Abstract: Although the Tax Cuts and Jobs Act took much of the "teeth" out of the AMT by raising the inflation-adjusted exemption, high-income earners (and even some middle-income earners) should still watch out for its bite. This article discusses the basic rules and the role of itemized deductions. A sidebar warns investors that capital gains can trigger the AMT.

AMT less "toothy" but may still take a bite

For many years, the alternative minimum tax (AMT) posed a risk to many taxpayers in the middle- to upper-income brackets. The Tax Cuts and Jobs Act (TCJA) took much of the "teeth" out of the AMT by raising the inflation-adjusted exemption. As a result, middle-income earners have had less to worry about, but those whose income has substantially increased (or remains high) should still watch out for its bite.

Basic rules

The AMT was established to ensure that high-income individuals pay at least a minimum tax, even if they have many large deductions that significantly reduce their "regular" income tax. If your AMT liability is greater than your regular income tax liability, you must pay the difference as AMT — in addition to the regular tax.

As mentioned, the TCJA substantially increased the AMT exemption for 2018 through 2025. If your income (calculated for AMT purposes) falls at or below the exemption, you won't have to pay the AMT. The 2020 exemption amounts are $72,900 (for single filers), $113,400 (for married joint filers) and $56,700 (for married separate filers).

If you do get caught by the AMT, applicable rates begin at 26% and rise to 28% at higher income levels. That top rate is lower than the maximum regular income tax rate of 37%, but far fewer deductions are allowed for the AMT. For example, you can't deduct state and local income or sales taxes, property taxes and certain other expenses.

Itemized deductions

The AMT exemption phases out when your AMT income surpasses the applicable threshold, so high-income earners remain susceptible. However, even some taxpayers who consider themselves middle-income earners may trigger the AMT by exercising incentive stock options or incurring large capital gains.

Also, if you typically claim many itemized deductions for expenses that aren't deductible for AMT purposes, you might find yourself falling into the AMT net. These include state and local income taxes and property taxes.

If you're on the threshold of AMT liability this year, you might want to consider delaying state tax payments — as long as the late-payment penalty won't exceed the tax savings from staying under the AMT threshold.

Appropriate strategies

Since passage of the TCJA, the AMT may have become an afterthought for many people. However, it's still worth a look to see whether it could create undesirable tax consequences for you. Please contact us for help assessing your exposure to the AMT and, if necessary, implementing appropriate strategies for your tax situation.

Sidebar: Investors beware: Capital gains could trigger AMT

Many higher-income individuals and couples are active investors. Because the alternative minimum tax (AMT) exemption phases out based on income, realizing substantial capital gains could cause you to lose part or all of that exemption and, thus, subject you to AMT liability.

If it looks like you could get hit by the AMT this year, you might want to delay sales of highly appreciated assets until next year (if you don’t expect to be subject to the AMT then) or use an installment sale to spread the gains (and potential AMT liability) over multiple years. Contact us to discuss further.