# Alternative minimum tax may get new patch

Kathleen Pender, Chronicle Columnist

Updated 5:39 p.m., Saturday, December 1, 2012

Nobody likes the alternative minimum tax - an alternative tax system that was originally designed to make sure wealthy people who used a lot of esoteric tax shelters paid some federal income tax. Most of those shelters are gone now and the AMT is mainly hitting higher-income people who pay a lot of state income and real estate taxes and, to a lesser extent, families with a lot of children.

Taxpayers are supposed to compute their taxes under both the AMT and the regular system and pay whichever is higher. Although AMT rates are lower - the top rate is 28 percent compared with a maximum rate of 35 percent under the regular tax system (or 39.6 percent if the Bush tax cuts expire) - fewer deductions are allowed under the AMT.

The result is that most higher-income people owe AMT, especially if they live in high-tax states. Nationwide, only 2.8 percent of tax returns filed in 2010 owed AMT, but 4.5 percent of those coming from California did. Among those in California with adjusted gross income between $200,000 and $1 million, about 85 percent owed AMT. Above $1 million it is somewhat less common because the super-rich often owe more under the regular tax system.

The AMT has been in the news lately because Congress still has not passed a so-called patch that would prevent it from reaching further down into the middle class and hitting an estimated 33 million taxpayers in 2012 compared with about 4 million in 2011. Most people think Congress will pass a patch.

What's less well known is that for some people, the AMT has a silver lining. Assuming Congress passes a patch for 2012 and 2013, people who are in AMT and stay in AMT will be somewhat protected from an increase in regular income tax rates if the Bush-era tax cuts expire.

That's because they will still be paying a top AMT rate of 28 percent even if the top regular rate goes to 39.6 percent. This won't be true for everyone in AMT; people who fall out of the AMT could see their taxes go up.

To understand why, you have to know how the tax is computed.

To calculate AMT, you start with your taxable income under the regular tax system, then add back deductions not allowed under the AMT. This includes state and local income and property taxes, miscellaneous itemized deductions and the personal exemptions you get for yourself, spouse and dependents.

### How AMT works

From this, you subtract a flat amount known as the AMT exemption (which phases out over a certain income level).

If what is left is greater than zero, you calculate a tentative AMT at a rate of 26 percent up to a certain amount of income and 28 percent over that. If this is bigger than your regular income tax, you pay the excess as an additional tax. That additional tax shows up on tax returns as alternative minimum tax.

The amount can be substantial: In 2010, people with $200,000 to $500,000 in adjusted gross income who were subject to AMT paid an extra $6,150, on average.

The Bush tax cuts reduced regular marginal tax rates, but left the AMT, including the exemption amount, alone. As regular taxes came down and people's incomes grew, more people got pushed into AMT.

### Several patches

To prevent it from falling into the middle class, Congress has been passing temporary, one-year increases in the exemption amount at the end of each year. This is the patch.

For 2011, the exemption was $74,450 for married couples filing a joint return and $48,450 for singles. If Congress passes a patch for 2012, which is expected, those amounts would rise about 2.4 percent for 2012 and the AMT would hit roughly the same number of people as in 2011.

Without a patch, the amounts would revert to $45,000 for couples and $33,750 for singles - and throw about 29 million more people into AMT.

Among people with $75,000 to $100,000 in income, the percentage subject to AMT would rise from 1 percent to 52 percent, and their average tax increase would be about $1,600, according to Bob McIntyre, director of Citizens for Tax Justice. Even so, the bulk of the alternative minimum tax - 82 percent - would still be paid by people making more than $100,000, he says.

Congress is expected to patch the AMT by raising the exemption amount this year, but what happens next year?

If Congress approves another patch for 2013 but the Bush tax cuts expire and regular rates go up, many people who are in AMT will be somewhat protected from higher taxes if they are still in AMT next year; their tax rate will still be 28 percent.

### Unusual possibilities

People who are in AMT now but go back into the regular tax system if the Bush tax cuts expire would see a tax increase. This could, perversely, make them "nostalgic for the AMT," says Patrick Geddes, chief investment officer with Aperio Group.

This could happen to people who are on the borders of AMT at both the high and low end of the income spectrum.

Republicans have proposed extending all of the Bush tax cuts; President Obama favors letting taxes go up only for people making more than $250,000 (married) or $200,000 (single).

If Obama's plan wins, some people with incomes above $200,000/$250,000 won't be affected because they will still be in AMT, paying a top rate of 28 percent (assuming that rate does not change). "If you are deep into AMT, you are not going to be affected," Geddes says. "AMT may make the debate (over marginal tax rates) moot for a lot of high-end taxpayers."

Take a hypothetical married couple with two children and $400,000 in income, including $5,000 in long-term capital gains and $5,000 in qualified dividends. They have $70,000 in itemized deductions, including $45,000 in state income and property taxes.

In 2012, they would owe $93,900 in taxes, according to CCH, a tax information firm.

In 2013, under the Obama plan, their regular marginal rate would rise to 36 from 33 percent, but they would still be in AMT. Their tax bill would go up by $900, less than a 1 percent increase.

(The example assumes the AMT exemption is patched at $78,750 for 2012 and 2013 and that capital gains are taxed 20 percent and dividends are taxed as ordinary income in 2013.)

What happens to any individual depends on their unique circumstances. Taxpayers can use calculators at the Tax Policy Center (calculator.taxpolicycenter.org) or Tax Foundation (mytaxburden.org) to estimate their tax under various scenarios, but it helps to know something about taxes and the policy options.

If Congress overhauls the tax system, all bets are off. The AMT could be abolished or replaced with some better way of making sure that the super-rich don't pay a lower effective tax rate than people earning less.

### Who pays AMT?

Only 2.8 percent of federal tax returns filed in 2010 owed alternative minimum tax, but 4.5 percent of returns from California had it. AMT is most common among taxpayers with $200,000 to $1 million in income.

| Adjusted gross income | Calif. returns with AMT | U.S. returns with AMT |
|---|---|---|
| $0-75,000 | 0.1% | 0.1% |
| 75,000-100,000 | 1.3 | 0.8 |
| 100,000-200,000 | 9.6 | 5.9 |
| 200,000-500,000 | 85.4 | 74.4 |
| 500,000-1 million | 86.6 | 67.3 |
| Over 1 million | 40.0 | 28.6 |
| Total | 4.5 | 2.8 |

Source: Internal Revenue Service statistics

*Kathleen Pender is a San Francisco Chronicle columnist. Net Worth runs Tuesdays, Thursdays and Sundays. E-mail: kpender@sfchronicle.com Blog: sfgate.com/pender Twitter: @kathpender*

**Ads by Yahoo!**