

# Unlocking the mysteries of AMT

While few people find the Internal Revenue Code easy to follow, certain sections are more challenging than others. The one area I find confounds explanation is Alternative Minimum Tax, or AMT, aka AltMin. I will try to succeed where others have failed and explain the dreaded AMT and actually make it understandable to people other than tax geeks.

AMT is a parallel tax system to our existing system. It was created to insure that wealthy people couldn't avoid paying taxes. Now it affects millions of middle-class Americans. We compute your regular tax, under the more understandable system, then we calculate your tax for AMT. The larger tax figure is used. I'm going to make a big assumption and guess that you understand the regular tax system. Here we go...beware, the following is not for the faint of heart or for numerically challenged people (you know who you are).

We recalculate your tax for AMT on Form number 6251 by removing certain items, applying an exemption amount, and multiplying that number by a flat percent. Let's start with your adjusted Gross Income (AGI). This is the last figure on page one of your return and the first figure on page two. Subtract your itemized deductions from AGI. This is where we begin the AMT calculations. We remove certain items to calculate AMT. There are many, but I'll focus on the most common: state tax, local tax and property tax. Another fairly common AMT adjustment is in Miscellaneous Itemized Deductions; which includes Unreimbursed Employee Expenses, costs for tax advice and preparation, union dues, investment advice, etc. If you have stock options that you buy and hold onto, that creates an AMT problem too.

The best way to get this is through pictures, so I have created a scenario that illustrates AMT. Below are parts of page two of the 1040, parts of Schedule A and Form 6251. In our example, we have wages of \$195,000 for our couple with two kids and itemized deductions of \$45,000 (A), consisting of \$20,000 in taxes (\$15,000 Oregon, \$3,500 property and \$1,500 local ITAX), \$20,000 in interest and \$5,000 in charity.

Form 1040 (2005) Page 2

<b>Tax and Credits</b>	38	Amount from line 37 (adjusted gross income)	38	195,000	
	39a	Check <input type="checkbox"/> You were born before January 2, 1941, <input type="checkbox"/> Blind. Total boxes if: <input type="checkbox"/> Spouse was born before January 2, 1941, <input type="checkbox"/> Blind. checked <b>▶</b> 39a			
<b>Standard Deduction for—</b> • People who checked any box on line 39a or 39b or who can be claimed as a dependent, see page 36. • All others:	b	If your spouse itemizes on a separate return or you were a dual-status alien, see page 35 and check here <b>▶</b> 39b			
	40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	40	45,000	(A)
	41	Subtract line 40 from line 38	41	150,000	
	42	If line 38 is over \$109,475, or you provided housing to a person displaced by Hurricane Katrina, see page 37. Otherwise, multiply \$3,200 by the total number of exemptions claimed on line 6d	42	12,800	
	43	<b>Taxable income.</b> Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43	137,200	
	44	<b>Tax</b> (see page 37). Check if any tax is from: a <input type="checkbox"/> Form(s) 6614 b <input type="checkbox"/> Form 4972	44	28,147	(B)
	45	<b>Alternative minimum tax</b> (see page 39). Attach Form 6251	45	2,273	
	46	Add lines 44 and 45	46	30,420	

The form above tells us that our couple has regular tax of \$28,147 (B).

**SCHEDULES A&B (Form 1040)** **Schedule A—Itemized Deductions** OMB No. 1545-0074

Department of the Treasury Internal Revenue Service (99) ▶ Attach to Form 1040. ▶ See Instructions for Schedules A&B (Form 1040). **2005**  
Attachment Sequence No. 07

Name(s) shown on Form 1040 Your social security number

<b>Medical and Dental Expenses</b>	Caution. Do not include expenses reimbursed or paid by others.				
1	Medical and dental expenses (see page A-2)	1			
2	Enter amount from Form 1040, line 38	2			
3	Multiply line 2 by 7.5% (.075).	3			
4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4			
<b>Taxes You Paid</b> (See page A-2.)	5 State and local (check only one box):	5	15,000		
	a <input checked="" type="checkbox"/> Income taxes, or				
	b <input type="checkbox"/> General sales taxes (see page A-3)	6	3,500		
	7 Real estate taxes (see page A-5)	7			
	8 Other taxes. List type and amount <b>▶</b>	8	1,500		
	ITAX				
9	Add lines 5 through 8	9	20,000		(C)

The form above tells us that the taxes portion of their itemized deductions is \$20,000 (C).

**Alternative Minimum Tax—Individuals**

▶ See separate instructions.

▶ Attach to Form 1040 or Form 1040NR.

