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Point of View

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THE GROWING IMPACT OF THE ALTERNATIVE MINIMUM TAX by Brenda S. Doherty, Esq.

The alternative minimum tax, or "AMT," is a separate system of tax that was originally enacted to prevent high income taxpayers from avoiding income tax liability by claiming numerous deductions. The AMT was initially introduced in 1969, after the Secretary of Treasury reported that 155 people with adjusted gross income in excess of \$200,000 (the equivalent of more than \$1,000,000 today) had paid no federal income tax. To prevent taxpayers from taking unfair advantage of tax benefits, such as special deductions and allowances for certain kinds of income, the AMT is a separately calculated tax system that treats selected tax preferences and adjustments less favorably than the regular income tax does. Because the AMT is not indexed for inflation, it is affecting a growing number of taxpayers. In 1990, approximately 132,000 taxpayers paid the AMT; in 2000, approximately 1.3 million taxpayers paid it, and it is projected that approximately 17 million taxpayers will pay it in the year 2010.

The driving goal of the AMT was to make sure that everyone with significant income paid

some federal income tax. It was enacted out of concern that certain high income taxpayers either were or were perceived to be exploiting the system by taking numerous deductions and thereby avoiding income taxes. Although the AMT actually has a lower top rate than the regular income tax, it defines the term "taxable income" far more broadly than the regular income tax by denying certain deductions, reducing other deductions and limiting other steps used to reduce tax liability. The AMT tax rate is 26% for the first \$175,000 of income minus permitted exemptions; and 28% for income in excess of that amount. The exemption is \$45,000 for married couples filing a joint return, or \$33,750 for single filer or head of household. This structure is designed to prevent the tax from impacting low income taxpayers.

All taxpayers potentially affected by the AMT must file special form (IRS Form 6251), even if it ultimately turns out after the calculations are done that the tax is not owed. In 1997, only about 20% of the 4.4 million taxpayers who filed the form actually had to pay AMT. If the AMT

AMT calculations results in a higher tax, the taxpayer must pay that higher amount, technically by paying the ordinary income tax, plus the difference between the AMT and that ordinary tax. (This distinction matters because taxpayers subject to the AMT may be entitled to a credit which can reduce their tax liability in future years).

Taxpayers take four steps to calculate the AMT:

1. Calculate regular income tax;
2. Determine whether the AMT may apply;
3. Complete IRS Form 6251 to recalculate taxable income using the AMT rules, thereby determining the "tentative AMT"; and
4. Compare the regular income tax before credits with the "tentative AMT" and pay whichever is greater.

Generally, tax items that cause AMT liability include claiming too many exemptions or deductions, either in number or total dollar value, or claiming some of the most common deductions that are permitted under the ordinary tax system but not allowed under the AMT. Among the most common adjustments or preferences permitted under the regular income tax but disallowed under the AMT are the standard deduction, as well as deductions for state and local taxes, interest on second mortgages, medical expenses, miscellaneous itemized deductions such as unreimbursed employee expenses, tax preparations fees and investment expenses. The AMT also disallows the favorable tax treatment the regular income tax rules afford to various credits, long term capital gains, incentive stock options, tax exempt interest and tax shelters.

As the foregoing suggests, there is no easy rule of thumb for avoiding the AMT. If a taxpayer's regular income tax return contains too many of the deductions, exemptions and preferentially treated items allowed under the income tax rule but disallowed under the AMT, the AMT will be triggered and generally speaking each of those items will be disallowed or treated less favorably.

While the AMT has changed over the years, it is currently controversial, in large part because of its increasing impact on taxpayers. It is very complex, costly to comply with, and can have extreme consequences in terms of liability. Although the exemption has periodically been raised, the fact that it is not indexed for inflation means that the number of taxpayers it impacts will continue to grow. The Treasury Department estimates that in 2004 3.3 million taxpayers will be affected by the AMT, and that if the AMT is not changed, the number will grow to 16.2 million in 2005 and 46.4 million in 2014. There are currently multiple bills pending before Congress to repeal or amend the AMT.

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