

## Think tax-backward to avoid the AMT

**REUTERS** 

By Linda Stern

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Taxpayers, walk away from the gift wrap and pick up your pencils. You have less than a month to strategize your way out of the alternative minimum tax for 2006.

The AMT has become a universally unpopular symbol of policy gone awry. Initiated in 1969 as a way to catch high-income Americans who were dodging all income taxes, it has morphed into an almost-incomprehensible parallel tax system that disproportionately affects middle-income taxpayers who have many kids or live in high-tax states.

Because its brackets are not automatically indexed for inflation (unlike the regular income structure, which is), it catches more taxpayers every year as their incomes rise to AMT levels.

"This year it will affect 3.6 million taxpayers, at an average of about \$6,000 per return," says Lonnie Davis, director of tax services for CBIZ Accounting, Tax & Advisory Services in Plymouth Meeting, Pennsylvania.

It's tough to understand, but ignore it at your own peril. Every year the AMT snags more taxpayers, and if it snags you, the very actions you take to cut your taxes (such as making extra mortgage payments in mid-December) could come back to bite you.

Here's what you need to know -- and do -- right now:

-- Get a basic idea of how the AMT works.

In most simple terms, it applies a lower tax rate to a broader definition of income. It defines income more broadly by disallowing some write-offs, such as state and local taxes deducted, some home equity interest, some medical expenses and some profits on employee stock options.

It also disallows personal exemptions, hitting big families hard. (For a complete list of the so-called "preference" items disallowed by the AMT, go to the IRS Web site and download Form 6251 and its instructions.) Then it subtracts a special AMT exemption amount, and then it subjects the income left to tax rates of 26% on the first \$175,000 (\$87,500 for married couples filing separately) and 28% on the excess.

-- Drill down and guesstimate whether you're going to be subject to the AMT.

Look at last year's return and see if you paid any AMT. Even if your situation is pretty similar this year, you may not be subject to it because of two changes made in the tax bill passed earlier this year.

That bill slightly increased the AMT exemption that gets subtracted from your income. The same law eased up on AMT treatment of a variety of credits including the child and dependent care credit and Hope scholarship and lifetime learning credits.

A quick and dirty way to see if you'll be hit by the AMT is this: Find out what your marginal tax rate is, and subtract the AMT rate. If, for example, you're married filing jointly with an income of \$150,000, your regular marginal tax rate is 28 percent and your AMT rate is 26 percent, making the spread between the two taxes only 2 percent of your income. If your list of preference items, personal exemptions and the like exceed 2 percent of your income, there's a good chance you'll be AMT bait.

If you use tax-preparation software, you can open last year's forms, guesstimate your income and deductions, raise the AMT exemption amount on form 6251 to 2006 levels of \$62,550 (married joint), \$42,500 (single) or \$31,275 (married filing separately.) See if it calculates an AMT payment for you.

-- Then what?

If you expect to be AMT'd, think backward, says Davis. Put off that year-end home equity or tax payment until January. Defer your miscellaneous expenses, like investment interest or job-hunting expenses. Bring extra income, such as bonuses, into this year. Your mission is to keep preference items a low-enough proportion of your taxes to kick you out of AMT contention, at least for one more year.

-- Watch Washington.

Both Democrats and Republicans say they want to "fix" the AMT problem, but they'll have their own problems doing that. They're not supposed to cut taxes in the future (as any AMT fix would do) without finding like income elsewhere, and there's not many other places for legislators to go to fund that.

It's more likely that the best they will do is continue to adjust it annually. That buys them continued attention from tax-focused lobbyists, and it buys them higher revenues that they can count in the out-years, even if they're just going to adjust them away too.

That means if you're just falling under AMT radar, you might continue to escape it, one year at a time.

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