

TAXES

GIMME A BREAK

Alternative Minimum Tax sending Eastern lowans to the poorhouse

By Dave DeWitte The Gazette

Ron Speltz of Ely never expected his moment of fame to come from a fight with the government over a quartermillion-dollar tax bill.

Sandra Lafferty of Cedar Rapids never suspected she would be clobbered by a tax bill so overwhelming that she would have to sacrifice her credit record by filing bankruptcy.

Welcome to the world of lowans who face massive tax bills on profits never realized.

Most were executives whose employers granted them incentive stock options to reward their loyalty. Few knew how this special form of incentive pay could be affected by a set of federal tax rules called Alternative Minimum Tax.

The chance to become a stock millionaire, or at least accumulate a comfortable retirement, was the dream. ISO programs allow employees to buy company stock at a price much lower than market value.

But stock options were a tax trap for many who bought during the early stage of the stock market downturn in 2000 and 2001. As prices plummeted, shareholders hung onto their stock in hopes the market would recover.

Then they began receiving tax notices for huge tax obligations they had not foreseen.

The IRS maintains the ISO shareholders owe tax on the difference between the amount they paid for their shares and the market value of those shares at the time they were purchased — not the value of their shares a year later, after the stock market swooned.

The tax code requires the IRS to take that position, officials say, even when taxpayers realized no profit from a stock sale.

Speltz, 38, works at McLeodUSA, where an e-mail survey turned up at least 125 employees who had suffered a similar fate.

Speltz himself had invested seven years of savings, about \$34,000, into 30,000 shares of McLeodUSA stock. His options allowed him to pay a little over \$1 per share for stock that was trading for about \$24.

By the time Speltz sold the stock, it was worth about \$2,000.

The tax bill totaled \$263,000, representing the difference between the amount Speltz paid for the shares and their market value when he bought them.

Speltz and his wife, June, drained their investments and savings and borrowed from relatives to muster enough to pay half of the tax bill.

But paying half only seemed to convince the IRS that the Speltzes could pay the total, making the agency less flexible in efforts to reach a settlement.

After paying his lawyers and part of his taxes, Ron Speltz said, he is in worse financial condition than he was at

age 14, despite having the financial needs of a family.

“It’s caused us to change everything in life,” he said. “It’s shoved us into a position where we literally have a hard time putting food on our table.”

The Speltzes fought back harder than most, taking their case to tax court, where they lost. It is now on the way to the U.S. Circuit Court of Appeals.

Tax specialist Dick George of RSM McGladrey in Cedar Rapids has worked with many clients hurt by ISO AMT, most of whom were employed at McLeodUSA. He said some borrowed money to pay their tax bills, while others tried to make a deal with the IRS, and still others sold their stock to pay their tax bills.

George said employers have become better about informing their employees about the possible consequences of ISO AMT.

Sandra Lafferty, 46, didn’t even understand the ISO AMT bills on her husband’s stock options with a telecommunications company until her divorce. He agreed in their divorce settlement to pay them. More than a year later, when she had taken a full-time job to support her three children, the government came after her because the debt remained unpaid.

“It didn’t matter what the divorce decree said or that it was income from his employment,” she said. “It was a joint return.”

Lafferty and Speltz are members of the Coalition for Tax Fairness, a group working to reform ISO AMT rules.

The Speltz case has been told again and again in the financial media throughout the country, including prominent articles in the New York Times and Business Week.

Virtually everybody who’s heard the story agrees that the tax is unfair, Speltz said. Now, the Coalition for Tax Fairness says it may finally be in a position to change the unfair rules.

House bill 3385, introduced in July by Rep. Sam Johnson, R-Texas, would refund AMT tax credits to the taxpayer over five years.

“It will get something on the table that will pass the Congress, and give the affected people a ray of hope that things will get better,” said Tim Carlson, president of the coalition.

Rep. Jim Leach, R-Iowa, recently signed on as a co-sponsor of the bill.

“This will resolve what has obviously become a clear inequity,” Leach said.

Sen. Chuck Grassley, R-Iowa, supports the intent of Johnson’s legislation, said spokeswoman Jill Kozeny. She said Grassley hopes it will become an issue for House-Senate conference negotiations on Grassley’s tax reconciliation bill, which passed the Senate last week. If not, he hopes the House will send the Senate an AMT bill including the changes.