filed income tax returns[2] must be approved by

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1 Robert Farrington, *How Much Americans Pay to File Their Taxes*, THE COLLEGE INVESTOR (Sept. 18, 2021), https://thecollegeinvestor.com/35771/file-taxes-survey-2021 [https://perma.cc/8VMQ-992C]. According to the survey, 46 percent of returns were prepared by using tax software, 11 percent were prepared virtually (online) using tax software, and 27 per cent were prepared by a CPA or tax preparer (through tax software). The remaining 16 percent of returns were prepared by pen and paper.

2 In fiscal year 2022, 93.8 percent of all returns were electronically filed. IRS, RETURNS FILED, TAXES COLLECTED & REFUNDS ISSUED (Apr. 14, 2022), https://www.irs.gov/statistics/returns-filed-taxes-collected-and-refunds-issued [https://perma.cc/GTL2-V7CY].

the IRS.[3] Such tax software must be programmed to input "information requested on tax form instructions to support specific lines (such as, ItemizedOtherIncomeSchedule . . .)."[4]

Due to the complexity of the Internal Revenue Code ("IRC") particularly, tax formulas that affect multi-computations, tax preparers' reliance on IRS instructions integrated into tax preparation software cannot be overstated.[5] When the tax software generates a return with no error messages, it is presumed to be correct and is efiled to the IRS with no further tax preparer review. Consequently, if the directions in an IRS instruction are erroneous, the domino effect of a wrong number or percentage entered on a form or schedule flowing through to another form or schedule that produces a flawed computation could ultimately result in an egregiously inaccurate tax liability. Unfortunately, because IRS instructions are rarely scrutinized for correctness, return errors they create may never be discovered and potentially repeated indefinitely — damaging the integrity of our tax system.

Due to blind reliance on the accuracy of IRS instructions and their importance in tax return preparation, the IRS has a duty to ensure that they faithfully track the underlying tax law/Code section(s), ideally as supplemented by applicable authoritative guidance provided by Treasury regulations, notices, announcements, revenue rulings and revenue procedures. Significantly, if there are no Treasury regulations or other authoritative guidance from the IRS in a particular area of tax law, an IRS instruction may be the sole source of interpretation available to the taxpayer. Because an IRS instruction is considered unpublished subregulatory authority, however, its Code interpretations are not binding on the IRS and cannot be relied on by the taxpayer.[6]

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3 IRS, *How Tax Preparation Software Is Approved for Electronic Filing* (Sept. 29, 2022), https://www.irs.gov/e-file-providers/how-tax-preparation-software-is-approved-for-electronic-filing [https://perma.cc/B7KH-GXGM].

4 IRS, MODERNIZED E-FILE (MEF) GUIDE FOR SOFTWARE DEVELOPERS AND TRANSMITTERS, PUB. NO. 4164, 50 (2023).

5 *See* Robert P. Strauss & Helen Lin, *The Readability of the US Federal Income Tax System: Some First Results*, 14 (stating the reading level of individual income tax instructions is 8th grade), https://www.irs.gov/pub/irs-soi/14rpreadabilityfederalincometaxsystem.pdf [https://perma.cc/6P5F-KVA8].

6 *See* CONG. RSRCH. SERV., RELIANCE ON TREASURY DEPARTMENT AND IRS TAX GUIDANCE 1 (2023). There are three categories of IRS guidance. At the highest authoritative level of guidance are Treasury regulations and Internal Revenue publications such as revenue rulings, revenue procedures, notices and announcements. Forms, instructions and publications are considered unpublished subregulatory authority because they are not published in the

For those reasons, the consequences of an IRS instruction that is the sole source of authority in a particular area of tax law can be problematic for the taxpayer. As previously noted, because an IRS instruction carries no definitive authoritative weight, if its interpretation of tax law is incorrect the taxpayer should not be compelled to follow it – nor should the IRS be able to enforce it against the taxpayer. Thus, in the absence of regulatory authority, the IRS' organizational commitment to due diligence in properly vetting IRS instructions is imperative to ensure their veracity and accuracy. Assuming the vetting process is as thorough as it is described in the IRS Manual,[7] inaccurate IRS instructions are inexcusable. All newly drafted or revised IRS instructions are subject to several levels of institutional review before they are inserted into the applicable IRS form or schedule. The Tax Forms and Publication Division is responsible for coordinating the processing of tax forms (including IRS instructions) and publications.[8] First, an IRS instruction is reviewed by the Tax Forms Coordinating Committee ("TFCC").[9] In the context of this review, the IRS Office of Chief Counsel is responsible for advising the TFCC regarding "the technical accuracy of interpretations of legislation for which regulations have not been published . . . . It is responsible for interpreting the applicable Code sections for reviewing the forms and instructions."[10] If approved by the TFCC, which includes a representative from the Office of the Associate Chief Counsel, the instruction is sent to the Technical Service Support Branch at Forms & Publications for a second review. If the reviewers believe legally required changes should be made, they are addressed in a memorandum sent to another group, Tax Forms & Publications, responsible for making those changes.[11] Final approval of the IRS instruction for publication requires a signature on behalf of the IRS Chief Counsel.[12]

Internal Revenue Bulletin. *See* Benjamin M. Willis & Michael J. Desmond, *The Potential for Tax Enforcement Through Subregulatory Guidance*, 173 TAX NOTES FED. 959, 960 (2021) (explaining that "FAQs, forms, instructions, publications and guidance not published in the Internal Revenue Bulletin" are not afforded the same deference as subregulatory authority published that is not.).

7 I.R.M. 33.3.7 (Sept. 10, 2017).

8 I.R.M., 33.3.7.1 (Aug. 11, 2004).

9 I.R.M. 33.3.7.1(1) (Aug. 11, 2004).

10 I.R.M. 33.3.7.1.2(1) (Aug. 11, 2004) (stating the IRS Chief Counsel is the chief legal advisor to the IRS Commissioner).

11 I.R.M. 33.3.7.2(7)c (Aug. 12, 2010).

12 I.R.M. 33.3.7.1.2(1) (Aug. 11, 2010) (stating the IRS Chief Counsel is the chief legal advisor to the IRS Commissioner). Additionally, Chief Counsel is responsible for advising the TFCC "on current developments in legislation,

Although this attention to detail including the approval of Chief Counsel in the IRS vetting process should be reassuring to taxpayers, as noted above, an IRS instruction is not on the same authoritative level as a Treasury regulation promulgated pursuant to the Administrative Procedure Act.[13] Therefore, despite the participation and input of the Chief Counsel in the IRS instructions review process, an IRS instruction should never function as a rulemaking surrogate for a Treasury regulation. Consequently, if, in the absence of authoritative guidance, an IRS instruction deviates from the plain meaning of the underlying Code section or presents an interpretation that functions as a de facto Treasury regulation it should be considered invalid *ab initio*.[14]

To underscore how this issue compromises the integrity of our tax system, this Essay focuses on an IRS instruction that unilaterally and radically changed a tax computation formula. Although the underlying Code section was amended only one year after its effective date, the amendment appeared to simply expand, not fundamentally change a tax computation in the manner set forth in the IRS instruction. Even more puzzling is that in the year in which the amendment was enacted (long before the IRS instruction was published), the pre-amendment IRS instruction revised a subsequent IRS instruction in a manner that was consistent with the expansion – not a radical change to the formula.

Inexplicably, as noted above, twenty-three years following the enactment of the amendment, and with no explanation, the new IRS instruction radically revised the previous IRS

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regulations and all legal aspects of forms and instructions." I.R.M. 33.3.7.1.2(1) (Aug. 11, 2004).

13 *See* I.R.C. § 7805(a). Rules and regulations are to be prescribed by the Secretary of the Treasury or its delegate, i.e., the Commissioner of the IRS. *See* Treas. Reg. § 301.7805-1(a). Ruling making, as required by the statute usually followed by the Treasury even in issuing interpretative regulations, requires a general notice to be published in the Federal Register. *See* 5 U.S.C § 553. Following the notice, there is a comment period in which individuals can express their concerns and recommendations. *Id.* The IRS then has an opportunity to respond to those concerns – possibly following some or all the recommendations. *Id.* This would not be the case with respect to IRS instructions on forms which would be considered unpublished subregulatory guidance. Because Congress has delegated rulemaking to the IRS, Treasury regulations are afforded the highest deference by courts. *See* Redlark v. Commissioner, 141 F.3d 936, 939 (9th Cir. 1998).

14 *See* Miller v. Commissioner, 114 T.C. 184, 195 (2000) (discussing the authoritative reliability of an IRS publication equally applicable to IRS instructions by stating that "administrative guidance contained in IRS publications is not binding on the Government, nor can it change the plain meaning of tax statutes").

instruction by changing the computational formula in a nonsensical and taxpayer punitive way. The following year, the IRS instruction was again revised with even more nonsensical language having the same punitive tax consequences to the taxpayer. To date, this IRS instruction remains unchanged.

