Are you a target for the alternative minimum tax?

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Will I or won't I? Now that it's January, let the annual AMT guessing game begin.

Even if you've been paying the reviled alternative minimum tax known as the AMT for years, your status can change. It all hinges on how much you make, where your money comes from and the deductions you can claim.

"I love to describe the AMT as one of those big roulette-type wheels that goes round and round, and where it stops nobody knows," said Pete Lang, president of Lang Capital LLC, a Hilton Head, S.C.–based private wealth manager.

This may come as a surprise, but it's not the rich who have the most to worry about. Some 3.9 million taxpayers—4.2 percent of the nation's total—are expected to get hit with the AMT for 2013, according to experts from the Tax Policy Center. The average tab for individuals: $6,600.

"Unfortunately, AMT is really targeted at the middle market," said Dave McKelvey, partner in Friedman LLP, a New York City accounting and advising firm. "If you make a lot of money, your regular tax is going to be high enough that AMT is not going to be an issue, and if you make an income that's low enough, AMT is not going to be an issue."

Determining your risk factor

Under the dual tax system, taxpayers must pay whichever is higher—regular income tax or AMT—a rule established in 1969 to make sure no one escaped tax entirely. The AMT does not permit many of the deductions available for the regular return, such as personal exemptions, standard deductions and deductions for state and local taxes paid.

So how do you know if you'll face AMT this year? Past experience may be a better guide this January than it's been in the past.

That's because the compromise that ended the "fiscal cliff" showdown early in 2013 ended the annual uncertainty about the income levels exempt from AMT. Now the thresholds are automatically adjusted each year for inflation. The full exemption applies to an adjusted gross income of $80,800 for a couple filing a joint return, $51,900 for singles. The exemption phases out as income rises.

"We shouldn't have the threat of huge numbers of additional people being caught by the AMT going forward," said Mark Luscombe, principal federal tax analyst for CCH, a Wolters Kluwer business that studies tax issues.

The fiscal cliff deal also raised tax rates for higher-income earners. Couples making more than $450,000 a year and singles earning $400,000 or more now face a "marginal rate" of 39.6 percent rather than 35 percent on income above those levels. Because the maximum AMT rate is 28 percent, these well-to-do taxpayers will typically be charged more on their regular returns so they won't face the AMT.

Taxpayers with small incomes fall within the AMT exemption limits. That leaves the upper middle class to face the tax, especially those with incomes between $200,000 and $500,000, Luscombe said.

Certain factors raise the AMT risk. The seven triggers are:

1. living where there are high state and local taxes, which produce big deductions on the regular return
2. exercising stock options
3. reporting large investment options
4. having lots of children
5. using a home-equity loan for something other than home improvement
6. having a pile of miscellaneous deductions
7. claiming business depreciation

Smart money moves for 2014

There's not much to do now to reduce your AMT risk for 2013, but experts say taxpayers at risk have lots of moves available for the 2014 tax year."If you've been close or have paid the AMT in the past, you're likely to pay the AMT in the future," Lang said, adding, "If you want to get out of the AMT," he said, "you really want to push earnings into the future."

Taxpayers can also reduce current income with moves like maximizing tax-deductible contributions to IRAs and 401(k)s, he added. And they can offset capital gains by selling money-losing investments.

Luscombe said taxpayers should start by looking at the reasons they faced the AMT in 2013. If a home-equity loan hurt you, for example, think about paying it off. A taxpayer who lives in a state with high state and local taxes like New York might even, as an extreme move, consider changing the primary residence to a state like Florida, which has no income tax, he said.

McKelvey said much AMT strategy involves smart timing of matters, like when to take income or prepay taxes. A number of his clients who own construction companies, for instance, can time their billings to receive income in the current tax year or to wait until the next, allowing them to book income in the year they'll face the lowest tax rate, he explained.
Similarly, clients with stock options can sometimes minimize the overall tax by exercising the option in one year, triggering AMT, and then waiting until a subsequent year to sell the shares. That way, they get a credit on regular tax for the AMT paid earlier.
"That's a timing difference," he explained. "We do models on how that would treat them."

Because the new higher tax rates for regular taxes will eliminate AMT for many who have paid it in the past, these taxpayers should reexamine past strategies, said Paul Gevertzman, partner, Anchin, Block & Anchin, a New York City accounting firm. He said that one of his clients, an engineer with a mid-six-figure income, has for years declined to claim a deduction for research and development because he was always subject to AMT, which does not allow this deduction. But with the higher income tax rates, this client will now pay the regular income tax, which does allow that deduction.

So if you're exposed to AMT for 2013, sorry, you may be stuck. To ease the pain of an ugly surprise, do your return as early as possible, and be sure to have some cash on hand to pay a tax bill if it comes to that.

Then follow the experts' advice: Start this year's AMT planning sooner rather than later.

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