

Point-of-View Report

ALTERNATIVE MINIMUM TAX AND THE ROLE OF AMT-EXEMPT MUNICIPAL BONDS

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The Alternative Minimum Tax – What is it?

The purpose of the Alternative Minimum Tax (AMT) is to ensure that everyone foots their fair share of the bill to run the country. AMT, the government's attempt to keep certain individuals from taking too many tax breaks, and effectively paying little or no tax, went into effect in 1983 and was further tightened with TRA 1986. The alternative minimum tax concept was developed out of the favored or preferred status Congress gave to certain types of income – so called preference items.

The individual alternative minimum tax (AMT) operates parallel to the regular income tax, with different rates and definitions of income and deductions. Essentially, a flat tax rate is applied on alternative minimum taxable income in excess of an exemption amount.

What constitutes “alternative minimum taxable income?” Generally, it is your adjusted gross income as determined for regular income tax purposes increased by certain tax preference items and decreased by certain itemized deductions. After taking into account certain tax credits and adjustments, the AMT is then computed. However, AMT is payable only if it exceeds the taxpayers regular tax. Because regular taxes were generally lowered by TRA '86 and because the new laws tighten up the AMT, many more taxpayers are now subject to the AMT's bite.

The Encroachment of AMT on Taxable Investors

It is estimated that by 2010, the AMT will affect 33 million taxpayers—about one-third of all tax returns—up from 1 million in 1999. This would make the AMT almost as common as the mortgage interest deduction is today. The AMT will be the *de facto* tax system for households with income between \$100,000 and \$500,000, 93 percent of whom will face the tax. It will encroach dramatically on the middle class, affecting 37 percent of households with income between \$50,000 and \$75,000 and 73 percent of households with income between \$75,000 and \$100,000 (compared to less than 3 percent for each group in 2002).

A Strategy to Minimize the Impact of AMT

While municipal bonds or portfolios thereof provide excellent tax exempt income and risk adjusted returns, it is important to understand the application of AMT to all investment portfolios and the solutions available to mitigate its application. Many municipal bonds, but not all, are AMT exempt. Havell Capital provides portfolios which are sensitive to the needs of investors subject to AMT.

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