More specifically, the IRS instruction at issue appears on Form 6251 (Alternative Minimum Tax—Individuals). As the term suggests, the alternative minimum tax ("AMT") is essentially "a separate and independent tax system"[15] intended by Congress to prevent wealthy taxpayers with financial means from taking advantage of legal tax avoidance strategies to significantly reduce, if not, eliminate their tax liability.[16] Yet, despite its characterization as a separate and independent tax system, AMT is computed on a single separate form—essentially as a regular income tax add-on.[17] In other words, AMT is not computed from scratch on an "AMT Form 1040." Instead, on Form 6251, a complex and daunting three-part form, starting with regular taxable income as computed on Form 1040, [18] AMT adjustments are made to arrive at alternative minimum taxable income ("AMTI").[19] Once AMTI is computed, it is reduced by the applicable exemption amount based on filing status.[20] The AMT is calculated based on two graduated tax rates of 26 percent and 28 percent.[21] Due to the number and complexity of the AMT adjustments made in the computation of AMTI, the necessity for clear, concise and accurate line item IRS instructions is paramount. Yet, to date, the IRS has failed to promulgate any interpretative regulations explaining these adjustments with numeric examples. In other words, for the most part, the IRS instructions discussed in this Essay have provided the sole guidance in the computation of the AMT formula at issue.

The genesis of the "rogue" IRS instruction is the massive Tax Reform Act of 1986[22] ("TRA 86") which made significant modifications to AMT, including the enactment of section

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15 STAFF OF JOINT COMM. ON TAXATION, 99TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 438 (J. Comm. Print 1987).

16 *Id.* at 434.

17 *See* I.R.C. § 55(a) ("There is hereby imposed (in addition to any other tax . . . a tax equal to the excess (if any) of (1) the tentative minimum tax for the tax year, over (2) the regular tax for the taxable year . . ."). If a taxpayer is subject to AMT it is reported on line 1, Schedule 2 (Additional Taxes) of Form 1040.

18 IRS, Form 6251, line 1.

19 I.R.C. § 55(b)(1)(D).

20 I.R.C. § 55(b)(1)(B).

21 I.R.C. § 55(b)(1)(A).

22 Pub. L. No. 99-514, 100 Stat. 2085 (1986).

56(b)(1)(B)(ii).[23] That section was enacted as consequence of other related changes to AMT made by TRA 86. Particularly, Congress enacted section 57(a)(5)(A) designating specified private activity bond ("SPAB") interest income, tax-exempt for regular income tax purposes,[24] as an investment income tax preference includible in AMTI. Concurrently, section 57(a)(5)(A) also allowed the taxpayer to claim investment expense deductions (other than investment interest expenses dealt with elsewhere) related to SPAB interest income that are not deductible for regular tax purposes as a deduction for AMT purposes.[25] In other words, the AMT positive adjustment to AMTI is gross SPAB investment interest less SPAB related deductible investment expenses.

As alluded to above, investment interest expenses related to the purchase or carrying of an SPAB are not factored into the computation of net SPAB investment interest income – as they are dealt with separately and are subject to different rules. Although such interest expenses related to SPAB tax-exempt income are non-deductible for regular income tax purposes,[26] they are deductible for AMT purposes.[27] In TRA 86, Congress amended the regular tax rules limiting the deductibility of investment interest expenses to the extent of net investment income. Net investment income is defined as gross investment income minus deductible interest expenses (Regular Tax Computational Formula). [28] Those deductible interest expenses are claimed as miscellaneous itemized deductions on Schedule A of Form 1040. Also an itemized deduction (a regular, not a miscellaneous itemized deduction), the investment interest expense deduction is the last investment related deduction claimed.[29] Thus, due to the designation of

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23 As originally enacted, it was I.R.C. section 56(b)(1)(B)(iii). Subsequently, it was re-numbered as (ii) as it will be referred to in this Essay.

24 I.R.C. § 103(b)(1).

25 I.R.C. § 265(a)(1) ("No deduction shall be allowed for – [a]ny amount otherwise allowable as a deduction allocable to one or more classes of income . . . wholly exempt from the taxes . . .").

26 I.R.C. §§ 265(a)(1)-265(a)(2).

27 I.R.C. § 57(a)(5)(A). *See also* STAFF OF J. COMM. ON TAX'N, *supra* note 15, at 443 ("In the case of a taxpayer who is required to include in alternative minimum taxable income any interest that is tax-exempt for regular income tax purposes, section 265 (denying deductions for expenses and interest relating to tax-exempt income) does not apply to the extent of such inclusion, for purposes of the minimum tax.").

28 I.R.C. § 163(d)(1).

29 Investment interest expenses is an itemized deduction claimed on Schedule A of Form 1040. The limitation of the deduction to net investment income ensures that investment interest expenses cannot create a "net"

SPAB investment interest income as a tax preference and related investment interest expenses as a deduction, section 56(b)(1)(B)(ii) was added to the Code to make the regular income tax investment expense limitation rules applicable in determining the deductibility limitation of investment interest expenses related to SPAB interest income (AMT Computational Formula). This result is consistent with the legislative history indicating that the purpose of enacting section 56(b)(1)(B)(ii) was to create parity in the way the deductibility of investment interest expenses was computed under both computational formulas.[30] Stated differently, Congress intended the methodology in computing the AMT interest deduction and the regular tax interest deduction to be the same.

For tax year 1987, the effective date of TRA 86, a line-item entry for an adjustment to AMTI based on the AMT Computational Formula appeared on the 1987 Form 6251.[31] Although as discussed later in the Essay,[32] the IRS instruction likely overestimated or overlooked the taxpayer's fluency or lack thereof in grasping complicated new tax legislation, it nonetheless provided directions that were consistent with section 56(b)(1)(B)(ii).[33]

Two years following the enactment of TRA 86 Act and one year after its effective date, the Technical and Miscellaneous Act of 1988[34] (TAMRA) amended section 56(b)(1)(B), by adding clause (iv) (TAMRA Amendment).[35] Although the legislative history was sparse (less than a single sentence), the TAMRA Amendment simply appeared to expand and tweak the AMT Computational Formula—not to fundamentally change it.[36] In fact as discussed in more detail below, this Essay's thesis (Essay's TAMRA Amendment thesis) is that for purposes of the AMT Computational Formula, the TAMRA Amendment (1)

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investment loss potentially deductible against other types of income.

30 H.R. REP. NO. 99-841, at 259 (1986) ("the definition of net investment income is conformed to the definition for regular tax purposes"); STAFF OF J. COMM. ON TAX'N, *supra* note 15, at 462 ("[T]he investment interest [deduction] are generally conformed to the regular tax limits.").

31 IRS, Form 6251, line 4h (1987).

32 *See infra* Part III.C.

33 *Id.*

34 Pub. L. No. 100-647, 1012 Stat. 3342.

35 *Id.* at 3428 ("[T]he adjustments of this section and section 57 and 58 shall apply in determining net investment income under section 163(d)."). As originally enacted, it was section 56(b)(1)(C)(v) but was subsequently renumbered as clause (iv).

36 *See* S. REP. NO. 100-445, at 94 (1988) ("investment income for purposes of [alternative] minimum tax takes into account the [alternative] minimum tax preferences and adjustments.").

expanded the definition of gross investment income that was limited to SPAB income, to include any type of tax preference investment income, and, (2) required appropriate AMT adjustments be made in the determining the correct amount of such income to be included in gross investment income.

In 1988, presumably in conjunction with the newly enacted TAMRA Amendment, a new IRS instruction replaced the 1987 IRS instruction. The wording of the 1988 IRS instruction was consistent with the Essay's TAMRA Amendment thesis.[37] Inexplicably, twenty-three years later, for tax year 2011, the 2011 IRS instruction replaced the 1988 IRS instruction with a radically different version of the AMT Computational Formula. Such a radical change was perplexing considering that during those intervening years, the IRS provided no authoritative guidance including any promulgated regulations or revenue rulings to suggest that the 1988 IRS instruction's explanation of the TAMRA Amendment was incorrect.

Specifically, the 2011 IRS instruction appears to alter the AMT Computational Formula by directing the tax preparer to double reduce deductible SPAB related investment expenses in the computation of AMT net investment income. Because the investment interest expense deduction is limited to net investment income, a double reduction of those expenses would inappropriately reduce net investment income resulting in a lesser and possibly eliminated AMT investment interest expense deduction in any given tax year.[38] Then, again with no explanation, in 2012, the 2011 IRS instruction was rewritten with awkward wording that produced the same result as the 2011 IRS instruction. To date, the 2012 version of the 2011 instruction remains on Form 6251.[39]

As discussed in more detail later in the Essay,[40] if as it appears the 2011 IRS instruction incredulously altered the AMT Computational Formula in a way that produces an unwarranted and punitive outcome for the taxpayer, this raises serious and disturbing procedural questions. First, for

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37 *See infra* Part V.

38 Although investment interest expenses in excess of the deduction limitation amount are carried forward to succeeding years, the deduction would be delayed to subsequent tax years at best and at worst eliminated if the taxpayer lacks sufficient gross investment income as an offset. *See* I.R.C. § 163(d)(2).

39 Throughout the balance of this Essay, references to either the 2011 instructions or the 2012 instructions are interchangeable as both instructions express the radically modified AMT Computational Formula.

