

By Chelan David

## A Taxing Situation?

The Alternative Minimum Tax affects more Americans each year.  
Do you need to pay?

IF YOUR SPA FOLLOWS CURRENT INDUSTRY TRENDS, then business is probably good and your income reflects the prosperity. Thanks to that prosperity, it's also possible that you'll owe Uncle Sam under the Alternative Minimum Tax (AMT) sometime in the near future.

If you're already vaguely familiar with the AMT, you're probably aware of its noble intent. "The AMT is in place to make sure that those who have certain types of income or who qualify for certain deductions don't escape paying any tax," explains Judy Sescil, a CPA with Farm Credit of

Western New York ([farmcreditwny.com](http://farmcreditwny.com)), based in Batavia, New York. The AMT was created after Joseph W. Barr, the U.S. Treasury secretary under Lyndon B. Johnson, informed Congress that 155 wealthy families had used loopholes to avoid paying any income tax in 1966. These well-to-do wage earners cleverly cut their taxes by taking a variety of deductions, exemptions and credits that were generally available only to the wealthy. In 1970, its first year, only 19,000 filers paid the AMT.

You might be surprised to learn that it isn't only the super-wealthy who are affected by the AMT. Today, even some middle-class earners with incomes as low as \$75,000 are subject to it. In fact, in 2005 almost 4 million American taxpayers owed under the AMT, and it's projected that by 2010 nearly a third of all filers will be subjected to the tax.

Why the upsurge? The primary reason is inflation. "The AMT isn't currently indexed for inflation while the regular tax system is," points out Sescil. Because the AMT brackets and exemptions aren't indexed to inflation, as incomes have risen the percentage of taxpayers subject to the AMT has increased. Especially vulnerable are people with children, high state and local taxes, interest deductions from second mortgages, and capital gains when the household income exceeds \$75,000.

### Are You In?

Nearly everyone agrees that the AMT is structured in such a way that it's difficult to circumvent, primarily because it disallows the exemptions that would otherwise lower one's tax liability. The AMT is a separate tax system with its own set of rules. Under AMT rules, some deductions allowed when computing standard tax are restricted, certain items of income and deduction are computed differently and a different rate schedule applies.



## MONEY MATTERS



In short, if your AMT income tax liability is greater than your regular taxable-income calculation then you would be subject to the AMT.

So how do you know if you have to pay the AMT? Unfortunately, there's no simple formula for determining this. The AMT targets taxpayers with deductions, exemptions and exclu-

to arrive at your AMT income.

First, you'll need to add back your personal—and dependent—exemption deductions, which for 2006 equal \$3,300 each. Next, add back your standard deductions if you don't itemize, which comes out to \$10,300 for joint filers and \$5,150 for singles. Finally, you may also

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sions from regular income tax, and it can be triggered by a combination of small things, or just one large item.

If your household income is \$75,000 or higher and you suspect you may be subject to the AMT, the only way to determine if you're required to pay it is by filling out the necessary forms and essentially redoing your taxes. Begin by completing Form 6251. This form disallows some tax deductions and income exclusions for your regular taxable income

lose some miscellaneous itemized deductions such as employee business expenses, investment expenses, state and local income and property tax write-offs and home equity loan interest (if the loan wasn't used for home improvements).

Sound complicated and confusing? Unfortunately it is, but it's important that you or your tax preparer take the AMT into account. If the IRS audits you and it turns out you should have paid the AMT,

you'll owe the back taxes as well as any interest or penalties that the IRS deems fit to assign.

### **Best-Laid Plans**

Completely avoiding the AMT is difficult because things done to reduce AMT payments end up increasing regular tax. With careful planning and proper timing, however, you can find the crossover point where you're paying the lowest amount possible while retaining the deductions you've earned. Perhaps the best strategy is to carefully analyze potential deductions. If you find you fall under the AMT for the tax year, defer some of your deductions so you don't lose them. You may be able to shift these

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deductions into the following year when you aren't affected by the AMT and can take full advantage of them. This works best if your deductions aren't evenly spread out and you tend to have fluctuations in income from year to year. If your AMT liability and your regular tax liability tend to be consistent from year to year, it might be best to maintain this stability.

The AMT is highly complex, so as you plan, it's smart to have a tax professional walk you through your options. After all, combing through detailed records and identifying possible tax breaks is their area of expertise. Stephanie Baker, owner of Two Rivers Salon & Spa (tworiversspa.

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com) in Eagle, Idaho, concurs. She used to keep her own books, but now relies heavily on her accountant's knowledge. "I'm in contact with my accountant every day,"

she says. "Outside of our immediate business, I talk to my accountant more than anyone else."

With planning, you can also help protect your employees from

feeling the burden of the AMT. Sescil recommends establishing a qualified reimbursement plan. "This will limit the employee business expense, which is an AMT adjustment," she points out. If you have a qualified reimbursement plan, your employees don't have to file itemized deductions such as traveling, auto expenses and computers, so they're less likely to be subjected to the AMT. By directly paying for work-related expenses (while reducing salary to cover these expenses), the business has the same out-of-pocket total and the employee doesn't have to claim as many deductions.

### The Future of the AMT

While the AMT isn't perfect, don't look for it to go away anytime soon. The government would be giving up a huge source of revenue if it abolished the AMT. In fact, according to The Brookings Institution ([brook.edu](http://brook.edu)), an independent research and policy institute, abolishing the AMT would cost the government upwards of \$500 billion over a 10-year period.

Sescil is hopeful that eventually the AMT will be reformed. "Congress needs to either reform or repeal [the AMT] because each year more average-income households are becoming subject to the tax," she says. "Without any further changes in the law, it will affect an estimated 23 million people in 2007." ●

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