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TO: Honorable William M. Thomas, Chairman of the
Committee on Ways and Means

FROM: ReformAMT Leadership

RE: Alternative Minimum Tax Treatment of Incentive Stock
Options

**To the Honorable Chairman Thomas and the Honorable Members of the Ways and Means
Committee :**

Thank-you for allowing ReformAMT the opportunity to communicate the urgent need for legislation addressing the life-destroying impact of the Alternative Minimum Tax (AMT) and its treatment of Incentive Stock Options (ISO). The average individual in our organization faces tax rates that exceed 300% of their income.

Introduction

Formed in April 2001, ReformAMT is a national grass roots organization whose mission is to educate, correct, and prevent the injustices created by the ISO AMT and its inappropriate means of taxing Incentive Stock Options, which are intended to be a form of compensation. We have members in 48 different states, plus Puerto Rico and the District of Columbia.

Through ReformAMT, we plead with Congress to correct this flawed tax code that has resulted in financial devastation for not only our members but also thousands of others across the country who are too embarrassed or discouraged to publicize their dilemma. Originally intended to “ensure that a very small group of high-income individuals who paid no income tax would pay at least some income tax”¹, the AMT has hit hardest those honest, hard-working employees who traded longer work hours, lower salaries, fewer benefits, and job security for stock options that might someday provide for their children’s education, assist in purchasing a home, or help fund their retirement. Unfortunately, caught in the AMT trap, these workers were forced to pay taxes on money they never received and never will receive. Consequently, they are losing or have lost their homes, education funds, and retirement funds.

These people were committed, dedicated, and loyal to their companies. “Hold for the long term”, “be a part of the company”, and “don’t dump and cash in” was the advice of brokers, Certified Public Accountants, financial advisors, and the companies themselves. However, as we all now know, the Incentive Stock Option AMT provisions tax when you *buy*, NOT when you sell, forcing these workers to pre-pay taxes on stock gains they never realized. To add insult to injury, these taxpayers have honestly complied with this self-reported tax. While the IRS machine destroys their lives, they have watched many of their fellow coworkers go unharmed by simply omitting the reporting of the stock option transaction.

Demographics

These are the results of a recent survey of our members in April 2005:

¹ Robert Carroll, Deputy Assistant Secretary (Tax Analysis), submitted a paper to the President’s Advisory Panel on Federal Tax Reform on March 7, 2005, entitled: “The Fact Sheet: The Alternative Minimum Tax”

- 65% of our members affected by AMT are secretaries, engineers, lower level managers and other rank & file employees (as opposed to Managers, Executives and Founders).
- Our members owe or owed an average of \$322,428 in ISO AMT over and above what they would owe under the regular tax code for income received (that is 100 times what the average taxpayer hit with AMT pays in additional taxes, according to testimony by the GAO at a recent Senate Hearing).
- Our members' average tax rate was 355% of their income.
- Our members have an average outstanding AMT credit of \$213,620 due to their overpayment of taxes. With the current annual deduction for AMT credits of \$3,000 per year, it will take 71.2 years – more than a lifetime – to finally recover their overpayment credit. Also, this credit does not accrue interest – on the flip side – individuals who still have outstanding liabilities are expected to pay interest and penalties on this tax prepayment.
- Because of the extreme difficulty/impossibility of paying huge taxes on money never received, about 3% of ReformAMT members have filed bankruptcy, with another 18% admitting they are considering bankruptcy.
- For every 2 people who complied with the AMT regulations, there were 3 people who did not, taking advantage of the fact that no independent reporting exists.
- For every 4 people who complied, there was 1 person who expatriated rather than have their lives destroyed by working the rest of their lives to pay taxes on income they never received.
- We know of 2 members who committed suicide due to the horrendous effects this ISO AMT tax had on their lives.

Flaws of the AMT Treatment on ISOs that Distort Business and Personal Decisions and Create Unfair and Unjust Results for Hardworking Americans.

