

Financial Focus

Be Aware of Alternative Minimum Tax

If you're like many people, you may not be that familiar with the alternative minimum tax (AMT). However, you might want to acquaint yourself with it, because it's becoming less "alternative" and more "mainstream"...and its cost to you can be far from "minimum."

Here's a little background on the AMT. First, there has been some type of minimum tax ever since 1969. Because many well-off individuals used credits and tax breaks to cut their tax liability to little or nothing, Congress passed laws requiring taxpayers to calculate their tax liability first under the conventional method and then under the AMT method—and then pay whichever is higher.

Although the AMT tax rates are lower than the top regular tax rates, the AMT rates are levied on a broader income base—one that excludes personal exemptions and many itemized expenses. For many years, the AMT affected relatively few people, but that has begun to change. Just five years ago, only about 1.4 million people were subject to the AMT, but this figure will rise to about 30 million in 2010, according to the Tax Policy Center of the Brookings Institution and the Urban Institute. And if the tax cuts of 2001 and 2003 are extended, this number will climb to almost 40 million by 2014.

Two key factors are behind these big jumps:

- No adjustment for inflation—Most taxpayers have been shielded from the AMT by its large exemption. But this exemption is not adjusted for inflation, so as wages and earnings rise each year, more and more people will be subject to the AMT. In 2006, Congress raised the exemptions to \$62,250 for joint filers, \$42,500 for singles, and \$31,275 for married persons filing separate returns. But, even these higher exemptions are only a short-term fix to a long-term problem.
- New tax brackets—in 2003, Congress lowered the tax brackets. These lower brackets, combined with the available exemptions and deductions, mean that many middle-and upper-income taxpayers' regular taxes will now be lower than the AMT, which means they'll have to pay the AMT.

Unfortunately, you may unwittingly be doing things that make you even more susceptible to the AMT, such as receiving incentive stock options or pre-paying property taxes due in 2007 to gain a larger deduction on your 2006 taxes.

If you do need to pay the AMT, it can greatly affect your investment strategy. For example, you might find interest payments from some types of municipal bonds could be taxable to you. Also, if you have a home-equity loan, your interest payments may not be deductible, particularly if the loan is used for purposes other than home improvement.

The AMT debate is still alive and well in Washington, so make sure you are following the legislative proposals that deal with this controversial topic. In the meantime, though, see your tax adviser to determine if you're susceptible to the AMT. And, if so, what you can do about it. The AMT can be complicated, but if you've got a good understanding of how it works, you might not be unpleasantly surprised when tax time rolls around.