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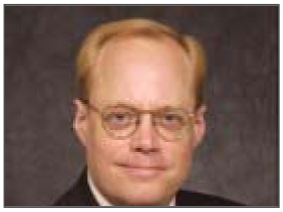

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Buffett's Tax Buffet Is No Smorgasbord

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Warren Buffett likes talking tax and knows a lot about becoming wealthy. But many are wondering if he should stay in Omaha, perhaps even take up peddling mail-order steaks. His Buffett Rule may be attractive to President Obama and to low income earners who've never heard of the alternative minimum tax—otherwise known as AMT. Tax me more is also a nice sound bite.

But even if a tax increase is a good idea, many others are wondering whether the Buffett Rule is a good way to do it. See The Buffett Alternative Tax. A rate increase or an examination into how dividends and capital gains are taxed is one thing. Even certain targeted modifications may make sense.

For example, one arguably appropriate change is to eliminate the rule that private equity and hedge fund managers are taxed at capital gain rates on their "carried interest." It's an amazing rule given the fact that they are performing services. If you want to point at any one rule as out of place that might be it. (Please, gentle readers who happen to be hedge fund managers, no hate mail).

However, saying that all dividends or all capital gains should face high rates may be throwing the baby out with the bath water. The same for taxing municipal bond interest. Plus, any rule suggesting that no matter what other tax provisions apply anyone earning over a million dollars should pay some kind of surtax sounds dangerous.

In 1969, our predecessors started with the same idea—to make sure that the wealthy pay some minimum level of tax. The AMT was born. Since then, it has grown into the most insidious and counterintuitive tax there is. Even if you're good with numbers, it's hard to see the AMT coming and it can make your taxes spin out of control. See Will Everyone Pay AMT Next Year?

The AMT was enacted in 1969 to impose a minimum tax on fat cats who claimed huge and unusual tax deductions—things like drilling expenses from oil deals. But gradually the AMT grew like wildfire to cover almost everything. Whether you know it or not, your accountant may be calculating AMT for you too.

You compute regular tax and AMT, and if the AMT is higher, you must pay it. Given the ingredients that go into the AMT, you can't eyeball it. In fact, you must compute your tax both ways to tell. Even IRS Commissioner Doug Shulman practically begged Congress to fix it. Congress only slapped on a two-year patch for 2010 and 2011.

A Congressional Research Service Report, "The Alternative Minimum Tax for Individuals" says it's only going to get worse—even without the Buffett Rule. See CRS Says Inflation, Income Tax Reductions Will Cause More Taxpayers to Be Subjected to AMT. If you think this doesn't apply to you, think again. Consider this trend:

- In 1997, about 1% of all taxpayers were subject to the AMT.
- In 2008, about 2.8% of all taxpayers were subject to the AMT.
- In 2012, estimates suggest 20% of taxpayers will face AMT.

Another Disturbing Statistic? In 2008 (the most recent year for which such statistics are available), 27% of the households that paid the AMT had adjusted gross income of $200,000 or less.

As we watch this debate unfold, watch out for hyperbole.

For more, see:

'Buffett Rule' Is More Complicated Than Politics Suggest

The 2013 Tax Cliff

Millionaire's Tax To Be Tough Sell

Buffett's New AMT

The Bush Tax Cuts—Better By Another Name?

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