

103^D CONGRESS
1ST SESSION

S. 1175

To amend the Internal Revenue Code of 1986 to allow corporations to issue performance stock options to employees, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JUNE 29 (legislative day, JUNE 22), 1993

Mr. LIEBERMAN (for himself, Mr. MACK, Mrs. FEINSTEIN, and Mrs. BOXER) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to allow corporations to issue performance stock options to employees, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Equity Expansion Act
5 of 1993”.

6 **SEC. 2. PERFORMANCE STOCK OPTIONS.**

7 (a) IN GENERAL.—Part II of subchapter D of chap-
8 ter 1 of the Internal Revenue Code of 1986 (relating to
9 certain stock options) is amended by redesignating section

1 424 as section 425 and by inserting after section 423 the
2 following new section:

3 **“SEC. 424. PERFORMANCE STOCK OPTIONS.**

4 “(a) IN GENERAL.—Section 421(a) shall apply with
5 respect to the transfer of a share of stock to any person
6 pursuant to the exercise of a performance stock option if
7 no disposition of such share is made by such person within
8 1 year after the transfer of such share to such person.

9 “(b) PERFORMANCE STOCK OPTION.—For purposes
10 of this part—

11 “(1) IN GENERAL.—The term ‘performance
12 stock option’ means an option granted to any person
13 for any reason in connection with the performance
14 of services for an entity described in paragraph (4)
15 to purchase stock of any corporation described in
16 paragraph (4).

17 “(2) ADDITIONAL REQUIREMENTS.—An option
18 shall not be treated as a performance stock option
19 unless the following requirements are met:

20 “(A) NONDISCRIMINATION.—Either—

21 “(i) the option is granted to an em-
22 ployee who, at the time of the grant, is not
23 a highly compensated employee, or

24 “(ii) immediately after the grant of
25 the option, employees who are not highly

1 compensated employees hold performance
2 share options which permit the acquisition
3 of at least 50 percent of all shares which
4 may be acquired pursuant to all perform-
5 ance stock options outstanding (whether or
6 not exercisable) as of such time.

7 For purposes of clause (ii), only that portion of
8 the options held by persons other than
9 nonhighly compensated employees which results
10 in the requirements of clause (ii) not being met
11 shall be treated as options which are not per-
12 formance stock options, and such portion shall
13 be allocated among options held by such per-
14 sons in such manner as the Secretary may
15 prescribe.

16 “(B) SPECIFIC NUMBER OF OPTIONS.—
17 The option is granted pursuant to a plan that
18 includes either—

19 “(i) the aggregate number of shares
20 that may be issued under options granted
21 under the plan, or

22 “(ii) a method by which the aggregate
23 number of shares that may be issued under
24 options granted under the plan can be de-
25 termined (without regard to whether such

1 aggregate number may change under such
2 method),

3 and which is approved by the stockholders of
4 the granting corporation within 12 months be-
5 fore or after the date such plan is adopted.

6 “(C) TIME WHEN OPTION GRANTED.—The
7 option is granted within 10 years after the date
8 the plan described in subparagraph (B) is
9 adopted, or the date such plan is approved by
10 the stockholders, whichever is earlier.

11 “(D) TIME FOR EXERCISING OPTION.—
12 The option by its terms is not exercisable after
13 the expiration of 10 years from the date such
14 option is granted.

15 “(E) OPTION PRICE.—Except as provided
16 in paragraph (6) of subsection (c), the option
17 price is not less than the fair market value of
18 the stock at the time the option is granted.

19 “(F) TRANSFERABILITY.—The option by
20 its terms is not transferable by the person hold-
21 ing the option, other than—

22 “(i) in the case of an individual, by
23 will or the laws of descent and distribution,
24 or pursuant to a qualified domestic rela-

1 tions order (as defined in subsection (p) of
2 section 414), and

3 “(ii) in the case of any other person,
4 by any transaction in which gain or loss is
5 not recognized in whole or in part.

6 “(3) ELECTION NOT TO TREAT OPTION AS PER-
7 FORMANCE STOCK OPTION.—An option shall not be
8 treated as a performance stock option if—

9 “(A) as of the time the option is granted
10 the terms of such option provide that it will not
11 be treated as a performance stock option, or

12 “(B) as of the time such option is exer-
13 cised the grantor and holder agree that such
14 option will not be treated as a performance
15 stock option.

