

COVER PAGE



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TO: President's Advisory Panel on Tax Reform
FROM: ReformAMT Membership within 48 different States
RE: Tax Reform Proposal: Alternative Minimum Tax
(AMT) Treatment of Incentive Stock Options

Formed in April 2001, ReformAMT's mission is to educate, correct, and prevent the injustices created by the Alternative Minimum Tax (AMT) and its inappropriate means of taxing Incentive Stock Options (ISO). Through ReformAMT, we urge Congress to correct this flawed tax code, which has resulted in financial devastation for our members and tens of thousands of others across the country. Originally intended to "ensure that a very small group (155) of high-income individuals who paid no income tax would pay at least some income tax"¹, this tax has hit hardest those employees who traded long hours, lower salaries, and a commitment to see their companies successful, for stock options which might someday provide a nest egg for their families. Unfortunately, caught in the AMT trap, these workers were forced to pre-pay taxes on stock gains they never realized.

ReformAMT has members in 48 different states, plus Puerto Rico, the District of Columbia, England, France, Canada and Pakistan. We have members in 290 (66%) of the 435 Congressional Districts. 65% of our members affected by AMT are rank & file (as opposed to Managers, Executives and Founders). In our most recent survey (4/05), our average member owes/owed \$322,428 in AMT. Our average member has an outstanding \$213,620 AMT credit (it would take an estimated 71.2 years to recoup their credit from the Treasury coffers). About 3% of ReformAMT members have filed bankruptcy, with another 18% considering bankruptcy. For every 2 people who complied with the AMT regulations, there were 3 people who did not. For every 4 people who complied, there was 1 person who expatriated. We know of two members who have committed suicide over this issue. Our average tax rate was 355%

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"

I. Description of the Proposal:

ReformAMT proposes legislation that respects the Congressional purposes of the Tax Code by aligning the AMT prepayment structure with the regular tax code incentives for ISOs in a comprehensive and consistent manner. This proposal generates revenue & reduces Administration's compliance and enforcement burdens by ensuring that everyone pays their fair share, while at the same time ensuring that the AMT ISO provisions will no longer unintentionally impose exorbitant and devastating tax liability on honest taxpayers while adding a reporting or IRS matching component. The refund provisions for past taxpayers resolve the current injustice where taxpayers are being subjected to unintentional and outrageously disproportional tax rates and irretrievable tax prepayment credits. Key provisions include:

1. For exercises during and after year of enactment:
 - a. Proposal changes the current AMT/ISO prepayment rate (ordinary AMT income rate 26%/28%) to AMT capital gains rate.
 - b. Valuation of stock, and year of inclusion in income, shifts from date of exercise to one year after date of exercise. Under current law, and unchanged by this proposal, option qualifies as ISO only if option is granted at least two years before disposition and stock is held at least one year.
2. For exercises prior to the year of enactment:
 - a. AMT credits currently being carried forward (and penalties and interest already paid with respect to AMT/ISO liabilities) are

returned in connection with the first three tax returns filed after the date of enactment. The amount returned each year is the greater of one-third of the AMT credit (including penalties and interest already paid as well as interest paid to those who have paid their tax liability in full) or the regular tax liability reported on the return.

- b. Any unpaid AMT/ISO liabilities with interest and penalties are abated in connection with the first three tax returns filed after the date of enactment.
3. To Ensure Fair and Equal Compliance and Enforcement, this proposal provides that the issuer must report all ISO taxable events to the taxpayer and the IRS.

II. Impact of Proposal Relative to Current System

Please see slides at bottom of Presentation for graphical depiction

New Valuation Date Aligns AMT Prepayment with ISO Incentives: The Proposed ISO AMT Legislation matches (a) the date on which the AMT prepayment tax is imposed, with (b) the date on which the underlying stock becomes a long-term capital asset. This new valuation date generally will be one year after exercise, at which point the taxpayer can satisfy the AMT tax by paying the proportional amount of current value eliminating the cash-flow crunch currently impaled on Taxpayers by the

forcing of overpayments on unrealized gains. The vagaries of the stock market, during the period prior to the stock becoming a long-term capital asset, will no longer create the unintended “trap” or Hobson’s choice for taxpayers.

Compliance Provisions Generate Revenue: Current law does not provide for a matching notice to the IRS when a taxpayer exercises ISOs. Accordingly, the only people paying the ISO prepayment tax are honest self-reporters. Given the devastation visited on these honest self-reporters, and the fact that no independent reporting exists, compliance is at an all-time low.