40 *See infra* Part VI.

what reason(s) did the IRS instruction writers deem it appropriate to radically alter the AMT Computational Formula twenty-three years after the enactment of the TAMRA Amendment? Assuming IRS instruction writers believed that the 1988 IRS instruction incorrectly interpreted the TAMRA Amendment, why did the legislative history (that was very brief) fail to explain the change or even mention it? Further, assuming, *arguendo*, that Congress intended the TAMRA Amendment to alter the AMT Computational Formula, why contemporaneous with a change of that magnitude did the IRS not promulgate Treasury regulations, issue a revenue ruling, notice or an announcement explaining and providing guidance for the change? Why was the 2011 IRS instruction revised in 2012 replacing the wording with even more awkward wording in achieving the same result? What were the particulars of the 2011 IRS instruction and 2012 IRS instruction vetting process that resulted in the approval of the change in both instances by the IRS Chief Counsel? Finally, in the legal analysis made by the IRS instruction writers, reviewers and IRS Chief Counsel, did they ever consider whether those IRS instructions could be construed as the equivalent of an improper de facto Treasury regulation. If so, what was the rationale for whatever conclusion they reached?

Because this Essay focuses solely on the substantive aspects of the 2011 IRS instruction appearing to radically depart from the intended purpose of the TAMRA Amendment, the foregoing procedural misstep questions are beyond its scope. The author does intend, however, to write a sequel article in which those procedural questions are addressed. In doing so, a freedom of information request for all documentation relevant to the vetting process of the 2011 and 2012 IRS instructions will be submitted to the IRS.

As to the interpretation of the TAMRA Amendment, as mentioned above, this Essay's TAMRA Amendment thesis is that Congress intended to expand the AMT Computational Formula and add a few overlooked tweaks but not to radically change it. Consistent with this thesis, as explained in Part IV, prior to the TAMRA Amendment, section 56(b)(1)(B)(ii) only specified SPAB interest income as gross investment income for purposes of the AMT Computational Formula. In retrospect, this limited inclusion was short sighted as if at a later date, Congress were to designate another type of tax-free or tax-exempt investment income as a tax preference, clause (ii) would not be broad enough to include it in AMT gross investment income. Thus, the language of the TAMRA

Amendment, section 56(b)(1)(B)(iv) "the adjustments [of] sections 57 and 58 shall apply in determining net investment income . . ." was intended to expand the AMT Computational Formula to include any tax preference investment income set forth in those sections – not just SPAB investment interest income.[41] In conjunction with expanding the AMT Computational Formula to include types of tax preference investment income, the TAMRA Amendment supplementally required that the amount of tax preference investment income so included be subject to appropriate AMT adjustments. Assuming this Essay's TAMRA Amendment thesis is correct, it plausibly explains the lack of any IRS authoritative guidance well after the TAMRA Amendment was enacted. In other words, if the IRS shared the Essay's TAMRA Amendment thesis (at least prior to the publication of the 2011 IRS instruction) perhaps the IRS did not believe that guidance was necessary.

The Essay conjectures that there are three possible explanations for what appears to be a rogue 2011 IRS instruction: (1) inexplicably, undetected in the vetting process, the IRS instruction writers poorly worded the 2011 IRS instruction and again in 2012 without intending to change the essence of the AMT Computational Formula as set forth in the 1988 IRS instruction, (2) the IRS instruction writers went very rogue and radically changed the AMT Computational Formula and neither the 2011 nor 2012 IRS instruction was properly vetted, or (3) beyond the realm of the IRS instruction vetting process, the IRS decided to go rogue and resorted to publishing the 2011 IRS instruction as a surrogate for issuing a Treasury regulation that would have required notice to the public followed by a comment period.[42] If any of these explanations are true, it is an alarming indictment on the IRS.

Based on the Essay's TAMRA Amendment thesis, the following remedial measures are recommended. If the 2011 IRS instruction (as well as the 2012 IRS instruction) was simply poorly worded without intending to radically alter the AMT Computational Formula, it should be withdrawn and replaced by a clear and concise version of the 1988 IRS instruction. Similarly, if the IRS instruction writers went rogue and the 2011 IRS instruction (as well as the 2012 instruction) was published without property vetting, it should be

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41 Section 57 lists tax preferences which does include other types of gross investment income that would be included in the Regular Tax Computational Formula if they were not tax-exempt or tax-free.

42 *See* I.R.M. 33.3.7.1.2(1).

withdrawn and replaced as described above. Finally, if the 2011 IRS instruction as reworded by the 2012 IRS instruction was intended to be or is the equivalent of a Treasury regulation that fundamentally changed the AMT Computational Formula, consistent with the Treasury's recent policy commitment to the regulatory process as the optimal means of conveying tax law interpretation to taxpayers, the IRS should promulgate interpretative Treasury regulations (including notice and comment period) with computational examples.[43]

Fortunately, time is not of the essence in the implementation of the Essay's recommendations. This is because the double reduced investment expenses at issue are miscellaneous itemized deductions.[44] Pursuant to the Tax Cuts and Jobs Act,[45] ("TCJA") for tax years beginning after December 31, 2017, and before January 1, 2026, miscellaneous itemized deductions are suspended and not allowed.[46] Thus, due to the non-deductibility of those investment expense deductions, for all tax years since the enactment of the TCJA,[47] those expenses have not been a component of the AMT Computational Formula. In other words, during this period, there has been no reduction (single or double) of gross investment income by the currently non-deductible investment expenses.

Accordingly, in the short term, there is no pressing need for immediate IRS action. If Congress does not extend the disallowance of miscellaneous itemized deductions beyond 2025, however, the issue will resurface. Moreover, even if Congress does extend the disallowance beyond 2025, it may decide to make investment expenses deductible sometime thereafter. In either scenario, whether this Essay's TAMRA

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43 *See* DEPARTMENT OF THE TREASURY, POLICY STATEMENT ON THE TAX REGULATORY PROCESS 1 (2019) ("The Department of the Treasury and the Internal Revenue Service (IRS) reaffirm their commitment to a tax regulatory process that encourages public participation, fosters transparency, affords fair notice, and ensures adherence to the rule of law."). For a discussion of the Policy Statement, *see* Matt Lerner et al., *To Rely On or Not to Rely On? Sub-Regulatory Tax Guidance in Turbulent Times*, TAX EXEC. (Feb. 2, 2021), https://taxexecutive.org/to-rely-on-or-not-to-rely-on-sub-regulatory-tax-guidance-in-turbulent-times/ [https://perma.cc/8FQ6-CWQV].

44 I.R.C. § 67(a). Investment expenses treated as miscellaneous itemized deductions include I.R.C. § 212 (ordinary and necessary expenses) and I.R.C. § 167(a) (depreciation of property held for the production of income). Conversely, as discussed *infra* Part II.A.1, the investment interest expense is an allowable itemized deduction that is not a miscellaneous itemized deduction.

45 Pub. L. No. 115-97, 131 Stat. 2054 (2017).

46 I.R.C. § 67(g).

47 Calendar tax years 2018, 2019, 2020, 2021 and 2022.

Amendment thesis is correct or incorrect, the AMT Computational Formula is muddled with uncertainty. Minimally, pursuant to the Taxpayers Bill of Rights, the IRS has a duty to clearly explain relevant tax law to taxpayers.[48]

The Essay is organized as follows: Part I reveals the lack of any explanatory guidance or commentator attention to the 2011 IRS instruction apparent radical change to the AMT Computational Formula that is hiding in plain sight. Next, Part II examines the AMT Computational Formula prior to the TAMRA Amendment. Also included is a discussion of the mechanics of the Regular Tax Computational Formula, an analysis of the AMT correlative adjustments that created parity with the Regular Tax Computational Formula and finally an analysis of the 1987 IRS instruction explaining the AMT Computational Formula. Then, in Part III, this Essay's TAMRA Amendment thesis is articulated postulating that the purpose and effect of the TAMRA Amendment was to expand the scope of AMT gross investment income to include any investment income preference subject to appropriate AMT adjustments. In Part IV, the Essay explores the significance of the required correlative adjustments in determining the amount of tax preference investment income includible in AMT gross investment income per the TAMRA Amendment. It does so with an analysis of a hypothetical scenario involving net capital gain from the sale of stock acquired through the exercise of an investment stock option. Comparing the outcome pursuant to the 1988 IRS instruction with a TAMRA Amendment required adjustment to the 1987 IRS instruction lacking that adjustment reveals that the former instruction closes a pre-TAMRA Amendment loophole. Then, in Part V, the Essay provides an in-depth examination of the 2011 IRS instruction in apparently creating a nonsensical and punitive version of the AMT Computational Formula. Part VI highlights the challenges to tax preparers due to the complexity of Form 6251 as reinforcing the necessity and importance of clear and concise IRS instructions.

I
THE 2011 IRS INSTRUCTION MODIFICATION OF THE AMT COMPUTATIONAL FORMULA HAS BEEN HIDING IN PLAIN SIGHT

An important factor the author considered in developing the Essay's TAMRA Amendment thesis is it is a rational

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48 IRS, *Taxpayer Bill of Rights* (May 1, 2023), https://www.irs.gov/taxpayer-bill-of-rights [https://perma.cc/M5R2-2NAJ].

explanation of the statute. Given the choice between a rational explanation or one that produces a nonsensical tax outcome with no legislative history support or any form of IRS authoritative guidance, the former explanation is more likely to be correct. In other words, this Essay rejects the notion that Congress would have made such a radical change to the AMT Computational Formula two years after it was originally enacted without specifically addressing it in the legislative history. Moreover, the legislative history, brief as it is, is consistent with the Essay's TAMRA Amendment thesis. Further, it is incomprehensible that the IRS would have ignored such a significant change and not provided any type of contemporaneous authoritative guidance. Yet, despite the 2011 IRS instruction radical change to the AMT Computational Formula followed by the reworded but equally radical 2012 IRS instruction, the IRS has remained silent to this date.

