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THE WEEK ON THE STREET

## AMT: The tax we love to hate

By *Marshall Loeb*, MarketWatch

Last update: 6:01 p.m. EST Feb. 25, 2005

NEW YORK (MarketWatch) -- If anybody can be expected to file his income taxes correctly, it's Len Burman, former Treasury deputy assistant secretary for tax analysis and now co-director of the Tax Policy Center in Washington, D.C. But some time ago, after he dutifully sent in his return, he realized that he had erred and paid too much -- because of the complex, controversial alternative minimum tax.

Burman's story briefly goes as follows: He had elected to claim his two college-age children as personal dependents, thinking that this would reduce his taxes by about \$1,000 for each child. This would also mean that the children would not be eligible for several hundred dollars' worth of Lifetime Learning tax credits. Yet he forgot that since he was subject to the AMT, those dependent exemptions were worth nothing to him. So he -- and his children -- lost out.

The AMT is so loaded with snares and traps that even the best of experts have trouble taming it. Whereas sensible tax policy is simple, efficient and fair, the AMT is maddeningly complex, inefficient and unfair.

In 1969, Congress created the AMT as a quickie, stop-gap minimum tax designed to ensure that high-income filers would no longer use so many tax exemptions and shelters (such as tax-free municipal bonds) to pay little or no taxes. But, said Burman, "it has morphed over time into this monster that is hitting middle-income people."

Americans now have to pay either the regular income tax or the AMT, whichever is steeper. This year, 3.8 percent of taxpayers will file under the AMT. But by 2010, unless the law is changed, that number will swell to 30.4 percent of taxpayers. They will include virtually all middle-class families with two or more kids.

Basically you calculate the AMT by adding back in many of the deductions and exemptions you would take on your regular income taxes. These include everything you deducted for state, local, foreign, personal property and real estate taxes; personal exemptions; miscellaneous deductions above the 2 percent floor; a portion of medical deductions; incentive stock options and more.

You then subtract the AMT exemption (this year it's \$58,000 for couples filing jointly, \$40,250 for singles) plus exemptions for mortgage interest, charitable contributions and very few other things. What remains is taxed at 26 percent or 28 percent.

If you are swept up by the AMT, here are some of the very few things you should try to do:

- If you own municipal bonds, see if they are the kinds that are eligible for tax deduction. Most so-called private activity tax-exempt bonds are not, though within that category qualified 501(c)3 bonds and certain refunding bonds are eligible.
- If you have incentive stock options, your safest strategy may well be to sell the shares in the same year that you exercise the option. If you don't, you may wind up paying taxes under the AMT for a gain that never materializes.
- Consider not taking your college-age children as dependents; that way, they probably will be eligible for Lifetime Learning credits.

Almost everyone agrees that the AMT is a bad tax that urgently requires repair. Congress has tried to tinker with it, but it is too expensive to fix. And every year it gets harder.

"It generates so much revenue that repeal is almost out of the question," said Tom Ochenschlager, vice president of tax for the American Institute of Certified Public Accountants.

Just about any change would cost huge sums in lost income. The Tax Policy Center figures that by 2008, it will cost more to repeal the AMT than to repeal the regular income tax.

### What's to be done

Like many others, Yale professor Michael Graetz, a tax expert, figures that any change should be dealt with as part of a broad tax reform. President Bush has appointed a commission, chaired by former U.S. Senators Connie Mack and John Breaux, to recommend such a broad-based reform. The commission is scheduled to report, at the latest, on July 31.

To purge the AMT and create a sensible, effective tax policy, Graetz recommends that the nation enact a value-added tax and use the revenues to replace a large part of the income tax. He calculates that this would eliminate roughly 100 million of the 130 million tax forms that the IRS receives each year, and that 150 million taxpayers no longer would have to file returns. Graetz also would lower the top income tax rate from 35 percent to 25 percent, and lower corporate rates.

This, he said, would make U.S. consumption taxes about the same as in much of the rest of the world, while making the income tax considerably smaller. All in all, it would make the America one of the best places in the world for saving and investment.

Reporter Kelli B. Grant contributed to this article. ■

Marshall Loeb, former editor of *Fortune*, *Money*, and *The Columbia Journalism Review*, writes "Your Dollars" exclusively for MarketWatch.

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