PROTECT YOUR POT OF GOLD FROM BAD ADVICE

THE END OF THE RAINBOW

DR. DAHLE is the author of *The White Coat Investor: A Doctor's Guide to Personal Finance and Investing* and blogs at http://whitecoatinvestor.com. He is not a licensed financial adviser, accountant, or attorney and recommends you consult with your own advisers prior to acting on any information you read here.

Avoid the Alternative Minimum Tax

by JAMES M. DAHLE, MD, FACEP

Question. ***I end up having to pay thousands in alternative minimum tax (AMT) each year. What is the AMT, and what can I do to avoid paying it?***

A. The AMT should really be called the alternative maximum tax rather than the minimum tax. Tax law requires you to figure your tax using two separate, parallel tax systems—the regular income tax system and the AMT—and then pay whichever one is higher. The so-called alternative minimum tax on line 45 of your 1040 is really just the difference between what you would owe under the regular tax system and what you would owe under the AMT. If the regular tax bill is higher, that line is zero. If the AMT tax bill is higher, then line 45 is the difference between your tax bills under the two systems.

Historically, the law came into place in 1969 due to political outrage that 155 well-to-do taxpayers were not paying their share of the expenses of our nation thanks to their taking advantage of perfectly legal deductions. In 1982, it became the parallel tax system we know today. In many ways, the AMT is a simpler, better tax system than the regular system, with fewer deductions and brackets. However, until 2012, the exemption and brackets under the AMT were not indexed to inflation, although Congress dutifully "patched" it each year for decades. With time and inflation, many households that would not have been subject to the AMT in 1982 have become subject to it, and now 4–5 percent of taxpayers owe more under the AMT system than the regular system. Because most physicians have top 5 percent incomes, many of them are subject to the AMT.

How AMT Works

Having a goal to pay less AMT may be shortsighted. As a general rule, the goal should be to maximize your after-tax income or at least to minimize the total amount of tax paid. For example, the two easiest ways to pay less AMT are to make less money (and thus owe less tax) and to make more money (and thus owe more under the regular tax system than under the AMT). As a general rule, making less than $250,000 or more than $500,000 will keep you from owing AMT, although there are exceptions.

> The key to understanding the AMT and decreasing your AMT tax bill lies in understanding which deductions can be used under both systems and which ones can only be used under the regular tax system.

ILLUSTRATION/PAUL JUESTRICH; PHOTOS SHUTTERSTOCK.COM

The AMT system has just two brackets. In 2014, taxable income under $182,500 ($91,250 if married filing separately) is taxed at 26 percent, while taxable income above that amount is taxed at 28 percent. The exemption is also simpler. Instead of getting $3,950 for yourself and each dependent, the taxpayer receives an exemption of $52,800 ($82,100 if married filing jointly). However, this exemption is phased out between taxable incomes of $117,300 and $328,500 ($156,500 and $484,900 if married). The effect of this phase-out is to increase your marginal tax rate within the phase-out range from 28 percent to 35 percent. However, there is often a "sweet spot" above this phase-out range, where your marginal tax rate actually decreases from 35 percent back to 28 percent. If you are in this range, you may actually