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AMT Sending Tens of Thousands to Financial Ruin

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Tens of thousands of Americans face financial ruin because they voluntarily reported incentive stock options to the Internal Revenue Service.

The IRS is using provisions of the Alternative Minimum Tax (AMT) to hit some persons who received incentive stock options with tax bills that often exceed their annual earnings or net worth even though they never collected any money from the stock, took losses on the stock, or saw the value of their options wiped out. "Thousands of us found out a few years ago we owe an exorbitant amount of taxes on money we never made," said Jay Cena, co-founder of ReformAMT, which has been trying to persuade Congress to address the issue. "The IRS has based the tax on a moment in time that has no correlation to actual gains. It forces you to pre-pay a tax that you may owe in the future."

Law Punishes Stock Losses

Many of those affected in this way worked for technology companies that crashed when the dotcom bubble burst. They have been fighting the IRS since 2001 and are running out of time. The IRS has been refusing settlement offers and has begun garnishing wages and seizing houses and other personal assets.

"The law was not written to allow for a declining market," said Cena, who grew up in New Jersey but now lives in Cupertino, California. "The tax bill often exceeds their annual salary or entire net worth."

$2,000 Value, $252,893 Owed

Citizens across the country face this predicament. Typical among them are Ron and June Speltz of the Eastern Iowa town of Ely. The Des Moines Register wrote about them and other Iowans in similar tax straits on February 5:

"In 1992, Ron took a job with McLeodUSA, then a small telecommunications start-up," the Register wrote. "The company provided stock options as part of employee compensation. He saved the options, hoping to use the nest egg to build a home and save for his daughters' college costs. In 2000, he and his wife, June, consulted financial advisers on the best way to cash out the stock. The couple was told to exercise the options and hold the stock for a year to take advantage of low tax rates on capital gains.

"That's what they did. But as the year passed, the stock price fell. And fell. What was once worth about $700,000 was eventually worth $2,000.

"The Speltzes didn't collect any money from the stock. Yet that year, they owed $252,893 in state and federal taxes related to the stock because of a 28 percent prepayment tax on what the stock was worth. They're not mega-rich. In 2000, Ron earned about $70,000 at McLeod, less than a third of the tax they owed."

Gains, Losses Deemed Irrelevant

In Cena's case, he learned in March 2001 while undergoing chemotherapy treatments for cancer he would have to pay an effective tax rate of nearly 2,000 percent of his income because of incentive stock options he received in 2000.

"I traded salary for stock options," said Cena. "They're going after me for year 2000, at the peak of value." The dotcom bubble burst soon after he took the stock options.

"They effectively tax the value of the stock on the day you buy it," Cena said, "not on the amount of money you might have made or lost. I know of no other event that taxes when you buy an asset. It's always on when you sell, to determine if there is a gain or loss. I know a person in California who has been taxed $400,000 on a $5,000 gain. The company [he worked for] has gone bankrupt. Not only has he prepaid the tax, the company is nonexistent. There is nothing to trade anymore."

A tax credit of $3,000 a year is allowed on the prepaid tax. But with prepaid tax bills of hundreds of thousands of dollars, people would have to live hundreds of years to recoup their payments.

Taxpayers Volunteered Information

There are two ironies common to most of those in Cena's position, and one irony that may be unique to him and his fellow former coworkers.

First, the IRS never would have known about the stock options had the taxpayers not voluntarily reported them. The companies that issued the stock options were not required to report them to the IRS.

Second, in many instances, if the incentive stock options had been traded to avoid losses, the individuals could have been prosecuted by the Securities and Exchange Commission for insider trading, according to Tim Carlson, senior counsel at Texas Instruments and president of the Coalition for Tax Fairness.

An irony that may be unique to Cena and his former coworkers is that the company they worked for Network Appliance, Inc. supplied the IRS with file servers and network storage. So the IRS may be using against them the products they helped deliver.

Options Encouraged

Congress has encouraged the use of incentive stock options by granting them favorable tax treatment, but only if the person owns the stock at least one year from the date of exercise and two years from the grant date.

"In an up market this is not a problem," Cena said. "Congress gave this incentive because it didn't want people to flip their stock [sell soon after obtaining it]. On the back end of this policy, though, there is no way in a down market to recoup the credit you had to prepay to get the stock. The other thing is that after you sell the stock, there is no way to get back the tax that is owed."

Remedy Offered

Rep. Sam Johnson (R-TX) has introduced HR 3385, the AMT Credit Fairness Act, to remedy the situation. Sponsors include conservative Republican Rep. Mike Pence of Indiana and liberal Democrat Rep. Barney Frank of Massachusetts. Other congressmen and senators sponsoring the legislation include Rep. Richard Neal (D-MA), Rep. Rahm Emanuel (D-IL), and Senators Tom Harkin, (D-IA), John Kerry (D-MA), Joe Lieberman (D-CT), and Chuck Schumer (D-NY).

"Tax rates three times a person's entire income for the year is not a partisan issue or a conservative or liberal issue," said Carlson in explaining why lawmakers from both parties and a broad range of perspectives support the legislation. "Everyone who understands it knows it's wrong."

Congress Can't Believe It

But he added getting lawmakers to understand the issue is no easy task.

Carlson, who through the Coalition for Tax Fairness is defending ReformAMT members, said the facts surrounding the IRS's treatment of people who received incentive stock options and derived no benefit from them are so outrageous that many in Congress do not believe they're true.

"Part of the issue on Capitol Hill is incredulity," Carlson said. "People don't believe the law can be going this far awry."

"It's so egregious it's almost harder to get people to believe it's happening," Carlson said. "The average additional [incentive stock option] tax owed under the AMT is $300,000, and the salary is $70,000. That is an anchor that sinks people to the bottom. These Congressional staffers are used to complaints. They hear these stories and think they're exaggerations, but they're not."

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For more information ...

Information on the IRS's treatment of incentive stock options under the Alternative Minimum Tax is available at **http://www.reformamt.org**.