The GAO report dated April 27, 2005 on Internal Revenue Service: Assessment of the Fiscal Year 2006 Budget Request. GAO-05-566, shows that nearly twice the amount of resources (funding & headcount) are allocated to enforcement and compliance than that of the service arm of the IRS. This proposal would help reduce the resources needed for enforcement and add some balance to the IRS allocation of budget and FTEs. This Proposal requires companies to provide matching reports to the IRS (as are currently required for Non Qualified Options), allowing the IRS to track when AMT prepayments are owed, without additional cost to the companies. This matching provision, along with the fair and equitable payment provisions, combine to remove reporting disincentives and add reporting incentives, thereby bringing compliance to virtually 100% and generating substantial revenue (See, California and IRS recent examples).

Provisions Treat Taxpayers Fairly for Past Years: Honest taxpayers are being subjected to disproportional and devastating tax rates for past ISO exercises, forced to liquidate their stock options as well as any additional assets (including their homes, retirement & college funds) to prepay a tax for which their was no economic benefit.

This prepayment of tax then generates irretrievable AMT “credits” which are in essence a lifetime (or longer) interest free loan to the government. Because taxpayers did not receive economic benefit from the stock or made significantly less than the “phantom” income on which they are being taxed, many taxpayers have taken out loans themselves (on which they are paying interest) to then turn around and make this loan to the government. This proposal provides for a refund of these overpayment credits in the next 3 filing periods, thereby avoiding the injustice of forcing taxpayers to make a lifetime interest-free loan to the government based on future income they will never receive. The 3-year provision affords the government some leveling for the repayment of the inflated tax, as opposed to having to give the entire credit back in one year.

III. Transitions, Tradeoffs and Special Issues:

Please see slides at bottom of Presentation for graphical depiction

Closing

ReformAMT strongly supports efforts to comprehensively overhaul or eliminate the Alternative Minimum Tax system and install a straightforward, fair and balanced tax regime. We urge you to please read our members personal submissions to the Tax Panel if you haven't yet. Our members are faced with losing everything they own, along with future earnings. That reality is at a crisis stage and as such they cannot wait for relief during the time needed to develop and implement a comprehensive overhaul to the full AMT tax code. ReformAMT was formed in 2001 and since that time we have had the opportunity to speak to many members of both House and the Senate as well as many

journalists, lay people, etc. Everyone agrees that the ISO-AMT laws are complex, unfair and egregious. Please, it's time to do something about it.

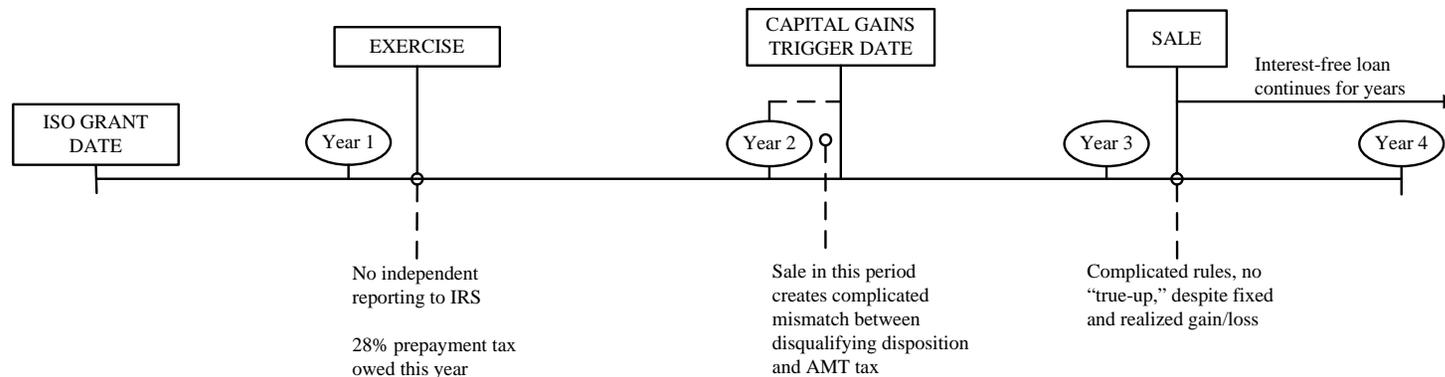
ReformAMT therefore respectfully urges this Panel to support much needed, immediate relief for these American taxpayers trapped by a complex tax provision and subjected to an unintended, devastating, and unfair effect of the AMT treatment of incentive stock options. We want to thank you for this opportunity to let the voices of our members be heard. We would also be delighted to meet with you to discuss our proposal or any intended fix the Panel maybe contemplating.