Assuming the Essay's TAMRA Amendment thesis is correct, the lack of IRS authoritative guidance through 2010 is understandable. The IRS may have believed that the AMT Computational Formula was straightforward and consistent with the 1988 IRS instruction. Thus, no authoritative guidance was unnecessary. This makes the 2011 IRS instruction radical revision of the formula twenty-three years after the TAMRA Amendment was enacted perplexing. Equally perplexing is why, following the 2011 IRS instruction and the 2012 IRS instruction, the IRS fail to issue regulatory or subregulatory guidance. Additionally puzzling is that despite the myriad articles written on AMT in the interim an internet search of scholarly tax journals on three extensive databases revealed not a single article or comment addressing this issue.[49]

Perhaps one explanation for the lack of scholarly comment is that IRS instructions are taken for granted. Generally, because tax law is so complex, tax preparers presume, with blind faith, that if entries are made as directed by the tax software (presumably tracking the relevant IRS instructions) the resulting computations will be accurate. So, if an instruction is incorrect or produces a nonsensical tax outcome it may remain undetected.

Another possible explanation is the esoteric nature of AMT investment interest expense deduction. Relatively few taxpayers are subject to AMT and, of those who are subject to

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49 The three databases were Hein Online, JSTOR and Google Scholar. The author also searched the IRS website and found nothing there remotely on point.

it, there is likely a small number that have sufficient SPAB interest income, related investment expenses as well as investment interest expenses to be affected by it. Thus, the veracity of the AMT Computational Formula may lack the relevance sufficient to attract scholarly or practical inquiry.

Finally, since tax year 2018 to date, as a consequence of the TCJA, the AMT Computational Formula has not produced the nonsensical and punitive result described in this Essay. This is because miscellaneous itemized deductions that include investment expenses (other than interest) are not allowed. [50] Per statute, the deductibility of investment expenses remain non-deductible until tax years beginning after 2025. Thus, for the past five plus years, the regular tax and AMT interest expense deduction limitation is gross investment income – unreduced because there are not currently deductible investment expenses to reduce it. Hence, the non-attention to the issue may be explained as being "out of sight, out of mind." Conversely, the current lack of relevance of the AMT Computational Formula does not explain why the issue was not discovered for tax years 2011 through 2017.

In any event, for whatever reason the veracity of 2011 IRS instruction as reworded but not changed by the 2012 IRS instruction has to date never been scrutinized by commentators or the IRS. Despite its current lack of relevance, it raises an issue that affects the integrity of the IRS in both the instruction vetting process as well as the regulatory process in ensuring that taxpayers' tax liabilities are accurately calculated in a manner consistent with the underlying tax law. Hopefully, this Essay will be a catalyst for meaningful remedial measures not just for the 2011 and 2012 IRS instruction, but other similar undiscovered flaws in other IRS instructions.

II
EXAMINATION OF THE AMT COMPUTATIONAL FORMULA PRIOR TO THE TAMRA AMENDMENT

As mentioned in the Introduction, the legislative history is clear that section 56(b)(1)(B)(ii), as enacted as part of TRA 86, was intended to create an AMT Computational Formula that was consistent with the methodology of the Regular Tax Computational Formula.[51] Hence, in Part II.A. below, prior to exploring the nuances of the AMT Computational Formula as

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50 I.R.C. § 67(g).

51 *See supra* note 30 and accompanying text.

it was prior to the TAMRA Amendment, the mechanics of the Regular Tax Computational Formula are discussed. Then, in Part II.B., there is a discussion as to how correlative AMT adjustments create parity with respect to the Regular Tax Computational Formula and the AMT Computational Formula. Finally, if Part II.C., there is an examination of the AMT Computational Formula as explained by the 1987 IRS instruction.

A. The Regular Tax Computational Formula

The regular tax investment interest expense deduction[52] is an itemized deduction[53] that is limited to the taxpayer's net investment income for the tax year.[54] Pursuant to the Regular Tax Computational Formula, net investment income is gross income from property held for investment such as interest, ordinary dividends, annuities and royalties minus deductible investment expenses (other than interest).[55] Additionally, if elected by the taxpayer, gross investment income also includes recognized net capital gain from the sale or exchange of investment property as well as qualified dividends.[56] Because the investment interest expense deduction is limited to net investment income, it can never create a "net" investment loss that would be deductible from other types of income.[57]

As an illustration, consider Scenario 1 and Scenario 2 as summarized in Table 1. Scenario 1: In 2026, when investment expenses are deductible as miscellaneous itemized deductions, Asher, a single taxpayer who itemizes deductions, has ordinary dividend income of $3,000, taxable interest income from corporate bonds of $4,000 and annuity income of $3,000, or

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52 I.R.C. § 163(d).

53 I.R.C. § 67(b)(1).

54 I.R.C. § 163(d)(1). If investment interest expenses exceed net investment income for the tax year, the non-deductible excess is carried forward to the succeeding tax year. IRC § 163(d)(2).

55 I.R.C. § 163(d)(4)(B). Deductible investment expenses (suspended until 2026) are miscellaneous itemized deductions. I.R.C. § 67(a). Pursuant to the legislative history, the investment expenses that are subtracted from gross investment income are only the amount of those expenses that exceed the 2 percent of adjusted gross income floor. H.R. CONF. REP. NO. 99-841, at 153-54 (1986).

56 I.R.C. § 163(d)(4)(B)(ii). To the extent that the taxpayer elects to treat investment net capital gain as gross investment income, it is taxed at ordinary income tax rates not preferential net capital gain rates. I.R.C. § 163(d)(1)(h)(2).

57 The likely rationale for this rule is to prevent taxpayer's from maximizing the economic benefit of generating investment income funded with borrowed funds with investment interest expense deductions that would be deductible against non-investment income.

gross investment income of $10,000. Additionally, Asher has a variety of deductible investment expenses totaling $5,000[58] and investment interest expenses of $4,000. Accordingly, Asher's net investment income is $5,000, or $10,000 of gross investment income minus $5,000 of deductible investment expenses. Since Asher's $4,000 of investment interest expenses are less than his net investment income, they are totally deductible.

Scenario 2: Same as Scenario 1, except that Asher's total gross investment income is $6,000 and, thus, his net investment income is $1,000 ($6,000 minus $5,000). Since the investment interest expense deduction limitation is $1,000, only $1,000 of Asher's $4,000 of investment interest expenses are deductible. The balance of nondeductible investment interest expenses of $3,000 are carried forward to the following tax year.[59]

Table 1 – Regular Tax Computational Formula

Asher – Single Taxpayer	**Scenario 1**	**Scenario 2**
Investment Interest Expense	$4,000	$4,000
Gross Investment Income	$10,000	$6,000
Investment Expenses	($5,000)	($5,000)
Net Investment Income – Deduction Limitation Amount	$5,000	$1,000
Deductible Amount	$4,000	$1,000
Carryforward to Succeeding Tax Year	$0	$3,000

B. Pre-TAMRA Amendment AMT Correlative Adjustments Created Parity in the Methodology of the Regular Tax and AMT Computational Formulas

Due to the TRA 86 designation of SPAB interest income as a tax preference,[60] to create parity with the Regular Tax Computational Formula, several AMT correlative adjustments are incorporated into the AMT Computational Formula. In other words, the AMT Computational Formula is essentially the Regular Tax Computational Formula as appropriately adjusted. To this point, the addition of SPAB investment income to regular investment income in the AMT

58 The amount exceeding two percent of adjusted gross income.

59 I.R.C. § 163(d)(2).

60 I.R.C. § 57(a)(5)(A).

Computational Formula requires the correlative addition of AMT deductible investment expenses related to such income to the amount of regular tax-deductible investment expenses.

To further explain this concept, for regular tax purposes, interest income paid to holders of state or local bonds, such as SPABs and municipal bonds is tax-exempt. [61] Unlike investment expenses (including investment interest expenses) related to taxable income that are deductible, investment expenses related to tax-exempt income are disallowed.[62] The rationale for the disallowance is to prevent the taxpayer from receiving an unwarranted double tax benefit. The first benefit would be the tax-exempt income and the second benefit would be the deduction of tax-exempt income related expenses to reduce other taxable income.

The designation of SPAB investment interest income as a tax preference, however, essentially converted regular tax-exempt income into taxable AMTI. Accordingly, the regular tax double benefit is eliminated, and otherwise non-deductible investment related expenses (including investment interest expenses) should be deducted from AMTI. This was accomplished through correlative adjustments made pursuant to Code sections 57(a)(5)(A) and 56(b)(1)(B).[63] First, pursuant to Code section 57(a)(5)(A), "[SPAB interest income] reduced by *any deduction* (not allowable in the computing the regular tax) which would have been allowable if such interest were includible in gross income." [64] Thus, the "adjusted" tax preference addition to AMTI is "net" SPAB investment interest income (excluding investment interest expenses).

