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September 29, 2004

The Honorable Jim McCrery  
Chairman, Subcommittee on Select Revenue Measures  
Committee on Ways and Means  
1102 Longworth House Office Building  
Washington, DC 20510

Dear Mr. Chairman:

Thank you for holding the September 23, 2004 hearing regarding the application of the Alternative Minimum Tax to stock options. The San Diego area that I represent is home to many high tech and biotechnology companies. Many of my constituents, particularly the lower and mid-level employees who work in highly volatile industries, receive stock options as a part of their compensation packages.

I am concerned that many of my constituents are being penalized by the IRS when they exercise their stock options, and the alternative minimum tax is forcing them to pay taxes on paper gains which they never actually realize. The current volatility of the market is forcing many individuals to pay taxes which are actually in excess of the current value of their stock. For example, one of my constituents owes \$350,000 in taxes on stock which is currently valued at only about \$50,000.

I would like to thank you for your continuing leadership on reform of our tax system, and I look forward to working with you to recharge our economy. I ask that my attached statement be submitted to the record for the September 23 hearing on Select Revenue Measures.

With best regards,

Sincerely,

Randy "Duke" Cunningham  
Member of Congress

RDC:es

**Congressman Randy "Duke" Cunningham**  
**Statement for the Record**  
**Subcommittee on Select Revenue measures**  
**September 23, 2004, 11:30 AM – Hearing on Select Tax Measures**

Mr. Chairman, thank you for holding this hearing on discrete revenue measures, and I appreciate the opportunity to highlight a single provision in the Internal Revenue Code: section 56(b)(3), the Alternative Minimum Tax's Incentive Stock Option Rule. For the last 5 years this provision has had an unintended devastating effect on hard-working, honest taxpayers. The taxpayers affected by the ISO provision are desperately in need of a solution; many of them have been subjected to tax rates in excess of 300% of their annual income. Of course they do not have the money pay these taxes, so the IRS is moving these cases into collection status, and has been garnishing their wages, seizing their retirement accounts, and forcing sales of their vehicles and homes. More taxpayers are suffering under these extreme and unfair measures each year.

Congressman Sam Johnson succinctly stated the problem on the floor earlier this year in the debate on the hold harmless extenders. He stated that:

*One additional interim step we need to take is to help those trapped in AMT through exercise of Incentive Stock Options or ISOs. In this instance, the AMT requires people who exercise options on their employer's stock to pay tax on phantom profits. Many people stuck in AMT owe tens of thousands or hundreds of thousands of dollars in AMT on phantom profits never realized because the bottom fell out of the market. We cannot justify a tax system where taxes are owed when no gain was ever realized.*

The San Diego area that I represent is home to many high tech and biotechnology companies. Many of my constituents, particularly the lower and mid-level employees who work in highly volatile industries, receive stock options as a part of their compensation packages. I am concerned that many of my constituents are being penalized by the IRS when they exercise their stock options, and the alternative minimum tax is forcing them to pay taxes on paper gains which they never actually realize. The current volatility of the market is forcing many individuals to pay taxes which are actually in excess of the current value of their stock. For example, one of my constituents owes \$350,000 in taxes on stock which is currently valued at only about \$50,000.

Congress never intended for taxpayers to be liable for tens or hundreds of thousands of dollars on stock that became virtually worthless, or for taxpayers to make a prepayment of tax that ends up being a lifetime interest free loan to the government. Despite Congress's best intentions, these are just some of the consequences befalling our taxpayers. Both the IRS and Congress must act to remedy this situation before more taxpayers are financially destroyed.

I support addressing this serious problem in a two step process:

The first necessary step is to utilize the flexibility Congress provided the IRS under current law; the Special Circumstances and Effective Tax Administration provisions of the Offer in Compromise process. 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. I encourage this Select Revenue Measures Subcommittee to utilize its position to urge the IRS to take appropriate remedial action.

The OIC measure, however, is merely a stop-gap remedy, and a comprehensive solution is required on a going-forward basis to restore fairness and justice to these taxpayers.

The second necessary step is the introduction and passage of a Bill that will fairly and comprehensively correct the AMT ISO provision – ideally in a manner that also simplifies this complex provision. Four former IRS Commissioners testified that with respect to the AMT, the sooner the remedy, the better. The consensus reached in that Hearing determined that the best way to handle the AMT is "one bite at a time."

This issue is of prime importance to everyone who's been touched by it, to all the companies for which they work, and to all America to show our tax system is fairly and justly applied.

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. First, ensure that the IRS will begin properly administering the Offer-in-Compromise program, such that the IRS will apply the same common sense and equitable standards to AMT ISO liabilities as they do to any other liability. Second, enact a law that will fairly, simply, and comprehensively address the issue of AMT ISO liabilities. The ISO AMT law has gone awry, and its complexity and application has ruined many American families. I look forward to working with you to right this wrong.