16 “(4) ENTITIES TO WHICH SECTION APPLIES.—
17 This section shall apply to an option granted to a
18 person who performs services for—

19 “(A) the corporation issuing the option, or
20 its parent or subsidiary corporation,

21 “(B) a partnership in which the corpora-
22 tion issuing the option holds (at the time of the
23 grant) a capital or profits interest representing
24 at least 20 percent of the total capital or profits
25 interest of the partnership, or

1 “(C) a corporation or a parent or subsidi-
2 ary corporation of such corporation issuing or
3 assuming a stock option in a transaction to
4 which section 425(a) applies.

5 “(5) HIGHLY COMPENSATED EMPLOYEE.—For
6 purposes of this subsection, the term ‘highly com-
7 pensated employee’ has the meaning given such term
8 by section 414(q).

9 “(c) SPECIAL RULES.—

10 “(1) GOOD FAITH EFFORTS TO VALUE
11 STOCK.—If a share of stock is acquired pursuant to
12 the exercise by any person of an option which would
13 fail to qualify as a performance stock option under
14 subsection (b) because there was a failure in an at-
15 tempt, made in good faith, to meet the requirement
16 of subparagraph (E) of subsection (b)(2), the re-
17 quirement of subparagraph (E) of subsection (b)(2)
18 shall be considered to have been met.

19 “(2) PERMISSIBLE PROVISIONS.—An option
20 that meets the requirements of subsection (b) shall
21 be treated as a performance stock option even if—

22 “(A) the option holder may pay for the
23 stock with stock of the corporation granting the
24 option,

1 “(B) the option holder has the right to re-
2 ceive property at the time of the exercise of the
3 option,

4 “(C) the right to exercise all or any por-
5 tion of a performance stock option may be sub-
6 ject to any condition, contingency or other cri-
7 teria (including, without limitation, the contin-
8 ued performance of services, achievement of
9 performance objectives, or the occurrence of any
10 event) which are determined in accordance with
11 the provisions of the plan or the terms of such
12 option, or

13 “(D) the option is subject to any condition
14 not inconsistent with the provisions of sub-
15 section (b).

16 “(3) FAIR MARKET VALUE.—For purposes of
17 this section, the fair market value of stock shall be
18 determined without regard to any restriction other
19 than a restriction that, by its terms, will never lapse.

20 “(4) DEFINITION OF PARENT AND SUBSIDIARY
21 CORPORATIONS.—For purposes of this section, the
22 terms ‘parent corporation’ and ‘subsidiary corpora-
23 tion’ have the meanings given such terms by sub-
24 sections (e) and (f) of section 425 except that such

1 subsections shall be applied by substituting ‘20 per-
2 cent’ for ‘50 percent’ each place it appears.

3 “(5) PERFORMANCE CRITERIA.—In the case of
4 a performance stock option that provides that its ex-
5 ercise is subject to any conditions or criteria de-
6 scribed in subparagraph (C) of paragraph (2), the
7 date or time the option is granted with respect to
8 each share that may be acquired shall be the date
9 or time the original performance share option is
10 granted and subject to the provisions of section
11 425(h), no portion of the option shall be treated as
12 granted at any other time.

13 “(6) CONVERSION OF OPTIONS.—If—

14 “(A) there is a transfer of an incentive
15 stock option in exchange for a performance
16 stock option, and

17 “(B) the number of shares that may be ac-
18 quired pursuant to such performance stock op-
19 tion and the transferred incentive stock option
20 are the same,

21 then the option acquired shall qualify as a perform-
22 ance stock option if the option price pursuant to the
23 performance share option is no less than the option
24 price under the transferred incentive stock option.”

25 (b) CONFORMING AMENDMENTS.—

1 (1) Section 421(a) of such Code is amended by
2 striking “or 423(a)” and inserting “, 423(a), or
3 424(a)”.

4 (2) Section 421(b) of such Code is amended—

5 (A) by striking “or 423(a)” and inserting
6 “, 423(a), or 424(a)”, and

7 (B) by striking “or 423(a)(1)” and insert-
8 ing “423(a)(1), or 424(a)”.

9 (3) Section 421(c)(1)(A) of such Code is
10 amended by inserting “and the holding period re-
11 quirement of section 424(a)” after “423(a)”.

12 (4)(A) Sections 421(a)(2), 422(a)(2), and
13 423(a)(2) of such Code are each amended by strik-
14 ing “424(a)” and inserting “425(a)”.

15 (B) Clause (ii) of section 402(e)(4)(E) of such
16 Code is amended by striking “424” and inserting
17 “425”.