Second, section 56(b)(1)(B), the source of the AMT Computational Formula, created parity with the Regular Tax Computational Formula stating "in determining the amount allowable as a deduction for interest, subsections (d) and (h) of

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61 Both types of bonds are excluded from regular tax gross income pursuant to I.R.C. § 103(a). SPABs are defined in I.R.C. § 141(a). Municipal bonds are issued to finance capital public projects such as building schools, roads, libraries, sewer systems, etc. In contrast, private activity bonds, or SPABs are essentially funds borrowed by state or local government to be re-loaned to private companies to fund projects that would benefit the municipality (such as building an airport or a sports facility).

62 I.R.C. § 265(a)(1)-(2).

63 STAFF OF J. COMM. ON TAX'N, *supra* note 15, at 443 ("In the case of a taxpayer who is required to include in alternative minimum taxable income any interest that is tax-exempt for regular income tax purposes, section 265 (denying deductions for expenses and interest relating to tax-exempt income) does not apply to the extent of such inclusion, for purposes of the minimum tax.").

64 "Net" SPAB is entered on line 2g, Part 1, Form 6251 (emphasis added).

section 163 shall apply . . . ."[65] Thus, the AMT investment interest expense deduction is computed per the AMT Computational Formula by simply adding SPAB investment interest income, related AMT deductible investment expenses as well as SPAB related investment interest expenses to the corresponding Regular Tax Computational Formula amounts.

C. The 1987 IRS Instructions "Adequately" Explain the AMT Computational Formula

In many instances, IRS instructions are poorly written and appear to presume (often incorrectly) that taxpayers and/or their tax preparers are fluent with the intricacies of tax law. The 1987 IRS instructions, the first instruction to "explain" the AMT Computational Formula, is no exception.[66] Nonetheless, they do provide an adequate albeit incomplete explanation of the AMT Computational Formula. The 1987 IRS instructions for line 4f of Form 6251 stated as follows:

> *If you have investment interest, refigure Form 4952 (Investment Interest Expense Deduction) through line 7 for purposes of the alternative minimum tax, and include interest expense or income relating to a private activity bond issued after August 7, 1986 [SPAB], as investment interest or income. . . . enter the amount on line 7 on line 14. Subtract your recomputed line 15 from line 15 of the Form 4952 you used for regular tax. Include that result on Form 6251, line 4f.*[67]

Consistent with section 56(b)(1)(B), the IRS instruction directs the tax preparer to "refigure" the regular tax investment interest expense deduction for AMT purposes.[68] Although far from clear, after completing a Form 4952 (Investment Expense Deduction) for regular tax purposes, the taxpayer's AMT deductible investment interest expenses are computed on, a separate "AMT" Form 4952 by redoing lines 1 through 7 of the form.[69] Specifically, on the appropriate lines, the tax preparer is directed to input "interest expense or income relating to [SPAB] as investment interest or income."[70] Notably, the

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65 I.R.C. § 56(b)(1)(C).

66 According to Art Altman, who was the chairman of the IRS's Tax Forms Coordinating following the enactment of TRA 86, developing and revising forms to conform with the new legislation was a large challenge as the IRS was required to revise over 200 existing forms and draft 40 new forms. *In Washington*, 65 Taxes 438, 438 (1987).

67 IRS, Instructions for Form 6251 (1987).

68 *Id.*

69 *Id.*

70 *Id.*

instruction fails to direct the tax preparer to include SPAB related deductible investment expenses (other than interest) to regular tax investment deductions.[71] Either this direction was inadvertently omitted, or the IRS instruction writers believed that the taxpayer or hired tax preparer would know to include those expenses in the computation of net investment income on line 6 of AMT Form 4952.

The next step directed the tax preparer to compare the investment interest expense deduction as computed on each Form 4952. Depending on the amount of SPAB investment interest income added to regular tax investment income as well as SPAB related deductible investment expenses and investment interest expenses, the AMT investment interest expense deduction was likely to be greater than the regular tax interest expense deduction. Since the computation of AMTI begins with regular taxable income, the regular tax investment interest expense deduction is already included in AMTI. Consequently, the IRS instruction directs the tax preparer to make the appropriate adjustment which in case the AMT investment interest deduction is the greater of the two, would be inputting a negative number on line 4f, Form 6251, equal to the difference between the AMT Form 4952 deductible investment interest expense deduction and the regular tax Form 4952 deductible investment interest expense deduction.

III
THE ESSAY'S TAMRA THESIS—THE TAMRA AMENDMENT EXPANDED THE AMT COMPUTATIONAL FORMULA SUBJECT TO ADJUSTMENTS

The wording of the TAMRA Amendment is "the adjustments of this section [56] and sections 57 and 58 shall apply in determining net investment income under section 163(d)."[72] Based on the brief legislative history and the wording of the TAMRA Amendment, the Essay theorizes that Congress enacted the TAMRA Amendment for two reasons: First, clause (ii) of Code section 56(b)(1)(B) only designated SPAB investment interest income as being includible as gross investment income for purposes of the AMT Computational Formula. Thus, in the absence of an amendment, if Congress were to designate other types of tax preference investment income in subsequent AMT amendments, they would not be

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71 *Id.*

72 Pub. L. No. 100-647, 1012 Stat. 3342 (1988).

included in gross investment income.[73] Second, to avoid unintended tax consequences, in conjunction with expanding AMT gross investment income to other investment income tax preferences, appropriate AMT adjustments are required to ensure that the correct amount of a given investment income tax preference is included in gross investment income.[74]

A. Expanding Gross Investment Income to Include All Investment Income Tax Preferences

As noted in the Essay, pursuant to the Regular Tax Computational Formula, the investment interest expense limitation is gross investment income minus deductible investment expenses (excluding investment interest expenses), or net investment income.[75] For AMT purposes, prior to the TAMRA Amendment, the only AMT investment tax preference specifically included in gross investment income was SPAB interest income. Accordingly, there would be no authority for the inclusion of any other type of investment income tax preference in gross investment income. The legislative history indicates that the purpose of the TAMRA Amendment is to "provides (sic) that investment income for purposes of the minimum tax takes into account the minimum tax preferences . . . ."[76] Consistent with legislative intent, the Code language states in pertinent part "the adjustments [of] section 57 . . . shall apply in determining net investment income under section 163(d)."[77]

As is relevant to this analysis, section 57 contains several items of tax preference. For example, currently, there is an investment tax preference related to realized gain on the sale or exchange of section 1202 stock (qualified small business stock). Pursuant to section 1202(a), if a taxpayer sells or exchanges section 1202 stock held for more than five years (acquired after February 17, 2009, and before September 29, 2010), 75 percent of the realized gain is excluded from gross income for regular tax purposes.[78] For AMT purposes, 7 percent of the excluded capital gain is a tax preference (Section 1202 Tax Preference).[79] In the absence of the TAMRA Amendment, if as explained below, a taxpayer elected to treat

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73 *Id.*
74 *Id.*
75 I.R.C. § 163(d)(1).
76 *See supra* note 36.
77 I.R.C. § 56(b)(1)(B)(iv).
78 I.R.C. § 1202.
79 I.R.C. § 57(a)(7).

any amount of the Section 1202 Tax Preference as investment income, it would not be considered gross investment income in the calculation of net investment income for purposes of the AMT Computational Formula. Consequently, the taxpayer would be deprived of an otherwise potential investment interest expense deduction.

To understand how this could occur, it is necessary to take a deeper dive into the definition of "gross investment income." Gross investment income is defined as income from property held for investment.[80] It also includes net capital gain with respect to disposition of property held for investment provided the taxpayer elects to treat it as gross investment income.[81] If the taxpayer so elects, the net capital gain is taxed as ordinary income.[82] Thus, if a taxpayer desires a larger investment interest expense deduction by including net capital gain in gross investment income, the tradeoff is taxation at ordinary tax rates.

To illustrate the significance of treating the Section 1202 Tax Preference as gross investment income for purposes of the AMT Computational Formula, consider the following scenario as summarized in Table 2:

In 2026, Asher who itemizes deductions, realizes a gain of $500,000 on the sale of section 1202 stock he acquired on March 1, 2009, with borrowed funds, of which $125,000 (25% of $500,000) is recognized for regular tax purposes. For AMT purposes, $26,250 is a Section 1202 Tax Preference (7% of $375,000, the amount excluded for regular tax purposes). Of the investment interest expenses Asher paid that year, $2,000 of it is allocable to the Section 1202 Tax Preference.[83] Other than investment interest expenses, Asher has no other deductible investment expenses. If Asher elects to treat $2,000 of the Section 1202 Tax Preference in gross investment income, Asher can claim an investment interest expense deduction for the related $2,000 investment interest expense.[84] Conversely,

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80 I.R.C. § 163(d)(4)(B)(I).

81 *See* I.R.C. § 163, *supra* note 56 and accompanying text.

82 *Id.*

83 I.R.C. § 265(a)(1); Treas. Reg. § 1.265-1(c) allows for the allocation of otherwise deductible expenses between taxable and tax-exempt interest. In this instance, the interest paid with respect to the purchase of the section 1202 stock is allocated between the amount excluded for both regular tax and AMT purposes and the Section 1202 Tax Preference.

84 I.R.C. § 163(d)(4)(B)(iii). The taxpayer is allowed to elect to treat as much of the net capital gain as desired. In this scenario, because Asher has $25,250 of Section 1202 Tax Preference and no deductible investment expenses (other than Investment interest), he only needs to elect to treat $2,000 of it as gross

in the absence of the TAMRA Amendment, that election would not be available because the Section 1202 Tax Preference would not be considered gross investment income.

