Taxes and money: Time to prepare 2008 tax return, get ready for 2009 taxes

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New legislation, expiring provisions and existing provisions coming into effect will not only make preparing one's 2008 taxes difficult but could make 2009 and beyond just painful.

When it comes to preparing your tax return, whether you use a professional, do them yourself or just ignore them, there are a number of trouble spots or tax traps of which you should be aware and for which you should plan.

Listening to the news, we hear often of increasing deficit and decreasing tax revenues. This along with the complexity of these, “traps,” makes it apparent that taxes are not going to become simplified or less costly. In addition, these trends show that it has become necessary to plan for these during the year and not just wait and see what happens, when your taxes are prepared. Because of all of this, one’s tax situation should not be ignored during the year, but should be monitored periodically.

There are several areas of concern. However, there is one particular issue that is trapping more and more taxpayers into increased tax bills and that issue is the Alternative Minimum Tax, AMT. This is somewhat of a stealth issue because it seems that very few individuals know of its existence, yet every year its provisions are affecting more and more people.

The AMT, is a separate method of determining income tax. Despite the name, every taxpayer is potentially subject to this tax. The AMT is actually a flat tax, having its rates being either 26 percent or 28 percent depending on one’s level of income. If you are subject to this tax, you must prepare your income tax return and determine your tax using both the regular and alternative rules. You compare the tax calculated under both methods and pay the larger amount.

Most good software companies do the AMT calculations, when you use their products. However care must be taken to properly code preference items. Since the Internal Revenue Service is focusing on compliance, errors in doing this could generate letters from the IRS questioning items on your return.

The AMT appears to be a big secret, as most people I speak with have no idea what the AMT is. The AMT is in response to reports that wealthy taxpayers were paying no income tax due to “special deductions” only available to the rich. The AMT began in 1969 and reportedly was originally intended to apply to only 155 taxpayers.

The first step is to calculate AMT income. In general, this is calculated by adjusting the taxpayer’s current regular taxable income, using all the traditional laws, with a number of tax preference items and adjustments.

Tax preference items are additions to income with income that is generally excluded from regular taxable income. These items include tax-exempt interest from certain private activity bonds, depletion, intangible drilling costs and accelerated depreciation from certain property placed into service before 1987.

While tax preference items appear generally for the wealthy taxpayers, adjustments affects almost everyone and can either increase or decrease alternative income. These adjustments include the standard deduction or some itemized deductions, the personal exemptions, incentive stock options and the passive activity loss limitations, which include losses from residential and commercial rental activities.

From the total of regular taxable income with preference items and adjustments either added or subtracted, an exemption reduces that total. The exemptions for 2008 returns are $46,200 for single or head of household taxpayers, $69,950 for married filing jointly taxpayers and $34,975 for married taxpayers who file separately. This calculation will provide Alternative Minimum Taxable income, AMTI. This figure is multiplied by either 26 percent or 28 percent depending on one’s income. And you now have the AMT tax. This tax is compared to your tax liability calculated by regular tax rules and guess what? You pay the larger of the two taxes.

These calculations are found on IRS form 6251 and are a bit more complex than I have mentioned here. There is also a worksheet available from the IRS which will estimate, if you are subject to this tax. The complexities come from income from capital gains, large income over the AMT limits and AMT credits. However, to explain everything would take way too much space for one article. The State of California also has an AMT, which follows the federal rules somewhat closely.

The problems with the AMT are too numerous to fully mention. Not only are the rules extremely complex, but the exemptions amounts have not been regularly indexed for inflation, as California has regularly done.

In addition, the adjustments of the itemized or standard deductions and personal exemptions place the burden of this tax squarely on the shoulders of taxpayers that were never intended to be part of this system. The exemption amount for tax years 2007 and 2008 were scheduled to drop dramatically which would of caused millions of unsuspecting taxpayers to fall under the AMT. Only at seemly the last minute were “patches” added to the laws which kept the exemptions at the current levels.

The big question is, what will happen for tax year 2009? The AMT would be a very easy way to dramatically increase tax revenue. In addition, should this happen, some of your tax planning may become meaningless.

It is estimated by the taxpayer’s advocate’s office that without major changes, the AMT could affect over 30 million taxpayers by the year 2010. With the economy and tax revenue, as it currently stands, this appears to be a tax that is not going away soon.

With all the fallout from the “financial crisis” it is becoming very clear that the financial and tax rules have changed and will continue to change. Most likely the change will not be in the favor of ordinary taxpayers. The consequences of not knowing how your financial actions will affect your tax return could cause you to have a very large tax liability next year.

Jon Meyer is a local tax accountant and enrolled agent with over 25 years experience in tax preparation. The office of Jon the “Tax Man Meyer “also offers retirement planning and insurance options. Questions regarding this article can be made by calling 928-5200.

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