18 (5) Section 423(b)(3) of such Code is amended
19 by striking “424(d)” and inserting “425(d)”.

20 (6) Section 425(a) of such Code, as redesign-
21 nated by subsection (a), is amended by striking
22 “424(a)” and inserting “425(a)”.

23 (7) Section 425(c)(3)(A)(ii) of such Code, as re-
24 designated by subsection (a), is amended by striking

1 “or 423(a)(1)” and inserting “, 423(a)(1), or
2 424(a)”.

3 (8) Section 425(g) of such Code, as redesign-
4 nated by subsection (a), is amended by striking “and
5 423(a)(2)” and inserting “, 423(a)(2) and 424(b)(4)
6 (as modified by section 424(c)(4))”.

7 (9) Section 425(j) of such Code, as redesign-
8 nated by subsection (a) (relating to cross-ref-
9 erences), is amended by inserting “performance
10 stock option” after “employee stock purchase
11 plans,”.

12 (10) Section 1042(c)(1)(B)(ii) of such Code is
13 amended by striking “or 423” and inserting “423,
14 or 424”.

15 (11)(A) Section 6039(a)(1) of such Code is
16 amended by inserting “or performance stock option”
17 after “incentive stock option”.

18 (B) Section 6039(b)(1) is amended by inserting
19 “, performance share option,” after “incentive stock
20 option”.

21 (C) Section 6039(c) is amended by striking
22 “and” at the end of paragraph (1), by striking the
23 period at the end of paragraph (2) and inserting “,
24 and” and by adding at the end the following new
25 paragraph:

1 “(3) the term ‘performance share option’, see
2 424(b).”

3 (12) The table of sections for part II of sub-
4 chapter D of chapter 1 of such Code is amended by
5 striking the item relating to section 424 and insert-
6 ing the following new items:

 “Sec. 424. Performance stock options.

 “Sec. 425. Definitions and special rules.”

7 **SEC. 3. TAX TREATMENT OF GAIN ON PERFORMANCE**
8 **SHARE OPTIONS.**

9 (a) EXCLUSION.—

10 (1) IN GENERAL.—Part I of subchapter P of
11 chapter 1 of the Internal Revenue Code of 1986 (re-
12 lating to capital gains and losses) is amended by
13 adding at the end the following new section:

14 **“SEC. 1202. 50-PERCENT EXCLUSION FOR GAIN FROM**
15 **STOCK ACQUIRED THROUGH PERFORMANCE**
16 **STOCK OPTIONS.**

17 “(a) GENERAL RULE.—Gross income shall not in-
18 clude 50 percent of the gain from the disposition of any
19 stock acquired pursuant to the exercise of a performance
20 stock option if such disposition occurs more than 2 years
21 after the date on which such option was exercised with
22 respect to such stock.

23 “(b) DEFINITIONS AND RULES.—For purposes of
24 this section—

1 “(1) PERFORMANCE STOCK OPTION.—The term
2 ‘performance stock option’ has the meaning given
3 such term by section 424(b).

4 “(2) CERTAIN ACQUISITIONS DISREGARDED.—
5 If stock described in subsection (a) is disposed of
6 and the basis of the person acquiring the stock is de-
7 termined by reference to the basis of the stock in the
8 hands of the person who acquired it through exercise
9 of the performance stock option, such person shall
10 be treated as acquiring such stock pursuant to such
11 option on the date such stock was acquired pursuant
12 to the exercise of such option.

13 “(3) EXERCISE BY ESTATE.—If a performance
14 stock option is exercised after the death of an indi-
15 vidual holder by the estate of the decedent, or by a
16 person who acquired the right to exercise such op-
17 tion by bequest or inheritance or by reason of the
18 death of the decedent, the 2-year holding require-
19 ment of subsection (a) shall not apply to the disposi-
20 tion by such estate or person.”

21 (2) CONFORMING AMENDMENTS.—

22 (A)(i) Section 172(d)(2) of such Code (re-
23 lating to modifications with respect to net oper-
24 ating loss deduction) is amended to read as
25 follows:

1 “(2) CAPITAL GAINS AND LOSSES OF TAX-
2 PAYERS OTHER THAN CORPORATIONS.—In the case
3 of a taxpayer other than a corporation—

4 “(A) the amount deductible on account of
5 losses from sales or exchanges of capital assets
6 shall not exceed the amount includable on ac-
7 count of gains from sales or exchanges of cap-
8 ital assets, and

9 “(B) the exclusion provided by section
10 1202 shall not be allowed.”

