

Statement by Representative Michael Honda

Hearing on Select Tax Issues Subcommittee on Select Revenue Measures Committee on Ways and Means September 23, 2004

Mr. Chairman and Ranking Member McNulty, I thank you for this opportunity to share my concerns about the treatment of Incentive Stock Options under the U.S. tax code and to urge your Subcommittee to take timely legislative action to rescue thousands of Americans from financial ruin.

For the last five years, the Alternative Minimum Tax's Incentive Stock Option rule has had an unintended devastating effect on hard-working, honest taxpayers. This little known provision of the AMT assesses tax liabilities on private sector employees who exercise stock options, even when no gains have been realized. Congress certainly never intended for taxpayers to be liable for tens or hundreds of thousands of dollars on stock that became virtually worthless.

The AMT was designed to ensure that wealthy Americans could not avoid taxes through excessive use of tax preferences, but in this case, the AMT's Incentive Stock Option rule is most injurious to Average Americans hoping to secure a strong financial future for them and their families.

The taxpayers affected by the ISO provision are desperately in need of help. Many of them have been subjected to tax rates in excess of 300% of their annual income. Unable to pay, these Americans are at the mercy of the Internal Revenue Service, which has chosen to move these cases into collection status. As a result, wages have been garnished, retirement accounts seized, and the vehicles and homes forcibly sold. These measures are extreme and undeserving.

For too long Congress has neglected this incredibly important issue, and I appeal to my colleagues on this Subcommittee to pursue a legislative and regulatory remedy to this injustice before more taxpayers are financially harmed.

LEGISLATIVE REMEDY

The Congress must pass legislation to correct the AMT ISO provision. Our colleague, Zoe Lofgren, recently introduced H.R. 5141, legislation that will repeal the AMT treatment of incentive stock options, shifting the taxable event from the exercise of the stock option to the sale of stock. This same legislation was introduced during the 107th Congress, which adjourned without taking action on the bill. I was an original cosponsor of this bill, and I wholeheartedly support Rep. Lofgren's decision to reintroduce the bill. I hope the Subcommittee will give her proposal the consideration it deserves.

I am also intrigued by a proposal now in development by Rep. Sam Johnson. Following the advice of four former Internal Revenue Service commissioners, Rep. Johnson has crafted legislation that may comprehensively remedy the complexity and inequity of the current ISO

AMT system, for taxpayers, Congress, and the IRS. This new proposal includes measures to restore Congressional incentives that encourage workers to invest in their companies and retain that stock until it becomes a long-term capital asset. In addition, it addresses the AMT prepayment provision in such a way that it does not trap taxpayers during economic down turns, and it fairly resolves the current harm done to honest, hardworking Americans by the current AMT ISO rule.

REGULATORY REMEDY

Congress has provided the IRS flexibility in the resolution of tax code infractions, and the IRS must employ this flexibility to hold harmless those unduly harmed by the AMT ISO rule. More specifically, the IRS should consider greater use of Offers in Compromise (OIC). Proper application of these provisions would give some measure of relief to the most pressing cases.

AMT ISO liabilities were the subject of a Ways & Means Oversight Subcommittee hearing on June 15 of this year. At that Hearing, taxpayer Nina Doherty addressed the IRS's aggressive enforcement and refusal to consider Offers in Compromise with respect to this issue, despite the power afforded it by statute and its own regulations. The IRS's categorical denial of Offers in Compromise ignores its own standards of special circumstances, hardship, public policy, and the promotion of effective tax administration, and ignores the advice and pleading of numerous practitioners, professors, the National Taxpayer Advocate, and Congress. The OIC program is already in place, and if properly applied by the IRS, can help those taxpayers suffering under this severe burden. Although the OIC is merely a stop-gap remedy, I encourage this Select Revenue Measures Subcommittee to utilize its influence to urge the IRS to take appropriate remedial action.

Multiple coalitions of individuals and of companies have been formed to follow, address, and resolve this single issue, aided by the print and screen media. Unfortunately, although we've worked on this issue for years, the problem hasn't been solved for a single suffering taxpayer. I urge this Subcommittee, and the rest of Congress, to join in resolving this issue.

Thank you for this opportunity to testify on the importance of restoring fairness in the U.S. tax code.