Sparrow v. Commissioner, 86 T. C. 929 (1986)

When calculating the alternative minimum tax, the 'regular tax' must reflect the tax actually imposed after applying income averaging provisions.

Summary

In Sparrow v. Commissioner, the taxpayers used income averaging to reduce their 1980 tax liability but incorrectly calculated their alternative minimum tax (AMT) by using a higher 'regular tax' figure without income averaging. The U. S. Tax Court ruled that for AMT purposes, the 'regular tax' must be the tax as limited by income averaging, not a hypothetical tax without it. This decision clarified that the tax 'imposed' by the Internal Revenue Code, which includes reductions from income averaging, is the correct figure to use in AMT calculations, ensuring that taxpayers cannot manipulate AMT liability by ignoring elected tax benefits.

Facts

William and Lydia Sparrow elected to use income averaging on their 1980 tax return to reduce their tax liability due to a significant capital gain. They reported an adjusted gross income of $57,956, of which $38,140 was from long-term capital gains. After applying income averaging, their tax liability was $10,348. However, when calculating their AMT, they used a 'regular tax' of $13,329, which was calculated without income averaging, resulting in no AMT due. The IRS reassessed their tax using the $10,348 figure, determining an AMT deficiency of $1,865. 25.

Procedural History

The Sparrows filed a petition with the U. S. Tax Court challenging the IRS's determination of their AMT liability. The case was submitted fully stipulated, and the court heard arguments on the proper calculation of 'regular tax' for AMT purposes.

Issue(s)

1. Whether the 'regular tax' for purposes of calculating the alternative minimum tax should reflect the tax liability after applying income averaging provisions.

Holding

1. Yes, because the statutory language defines 'regular tax' as the tax 'imposed' by the Internal Revenue Code, which includes the tax as limited by income averaging provisions under section 1301.

Court's Reasoning

The court emphasized that section 55 of the Internal Revenue Code, which governs AMT, defines 'regular tax' as the taxes 'imposed' by Chapter 1 of the Code. Since

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the Sparrows elected income averaging under section 1301, the tax 'imposed' by section 1 was the tax as reduced by income averaging. The court rejected the taxpayers' argument that they should use a higher 'regular tax' figure to avoid AMT, stating that the statutory language was clear and required using the tax actually imposed. The court also noted that the legislative history of section 55 aimed to ensure a minimum tax on large capital gains, which supported their interpretation. The court concluded that the Sparrows' method of calculating AMT was contrary to the statutory purpose and language.

Practical Implications

This decision clarifies that taxpayers must use the tax as reduced by income averaging when calculating AMT, preventing them from manipulating their AMT liability by using a hypothetical tax without income averaging. Practitioners should ensure that clients' AMT calculations reflect all elected tax benefits, including income averaging. This ruling may impact how taxpayers with significant capital gains approach their tax planning, as it confirms that AMT cannot be avoided by ignoring income averaging. Subsequent cases have followed this precedent, reinforcing the principle that 'regular tax' for AMT purposes must reflect the tax actually imposed by the Code.

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