11 (ii) Subparagraph (B) of section 172(d)(4)
12 of such Code is amended by inserting “,
13 (2)(B),” after “paragraph (1)”.

14 (B) Paragraph (4) of section 642(c) is
15 amended to read as follows:

16 “(4) ADJUSTMENTS.—To the extent that the
17 amount otherwise allowable as a deduction under
18 this subsection consists of gain described in section
19 1202(a), proper adjustment shall be made for any
20 exclusion allowable to the estate or trust under sec-
21 tion 1202. In the case of a trust, the deduction al-
22 lowed by this subsection shall be subject to section
23 681 (relating to unrelated business income).”

24 (C) Paragraph (3) of section 643(a) of
25 such Code is amended by adding at the end

1 thereof the following new sentence: “The exclu-
2 sion under section 1202 shall not be taken into
3 account.”

4 (D) Paragraph (4) of section 691(c) of
5 such Code is amended by striking “1201, and
6 1211” and inserting “1201, 1202, and 1211”.

7 (E) The second sentence of paragraph (2)
8 of section 871(a) of such Code is amended by
9 inserting “such gains and losses shall be deter-
10 mined without regard to section 1202 and”
11 after “except that”.

12 (F) The table of sections for part I of sub-
13 chapter P of chapter 1 is amended by adding
14 after the item relating to section 1201 the fol-
15 lowing new item:

 “Sec. 1202. 50-percent exclusion for gain from stock acquired
 through performance stock options.”

16 (b) TREATMENT FOR WAGE WITHHOLDING AND EM-
17 PLOYMENT TAXES.—

18 (1) FICA TAXES.—Section 3121(a) of the In-
19 ternal Revenue Code of 1986 (defining wages) is
20 amended by striking “or” at the end of paragraph
21 (20), by striking the period at the end of paragraph
22 (21) and inserting “, or”, and by adding after para-
23 graph (21) the following new paragraph:

1 “(22) any gain from the exercise of a perform-
2 ance stock option (as defined in section 424(b)) or
3 from the disposition of stock acquired pursuant to
4 the exercise of such a performance stock option.”

5 (2) FUTA TAXES.—Section 3306(b) of such
6 Code (defining wages) is amended by striking “or”
7 at the end of paragraph (15), by striking the period
8 at the end of paragraph (16) and inserting “, or”,
9 and by adding after paragraph (16) the following
10 new paragraph:

11 “(17) any gain described in section
12 3121(a)(22).”

13 (3) WAGE WITHHOLDING.—

14 (A) Section 3401(a) of such Code (defining
15 wages) is amended by striking “or” at the end
16 of paragraph (19), by striking the period at the
17 end of paragraph (20) and inserting “, or”, and
18 by adding at the end the following new para-
19 graph:

20 “(21) any gain from the exercise of a perform-
21 ance stock option (as defined in section 424(b)) or
22 from the disposition of stock acquired pursuant to
23 such a performance stock option .”

24 (B) Section 421(b) of such Code (relating
25 to effect of disqualifying disposition) is amend-

1 ed by adding at the end the following new sen-
2 tence: “A deduction to the employer corporation
3 in the case of a transfer pursuant to an option
4 described in section 422, 423, or 424 shall not
5 be disallowed by reason of a failure to withhold
6 tax under chapter 24 with respect to gain on
7 stock acquired in the transfer.”

8 **SEC. 4. STOCK OPTION COMPENSATION.**

9 Section 14 of the Securities Exchange Act of 1934
10 (15 U.S.C. 78n) is amended by adding at the end the fol-
11 lowing new subsection:

12 “(h) STOCK OPTION COMPENSATION.—The Commis-
13 sion shall not require or permit an issuer to recognize any
14 expense or other charge in financial statements furnished
15 to its security holders resulting from, or attributable to,
16 either the grant, vesting, or exercise of any option or other
17 right to acquire any equity security of such issuer (even
18 if the right to exercise such option or right is subject to
19 any conditions, contingencies or other criteria, including,
20 without limitation, the continued performance of services,
21 achievement of performance objectives, or the occurrence
22 of any event) which is granted to its directors, officers,
23 employees, or other persons in connection with the per-
24 formance of services, where the exercise price of such op-
25 tion or right is not less than the fair market value of the

1 underlying security at the time such option or right is
2 granted.”

3 **SEC. 5. EFFECTIVE DATE.**

4 The amendments made by this Act shall apply to op-
5 tions granted after the date of the enactment of this Act.

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