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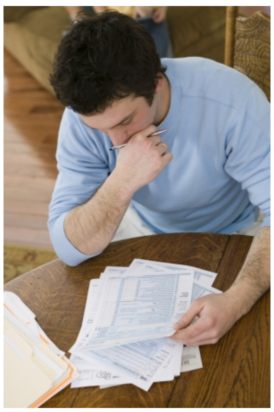
781-300-7777
www.AmericanPrivateWealth.com

# The Alternative Minimum Tax (AMT)



***TIP: If you owe AMT, you may be able to lower your total tax (regular tax plus AMT) by claiming itemized deductions on Form 1040, even if your total itemized deductions are less than the standard deduction. This is because the standard deduction is not allowed for the AMT and, if you claim the standard deduction on Form 1040, you cannot claim itemized deductions for the AMT.***

***Source: 2014 Instructions for Form 6251, Alternative Minimum Tax Individuals***

When it comes to federal income tax, there are few subjects capable of causing as much confusion as the AMT. And while the American Taxpayer Relief Act of 2012, passed in the first days of 2013, made permanent a number of temporary AMT provisions, it also changed some rules. Here's a quick guide to understanding the AMT.

## What is the AMT?

The AMT is essentially a separate federal income tax system with its own tax rates, and its own set of rules governing the recognition and timing of income and expenses. If you're subject to the AMT, you have to calculate your taxes twice--once under the regular tax system and again under the AMT system. If your income tax liability under the AMT is greater than your liability under the regular tax system, the difference is reported as an additional tax on your federal income tax return. If you're subject to the AMT in one year, you may be entitled to a credit that can be applied against regular tax liability in future years.

## How do you know if you're subject to the AMT?

Part of the problem with the AMT is that, without doing some calculations, there's no easy way to determine whether or not you're subject to the tax. Key AMT "triggers" include the number of personal exemptions you claim, your miscellaneous itemized deductions, and your state and local tax deductions. So, for example, if you have a large family and live in a high-tax state, there's a good possibility you might have to contend with the AMT. IRS Form 1040 instructions include a worksheet that may help you determine whether you're subject to the AMT (an electronic version of this worksheet is also available on the IRS website), but you might need to complete IRS Form 6251 to know for sure.

## Common AMT adjustments

It's no easy task to calculate the AMT, in part because of the number and seemingly disparate nature of the adjustments that need to be made. Here are some of the more common AMT adjustments:

- Standard deduction and personal exemptions: The federal standard deduction, generally available under the regular tax system if you don't itemize deductions, is not allowed for purposes of calculating the AMT. Nor can you take a deduction for personal exemptions.
- Itemized deductions: Under the AMT calculation, no deduction is allowed for state and local taxes paid, or for certain miscellaneous itemized deductions. Your deduction for medical expenses may also be reduced (starting with the 2013 tax year, the AMT adjustment for medical expenses only applies to those who have reached age 65), and you can only deduct qualifying residence interest (e.g., mortgage or home equity loan interest) to the extent the loan proceeds are used to purchase, construct, or improve a principal residence.
- Exercise of incentive stock options (ISOs): Under the regular tax system, tax is generally deferred until you sell the acquired stock. But for AMT purposes, when you exercise an ISO, income is generally recognized to the extent that the fair market value of the acquired shares exceeds the option price. This means that a significant ISO exercise in a year can trigger AMT liability. If ISOs are exercised and sold in the same year, however, no AMT adjustment is needed, since any income would be recognized for regular tax purposes as well.
- Depreciation: If you're depreciating assets (for example, if you're a sole proprietor and own an asset for business use), you'll have to calculate depreciation twice--once under regular income tax rules and once under AMT rules.

## AMT exemption amounts

While the AMT takes away personal exemptions and a number of deductions, it provides specific AMT exemptions. The amount of AMT exemption that you're entitled to depends on your filing status.

Your exemption amount, however, begins to phase out once your taxable income exceeds a certain threshold. (Specifically, your exemption amount is reduced by $0.25 for every $1.00 you have in taxable income over the threshold amount).

AMT Exemption Amounts by Filing Status

| | 2015 | 2016 |
|---|---|---|
| **Married filing jointly** | $83,400 | $83,800 |
| **Single or head of household** | $53,600 | $53,900 |
| **Married filing separately** | $41,700 | $41,900 |

AMT Exemption Phaseout Threshold

| | 2015 | 2016 |
|---|---|---|
| **Married filing jointly** | $158,900 | $159,700 |
| **Single or head of household** | $119,200 | $119,700 |
| **Married filing separately** | $79,450 | $79,850 |

***Technical Note:*** *In the context of AMT exemption amounts and tax rates, taxable income really refers to your alternative minimum taxable income (AMTI). Your AMTI is your regular taxable income increased or decreased by AMT preferences and adjustments.*

***Technical Note:*** *When it comes to the phaseout of AMT exemption amounts, a special calculation applies to individuals who are married filing a separate federal income tax return. These individuals have to add an additional amount to their AMTI before calculating the exemption phaseout.*

## AMT rates

Under the AMT, the first $186,300 (for 2016, $185,400 for 2015) of your taxable income is taxed at a rate of 26%. If your filing status is married filing separately, the 26% rate applies to your first $93,150 (for 2016, $92,700 for 2015) in taxable income. Taxable income above this amount is taxed at a flat rate of 28%.

The lower maximum tax rates that generally apply to long-term capital gain and qualifying dividends apply to the AMT calculation as well. So, even under AMT rules, a maximum rate of 20%, 15% (for individuals in the 25%, 28%, 33%, or 35% tax rate bracket), or 0% (for individuals in the 10% or 15% tax bracket) applies for 2015 and 2016. However, long-term capital gain and qualifying dividends are included when you determine your taxable income under the AMT system. That means large capital gains and qualifying dividends can push you into the phaseout range for AMT exemptions, and can indirectly increase AMT exposure.

## Summing up

Owing AMT isn't the end of the world, but it can be a very unpleasant surprise. It also turns a number of traditional tax planning strategies (e.g., accelerating deductions) on their heads, so it's a good idea to factor in the AMT before the end of the year, while there's still time to plan.

If you think you might be subject to the AMT, it may be worth sitting down to discuss your situation with a tax professional.