

ALTERNATIVE MINIMUM TAX – HAS IT BITTEN YOU YET?

Alternative minimum tax (AMT) rules were devised to ensure that at least a minimum amount of income tax is paid by high-income taxpayers who receive large tax savings by making generous use of certain tax deductions and exemptions. Who is considered “high income” may surprise you. Of the taxpayers hit by the alternative minimum tax in 1998, 27 percent had **adjusted gross income under \$100,000**. Those percentages are increasing each year and many taxpayers are being caught unaware.

Alternative minimum tax is an **extra tax** that is paid on top of the regular income tax. Essentially, AMT requires a second tax calculation after you have already determined your regular income tax. For AMT, certain deductions are not allowed and other items need to be added to income.

The calculation of AMT is a very complicated area of the tax law. You begin with your regular taxable income and then you add back certain deductions and exemptions that are not allowed for AMT. Some of the major deductions that are added back are the following:

- State and local income taxes
- Miscellaneous itemized deductions subject to the 2% floor
- Medical expenses are allowed only in excess of 10% (in lieu of 7.5%) of adjusted gross income
- Personal exemptions
- Standard deduction
- Depreciation adjustments
- Certain interest adjustments.

In addition, when calculating AMT there are items that must be added that are not considered income for regular tax purposes. Some of the major items are:

- Tax-exempt interest on private activity bonds
- Bargain element when exercising Incentive Stock Options.

Sometimes, with **proper planning**, you can **avoid the AMT tax**. For example, if you know that you will be liable for AMT in a given year then you may want to delay payment of disallowed deductions until after the end of the year. This can frequently be done with medical expenses, state taxes, and miscellaneous deductions. If you invest in tax-exempt bonds, then avoid those that are considered to be private activity bonds. If you have Incentive Stock Options through work you may be able to plan the exercise amounts from year to year to avoid AMT from kicking in.

Even with proper planning there are times that you just cannot avoid AMT. If you are in this situation then **use AMT to your advantage**. The top tax rate for AMT is 28%. If you are normally in a marginal income tax rate for regular tax purposes that is higher than 28%, then it makes sense to try to bring more ordinary income into the AMT year so that you only pay tax at 28%.

There is a credit in future years against regular tax for AMT paid, but only for certain items, such as when Incentive Stock Options are exercised. The AMT caused by disallowance of ordinary itemized deductions does not result in the credit.

It is very important to look at both the current year and next year to adequately plan the timing of deductions and income to avoid or lessen AMT.