Sincerely,

The Leadership of
ReformAMT

Current Law - Application of AMT provisions to Incentive Stock Options

- Prepayment tax of 28% due upon exercise on difference between amount paid (strike price) and current market value on exercise date.
- Prepayment becomes AMT “credits” with complicated rules on offsetting tax owed on future gains or returning credits on future losses.
- Sale before one-year holding period results in “disqualifying disposition” and gain for regular tax purposes, but if that sale occurs during the calendar year following the year of exercise, then there are significant tax consequences for both regular and AMT purposes.

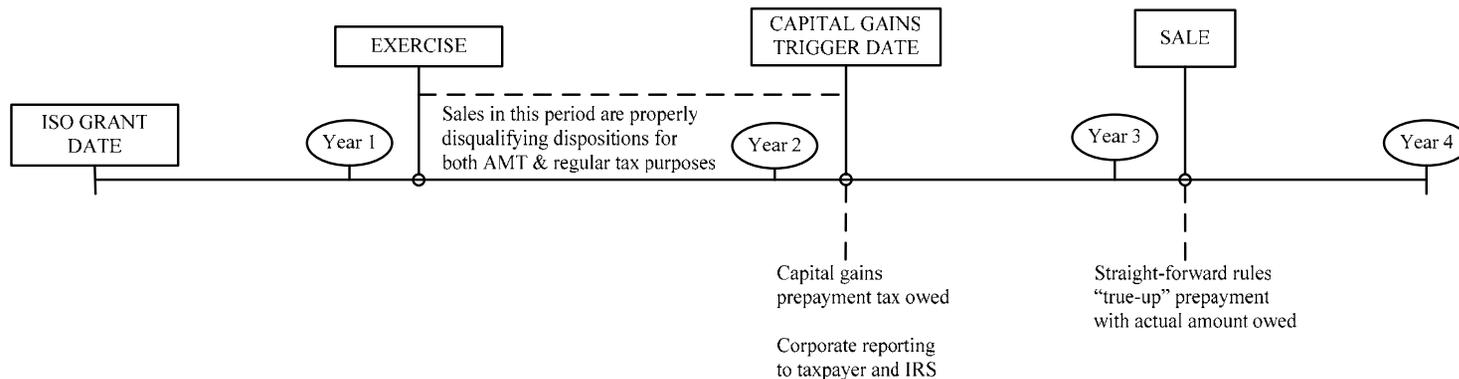


PROBLEMS:

- Employees have incentive under the regular tax law to hold stock for at least one year after exercise, but if the stock loses value between the exercise and the capital gains date, the AMT prepayment tax becomes disproportional and can be disastrous for the taxpayer if the stock drops significantly.
- Complicated rules on how prepayment AMT credits apply to actual gain and loss realized in the future, resulting in AMT prepayments becoming long-term (sometimes lifetime) interest-free loans of significant tax overpayments to the government.
- Disconnect between AMT calendar year trigger and the capital gains 365-day holding period trigger creates unnecessary complication of AMT credits even if there is a disqualifying disposition.
- Failure to synchronize prepayment rate with capital gains rate creates unnecessary “credit” generation even if the stock value at sale is the same as the stock value upon exercise (becomes even more severe when stock loses value).

Proposed Bill - Application of AMT provisions to Incentive Stock Options

- Prepayment tax of current capital gains rate is due concurrent with the capital gains rate trigger date on the difference between amount paid (strike price) and market value on capital gains rate trigger date.
- Prepayment becomes AMT “credit” with straightforward rules on offsetting tax owed on future gains or returning credits on future losses.
- Sale before one-year holding period results in “disqualifying disposition” and gain for regular tax purposes; synchronizing of valuation and due date of prepayment tax with the capital gains rate and trigger date eliminates complicated calculations.



SOLUTIONS:

- Restores incentive to hold stock for one year after exercise; AMT prepayment tax is proportional even if stock changes value between exercise and capital gains rate trigger dates; goals of both ISO and AMT provisions aligned.
- Revenue generated through corporate reporting to taxpayer and IRS. Reporting both educates and provides separate checks and balances to ensure increase to full compliance.
- Synchronizing the prepayment rate with the capital gains rate (rather than fixing it to a certain percentage) fixes the current illogic of having the prepayment *rate based on anticipated future gain* different from the *rate due when the gain is actually realized*; final true-up at sale creates logical and fair resolution point.
- Restores fairness to system for people with overpayment credits or outstanding tax liabilities due to severely disproportional taxes levied on unrealized gain, by refunding credits/abating liabilities in next 3 filings (1/3 each filing). This solution also resolves ongoing offers in compromise, and lawsuits in District and Tax Court, all of which are wasting significant government resources in attempts to collect disproportional and unfair prepayment taxes.