

Clearing up the confusion of alternative minimum tax

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With all the political debates this year, the news has been full of references to the "AMT problem" and how each candidate proposes to resolve this burden. The problem is that most Americans do not understand what this AMT tax is and many do not even realize that they are paying it.

What is the Alternative Minimum Tax? AMT dates back to 1969 and was intended to prevent a small number of very high income tax payers from benefiting from too many tax deductions and consequently paying too little income tax. When the Tax Reform Act of 1986 was signed, the AMT was expanded to include deductions that most average American's take on their tax returns. A brief issued by the Congressional budget office says, "In 2010, if nothing is changed, one in five taxpayers will have AMT liability and nearly every married taxpayer with income between \$100,000 and \$500,000 will owe the alternative tax."

How is it calculated? The calculation for AMT is very complicated. To put it in laymen's terms, here is how it works.

First, you calculate your regular income tax as normal. Then you calculate your AMT tax, which essentially "disallows" certain deductions, such as real estate taxes, state income taxes and not reimbursed employee expenses (including auto mileage) to name a few of the widely used. This means that these deductions are not allowed, so your taxable income is higher because you cannot deduct these expenses. After adding back the deductions you cannot take, you subtract the AMT exemption amount (this is what we are always waiting for Congress to increase for inflation at the end of the year) and then you calculate your AMT tax on this new taxable amount using the higher AMT tax rates. Finally, you go back and compare your regular tax to your AMT tax. If the AMT tax is higher, then that is what you will owe instead of the regular tax. Confused yet? The true calculation will make your head spin.

Here is a simplified example. A married couple has a taxable income of \$125,000 after all their itemized deductions and personal exemptions. They deducted \$9,000 of real estate taxes and \$4,000 of state income taxes. For AMT they will have to add these deductions back, so their AMT taxable income is \$138,000. Obviously the tax on the \$138,000 will be higher than the tax on the \$125,000 so this couple will pay AMT tax. At this income level, they are doing well but certainly don't seem to fit the definition of extremely wealthy individuals that the law was intended to target.

To see if you are paying AMT tax, look on page two of your 2007 individual tax return, form 1040. If there is an amount on line 45, then you are paying AMT tax. Don't worry, you are not alone.

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