

## Guide to the AMT

# Top Ten Things that Cause AMT Liability

This page provides a list of items that can cause (or contribute to) liability under the alternative minimum tax. The list isn't *complete* — there are other items that can contribute to AMT liability. Based on our experience, the items described below are likely to affect more people than other items. For a complete list, see [Form 6251, Alternative Minimum Tax — Individuals](#) and the instructions for that form. By the way, if you count more than 10 items below, just consider it a bonus.

## Exemptions

Believe it or not, exemptions contribute to AMT liability. The exemptions you claim for yourself, your spouse and your dependents are not allowed when calculating alternative minimum tax. We've never seen a tax return where someone had to pay AMT *solely* because of their exemptions, but the more exemptions you claim, the more likely it is that you'll have AMT liability when all is said and done.

## Standard Deduction

Some 70% of American taxpayers claim the standard deduction (rather than itemizing). The standard deduction isn't allowed under the AMT. Usually this isn't a problem because the AMT generally hits people with higher incomes, and these people are more likely to claim itemized deductions. Yet it's worth noting that a deduction that's so widely used can contribute to AMT liability.

## State and Local Taxes

If you itemize, there's a good chance you claim a deduction for state and local tax, including property tax and state income tax. These deductions are not allowed under the AMT. If you live in a place where state and local taxes are high, you're more likely to be subject to the alternative minimum tax.

## Interest on Second Mortgages

The AMT allows a deduction for interest on mortgage borrowings used to buy, build or improve your home. If you borrowed against your home for some other purpose, the interest deduction isn't allowed under the alternative minimum tax.

## Medical Expenses

The AMT allows a medical expense deduction, but it's more limited than the deduction under the regular income tax. If you claim an itemized deduction for medical expenses, part or all of it will be disallowed when you calculate your alternative minimum tax.

## Miscellaneous Itemized Deductions

Certain itemized deductions are available if your total in this general category is more than 2% of your adjusted gross income. Among the items here are unreimbursed employee expenses, tax preparation fees, and many investment expenses. You can't deduct these items under the AMT, though. If you claim a large number in this area, you could end up paying alternative minimum tax.

## Various Credits

Many of the credits that are allowed when you calculate your regular income tax aren't allowed when you calculate your AMT. The more credits you claim, the more likely it is that you'll end up paying alternative minimum tax. Fortunately, Congress has recently extended relief from the "personal credits" through the year 2000. (See [news story](#).)

## Incentive Stock Options

Generally you don't report anything on your regular income tax at the time you exercise an incentive stock option. But you have to report income for purposes of the AMT. Exercising a large incentive stock option is almost certain to cause you to pay alternative minimum tax.

Details concerning the AMT consequences of incentive stock options appear in our [Guide to Compensation in Stock and Options](#).

## Long-Term Capital Gains

Long-term capital gains receive the same preferential rate under the AMT as they do under the regular income tax. In theory, they shouldn't cause you to pay alternative minimum tax. In practice, it's possible to be stuck with [AMT liability because of a large capital gain](#). The reasons are a little complicated, but mainly have to do with the fact that a large capital gain reduces or eliminates the AMT exemption amount, which is designed to protect low-income taxpayers from having to pay alternative minimum tax.

## Tax-Exempt Interest

Interest that's exempt from the regular income tax may or may not be exempt from the AMT. It depends on complicated rules that are fully understood only by bond lawyers. Bonds that aren't exempt from AMT pay a slightly higher rate of interest to compensate for the fact that they aren't fully tax-exempt. If you invest in bonds that aren't exempt

under the alternative minimum tax, you're a candidate for AMT liability.

Many mutual funds that provide exempt interest invest at least *some* of their money in bonds that aren't exempt under the AMT, to get a higher rate of interest. Their annual statement tells you how much of the exempt interest dividend you received during the year is taxable under the alternative minimum tax.

## Tax Shelters

The Tax Reform Act of 1986 severely curtailed the ability to reduce income tax through tax shelters. Yet there are still some legitimate ways of reducing tax liability through investments in certain types of partnership or limited liability company arrangements involving such activities as oil and gas drilling. The AMT provides reduced tax benefits for these activities. You should always explore the alternative minimum tax consequences (among other things) before investing in a tax shelter.

by [Kaye Thomas](#)  
December 20, 1999

A publication of Fairmark Press Inc.  
© Copyright 1997-2002, Kaye A. Thomas  
All rights reserved