Understanding the Alternative Minimum Tax

When some taxpayers hear "Alternative Minimum Tax" (AMT), they are filled with dread at the complexity of the rule. Some balk at the perceived unfairness of it, and still others won't ever learn about the AMT until the IRS informs them that they owe more in taxes. Understanding the AMT is a good way to avoid all three reactions.

For many years, the IRS faced the problem that many high-earners were able to claim so many deductions that they owed little to no income tax. To solve this problem, the IRS enacted the AMT in 1969 to ensure that all income earners paid a minimum in taxes. The AMT is essentially a parallel or alternative tax code with its own rules—many deductions and credits aren't allowed under the AMT, and it has its own tax brackets as well. Taxpayers are expected to calculate their tax burden two ways, once under the regular tax code and once under the AMT's rules. Whichever outcome is higher is the tax they owe.

How it Works

When figuring your taxes, you normally subtract various deductions and exclusions from your income to arrive at your taxable income, which is then taxed at the rate corresponding with your income level. Under the AMT rules, many of those deductions don't apply, so your taxable income will be higher. Then, after calculating your taxable income, your tax rate will be different, too, either 26 or 28 percent of non-exempt income. This rate may actually be lower than your tax rate under the regular tax code, but the amount of taxable income will also be higher, which often makes the AMT the higher tax burden. If so, you owe the AMT amount. The AMT amount isn't always higher though; if your tax burden is higher when using the regular tax code, you'll pay that instead.

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Some of the common tax breaks not allowed under the AMT rules are as follows:

- The personal exemption
- State and local income/property taxes
- Child tax credits
- The standard deduction

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- Home equity loan interest (if the loan is not used to buy or improve a home)
- Certain medical and investment related deductions

Who Qualifies for the AMT

Those who make at least $75,000 a year are more likely to qualify, with your odds increasing at $100,000 of income. If your total deductions and credits come close to the AMT exemption amounts ($83,800 for those married people filing jointly and $53,900 for individuals and heads of household in 2016), you may have to file under the AMT. Your chances increase with each tax break you claim, so those with large families, significant capital gains or high state taxes should double check their tax liability.

To determine if you need to pay the AMT, you should calculate your tax burden both ways and pay the higher tax. The best way to do so is to consult a tax professional or use the AMT Assistant on the IRS website. The IRS also provides Form 6251 to help determine your AMT obligation.

Recent Changes to the AMT

The AMT was originally created to apply only to high-income taxpayers. However, because of inflation, more and more middle class taxpayers became subject to the tax over the years. The government periodically issued patches to increase the AMT exemptions, but this solution left many taxpayers uncertain and unprepared at tax time.

Starting in 2013, the AMT was indexed for inflation, meaning the exemptions increase at the rate of inflation, and no further patches are needed. This way, taxpayers aren't penalized for earning a salary that keeps up with inflation.

If you don't make at least $75,000 a year and you don't claim many deductions, you probably won't have to calculate your taxes both ways. However, if the IRS determines that you should have paid the AMT and you didn't, you'll owe back taxes with interest. Using a professional tax preparer ensures that you'll pay the correct amount to Uncle Sam.

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