Excess Depreciation

Generally, for regular tax purposes, equipment that a taxpayer acquires for use in business is depreciated (deducted over several years) using the 200% declining balance method. For AMT tax purposes, the equipment cannot be depreciated faster than the 150% declining balance method. The difference between these two methods of depreciation creates the AMT preference income. If a taxpayer is habitually taxed by the AMT method, it might be appropriate to always use the 150% declining balance method and thereby avoid the preference income. In addition, the Sec 179 expense deduction is allowable in full for both the regular tax and the AMT. It might be appropriate to utilize the Sec 179 deduction rather than depreciating the asset at all if other considerations will allow it.

Other AMT Adjustments

There are several additional AMT issues, including adjustments in the gain or loss from the sale of assets due to differences in regular tax and AMT basis created by different depreciation rates and preference income, intangible drilling costs, sale of small business stock, passive losses, passive farm losses, research and experimental expenditures, circulation costs and mining development and exploration costs, that are rarely encountered by taxpayers and are not discussed in this brochure. Please call this office for further details if such issues are encountered.

Computing The AMT

In computing the Alternative Minimum Tax, a substantial exemption amount is allowed against the AMT taxable amount based upon filing status. The exemption amounts are adjusted for inflation and subject to temporary adjustments by Congress. In addition, the exemption amount phases out as the taxpayer's AMT taxable income increases. Illustrated in the next column are the exemption amounts for 2009. Please call this office for amounts applicable to any other year.

AMT EXEMPTION & PHASE OUT

Filing Status	Exemption Amount	Income Where Exemption Is Totally Phased Out
Married Filing Jointly	$70,950	$433,800
Married Filing Separate	$35,475	$216,900
Unmarried	$46,700	$299,300

Where the rates for regular tax are in six tiers (10%, 15%, 25%, 28%, 33% and 35%), the AMT rates only have two tiers (26% and 28%).

AMT TAX RATES

AMT Taxable Income	Tax Rate
0 – 175,000[1]	26%
Over 175,000[1]	28%

[1] $87, 500 for married taxpayers filing separately

The following example illustrates the impact from typically encountered regular tax and AMT tax computations. In this example, Joe and Susan have three children and are filing a joint return. For the year, they have wages, some interest income, and deductions consisting of taxes, home acquisition debt interest, home equity debt interest and charitable contributions. Joe also exercised an ISO option which gave him a preference income for the year of $50,000.

	Regular	AMT
Wages	142,000	142,000
ISO Preference Income	0	50,000
Interest Income	500	500
Taxes	<17,475>	0
Acquisition Debt Interest	<9,105>	<9,105>
Equity Debt Interest	<6,145>	0
Contributions	<800>	<800>
Exemptions [1]	<18,250>	<70,950>
Taxable	90,725	111,645
Tax	15,056	29,028
		<15,056>
Increase due to AMT		**13,972**

(1) Exemption amounts used are for 2009. These amounts are subject to inflation adjustments and temporary increases. Call for amounts applicable to other years.

Even without the ISO Preference being added, Joe and Susan would have been subject to the AMT by virtue of AMT itemized deduction adjustments. The AMT taxable without the ISO preference income is $61,645, resulting in an AMT tax of $16,028, a $972 increase over the regular tax.

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Other AMT Issues

- **Taxation of Net Long-Term Capital Gains** – Net long-term capital gains are generally taxed at the same rate for AMT as they are for regular tax.
- **AMT Tax Credit** – When certain preferences create an Alternative Minimum Tax (like the incentive stock option did in our example earlier), an AMT Tax Credit is also created. It can be used in subsequent years to reduce the regular tax. This credit is equal to the difference of the AMT computed with and without the preference income. Using the previous example, the AMT with the preference income was $29,028. Without the preference income, it was $16,028 and resulted in an AMT Tax Credit of approximately $13,000. Since this credit reduces the regular tax in future years, it will be of no use in years where the taxpayer is subject to the AMT.
- **State Tax Refund** – If a taxpayer is taxed by the AMT and then in a subsequent year has a state tax refund, that refund is not taxable for regular tax purposes to the extent it provided no tax benefit in the computation year.

Call For Assistance

The issues relating to the AMT are complex. Although this brochure provides a general understanding of the adjustment and preferences that create the AMT, please call this office for assistance before taking steps that may possibly create AMT issues. This includes the refinancing of a home mortgage, which often creates equity debt interest not deductible for AMT, exercising incentive stock options, prepaying taxes, or taking other AMT-sensitive actions discussed in this brochure.

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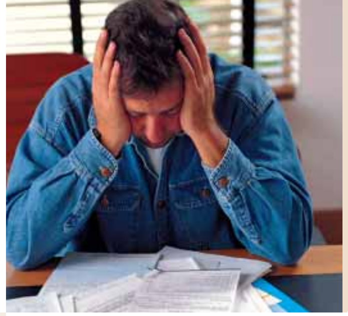

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The Alternative Minimum Tax (AMT) is a tax that was originally intended to ensure that wealthier taxpayers with large write-offs and tax-sheltered investments pay at least a minimum tax. To accomplish this, Congress created a second (alternative) tax computation that adds back to income certain tax preferences and eliminates some deductions. Taxpayers then compute their tax both ways and pay the higher of the two taxes. When it originated back in the '70s, the AMT impacted just a few, very wealthy, individuals. However, unlike the regular tax computation, the AMT is not fully adjusted for inflation and years of inflation have driven everyone's income up to where the number of taxpayers being affected by the AMT is increasing.

Anticipating when the AMT will affect you is difficult, because it is usually the result of a combination of circumstances. Although it is not always possible to avoid the AMT, it is sometimes possible to minimize this punitive tax by taking certain steps. Therefore, it is important for a taxpayer to have a basic understanding of the circumstances that can create an AMT.

