The ISO and AMT Guide

> Exercising incentive stock options can create a tax on a gain you have not cashed in. That surprise is the alternative minimum tax, and it is worth planning around.

Incentive stock options come with a valuable tax break and a trap in the same breath. Exercise and hold them the right way and you can turn the gain into lightly taxed long-term capital gains. Do it without planning and you can owe a tax on a profit you have not actually received.

The phantom gain

When you exercise an ISO and hold the shares, nothing is taxed under the regular tax system. But a second tax system, the alternative minimum tax, does not ignore it. The AMT counts the bargain element, which is the difference between the market price and your strike price, as income the year you exercise.

That is the trap. You have not sold anything and have no cash, yet the AMT can treat that paper gain as income and bill you for it. The larger the bargain element, the bigger the potential AMT hit, which is why a big exercise can create a surprising tax with no money coming in to pay it.

How the AMT decides your bill

The AMT runs a parallel calculation. It adds the bargain element to your income, subtracts an exemption, and applies its own rates of 26 and 28 percent. You then owe whichever is higher, your regular tax or this tentative minimum tax. The AMT only costs you the amount by which it exceeds your regular tax.

For 2026 the AMT exemption for a single filer is about 90,100 dollars, and it begins to phase out at higher income. Because of that exemption, small exercises often trigger no AMT at all, while large ones can. The ISO AMT Calculator estimates the tax for a given exercise so you are not guessing.

How to plan around it

The most common tactic is to exercise only as much each year as you can without crossing into AMT, spreading a large position across several tax years. Exercising early in the year also gives you until year end to watch the stock, since a large drop can let you sell before creating an AMT bill on a gain that evaporated.

There is also a silver lining. AMT you pay on an ISO exercise generally creates a credit you can recover in later years when you are not in AMT, so it can act as a prepayment rather than a permanent cost. Because the interactions are genuinely complex, this is an area where a tax professional often pays for themselves.

> **Key takeaway.** Exercising and holding ISOs can trigger AMT on a paper gain. Size your exercises to stay under the exemption, and remember the AMT often comes back later as a credit.

Assumptions

- The AMT exemption and thresholds shown are 2026 single-filer figures from IRS sources.
- This covers exercising and holding ISOs. Selling in the same year is a different, ordinary-income situation.

Sources

- IRS, incentive stock options (Pub. 525)
- IRS, alternative minimum tax and Form 6251