

## TAX LETTER

### ALTERNATIVE MINIMUM TAX

Dear Clients and friends:

This tax filing season like the last filing season, one item stood out like a sore thumb. More and more taxpayer are feeling the pinch and paying the AMT (Alternative Minimum Tax). Congress promised, again and again, to reform or repeal the AMT, but never get around to do it. All they did was to put an annual patch over the problem. Living with AMT just like living with an additional tax system. We have to calculate our income tax for the regular tax purposes using the regular method. Then, we must recalculate our income tax for the AMT purposes using the AMT method. At the end, if our AMT method resulted in bigger amount of tax due, we must pay AMT. It is not a choice.

The following paragraphs are an attempt to compare the similarities and dis-similarities between these two methods of income tax calculation.

#### **GROUP "A" - Income**

- (1) W2 income (or salary/wage income) – same for Regular Tax and for AMT.
- (2) Self employment and sole proprietor income are same for Regular Tax and AMT. One exception would be the amount of depreciation allowed.
- (3) Interest income – regular taxable interest earning is same for both methods. However, some exempt interest only exempt for Regular Tax, not for AMT, such as interest income from certain “private activities” or “special revenue” bonds
- (4) Capital gain from the sales of a qualified “small business” stock is allowed for a 50% exclusion for Regular Tax. There was only a 7% exclusion allowed for AMT .
- (5) State Tax refunds should be added back as income if it has been deducted in prior year for Regular Tax purposes, i.e. itemized deductions. All State and local tax refunds are excludable for AMT purposes.
- (6) Income from pass thru entities, such as “S” Corporation, partnerships and LLC Are based on Form K-1 from the pass thru entity regardless of Regular Tax or AMT. Any necessary AMT adjustment will be clearly indicated on Form K-1.
- (7) Exercise of Incentive Stock Option (ISO) resulted in no current taxable income for Regular tax purposes. However, the different between market value of the incentive stock and the exercise price are currently taxable for AMT purposes.

#### **GROUP "B" – Deductions & Exemptions**

- (1) Standard deduction is allowed for Regular Tax, but not allowed for AMT.

(2) For itemized deductions:

- a. For Regular Tax home mortgage interest can be deducted for both principle and one 2<sup>nd</sup> home for total mortgage principle balance up to \$1 million. Home or 2<sup>nd</sup> home can be a boat or motor home. Home equity loan or line of credit interest can be deducted for up to \$100,000 total equity loan principle. For AMT, motor home and boat can not be deducted as home or 2<sup>nd</sup> home. No deduction for interest paid on home equity loan or line of credit.
- b. For Regular Tax, qualified medical expenses must be in excess of 7.5% of Adjusted Gross Income (AGI). For AMT, it must be in excess of 10 % of AGI.
- c. For Regular Tax, State and local income taxes paid, personal and real property taxes paid are deductible. They are not allowed for AMT.
- d. For Regular Tax, miscellaneous deductions such as tax preparation fee, union due, etc. are allowed for amount over 2% of Adjusted Gross Income (AGI). For AMT purposes, no miscellaneous deductions are allowed.

(3) Personal Exemption:

For 2007 Regular Tax, each person has \$3,400 personal exemption. For a couple filing joint return with 2 children will have a total of \$ 13,600.

For 2007 AMT, the exemption for filing as a single person is \$ 44,350, for a couple filing joint return the exemption is \$ 66,250. These amounts are given regardless of number of dependent and are subject to AMT income level phase out.

**GROUP “C” – Tax Brackets**

For Regular Tax, there are six brackets from 10% to 35%. For AMT, there are only two brackets, 26% and 28%. For great many middle level taxpayers, they have a 26% flat tax rate for every dollar of their Alternative Minimum Taxable Income. For those who asked for a flat tax, we believe they got their prayer answered.

**Finally**, please bear in mind that the above discussion is only an attempt; by no means can it cover all the difference between Regular Tax and AMT. If you can not find your particular situation from the above comparison, please consult your tax professionals or give us a call.