Table 2 – Computing AMT Interest Expense Deduction Excluding and Including the Section 1202 Tax Preference

	Excluding the Section 1202 Preference	**Including the Section 1202 Preference**
Investment Interest Expenses	$2,000	$2,000
Gross Investment Income	$0	$2,000
Investment Expenses	$0	$0
Net Investment Income – Deduction Limitation	$0	$2,000
AMT Deduction	$0	$2,000

B. Appropriate AMT Adjustments Required to Determine the Amount of an Investment Tax Preference Includible in Gross Investment Income

As explained below, the treatment of regular untaxed income from the exercise of qualified incentives stock options ("ISO") as a tax preference requires correlative AMT adjustments. These adjustments are to the basis of the stock acquired by exercising the ISO as well as the amount of capital gain recognized on the subsequent sale of such stock. Since, to the extent elected, capital gain is treated as gross investment income, these adjustments are relevant to the AMT Computational Formula. Moreover, due to the inclusion of AMT ISO gain (discussed below), the AMT basis of the ISO acquired stock is greater than the regular tax basis of such stock. Consequently, the AMT capital gain or loss is also going to lower or higher, respectively, than it would be for regular tax purposes. As explained below, in the absence of the TAMRA Amendment, however, there would be no adjustment to the capital gain included as AMT gross investment income.

To elaborate, for regular tax purposes, when a taxpayer acquires stock by exercising an ISO[85] at a "bargain" price, i.e., an amount lower than the fair market value at the time the taxpayer's rights in the acquired stock become freely

investment income.

85 I.R.C. § 423(a).

transferable or no longer subject to risk of forfeiture, the spread between the fair market value of the stock and the amount the taxpayer paid for the stock is not taxable.[86] Conversely, for AMT purposes, the untaxed bargain element is treated as a tax preference and, thus is added to AMTI.[87] Because the bargain element has been subject to AMT, to prevent the taxpayer from being AMT double taxed on the same gain when the taxpayer sells the stock, the taxpayer's "AMT" basis in the stock is increased by the previously AMT taxed bargain element amount.[88] Accordingly, in the year of sale, the regular tax capital gain in AMTI is reduced by the previous AMT taxed bargain element amount – preventing it from being double taxed.[89]

To illustrate the treatment of ISOs for AMT purposes as well as the correlative adjustments, consider the following scenario as summarized in Table 3. On January 3, 2022, Asher was granted an ISO to acquire 100 shares of stock at a bargain price. On March 1, 2023, Asher acquired the 100 shares of stock with a fair market value of $100,000 for $10,000 – fully vested in Asher who is free to transfer any or all of it without restriction. Although for regular tax purposes, the bargain element of $90,000 (the excess of the fair market value minus the amount paid) is not subject to regular tax, it is subject to AMT. Consequently, to account for the gain, AMTI is increased by $90,000 and Asher's AMT basis in the unsold ISO stock is $100,000 ($10,000 paid by Asher plus the $90,000 of AMT gain). On April 5, 2024, Asher sells the stock for $150,000 and recognizes $140,000 of long-term capital gain for regular tax purposes ($150,000 minus $10,000) but only $50,000 for AMT purposes ($150,000 minus $100,000).

For simplicity, assume that Asher has no other income and investment interest expenses of $60,000 (including amounts carried over from other tax years). Without the TAMRA Amendment, Asher could elect to treat $60,000 of the $140,000 net capital gain as gross investment income, and, thus, deduct the entire $60,000 investment interest expense

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86 I.R.C. § 421(a).

87 I.R.C. § 56(b)(3).

88 *Id.* (stating in the last sentence that "[t]he adjusted basis of any stock so acquired shall be determined on the basis of the treatment prescribed by this paragraph.") *See also* Palahnuk v. Commissioner, 127 T.C. 118, 123 (2006).

89 I.R.C. § 422(a)(1). For the taxpayer to recognize a capital gain on the sale of the stock, the taxpayer must not dispose of it within the two-year period of the date the option was granted or within one year after the acquired stock was freely transferable.

for regular tax and AMT purposes. This is because in the absence of the TAMRA Amendment, there would be no requirement to adjust/reduce the regular tax net capital gain by the previously recognized AMT gain. With the TAMRA Amendment, however, for AMT purposes, the previously recognized AMT gain would be an adjustment and reduce the amount of gross investment income. So, the maximum amount of net capital gain Asher could elect to treat as gross investment income would be the $50,000 of AMT gain (the $140,000 of regular tax net capital gain reduced by the previously taxed $90,000 of ISO bargain tax gain). Consequently, Asher would only be able to deduct $50,000 of the $60,000 investment interest expense.

Table 3 – Computing AMT Interest Expense Deduction With and Without the AMT ISO Correlative Adjustments to Net Capital Gain		
	With the AMT ISO Adjustment	**Without the AMT ISO Adjustment**
Investment Interest Expenses	$60,000	$60,000
Gross Investment Income	$50,000[90]	$60,000[91]
Investment Expenses	$0	$0
Net Investment Income – Deduction Limitation	$50,000	$60,000
AMT Deduction	$50,000	$60,000
Carry Over Deduction	$10,000	$0

To summarize the Essay's TAMRA Amendment thesis, its purpose was to tweak the AMT Computational Formula by: (1) expanding AMT gross investment income beyond SPAB investment interest deduction to include all types of investment income tax preferences that Congress might add in the future, and (2) requiring appropriate correlative adjustments be made in determining the amount of investment tax preference income to be included in AMT gross investment income.

IV
THE 1988 IRS INSTRUCTION CONSISTENT WITH TAMRA AMENDMENT CLOSES AN AMT LOOPHOLE

This part of the Essay explains how the 1988 IRS instruction, consistent with the TAMRA Amendment, closed a loophole in the pre-TAMRA Amendment version of section

56(b)(1)(B). In doing so, a scenario is posed in which the AMT outcome pursuant to the pre-TAMRA 1987 IRS instruction is compared to the outcome under the post-TAMRA Amendment 1988 IRS instruction.

The analysis begins with the 1988 IRS instruction which stated as follows:

> *When computing line 2 [AMT Form 4952, Investment income minus investment expenses], recompute your gross investment income, any net gain attributable to the disposition of property held for investment and investment expenses taking into account all AMT adjustments and tax preference items that apply. Include any interest income and investment expenses from [SPAB].*[90]

Notably, the 1988 IRS instruction directs the tax preparer to "recompute" gross investment income with respect to every type of gross investment income – including tax preference investment income including, if applicable, the elected amount of net capital gain from the disposition of investment property. This is consistent with the first prong of the Essay's TAMRA Amendment thesis that its intended purpose was to expand AMT gross investment income beyond SPAB investment interest income to include any type of investment income tax preference.[91]

As relevant to this discussion, in sync with the second prong, per the IRS instruction, the determination of the amount of such tax preferences to include in gross investment income requires all applicable AMT adjustments. Notably, the 1987 IRS instruction did not require any AMT adjustments.[92]

The difference between the pre-TAMRA Amendment AMT Computational Formula per section 56(b)(1)(B) as explained by the 1987 IRS instruction and the TAMRA Amendment computation as explained by the 1988 IRS instruction is illustrated pursuant to following scenario as summarized in Table 4.

In 2026, when investment expenses are deductible as miscellaneous itemized deductions, Asher who itemizes deductions, has $22,000 of net capital gain from the sale of ISO acquired stock, deductible investment expenses of $4,000 and investment interest expenses of $6,000. Additionally,

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90 IRS, Instructions for Form 6251 (1998).

91 Also, the last sentence "include any interest income and investment expenses from [SPAB]" is an additional indication that gross investment income includes any investment income tax preference. *Id.*

92 IRS, Instructions for Form 6251 (1987).

Asher has $6,000 of SPAB interest income, $3,000 of related investment expenses and $3,000 of related investment interest expenses. Significantly, because Asher's AMT basis in the ISO acquired stock was much higher than his regular tax basis, Asher recognized an AMT $40,000 net capital loss. Asher elects to treat $10,000 of his regular tax net capital gain as gross investment income.

Pursuant to section 56(b)(1)(B) prior to the TAMRA Amendment and the 1987 IRS instructions, no provision in the Code would preclude Asher from electing to treat $10,000 of his net capital gain from the sale of ISO acquired stock as gross investment income. Yet, for AMT purposes, despite a net capital loss of $40,000 attributable to the sale of that same ISO acquired stock, his gross investment income would be $16,000 (regular tax gross investment income of $10,000 plus $6,000 of SPAB investment interest income). Clearly, this should not be the result as with an AMT net capital loss, electing to treat any of his regular tax capital gain in AMT gross investment income would be inappropriate. Prior to the TAMRA Amendment that was possible, however, because the 1987 IRS instruction did not require an AMT adjustment to preclude the inclusion of regular tax capital gain in AMT gross investment income when for AMT purposes, there was a net capital loss.

Conversely, per the TAMRA Amendment as explained by the 1988 IRS instruction, because of an AMT capital loss, triggered by the AMT adjustment, there would be no net capital gain to be elected by Asher to include as AMT gross investment income. Consequently, in this scenario, Asher's AMT gross investment income is limited to the $6,000 of SPAB investment interest income.

