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Confusing AMT can be an expensive surprise

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If you hear noises in the background when you're doing your taxes this year, it might not be the clacking of your computer or the nervous tapping of your spouse: It could be the footsteps of the alternative minimum tax monster coming to knock down your door.

What is it? The AMT was concocted in 1969 to target about 150 uber-wealthy people who were monkeying around with their tax deductions and ended up paying little or nothing in taxes. With AMT, many deductions are eliminated so that people can't inflate them. The problem is that the income tiers haven't been adjusted for inflation. That means that as incomes have increased the last 38 years (duh!), the Internal Revenue Service regards average workers as filthy rich and they're forced to pay higher taxes.

Who's getting hit? About 3.5 million filers are expected to get hit with AMT this season for tax year 2006; that's expected to jump to 23 million for returns filed next season for tax year 2007.

AMT is slamming a lot of people by surprise, said certified public accountant Cynthia Hatfield of J.M. Green CPA in Beachwood. "A lot of people don't realize this exists," she said, because the AMT was aimed at the rich but is increasingly hitting the middle class.

How does it affect me? Even if you don't end up being required to pay the extra tax, you may have to wade through two extra forms. Line 45 of the 1040 points you to a 12-line worksheet. If the taxable income calculated there is higher than the taxable income on the 1040, you must trudge through Form 6251, the massive 55-line AMT form. You then compare your regular return with Form 6251 and you pay whichever tax total is higher.

"I don't do it by hand. I won't do it by hand," said Ken Robinson, a Cleveland certified public accountant who also has a law degree. He relies on professional tax software and wouldn't recommend that anyone try it without a computer.

Who's at risk? Taxpayers who are most vulnerable include those who:

- Have incomes of more than $100,000 a year.
- Have more than the "normal" number of children.
- Pay high state, local or property taxes. Ohio taxpayers are hit particularly hard because taxes here are higher than the national average.
- Have unreimbursed employee or business expenses.
- Have higher than normal miscellaneous itemized deductions.

How did it get this bad? The AMT prohibits many common deductions and exemptions, such as the standard deduction, exemptions for the filer and dependents, deductions for income and property taxes paid, and miscellaneous itemized deductions.

The AMT reeks in other ways, CPAs say. For example, under the regular tax system, a long-term capital gain is taxed at 15 percent, at the most. A short-term gain is taxed at 35 percent, for the top tier of income. That difference, called a preference, must be added back to your taxable income when you calculate your AMT.

In another example of the AMT's sick humor, the likelihood that you will owe AMT actually increases under President Bush's existing tax cuts or additional cuts. Why? Because you must calculate your tax liability both the regular way and under AMT, then pay whichever one is higher.

The Tax Policy Center (a joint venture between the Brookings Institution and Urban Institute) estimates that, by 2010, the AMT will take back about 28 percent of Bush's tax cuts. If existing cuts remain in place, an estimated 53 million taxpayers will owe AMT in 2017. If existing cuts expire, 39 million taxpayers will owe AMT.

Why is it still in effect? The AMT has no known supporters, not Bush nor Congress. Lawmakers have approved temporary fixes on a year-by-year basis and Bush has proposed another one in this year's budget. The stopgap measure would lessen the AMT wallop (costing the government $36.5 billion this year). But the budget doesn't propose overhauling AMT or fixing it past 2008.

If lawmakers eliminated AMT today so that middle-income people weren't classified as wealthy, the government — according to expert estimates — would lose about $1 trillion (with a T) over the next 10 years if Bush's tax cuts expire. If they're extended — which, remember, would push more people into AMT territory — then dropping the AMT would cost the government about $1.6 trillion over 10 years.

That would have to be made up with new revenue (taxes) from some other source, or else the government would have to cut that much from the budget and existing programs. Neither are popular choices, so AMT remains.

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