- Tax Date Flaw - The regular tax code provides significant incentives to hold on to the stock and grow the company. However, the AMT imposes tax on the purchase date, not the sale date, making the tax rational only in a bull market. In a down market, the AMT can result in unreasonable and totally disproportionate tax rates, easily exceeding an individual's income or even exceeding an individual's entire net worth.
- Complexity Flaw – Due to the complexity of the AMT, investment counselors and “tax experts” are frequently unable or unwilling to give proper advice to constituents about the consequences of the ISO AMT. Many people were completely blind-sided by the AMT despite getting professional advice on how to treat their stock options.
- Reporting Flaw – The exercise of incentive stock options is not reported to the IRS by the company or by the broker – it is only reported by the individual, making it a self-reported tax. Thus, the ISO AMT provisions punish those who are honest and reward those who fail to accurately report their taxes under the AMT code (either through ignorance or intent).
- Credit Flaw
 - ISO AMT credit can easily outlive a taxpayer, since it can be applied only to the difference between the AMT and regular income tax. For those who are ready to retire and who have responsibly saved their entire lives to provide for a proper retirement, the ability to recoup the credit can be impossible.
 - The credit that is generated does not pass along to your family or estate.
 - The government does not pay interest on the credit.

- Tax Rate Flaw - Taxpayers exercise and hold stock options in order to pay 15% long-term capital gains tax at sale, but AMT forces them to instead pay 26 to 28% tax in advance. Thus, the AMT drastically exacerbates the risk of holding for long-term capital gains and discourages the economically beneficial practice of holding stock.
- Encouraging the Wrong Behavior Flaw
 - The combination of the Tax Rate Flaw and Tax Date Flaw results in encouraging behavior that is at odds with the goals of the company and the country (ie – forcing people to buy and sell short term and relinquish ownership in their own companies).
 - The combination of the Reporting Flaw along with the horror stories of IRS enforcement has discouraged compliance and undermines confidence in the government.

Unintended Consequences

In order to pay their AMT bills, taxpayers have been forced to liquidate much or all of their assets, including savings, retirement accounts, and children's college funds. Many have lost their homes. Some are forced to take out second mortgages and loans in order to comply with this pre-payment of tax. Others are forced into bankruptcy or expatriation.

Those who have attempted to resolve their outstanding liabilities through the IRS's Offer in Compromise (OIC) program have faced rejection after rejection. The offers often take years to resolve and result in unrealistic IRS demands, requiring the taxpayers to live at or below the poverty line. According to Nina Olsen's (TAS) 2004 report to Congress, only one OIC submission under the use of Effect Tax Administration (ETA) was accepted that year. The Tax

Court recently upheld the IRS position on its refusal to consider the Section 7122 “equity and public policy” considerations of the offer in compromise process for ISO AMT, stating that while it sympathized with the taxpayers, the remedy rests solely with Congress.

The emotional and financial hardship caused by the AMT’s treatment of ISOs has taken its toll on thousands. Marriages and families have suffered under the daily stress of dealing with the IRS; they have divorced, decided not to have children or to adopt children; their friends and parents watch in horror as their loved ones lose an entire life’s work because of how the AMT can force them into pre-paying taxes on stock for which they never received gains (for individual stories, visit www.reformamt.org). Meanwhile, those who did not comply with the law are leading their normal lives.

Aside from the obvious “un-American” treatment of imposing taxes based on no realized gain, the effects also reach beyond individuals and families. The ISO AMT provisions are destroying and stifling the productivity, innovation, and companies that contribute greatly to America’s economic success and growth. It undermines confidence in the tax system, encouraging non-compliance. These effects cannot be what Congress intended.

Request for Relief

Now, with the new bankruptcy laws going into effect in a few months, ReformAMT respectfully asks the Ways and Means Committee to consider an immediate and critical solution that will:

- Put a “stay” on IRS enforcement of this excessive tax prepayment and abate the liabilities, interest, and penalties based on phantom gain; and
- Restore taxpayers ISO AMT prepayment credits as quickly as possible.

The law as related to the AMT treatment of ISOs is fundamentally unfair and flawed, and comes at a tremendous cost to taxpayers. Our members are struggling with huge tax bills and IRS collections. They have pre-paid taxes from stock compensation for which they never received economic gain. Some of the companies whose stock was affected are now out of business. Our members are on the brink of financial ruin, suffering anxiety and depression that is so severe, it is destroying their daily lives. Please help us.

Thank-you for your time. We hope that you will take our voices into consideration.

Sincerely and gratefully,

ReformAMT.org