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Money Matters | How will Congress's game of chicken over the Alternative Minimum Tax end? History points towards a patch

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How Will Congress's Game of Chicken over the Alternative Minimum Tax End? History points towards a "Patch".

While Congress drives closer to the so-called "fiscal cliff", taxpayers in Kansas and Missouri are on edge, while financial planners are on guard.

The Alternative Minimum Tax (AMT) is a separately figured federal tax that eliminates or reduces many exclusions and deductions. Although it has evolved since its enactment in 1969, the amount of income that is exempt from the tax ($45,000 for married filers and $33,750 for single filers) was set in 1993. Whereas the standard deduction and personal exemption adjust each year for inflation by law, the income exemption for AMT purposes does not adjust, so we are stuck with an exemption amount in 2012 that is really applicable to 1993! Did you know that a gallon of milk cost about $1.00 in 1993? I think you get my point.

Congress's ongoing response to the further decoupling of the AMT exemption from today's income levels has been to pass legislation a.k.a. the AMT "Patch". By doing so, it shelters the AMT from unintentionally biting millions of middle-class taxpayers, and, instead focuses on its original target, high-income taxpayers. To Congress's credit, they have patched the AMT exemption almost every year since 2001, but it has not been without some anxious moments.

We only have to go back to December of 2010 for the last time Congress played the game of chicken with the Alternative Minimum Tax exemption. In the waning days of that year, Congress passed the 2010 Tax Act that extended the AMT "Patch" into 2010 and set the exemption amounts for 2011. Taxpayers, although relieved, were left scrambling in the last few days of 2010 to accelerate deductible expenses, which up to that point would not have been deductible without the legislation. The IRS also had to change its computer programs and tax forms late in the year to accommodate the law, which delayed the start of processing some returns. A similar event played out in December of 2007 with the passage of the Tax Increase Prevention Act of 2007.

If Congress does not act to increase the AMT exemption, then taxpayers with an Adjusted Gross Income (AGI) of $75,000 to $200,000 will be the most susceptible to its wrath. According to the most recent tax statistics provided by the IRS from 2010, there were about 236,000 Kansas tax filers and about 440,000 Missouri tax filers in this income range that, if not for the 2010 AMT "Patch", a majority would have been subject to higher taxes because of the AMT.

While Congress wrangles over this issue, here are some action items that you can take to prepare for either outcome:

Contact a CPA or CFP® Professional to help you to run the numbers. Do-It-Yourselfers can use the AMT Assistant.

The AMT issue for 2012 is not all we are facing. Higher income tax rates on ordinary and investment income are set to start in 2013, so reviewing a comprehensive projection of your income taxes over both years is vital.

Be ready to pay deductible expenses in December.

Preserve your tax deductions by paying them in the year that you will NOT be subject to the AMT. These include fourth quarter estimated tax payments to Missouri and Kansas, real estate taxes, and miscellaneous itemized deductions.

Be flexible with your income, if possible.

Strategically generating income in one year versus another can reduce taxes over a two-year period. Again, run the numbers before implementing this strategy.

If history is any indication of the future, then expect Congress to come to a screeching stop before heading over the cliff on the AMT issue by adjusting the exemption for 2012. When that happens, we can start planning around certainties, rather than the "What Ifs". That is, until the next time Congress plays the game of chicken.

The Money Matters column is written by members of the Financial Planning Association of Greater Kansas City. This week: Dan Mathews (dmathews@steppandrothwell.com), a Certified Financial Planner with Stepp & Rothwell, Inc., Overland Park.

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