



GELT & GRASSGREEN P.C.

Theodore Z. Gelt
Randi M. Grassgreen
Jeff C. Tauscher
Kristen L. Sweat

Attorneys and Counselors at Law
303 E. 17th Avenue, Suite 910, Denver CO 80203
303.830.1200 *telephone* 303.830.9400 *fax*
gg@gelntaxlaw.com

Of Counsel:
Jeffrey M. Nobel
Mark A. Vogel

Louis E. Gelt (1908-1997)

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RE: *Alternative Minimum Tax*

The alternative minimum tax (the “AMT”) is considered one of the major problems of our current income tax system. As such, the President’s Advisory Panel on Federal Tax Reform (the “Advisory Panel”) has recommended repealing the AMT altogether and included such repeal in two new tax systems it has recommended as possible replacements to the existing income tax system: (1) the Simplified Income Tax Plan and (2) the Growth and Investment Tax Plan (a consumption tax plan). While both proposals face great opposition and it is unlikely that Congress will pass a bill that mirrors the exact recommendations of the Advisory Panel, it is likely that Congress will investigate long-term resolutions for the AMT. However, until such resolutions are made law, a growing number of taxpayers will be subject to the AMT.

The AMT was enacted in 1970 to prevent high income taxpayers from paying little or no income tax. Prior to the enactment of the AMT, high income taxpayers were able to take advantage of certain deductions and exemptions which decreased the amount of their taxable incomes. As such, the AMT disallows certain deductions and exemptions so more of the high income taxpayers’ income is subject to income tax. If, after adding back the disallowed deductions and exemptions, a taxpayer’s AMT liability is greater than his or her regular income tax liability, the taxpayer must pay the AMT amount. While the AMT was originally enacted to target high income taxpayers, more and more middle income taxpayers are becoming subject to the AMT because the AMT exemption amount is not indexed for inflation.

The most common disallowed deductions and exemptions are as follows:

- ***The Standard Deduction.*** Taxpayers are not allowed to take the standard deduction when calculating alternative minimum taxable income (“AMTI”).
- ***Medical Expenses.*** Taxpayers may only deduct medical expenses that exceed 10% of their adjusted gross income (“AGI”) rather than medical expenses that exceed 7.5% of AGI as provided for in the regular income tax.
- ***Taxes.*** Taxpayers may not deduct state and local sales taxes, income taxes or property taxes for AMT purposes.
- ***Interest Deductions on a Second Mortgage.*** A taxpayer that takes a second mortgage on his or her home may not deduct the interest paid on such mortgage unless the loan proceeds are used for buying, building or improving the home.
- ***Miscellaneous Itemized Deductions.*** Taxpayers may not deduct unreimbursed employee expenses, tax preparation fees or investment expenses when determining AMTI.
- ***Tax-Exempt Interest.*** Certain tax-exempt interest is not exempt from income tax under the

AMT. Such interest includes interest attributable to private activity bonds issued to provide funds for nongovernmental activities such as building a sports stadium, industrial development, low-income housing or student loan financing.

- ***Incentive Stock Options.*** Taxpayers that exercise incentive stock options must include in income, for the year in which the option is exercised, the difference between the exercise price and the fair market value of the stock.
- ***Personal Exemptions.*** Taxpayers are not allowed to take personal exemptions, such as exemptions for the taxpayer, the taxpayer's spouse and the taxpayer's dependents, when determining AMTI.

Taxpayers are allowed to offset their AMTI with the AMT exemption: \$40,250 if single or head of household, \$58,000 if married filing jointly or qualified widow(er) and \$29,000 if married filing separately. Long-term capital gain is included in income for purposes of determining a taxpayer's allowable AMT exemption. However, the AMT exemption begins to phase out at certain amounts, depending on the taxpayer's filing status, and is not available for taxpayers whose AMTI is equal to or greater than \$273,500, \$382,000 or \$191,000, respectively.

Please note that the IRS recently implemented an online tool on their website (apps.irs.gov/app/amt) to help individual taxpayers determine whether he or she will be subject to the AMT.

To address the growing application of the AMT to unintended taxpayers, Congress has passed tax legislation over the years to increase the AMT exemption amount; however, such increased exemption amounts are set to expire after 2005. Therefore, Congress is currently considering two different tax bills which would extend and increase the expiring AMT exemption provisions.

We hope that you found this information useful. Please contact us if you have any questions. ***If you would prefer to have this newsletter sent via email, please send an email to gg@gelttaxlaw.com with the subject line "newsletter."***

Very truly yours,

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