AMT and the individual investor

Wealth Management

The alternative minimum tax (AMT) was first introduced in 1969 to prevent high-income individuals from avoiding paying income tax by piling up deductions. There have been several changes to the AMT since then, most recently when the Tax Cuts and Jobs Act (TCJA) of 2017, which temporarily frees most Americans from the AMT. Pinpointing which taxpayers are still subject to AMT is a highly individualized calculation.

What is AMT?

AMT is a separate tax computation under the Internal Revenue Code that, in effect, eliminates many deductions and credits and creates a tax liability for an individual who would otherwise pay little or no tax. For purposes of computing AMT, preference tax items as well as most itemized deductions are added back to regular taxable income to calculate AMT taxable income. A tiered exemption amount is then subtracted from the AMT taxable income, and the taxpayer is required to pay the higher of the regular tax liability or the AMT calculation.

Legislation has transformed the AMT

Historically, the AMT exemption amount was erratically adjusted by Congress, which exposed certain municipal bondholders to bracket creep as their incomes increased without a corresponding increase in the AMT exemption; however, permanent legislation in 2013 set forth a new provision that indexes the AMT benchmarks annually for inflation.

The most recent change to AMT came in 2017 when the TCJA raised the exemption and phase-out levels for AMT between 2018 and 2025. As a result, the Brookings Institution estimates only 200,000 taxpayers are subject to AMT compared to 5 million in 2017. To unpack it further, Brookings estimates AMT impacts only 0.1% of all households.

Tax brackets impacted by the AMT

Income	Pre-TCJA	2019	2025	2026
Less than $50,000	-	-	-	-
$50,000–$75,000	-	-	-	0.1%
$75,000–$100,000	0.2%	-	-	0.3%
$100,000–$200,000	1.6%	-	-	2.2%
$200,000–$500,000	23.3%	0.2%	0.2%	23.5%
$500,000–$1,000,000	63.8%	1.8%	1.5%	63.8%
Greater than $1,000,000	24.2%	12.5%	8.2%	19.8%
All tax brackets	3.0%	0.1%	0.1%	3.7%

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0319-2), RBC Wealth Management
Income is in 2019 dollars.

AMT and municipal bonds

As a simplified definition, municipal bonds that finance quasi-public projects—including stadiums, housing projects, student loans, airports, seaports and industrial development projects—are generally subject to AMT. In 2022, approximately 5% of all outstanding municipal bonds were subject to AMT.

Investors who are not currently subject to AMT may consider purchasing AMT bonds to gain a yield advantage. Historically, the yield premium on an AMT bond has averaged 10 to 25 basis points over the yield on a non-AMT bond to compensate for the potential tax risk. However, as individuals' financial circumstances and the tax code change over time, investors could potentially find themselves subject to AMT, which could lead to tax consequences for private activity municipal bonds.

Which taxpayers are subject to AMT?

There isn't a simple figure to determine if an investor is subject to AMT.

The simplified answer is that high earners who employ various tax shelters allowed under the regular tax calculation are more likely to be subject to AMT. The AMT calculation does not allow for most of the popular itemized deductions, including state and local income taxes, foreign tax credits, employee business expenses, investment interest subject to AMT (i.e., certain municipal bonds), incentive stock options and natural resource depletion.

To calculate if additional tax is owed under AMT, the taxpayer needs to fill out IRS form 6251. If the tax is higher, then the taxpayer owes the difference between the AMT calculation and the standard income tax calculation. To oversimply further, the table below indicates the exemption amount a taxpayer can use to adjust one's taxable income under AMT, and the income threshold where the exemptions begin to be phased out completely.

2023 AMT benchmarks snapshot

	Single	Married filing jointly	Married filing separately
Low tax rate–$0–$220,700	26%	26%	26%
High tax rate–Over $220,700	28%	28%	28%
2023 AMT exemption	$81,300	$126,500	$63,250
Exemption phase-out begins at	$578,150	$1,156,300	$578,150
28% bracket threshold	$220,700	$220,700	$110,350

Source: IRS.gov, RBC Wealth Management.

A highly individualized calculation

If an investor is not subject to AMT, we believe private activity municipal bonds subject to AMT are a great way to boost yield because municipal bonds subject to AMT have higher yields to offset the potential tax burden to attract sufficient investors. Encouragingly, most investors could benefit from the yield pickup without having to assume the additional tax obligation—at least until 2026—because the 2017 tax changes freed most Americans from AMT.

The subject of AMT bonds is far from simple, and when it comes to tax matters, we strongly suggest investors contact their tax advisor for tax advice.

