



Some say AMT system should be repealed

08:59 AM CST on Monday, March 13, 2006

By PAMELA YIP / The Dallas Morning News

Barbara Cornelius has never earned close to \$95,000 a year.

Yet she found herself writing a check for that amount to pay the dreaded alternative minimum tax after she exercised incentive stock options earned in a previous job.

"I had chest pains when I dropped that check in the slot at the post office," said Mrs. Cornelius, 54, now an executive assistant at Electronic Data Systems Corp. in Plano.

And the \$95,000 bill was a break from the original estimate of more than \$200,000 that an accountant told Mrs. Cornelius and her husband, Jerry, they owed under the AMT.

DallasNews.com/extra

[AMT assistant: IRS explains the alternative minimum tax and determines if you are subject to it](#)

The AMT is a complicated, vicious federal income tax that's morphed into a looming specter over the heads of more average taxpayers. The tax – a tax system with its own tax brackets that's parallel to the regular income tax system – isn't indexed for inflation. Thus, it's pulling in more middle-class taxpayers such as the Corneliuses each year.

The couple recently met with U.S. Rep. Sam Johnson, R-Plano, to urge Congress to fix the AMT. Mr. Johnson – a member of the House Ways and Means Committee, which oversees tax legislation – said Congress should repeal the AMT altogether.

"If we don't, it's going to be a worse burden on the average taxpayer over the years," he said.

Under the regular tax system, the tax brackets rise with inflation. But that's not the case under the AMT.

"Indexing means that at any given level of income – say, \$90,000 – you'll owe less regular tax next year than you did this year," said Mark Luscombe, principal federal tax analyst at CCH, which publishes information for tax professionals.

"But since AMT computations generally don't use indexed figures, the AMT on that same level of income would stay the same."

That means the AMT has reached further and further down the income scale over the years.

Double jeopardy

There's a lot to hate about our federal income tax system.

It's complicated and bloated, and reforming it is a real challenge because so many special interests have stakes in it.

But no component in the tax system is more reviled than the alternative minimum tax, or AMT.

"I think it stinks," said Kenneth Sibley, a certified public accountant and managing director of Sibley & Co. in Dallas. "It is affecting more and more people, and it's in effect a flat tax."

President Bush's tax reform panel has recommended repeal of the AMT.

Most taxpayers haven't heard of the tax. But they will if Congress doesn't fix a glitch that's scooping up more average taxpayers.

Congress created the AMT in 1969 when it discovered that many affluent taxpayers were paying little or no tax by cleverly using tax deductions and credits. The intent was to ensure that the wealthy paid at least some tax.

The AMT comes with its own tax brackets and set of rules that's parallel to the regular federal income tax system.

It's triggered when a taxpayer claims large deductions such as unreimbursed employee expenses, has lots of dependency exemptions or has high local and state taxes.

Because the tax isn't inflation-adjusted, it's ensnaring more average-income taxpayers.

Under current law, about 31 million people will pay the AMT by 2010 – almost nine times as many as in 2005, according to the Tax Policy Center, which studies tax issues.

"The increase in coverage will occur in all but the very lowest income classes," said a report on the AMT published by the center last May.

For example, in 2005, 1 percent of taxpayers with income between \$75,000 and \$100,000 faced the AMT.

"By 2010, 49 percent of filers in that income range will pay the AMT," the center said. "The AMT will become the de facto tax system for filers in the income range of \$200,000 to \$500,000 – 94 percent of whom will face the tax in 2010."

At the highest income levels, the share of taxpayers paying the AMT falls because the top AMT rate of 28 percent is lower than the regular income tax's top marginal tax rate of 35 percent.

You pay the higher of the two taxes.

"For taxpayers, it means doing your taxes twice," said Mark Luscombe, principal federal tax analyst at CCH, which publishes information for tax professionals.

Calling in a pro

Because the AMT is so mind-boggling, hiring a tax professional may be worth the money.

But find a tax adviser who really knows the AMT and who can help you fend it off through careful timing of your income and deductions.

Congress tried to fix the problem by raising the AMT exemption amount – which reduces the income subject to tax – to \$58,000 for couples and \$40,250 for single taxpayers.

But that patch has expired.

As a result, the exemptions will fall back to \$45,000 for couples and \$33,750 for singles for the 2006 tax year.

Congress must act on the issue this year to give taxpayers relief, said Rep. Sam Johnson, R-Plano, of the House Ways and Means Committee.

But it won't be easy because the AMT has become a big money maker for Uncle Sam. By 2013, it will raise more revenue than the regular income tax, according to estimates by the Treasury Department.

It's too late to take steps to avoid the AMT for the 2005 tax year, but there are precautions you can take for the future.

Many items deductible under the regular tax system aren't deductible under the AMT. These include personal and dependency exemptions, the standard deduction and state income and property taxes.

If you won't be affected by the AMT this year but think you will be next year, consider accelerating certain types of deductions into this year.

For example, you might want to pay property taxes that aren't due until early next year because you can't deduct them under the AMT.

Special rules apply to medical expenses, home mortgage interest and investment interest deductions in calculating the AMT.

Personal exemptions also aren't allowed under the AMT.

A particularly vicious AMT trap lies in wait for taxpayers who exercise incentive stock options from their employers.

Holders of these ISOs are ordinarily subject to a 15 percent capital-gains tax if the underlying stock is sold within a certain time frame. For calculating the AMT, the spread between the option price and the stock's fair-market value at the time of exercise is added to your income – even if you haven't sold the stock.

What's more, "if the stock plunges in value before the holder can actually sell it and realize the hypothetical windfall, that's too bad – the AMT still has to be paid," Mr. Luscombe said.

Snared by options

That's what happened to Barbara and Jerry Cornelius of Richardson after Mrs. Cornelius exercised ISOs she was granted as an employee at a fiber optics company.

She was granted ISOs to buy stock at 6 cents a share when she joined the company in 1999. The company later went public, and the stock shot up to \$295 a share.

Co-workers warned her about the AMT, but the couple's accountant assured them that "it was for the very wealthy," said Mrs. Cornelius, now at Electronic Data Systems Corp.

The accountant later came back with news that the AMT bill would be a "very, very high figure like \$200,000," she said.

"We couldn't have paid that if we sold everything we had," said Mr. Cornelius, who owns an art and picture frame shop with his wife. The couple hired a new accounting firm, which recalculated the AMT bill at \$95,000. They drained their savings and sold the fiber optics stock to pay that bill.

If you have ISOs, be precise about how many options you exercise and when in the tax year you do it, tax experts advise.

The Corneliuses met with Rep. Johnson to urge Congress to do something about the AMT.

"We'd like them to recognize how this has affected the average person," Mrs. Cornelius said.

E-mail pyip@dallasnews.com

AMT triggers

Here are the top 10 situations that could potentially throw you into the alternative minimum tax:

1. Personal exemptions
2. The standard deduction – it's added back to taxable income under AMT
3. State and local income, sales and property taxes
4. Mortgage interest on refinanced or second mortgages and home equity loans not used to buy, build or improve a home
5. Medical expenses
6. Miscellaneous itemized deductions subject to the 2 percent floor
7. Exercise of incentive stock options
8. Long-term capital gains
9. Tax-exempt interest from private-activity bonds (a type of municipal bond)
10. Business tax deductions

SOURCE: National Association of Tax Professionals

Online at: http://www.dallasnews.com/sharedcontent/dws/bus/personalfinance/stories/DN-perficover_13bus.ART.State.Edition1.914cac3.html