

## How the Alternative Minimum Tax Might Affect You

The alternative minimum tax (AMT) was enacted in 1969 as a remedy against 155 extremely wealthy individuals who had escaped paying any income taxes. In 2003, it is estimated that more than three million individuals, mostly middle-class and upper-middle class couples with children, were hit by the tax. By the end of this decade, barring expensive tax reform, as many as 33 million individuals, or one-third of all taxpayers, will pay AMT. That includes 70 percent of those making \$75,000 to \$100,000 and 90 percent of those making \$100,000 to \$500,000, in today's dollars.

The AMT is a parallel tax system that must be calculated after the income tax is computed in the regular fashion. The AMT starts with taxable income and then makes certain modifications. Certain items of income; for example, municipal bond interest from private activity bonds and income from the exercise of incentive stock options, that are not subject to tax under the regular system, must be added to income.

Certain deductions that are allowed under the regular tax system are not allowed in calculating AMT. These lost deductions include state and local income and real estate taxes, personal exemptions, unreimbursed employee business expenses, and other miscellaneous itemized deductions.

An AMT exemption of \$58,000 for married couples and \$40,250 for single individuals is then subtracted to calculate alternative minimum taxable income. The exemption begins to phase out after income exceeds \$150,000. Unless extended by Congress, the exemption will fall to \$45,000 in 2005. The AMT taxable income is subject to a 26 percent tax on the first \$175,000 and 28 percent on the excess. After the regular tax and the AMT are calculated, the higher of the two taxes must be paid.

AMT is becoming more common among individuals for two reasons. First, the regular tax rates were lowered as a result of tax bills enacted in 2001 and 2003. Secondly, the AMT exemption and rates are not indexed for inflation. Repeal or significant reform of the AMT will be prohibitively expensive for a federal government already running massive budget deficits.

The effects of AMT can be minimized in some cases by careful tax planning done prior to the end of the year. Most planning strategies involve a review of the timing of the receipt of income and the payment of deductions. If you would like more information about AMT and year-end tax planning, please contact Mike Stein, CPA, at 312-384-4285 at Legacy Professionals LLP.