OMB No. 1545-0074

**2005**

Attachment  
Sequence No. **32**

Name(s) shown on Form 1040

Your social security number

<b>Part I Alternative Minimum Taxable Income</b> (See instructions for how to complete each line.)	
1 If filing Schedule A (Form 1040), enter the amount from Form 1040, line 41 (minus any amount on Form 8914, line 2), and go to line 2. Otherwise, enter the amount from Form 1040, line 38 (minus any amount on Form 8914, line 2), and go to line 7. (If less than zero, enter as a negative amount.)	1 150,000
2 Medical and dental. Enter the <b>smaller</b> of Schedule A (Form 1040), line 4, or 2½% of Form 1040, line 38.	2
3 Taxes from Schedule A (Form 1040), line 9.	3 20,000
4 Enter the home mortgage interest adjustment, if any, from line 6 of the worksheet on page 2 of the instructions.	4
5 Miscellaneous deductions from Schedule A (Form 1040), line 26.	5
6 If Form 1040, line 38, is over \$145,950 (over \$72,975 if married filing separately), enter the amount from line 9 of the <b>Itemized Deductions Worksheet</b> on page A-9 of the Instructions for Schedules A & B (Form 1040).	6 ( )
7 Tax refund from Form 1040, line 10 or line 21.	7 ( )
8 Investment interest expense (difference between regular tax and AMT).	8
9 Depletion (difference between regular tax and AMT).	9
10 Net operating loss deduction from Form 1040, line 21. Enter as a positive amount.	10
11 Interest from specified private activity bonds exempt from the regular tax.	11
12 Qualified small business stock (7% of gain excluded under section 1202).	12
13 Exercise of incentive stock options (excess of AMT income over regular tax income).	13
14 Estates and trusts (amount from Schedule K-1 (Form 1041), box 12, code A).	14
15 Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6).	15
16 Disposition of property (difference between AMT and regular tax gain or loss).	16
17 Depreciation on assets placed in service after 1986 (difference between regular tax and AMT).	17
18 Passive activities (difference between AMT and regular tax income or loss).	18
19 Loss limitations (difference between AMT and regular tax income or loss).	19
20 Circulation costs (difference between regular tax and AMT).	20
21 Long-term contracts (difference between AMT and regular tax income).	21
22 Mining costs (difference between regular tax and AMT).	22
23 Research and experimental costs (difference between regular tax and AMT).	23
24 Income from certain installment sales before January 1, 1987.	24 ( )
25 Intangible drilling costs preference.	25
26 Other adjustments, including income-based related adjustments.	26
27 Alternative tax net operating loss deduction.	27 ( )
28 <b>Alternative minimum taxable income.</b> Combine lines 1 through 27. (If married filing separately and line 28 is more than \$191,000, see page 7 of the instructions.)	28 170,000

Line 1 here is from Form 1040 line 41 and reflects AGI minus itemized deductions.

Line 3 here is from Schedule A line 9 (C). This adds back the deduction you took for State, Local and Property tax. This increases your AMT income to \$170,000 on line 28.

<b>Part II Alternative Minimum Tax</b>		
29 Exemption. (If this form is for a child under age 14, see page 7 of the instructions.)		
IF your filing status is . . .	AND line 28 is not over . . .	THEN enter on line 29 . . .
Single or head of household . . . . .	\$112,500 . . . . .	\$40,250
Married filing jointly or qualifying widow(er) . . . . .	150,000 . . . . .	58,000
Married filing separately . . . . .	75,000 . . . . .	29,000
If line 28 is <b>over</b> the amount shown above for your filing status, see page 7 of the instructions.		
30 Subtract line 29 from line 28. If zero or less, enter -0- here and on lines 33 and 35 and stop here.	30 117,000	
31 • If you reported capital gain distributions directly on Form 1040, line 13; you reported qualified dividends on Form 1040, line 9b; or you had a gain on both lines 15 and 16 of Schedule D (Form 1040) (as refigured for the AMT, if necessary), complete Part III on the back and enter the amount from line 55 here. • <b>All others:</b> If line 30 is \$175,000 or less (\$87,500 or less if married filing separately), multiply line 30 by 26% (.26). Otherwise, multiply line 30 by 28% (.28) and subtract \$3,500 (\$1,750 if married filing separately) from the result.	31	
32 Alternative minimum tax foreign tax credit (see page 7 of the instructions).	32	
33 Tentative minimum tax. Subtract line 32 from line 31.	33 30,420	
34 Tax from Form 1040, line 44 (minus any tax from Form 4972 and any foreign tax credit from Form 1040, line 47). If you used Schedule J to figure your tax, the amount for line 44 of Form 1040 must be refigured without using Schedule J (see page 9 of the instructions).	34 28,147	
35 <b>Alternative minimum tax.</b> Subtract line 34 from line 33. If zero or less, enter -0-. Enter here and on Form 1040, line 45.	35 2,273	

Since line 28 is over \$150,000, this exemption is reduced from \$58,000 to \$53,000 on line 29.

Line 33 equals line 30 times 26%.

Line 34 is the regular tax from Form 1040 line 44.

Since line 33 above is larger than line 34, our couple owes an additional \$2,273 of tax. This goes on line 45 of Form 1040.

Believe it or not, this is a really basic explanation. To simplify this explanation, I've left out a few things that would have happened with this tax return. What's important to notice is that the higher your income gets, the less exemption you get on line 29. Another important thing to note is that, once line 30 above gets over \$175,000, you multiply line 30 by 28% instead of 26%.

Many of you may be saying to yourself, "I should have such problems as making \$195,000 in a year." Keep in mind that selling an investment property with a large gain, selling stock you've held with a large gain, cashing in a big chunk of retirement or getting a lump sum payment from a taxable legal settlement can easily push an otherwise average, middle-class family into AMT.

So what can you do about it? The best thing to do, if you anticipate AMT issues, is reduce the income you receive in a given year. Do this by maxing out your retirement contribution at work, avoiding large lump-sum payouts from retirement, showing losses on rentals (maybe), having capital losses of \$3,000 or more and deferring tax through a 1031 exchange or a deferred compensation plan with your employer. The only other big thing I can think of is to move to a state with lower or no state income tax; such as Washington.

There are rumors that Congress is going to get rid of AMT in the next year or two. We'll see if Congress acts on this. It has been a hot tax issue in Congress for quite a while now.