The AMT includes a myriad of adjustments and preference items and full or partial disallowances of certain deductions that are otherwise perfectly legal and allowed in figuring the regular income tax. There are far too many to discuss, especially those that are rarely encountered by the average taxpayer. There are, however, certain AMT issues that frequently affect taxpayers. They are listed below with comparisons to the regular tax computation, along with actions that might be taken to mitigate the effects of the AMT.

Personal Exemptions

Every taxpayer, spouse and dependent included on a taxpayer's tax return generates an exemption deduction for regular tax purposes. For AMT purposes, the exemption deduction is not allowed at all. When two individuals can possibly claim the exemption, such as in the case of a multiple support agreement between children supporting elderly parents, care should be taken to ensure the exemption is not claimed by one who is subject to the AMT.

Standard Deduction

For regular tax purposes, a taxpayer can choose between using the standard deduction or itemizing deductions. For AMT purposes, this creates sort of a dilemma for those who don't have enough to itemize for regular tax purposes but do have substantial itemized deductions that can be used to offset the AMT. However, taxpayers can elect to itemize even if the deductions are less than the standard deduction.

Itemized Deductions

The itemized deductions allowed for the AMT are far more restrictive than those allowed for regular tax purposes. The following is a comparison of the two:

- **Medical Deductions** – For regular tax purposes, the medical expenses are first reduced by $7\frac{1}{2}$% of the taxpayer's Adjusted Gross Income (AGI), and only the excess can be included in the itemized deductions. For AMT purposes, the expenses must be reduced by 10% of the AGI. When possible, attempt to defer medical expenses to a year not taxed by the AMT.
- **Taxes** – For regular tax purposes and as part of the itemized deductions, taxpayers are allowed to deduct certain taxes they pay, including home and investment real estate taxes, state income or sales tax, personal property tax, foreign taxes, etc. For AMT purposes, none of these taxes are deductible. When the AMT is anticipated, it might be beneficial to accelerate tax payments in the prior year or defer them to the subsequent year. This would include paying the fourth quarter state estimated tax installment after the end of the year. Taking a credit for foreign income taxes is generally more beneficial than taking it as an itemized deduction anyway, and if being taxed by the AMT, taking the credit is the only way to achieve any benefit. Taxpayers can annually elect to capitalize rather than deduct property taxes on unimproved and non-productive real estate.
- **Home Mortgage Interest** – Generally, for regular tax purposes, a deduction is allowed for interest paid on home acquisition debt and home equity debt within certain debt limits. For AMT purposes, however, only home acquisition debt interest is deductible. Many taxpayers have incurred equity debt on their homes to pay off credit cards, purchase cars, etc., in the belief that the equity debt interest is deductible. If the taxpayer is subject to the AMT, the equity debt interest is not deductible. When borrowing money against a home for business, investment, or higher education expenses, it is generally good practice to take out single purpose second loans or lines of credit. This allows the loan to be treated as unsecured by the home and then to trace the interest to a deductible purpose unaffected by the AMT. Home mortgage interest and the AMT is a complex issue. Please call this office for assistance.
- **Nonconventional Home Mortgage** – For AMT purposes, interest from debt to acquire a nonconventional home such as a motor home, boat, etc., is not deductible for AMT purposes. The only recourse is to avoid or minimize this type of debt.
- **Charitable Contributions** – The deduction for charitable contributions is the same for regular tax and for AMT.
- **Miscellaneous Itemized Deductions** – For regular tax purposes, miscellaneous deductions are broken down into two categories. The first category includes such items as gambling losses to the extent of gambling winnings and some other infrequently encountered deductions. This category is allowed as a deduction for both regular and AMT purposes. The other category includes expenses such as investment expenses, union dues, employment-related expenses, certain legal fees etc., which are allowed for regular tax purposes after being reduced by 2% of the taxpayer's AGI. For AMT purposes, the deductions in this category are not allowed at all. If one anticipates being taxed by the AMT, attempt to defer payment of expenses in this category to another year. If a significant amount of expenses is incurred for a taxpayer's employment, if possible, have the employer reimburse the expenses, even if it requires a pay reduction.

Nontaxable Interest from Private Activity Bonds

Generally, for both regular tax and AMT purposes, income from municipal bonds are tax-free. However, interest from certain municipal bonds used to support private enterprises (referred to as Private Activity Bonds*) is taxable for AMT purposes. If subject to the AMT, consider not investing in Private Activity Bonds if it makes investment sense.

* Certain Private Activity Bonds issued in 2009 and 2010 are not subject to AMT tax.

Statutory Stock Options (Incentive Stock Options) also referred to as ISOs

When this type of option is exercised, there is no income for regular tax purposes. However, the bargain element (difference between grant price and exercise price) produces preference income for AMT purposes in the year the option is exercised. The tax benefit of ISOs for regular tax purposes results when the stock acquired by exercising the option has been held the requisite time before it is sold, allowing gains to be taxed at the more favorable long-term capital gains rates. However, if one is being taxed by the AMT, the bargain element is taxable in the year of exercise which generally mitigates the regular tax benefits. If possible and when the investment considerations allow it, exercising ISOs in small blocks of stock may allow a taxpayer to avoid the AMT and take advantage of the long-term capital gains benefit. Otherwise, it may be better strategy to avoid the AMT preference issues altogether by selling the stock in the year of exercise. This is a complex area of tax law; please call this office for further details.

Depletion Allowance

For both regular tax and AMT purposes, the tax law allows taxpayers to deduct an allowance for depleting (using up) an asset such as interest in an oil well. However, once the total depletion on the asset exceeds a taxpayer's investment in the property (basis), the depletion allowance is only allowed for regular tax purposes and not for AMT, thus creating AMT preference income.