



Paying the IRS - Individual Alternative Minimum Tax

As if the regular federal income tax rules aren't complicated enough, you also may have to cope with a shadow tax system called the alternative minimum tax (AMT). Although it was originally designed to exact a minimum amount of tax from taxpayers who take advantage of complex tax shelters and big-yield deductions, the AMT has evolved to the point where it reaches mainstream taxpayers.

Unfortunately, although the AMT had originally been enacted to prevent the super-rich from not paying any income taxes at all in any given year because of tax shelters and other deductions, the AMT now poses a threat to "ordinary" individuals, some only in the middle-class brackets. Ironically, many of the same tax breaks given to taxpayers in the massive Economic Growth and Tax Relief Reconciliation Act of 2001 will trigger greater AMT liability than ever before. Estimates are that the 1.1 million taxpayers now subject to AMT will grow to approximately 30 million by 2010!

Here's how the AMT works in a nutshell. You begin with taxable income as computed for purposes of the regular federal income tax. Then you add back to taxable income many of the important deductions you claimed to arrive at regular taxable income. For example, state and local income and real property taxes, miscellaneous itemized deductions, and personal exemptions all may need to be added back. Depending on the types of businesses and investments you're involved in, there could be other adjustments as well. For example, certain tax breaks for incentive stock options aren't allowed for AMT purposes. After all adjustments and so-called preferences have been made, you subtract an exemption amount that varies with your income level. Then what remains is taxed at 26% or 28% to arrive at a figure called the tentative minimum tax. If this tentative minimum tax is higher than your regular income tax, you must pay the excess as AMT tax. For example, if your regular tax bill is \$25,000, and the tentative minimum tax is \$32,000, you will pay the regular tax bill plus an AMT tax bill of \$7,000 (\$32,000 less \$25,000).

Of course, the AMT often involves extra paperwork, more calculations and more tax forms to file.

The primary AMT relief included in the Economic Growth and Tax Relief Reconciliation Act of 2001 is a \$4,000 increase in the AMT exemption amount to \$49,000 for joint filers and a \$2,000 increase to \$35,750 for single filers. This relief is only available for the years 2001 through 2004. Even during this period when the exemption amount increase is effective, the JCT estimates that the number of taxpayers subject to the AMT would rise to approximately 5 million taxpayers in 2004.

What should you do about the AMT? The first step is to estimate whether or not you will have an AMT problem at tax return time. Then, if you may have AMT exposure, the key to lessening the damage often is timing. In particular, a mid-year and year-end analysis is useful. Most important of all, every major business and investment decision you're contemplating should be taken with the AMT in mind. The tax advantages you may be counting on to make a deal work may not be quite as robust as you expected because of the AMT.

You can see from this overview that an AMT checkup can help assure you won't be stuck with an extra tax at tax return time. Please feel free to call us at your convenience for an appointment.

Sincerely yours,

Stuart M. Mordfin