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WHAT is AMT AND HOW DOES IT AFFECT ME?

Alternative minimum tax (AMT) was originally created 40 years ago to capture tax on the most wealthy of Americans who were avoiding paying taxes via various tax shelters and schemes. It was broadened to its current form in the 1980s under President Reagan.

AMT is based on a parallel tax calculation that computes tax liability two ways. The calculation typically works with the same data that's used to compute taxpayers' "regular tax," but with adjustments, exclusions and different rates (details below). After both calculations are complete, the taxpayer is required to pay the higher of the two amounts.

Fifteen years ago, only individuals with unique transactions paid AMT. Today, however, the majority of taxpayers with incomes between $200,000 and $650,000 pay AMT.

How is it computed?

The AMT calculation differs from regular tax calculation in two ways:

- **Adjustments to taxable income** - The most common adjustment is where tax write-offs are added back, they aren't deductible for AMT purposes (i.e. state income, real estate, ad valorem, etc.) Also, personal exemptions aren't a deduction for AMT purposes either. For many taxpayers subject to AMT, those are often the only adjustments they'll have. Other common adjustments include: miscellaneous itemized deductions, depreciation, incentive stock options, private activity municipal bond interest, and intangible drilling costs.
- **How the computation is calculated** - There are two unique parts to the AMT tax calculation. First, taxpayers receive a large AMT exclusion ($74k in 2011) that phases out as income levels rise. Second, the tax rates for AMT only have two brackets (26 and 28 percent).

Why am I affected? What can I do?

There were several reasons for the sharp increase in the last decade regarding the number of taxpayers affected by AMT. Surprisingly, the biggest factor was tax cuts. The "Bush tax cuts" reduced regular tax rates to historic lows. Unfortunately, however, the cuts didn't affect AMT rates. Therefore, in a system where the taxpayer pays regular or AMT tax based on whichever is highest, the reduction in regular tax caused a massive number of taxpayers to owe AMT.

Today, as we look at potential tax increases discussed on a daily basis, the pendulum could easily swing back to the point where regular tax again exceeds AMT. Obviously, that isn't a solution anyone looks forward to.

Unfortunately, there isn't much planning that can be done to avoid AMT when a taxpayer has income levels within the ranges described above. However, when a taxpayer faces circumstances that may cause their income levels to drop below or rise above this range, planning opportunities emerge. They may include maximizing deductions not allowed by AMT during these years by bunching multiple years' expenses into one year. A year-end tax-planning discussion with your tax advisor is always best to cover these types of topics.

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