

## AMT – Tax Planning Under Uncertainty

By Michael L. La Motta, CPA

No doubt, Alternative Minimum Tax (AMT) adds to the complexity of the federal tax code and has both confounded and vexed individual taxpayers and small business owners alike. This alternate tax system has been in place for nearly three decades, but only in the last few years have so many taxpayers become aware of it when suddenly hit with an additional tax liability. How is it that AMT, a parallel tax system intended for a minority of people with high incomes, will affect nearly 30 million people by 2010?

The answer is twofold. The primary reason is that AMT parameters are not indexed for inflation. You expect that if your income increases with inflation, your effective tax rate will remain constant because regular income tax parameters (e.g., exemptions and standard deductions) also rise with inflation. With AMT, however, your effective tax rate actually *increases*.

The second reason behind the increasing number of taxpayers paying AMT is that tax cuts enacted from 2001 through 2004 reduced liabilities under the regular tax system without a corresponding reduction in AMT liabilities. Temporary increases in the AMT exemption since 2001 are the only reason why many more taxpayers are not now affected by AMT. As of this writing, however, Congress has not yet enacted a similar “patch” for 2007, exposing an estimated 23 million taxpayers to additional liability.

AMT was implemented specifically for a small population of high income individuals who completely avoided paying income tax by taking advantage of various tax shelters, in order for them to pay at least a minimum amount. As its name implies, Alternative Minimum Tax requires that people compute their taxes under alternate rules that do not allow the same preferences as the regular tax system. Taxpayers must calculate returns under both systems and pay the greater amount.

Did AMT meet its objective? In 2005, an estimated 7,600 high income taxpayers owed income tax only because of AMT. Many high income taxpayers tend to avoid AMT because a large portion of their income is taxed at regular rates that exceed AMT rates, and a significant number still avoid tax liability largely due to foreign tax credits.

So who does it affect? This year, about one-third of taxpayers with adjusted gross income (AGI) between \$50K and \$100K are projected to be liable for additional taxes due to AMT, and about 80% of those with AGI between \$100K and \$500K. If you haven't already felt its impact, get ready.

Whether, or how much, a taxpayer will be affected by AMT is primarily dependent on income, number of dependents, state and local taxes, and property taxes. AMT has a disproportionate impact on large families and those living in high tax areas. If you have two or more kids and live in New Jersey, you probably already know about AMT. Many

middle-income people with no dependents, however, may also find themselves liable for additional tax if they have large long-term capital gains, exercise incentive stock options, or incur a lot of unreimbursed business expenses. The bottom line is, the more deductions and credits claimed on regular income tax, the more likely AMT will be triggered.

AMT complicates end-of-year tax planning for small business owners whose profits are reflected in their reported income, and who routinely take advantage of deductions and credits under regular income tax. Potential AMT liability, uncertainty about marginal tax rates, and the effect of various tax incentives throws a wrench into routine tax planning strategies such as timing of income, expensing and depreciating. You effectively have to project your tax liability under two systems in order to determine your most advantageous moves.

Acceleration and deferral of income and expenses continue to be the mainstay of tax planning, but the scenarios are compounded by the *potential* of AMT liability. AMT disallows certain business deductions, such as accelerated depreciation of new equipment, and limits other deductions such as net operating losses. You must, therefore, consider potential AMT liability to determine what year to deduct such expenses. If, for example, you know you will be subject to AMT in one year, you may opt to defer deductible expenses to possibly reduce taxes in the subsequent year—or visa versa. The calculations are complicated any way you look at it.

In 2007, AMT is expected to generate over \$69B in tax revenue, accounting for almost 7% of all income tax revenue. The economic reality is that the federal budget now relies on tax revenues generated by AMT, so don't expect it to go away anytime soon. The best tax-planning strategy one can follow is to consult a tax specialist.

*Michael L. La Motta, CPA, is Partner-in-Charge of Tax Services for Wiss & Company, LLP in Livingston, New Jersey. Mr. La Motta can be reached at 973.994.9400 or [mlamotta@wiss.com](mailto:mlamotta@wiss.com).*