

ALTERNATIVE MINIMUM TAX

WHAT IS IT

The Alternative Minimum Tax (AMT) was originally designed by Congress to ensure that wealthy individuals could not avoid paying income tax by exploiting weaknesses in the tax code. AMT and regular tax calculations are performed concurrently and whichever tax is higher determines the actual liability. Both individuals and corporations can be subject to AMT. When first introduced in 1969 few were affected by this separate parallel system of taxation, however, by 2010 close to one third of all taxpayers may be affected by it because it is not indexed for inflation.

WHAT CAUSES IT

Here are some of the most common items that affect AMT.

1. **EXEMPTIONS** – are not allowed for AMT. Under regular tax calculations for 2006 a taxpayer is allowed a \$3,300 deduction each for himself, spouse and dependents.
2. **STANDARD DEDUCTION** – If taxpayers do not have enough deductions to itemize they can use this deduction to reduce their taxable income for regular tax purposes but not for AMT.
3. **STATE AND LOCAL TAXES** – Any state income tax, real estate property tax, or excise tax used as an itemized deduction is not deductible for AMT.
4. **MORTGAGE INTEREST ON SECOND MORTGAGES AND HOME EQUITY LOANS** – is not allowed for AMT unless the funds were used to purchase or improve your home.
5. **MEDICAL EXPENSES** - are allowed but the 7.5% limitation for regular tax is increased to 10% for AMT.
6. **MISCELLANEOUS ITEMIZED DEDUCTIONS** - are not allowed for AMT. Examples of these deductions are unreimbursed employee expenses, investment expenses, and tax preparation fees.
7. **TAX-EXEMPT INTEREST** - Interest received from private activity bonds are not tax exempt for AMT.
8. **LONG-TERM CAPITAL GAINS** – Because these gains are also included for AMT they can reduce or eliminate the AMT exemption amount that is designed to protect low-income taxpayers from having to pay AMT tax.
9. **DEPRECIATION** – AMT causes some depreciation to be expensed over longer periods of time thereby reducing the deduction in the current year and increasing the deduction in later years.

10. **INCENTIVE STOCK OPTIONS** – The difference between the amount paid for the option and the fair market value of the option at the exercise date is includible in income for AMT purposes.

11. **VARIOUS CREDITS** – Some tax credits allowed for regular tax purposes are either reduced or eliminated for AMT purposes (e.g. child tax credit, dependent care credit, adoption credit, and hope and lifetime learning credits)

The AMT credit may be able to reduce tax liabilities in future years if the AMT adjustments are a timing difference and not a permanent difference. However, only Items 9 and 10 above are considered timing differences.

Please contact our office if you would like more information on how AMT might affect you.