Therefore, as illustrated by Table 4, below, pursuant to the 1987 IRS instruction, despite having a net capital loss, by Asher making the regular tax election to treat $10,000 of net capital gain as gross investment income, Asher would have sufficient net investment income to deduct the entire combined total of regular tax and AMT investment income expenses. Pursuant to the 1988 IRS instruction, however, Asher's gross investment income would be limited to the $6,000 of SPAB investment interest income. With combined regular tax and AMT deductible investment expenses of $7,000, lacking any net investment income, Asher could not deduct any of the investment interest expenses. Clearly, the TAMRA Amendment/1988 IRS instruction outcome correctly prevents Asher from receiving the double tax benefit he would have received prior to the TAMRA Amendment, i.e., no AMT net

capital gain and an AMT investment interest expense deduction enhanced by regular tax net capital gain.

Table 4 – Comparing Pre-TAMRA Amendment (1987 IRS Instructions) to TAMARA Amendment (1988 IRS Instructions)
AMT Interest Expense Deduction

Taxpayer	**Regular Computational Formula**	**1987 IRS Instruction AMT Computational Formula**	**1988 IRS Instruction AMT Computational Formula**
Investment Interest Expenses	$6,000	$9,000	$9,000
Gross Investment Income	$10,000[92]	$16,000[93]	$6,000[94]
Investment Expenses	($4,000)	($7,000)	($7,000)
Net Investment Income – Deduction Limitation	$6,000	$9,000	$0
Final Investment Interest Expense Deduction	$6,000	$9,000	$0
Carry Forward to Subsequent Tax Year	N/A	N/A	$9,000

V
THE 2011 IRS INSTRUCTION APPARENT MODIFICATION OF THE AMT COMPUTATIONAL FORMULA

As discussed throughout this Essay, the 2011 IRS instruction (as well as the 2012 IRS instruction) apparently completely revised the 1988 IRS instruction by creating a nonsensical and punitive version of the AMT Computational Formula. Such a change suggests three possibilities: (1) for reasons unknown, undetected in the vetting process, the IRS instruction writers poorly reworded the 1988 IRS instruction without intending to alter the AMT Computational Formula, (2) the IRS instruction writers went very rogue and radically changed the AMT Computational with neither the 2011 nor 2012 IRS instructions being properly vetted, or (3) beyond the realm of the IRS instruction vetting process, the IRS decided to

go rogue and resorted to publishing the 2011 IRS instruction as a surrogate for a Treasury regulation that would have required notice to the public followed by a comment period.

Regardless of which of the three possibilities is correct, clarification is required. In this part of the Essay the substance of the 2011 IRS instruction is examined.[93] Unlike the 1988 IRS instruction, the 2011 IRS instruction directs the tax preparer to another line-item entry on the Form 6251, line 2g (interest from specified private activity bonds exempt from regular tax). The IRS instruction for line 2g states as follows:

> *Enter on line 2g interest income from "specified private activity bonds" reduced (but not below zero) by any deduction that would have been allowable if the interest were includible in gross income for the regular tax. Each payer of this type of interest should send you a Form 1099-INT showing the amount of this interest in box 9.*

The amount of line 2g is net SPAB investment interest income that is added to AMTI. Next, IRS instruction 2c, 2011 Form 6251 states as follows:

> *Include on line 4a [of an AMT Form 4952) any tax-exempt interest income from private activity bonds that must be included on Form 6251, line 12. If you have any investment expenses that would have been deductible if the interest on the bonds were includible in gross income for the regular tax, you can use them to reduce the amount on line 4a or include them on line 5.*[94]

Note the IRS instruction directs the tax preparer to input on line 4a (gross income from property held for investment), AMT Form 4952, the 2g, Form 6251 entry. That entry is "net" SPAB interest income. This is a significant change from the 1988 IRS instruction which directed the tax preparer to enter SPAB interest income as gross investment income and related expenses as deductible investment expenses. Conversely, by adding net, not gross SPAB interest income to regular tax gross investment income, this entry is essentially "net" SPAB investment income, the first reduction of AMT deductible investment interest expenses.[95] Continuing with the

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93 For the purposes of this discussion, the analysis is of the 2012 IRS instruction – a poor revision of the 2022 IRS instruction that achieves the same outcome. Since the radical change originated in the 2011 IRS instruction, the 2012 IRS instruction is referred to as the 2011 IRS instruction.

94 IRS, Instructions for Form 6251 (2012).

95 If the computation was done properly, SPAB interest income related investment expenses would have been added to regular tax investment expenses to be subtracted from all combined gross investment income.

computation, the 2011 IRS instruction states: "if you have any expenses that would have been deductible if the interest on the bonds were includible in gross income, you can use them to reduce the amount on line 4a [AMT Form 4952] or include them on line 5 (investment expenses) [AMT Form 4952]."[96]

The 2011 IRS instruction directing the tax preparer to either "reduce the amount of line 4a" or "include them on line 5" by subtracting or adding SPAB related investment expenses is confusing.[97] Since net SPAB investment interest income was entered on AMT Form 4952 as "gross investment income" there would be no reason to either reduce "net gross SPAB investment interest income" inputted as gross investment income or to increase investment expenses. Either way achieves the same second reduction of SPAB interest income related investment expenses. In other words, reducing gross investment income on line 4a by SPAB related investment expenses would be the second reduction of gross SPAB interest income. Alternatively, increasing investment expenses on line 5 by SPAB related investment expenses would also result in a second reduction.[98] This outcome the consequence of the double reduction of investment expenses is absurd, unduly punitive, and inconsistent with more rational Essay's TAMRA Amendment thesis.

The following scenario as summarized in Table 5 illustrates the difference between the AMT Computational Formula single reduction of SPAB related investment expenses per the 1988 IRS instruction and the double reduction of such expenses per the 2011 IRS instruction. In 2026, when investment expenses are deductible as miscellaneous itemized deductions, Asher who itemizes, has regular taxable investment income of $5,000 and related to such income, investment expenses of $2,000 and investment interest

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96 IRS, Instructions for Form 6251 (2012). The relevant language from the 2011 IRS instruction was as follows: "include on line 4a [AMT Form 4952] any tax-exempt interest income that must be included on Form 6251, line 12 [net SPAB interest income]. If you have any investment expenses that would have been deductible if the interest on the [SPABs] were includible in gross income for the regular tax, include them on line 5."

97 IRS, Instructions for Form 6251 (2012).

98 Another confusing aspect of the instruction is the word "use" the SPAB interest income related expenses in connection with the double reducing of SPAB related investment expenses. In the 2011 IRS instruction, the word was "include" such expenses. A possible explanation is that in the 2011 IRS instruction, the SPAB interest income related expenses were to be added to regular investment expenses. Conversely, in the 2012 IRS instruction, there is the option to reduce from gross investment income or add to investment expenses. So, perhaps "use" is more descriptive of either or.

expenses of $2,000. Additionally, Asher has SPAB interest income of $6,000, investment interest expenses of $2,000 related to such income and investment interest expenses of $3,000 related to purchase or carrying of the SPAB.

If Asher's AMT investment interest expense deduction limitation was computed pursuant to the 1987 IRS instruction, Asher's combined net investment income would be $6,000, or $11,000 ($5,000 regular taxable investment interest income plus $6,000 SPAB interest income) minus $5,000 ($2,000 regular tax-deductible investment expenses plus $3,000 AMT deductible investment expenses related to the SPAB investment interest income). Accordingly, because Asher's aggregate amount of investment interest expenses is $5,000 and the aggregate amount of net investment income is $6,000, the deductible AMT investment interest expense deduction would be the entire $5,000.

Conversely, as the table below reveals, per the 2011 IRS instruction, the double reducing of SPAB related deductible investment expenses deprives Asher of $1,000 of what should have been his entire $5,000 deductible amount of investment interest expenses. Although Asher's regular tax gross investment income was increased by $6,000 of SPAB interest income, however, due to the double reduction of the SPAB deductible investment interest expenses, the net amount of investment income was $2,000 less than it would have been if only reduced one time. This nonsensical result wrongfully deprives Asher of a deduction of all his investment interest expenses.

