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The Alternative Minimum Tax (AMT) was introduced as part of the Tax Reform Act of 1969. Its original purpose was to target 155 high income households that owed little or no income tax because of various preferences and incentives under the regular tax system. Because the AMT is not permanently indexed for inflation, however, the number of households paying AMT ballooned to over 4 million in 2007, and absent a one year patch, over 25 million taxpayers would have paid AMT in 2008.

The American Recovery and Reinvestment Act of 2009 added a patch for 2009 to prevent another 26 million taxpayers from being ensnared by the AMT. One of the legislative items for the current Congress is to establish a permanent solution for the AMT, either through indexing for inflation or total repeal.

How does this tax work? The AMT functions as a parallel tax system to the regular income tax, which you are likely familiar with. Taxpayers must calculate both their regular income tax and their AMT and pay the higher of the two taxes. In simple terms, here's what an AMT calculation looks like:

- First determine your taxable income under the regular tax system.
- Add back your personal and dependent exemptions (\$3,650 each in 2009).
- If you do itemize, add back deductions received for state and local income taxes, state and local sales taxes and property taxes. Also add home equity loan interest if the proceeds were not used for home improvements.
- The AMT also excludes miscellaneous itemized deductions, which include things like employee business expenses, investment management fees, etc.

Once these items have been added back to your regular taxable income, you get to deduct the AMT exemption, which in 2009 is \$70,950 for joint filers and \$46,700 for single filers. This exemption is reduced by 25 cents for each dollar of AMT taxable income above \$150,000 for married couples and \$112,500 for singles.

After the exemption is applied, the resulting number is called Alternative Minimum Taxable Income (AMTI). This number is subject to AMT rates, which are 26% on the first \$175,000 and 28% on the excess. Also, the preferential rates for net capital gain and dividends used for the regular tax are used in the AMT calculation. The number that is calculated using the AMT tax

rates is called your Tentative Minimum Tax (TMT). If the TMT is higher than your regular tax, you pay the higher amount. If your regular tax bill is higher, you do not pay AMT. In a simple equation format, here's what it looks like:

Regular taxable income + Disallowed deductions – AMT exemption = AMTI x tax rates = TMT

If TMT > regular tax, pay AMT. If TMT < regular tax, pay regular tax.

What causes so many people to pay AMT? There are two main reasons for the increase in the number of taxpayers affected by the AMT. First, the regular income tax is indexed for inflation, but the AMT is not. Over time, this has reduced the difference between regular income tax liabilities and AMT liabilities, and this difference will only become more pronounced if the AMT isn't permanently indexed for inflation. Secondly, the 2001 and 2003 marginal rate reductions of the regular income tax have further narrowed the differences between regular and AMT tax liabilities. The combination of these two factors means that, without legislative changes, there will continue to be significant growth in the number of taxpayers affected by AMT.

What are common characteristics that AMT taxpayers share? Although every individual's situation is unique, generally speaking, taxpayers who live in high tax jurisdictions such as California, New York, and Oregon are more likely to be in AMT because taxes paid are not deductible under the AMT system. In addition, taxpayers who generate the majority of their taxable income from qualified dividends and capital gains are more likely to be in AMT, because although the preferential rate is the same for AMT and regular tax payers, many deductions are lost for AMT purposes. This makes AMT taxable income higher which, when applied to the same tax rate, will make AMT higher than the regular tax.

Is there anything that can be done to minimize AMT exposure? Setting aside politics and value judgments, AMT is not inherently bad. In some cases, based on a taxpayer's particular circumstances, there is little to no planning we can undertake to minimize or eliminate AMT. In other situations, however, taxpayers often have ample opportunity to plan their affairs in a way that minimizes or eliminates AMT. What does Brighton Jones do about AMT? Because we have strong expertise regarding the inner workings of the AMT, we will always make sure we consider its impact on our clients' specific situations and do our best to minimize or eliminate it.

We hope this article has helped shed some light on this often discussed and much maligned tax system.