Table 5 – Comparing the AMT Computational Formula Per the 2011 IRS Instruction and the 1988 IRS Instruction in Determining the Investment Interest Expense Deduction

Taxpayer	Regular Tax Form 4952	AMT Form 4952 Adjustments 2011 IRS Instruction	AMT Form 4952 Adjustments 1988 IRS Instruction	AMT Form 4952 2011 IRS Instruction	AMT Form 4952 1988 IRS Instruction	Difference Between Column 3 and Column 4
Line 1 - Investment Interest Expense	$2,000	$3,000	$3,000	$5,000	$5,000	$0
Line 4a – Gross Investment Income	$5,000	$4,000[98]	$6,000[99]	$9,000[100]	$11,000[101]	($2,000)[102]
Line 5 - Investment Expenses	($3,000)	($2,000)[103]	$0	($5,000)[104]	($5,000)[105]	$0
Line 6 - Net Investment Income - Deduction Limitation	$2,000	N/A	N/A	$4,000[106]	$6,000[107]	($2,000)[108]
Line 8 – Deductible Amount	$2,000	N/A		$4,000[109]	$5,000[110]	($1,000)
Line 7 - Carryforward to Succeeding Tax Year	$0	N/A		$1,000[111]	$0	$1,000

VI
THE AMT COMPUTATIONAL FORMULA - ONE OF MANY COMPLEX AMT ADJUSTMENTS TO AMTI INPUTTED ON FORM 6251

The following discussion briefly highlights the complexity of Form 6251 in the computation of AMT and the necessity and importance of clear and concise IRS instructions to complete it accurately. As mentioned in the Introduction, despite being labelled as "a separate and independent tax system,"[99] AMT is essentially an add-on tax on top of regular income tax. In other words, if a taxpayer's AMT is greater than regular tax, the taxpayer is obligated to pay the additional amount.[100]

Computed entirely on Form 6251, beginning with regular taxable income and in conjunction with the preparation of interrelated computational forms and schedules, positive and negative adjustments are made in arriving at AMTI – the AMT tax base. In Part 1 of Form 6251, there are over twenty potential AMT adjustments that may increase or decrease AMTI. One potential adjustment is the AMT Computational Formula.[101] As another example, on line 2l, Part 1, Form 6251, the IRS instruction directs the taxpayer to input the difference between the regular tax depreciation computed pursuant to 200% declining balance depreciation ("MACRS") and AMT depreciation computed pursuant to 150% declining balance depreciation deduction.[102] If the regular tax depreciation deduction is greater than the AMT depreciation deduction, the adjustment is negative. Conversely, if the AMT deduction is greater than the regular tax depreciation deduction, the adjustment is positive.[103] Although the actual adjustment is relatively straightforward, due to the possibility of double counting depreciation deductions, there are several complicating twists. This is because depreciation deductions are relevant in a variety of loss limitation computations that may differ for regular tax and AMT purposes. To avoid the

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99 I.R.C. § 168(b)(1).

100 I.R.C. § 55(a).

101 IRS, Form 6251 Line 2c, Part 1.

102 I.R.C. § 56(a)(1)(A)(ii).

103 IRS, Instructions for Form 6251 (2022). This adjustment is made on line 2l, Part 1, Form 6251. If the AMT depreciation deduction is less than the regular tax depreciation deduction, the difference is an addition to AMTI. In the early years of the recovery period, due to the higher depreciation rate, the regular tax depreciation deduction is greater than the AMT depreciation deduction. Conversely, in the later years of the recovery period, once the depreciation rate shifts from declining balance to straight line, the AMT depreciation deduction is greater than the regular tax depreciation deduction. In that instance, the difference is a reduction from AMTI.

double counting of those deductions on Form 6251, the depreciation adjustment with respect to loss limitations are not made on line 2l. Instead, the IRS instruction directs the taxpayer to other line-item entries on the form in which to make the appropriate AMT depreciation deduction adjustments.[104]

For example, deductions (including depreciation) generated by partnerships and S corporations are passed through to partners[105] and shareholders,[106] respectively to be claimed on their individual income tax returns. In both instances, pass-through deductions are limited to a partner's outside basis[107] and shareholder's stock basis,[108] respectively. Consequently, due to the difference between AMT depreciation and regular tax depreciation, a partner's and a shareholder's distributive share of allowable depreciation deductions for each tax year as well as corresponding adjustments of outside basis and stock basis would be different.[109] Thus, the depreciation deduction adjustment affecting the taxation of partners and S corporation shareholders is not made on line 2l.

Other complex AMT adjustments are made by completing a regular tax form a second time just for AMT purposes. Often these AMT versions of the form are used to re-compute a particular loss limitation amount. For example, as relevant to this Essay, the regular tax investment interest deduction is computed on Form 4952.[110] For regular tax purposes, investment expenses including interest expenses paid to purchase or carry tax-exempt state or local bonds (such as SPABs) are not deductible.[111] For AMT purposes, however, SPAB interest income is included in AMTI and related investment expenses including investment interest expenses

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104 IRS, Instructions for Form 6251 (2022). To this point, the line 2l IRS instructions direct the taxpayer to make AMT depreciation deduction adjustments in computing passive income and deductions on line 2m. AMT depreciation deduction adjustments applicable to the at-risk rules are made on line 2n. Similarly, AMT depreciation deduction adjustments applicable to flow through income and loss flowing to shareholders and partners from S corporations and partnerships, respectively are also made on line 2n.

105 I.R.C. § 702(a)(7).

106 I.R.C. § 1366(a)(1)(A).

107 I.R.C. § 704(d).

108 I.R.C. § 1366(d).

109 *See* I.R.C. § 59(h). The partner/corporation loss limitation adjustment is made on line 2m, Part 1, Form 6251.

110 I.R.C. § 163(d)(1). The investment interest expense is limited to net investment income.

111 I.R.C. § 265(a)(1) and (2).

are deductible from AMTI. [112] Consequently, the IRS instructions direct the taxpayer to prepare an "AMT" Form 4952 on which to re-compute the investment interest deduction including all these items. The difference between the investment interest expense computed on the AMT Form 4952 and the regular tax Form 4952 would be a positive or negative adjustment to AMTI.[113]

Beyond the AMT computational examples discussed above there are many others of equal complexity. Ironically, a recurring theme in the Form 6251 IRS instructions is avoiding double counting or duplication of AMT adjustments or preferences in the completion of Form 6251.[114] Yet, the 2011 IRS instruction regarding the AMT investment interest deduction does the opposite by double counting AMT deductible investment expenses to produce a nonsensical and punitive tax outcome to the taxpayer.

CONCLUSION

IRS instructions properly vetted by the TFCC review process directing taxpayers and their hired tax preparers how to prepare tax returns that correctly compute the taxpayers' tax liability are essential. Often with blind faith, the accuracy of those instructions is presumed to be correct without scrutiny. Importantly, the IRS should not use the instruction process to issue an IRS instruction that is essentially a surrogate for a Treasury regulation. Thus, an erroneous IRS instruction that was not property vetted or an IRS instruction that functions as a surrogate for a Treasury regulation impugn the integrity of the Code.

In illustrating the seriousness of the issue this Essay has focused on the 2011 IRS instruction that without explanation radically altered the AMT Computational Formula twenty-three years after the source of the instruction, section 56(b)(1)(B) was amended by the TAMRA Amendment. The altered AMT Computational Formula was not only contrary to the TAMRA Amendment (that is consistent with the 1988 IRS instruction published during the effective tax year of the TAMRA Amendment), but also produced a nonsensical tax outcome that deprives the taxpayer of an otherwise allowable

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112 I.R.C. § 57(a)(5).

113 IRS, Form 6251 Line 2c, Part 1.

114 *See*, IRS, Form 6251, Line 2n, Part 1 ("To avoid duplication, any AMT adjustment or preference item taken into account on this line shouldn't be taken into account in figuring the amount to enter on any other adjustment or tax preference item line of this form.").

investment interest expense deduction. Based on years of non-comment by the IRS and no supportive legislative history suggesting such a change, the 2011 IRS instruction (slightly altered by the 2012 IRS instruction) that remains on Form 6251 is rogue, unacceptable and should be considered invalid *ab initio*.

Conversely, this Essay's TAMRA Amendment thesis expresses a rational interpretation of the TAMRA Amendment. According to the thesis, in the absence of the TAMRA Amendment, for purposes of the AMT Computational Formula, gross investment income and deductible investment expenses would be limited to gross SPAB interest income and related deductible investment expenses, respectively. Consequently, the TAMRA Amendment expanded the definition of gross investment income to include any type of tax preference investment income that Congress might include in the future. Correlatively, in determining the correct amount of tax preference income to include, the TAMRA Amendment requires appropriate AMT adjustments to be made.

Based on the foregoing, this Essay recommends the following: (1) if the 2011 IRS instruction and 2012 IRS instruction were simply poorly worded and were not intended to radically alter the AMT Computational Formula, it should be withdrawn and replaced by a clear and concise version of the 1988 IRS instruction; (2) if the IRS instruction writers went rogue and the 2011 IRS instruction and 2012 IRS instruction was not properly vetted, it should be withdrawn and replaced as described in (1) above; or (3) if the IRS intended to make such a radical change, the IRS, consistent with the Treasury's recent policy commitment to the regulatory process as the optimal means of conveying tax law interpretation to taxpayers, should promulgate interpretative Treasury regulations (including notice and comment period) with computational examples.[115]

Finally, despite the suspension of the deductibility of investment expenses until 2026 and, thus, the 2011 and 2012 IRS instructions have no current effect on AMT Computational Formula, the resolution of the issue in accordance with the above stated recommendations is important for several reasons. First, it will become relevant in 2026 or in whatever year such miscellaneous itemized deductions are made allowable by Congress. Second, regardless of the tax effect, to

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115 *See* DEPARTMENT OF THE TREASURY, POLICY STATEMENT ON THE TAX REGULATORY PROCESS, *supra* note 43.

preserve the integrity of the Code, IRS instructions should not be inserted into tax forms and schedules unless they are properly vetted in the review process - never to serve as a surrogate for a Treasury regulation. More generally, if a decision to radically modify an IRS instruction is being considered, for whatever reason, it should be made through the regulatory process. In any event, whether this Essay's TAMRA Amendment thesis is correct or incorrect, the AMT Computational Formula is muddled with uncertainty. In the final analysis, pursuant to the Taxpayer Bill of Rights, taxpayers have the right to clear and accurate explanations of tax law.[116]

116 *See id.*