

# EXTENSIONS OF REMARKS

## INTRODUCTION OF LEGISLATION TO PROVIDE TAX-ADVANTAGED STOCK OPTIONS TO NON-HIGHLY COMPENSATED EMPLOYEES

**HON. AMO HOUGHTON**

OF NEW YORK

IN THE HOUSE OF REPRESENTATIVES

Friday, October 31, 1997

Mr. HOUGHTON. Mr. Speaker, today I am introducing the Employee Stock Option Act of 1997, a bill designed to provide tax-advantaged stock options for more moderately paid employees. The legislation will enable these employees to participate meaningfully in their company's success.

### BACKGROUND

There is a growing concern about the wage gap. The perception is that there is a widening in the gap between the compensation of executives who are given stock options and regular employees. Much of executive compensation is made in the form of stock options. They have been profitable because of a rising stock market. Furthermore, many executives have earned substantial awards during a period of poor performance or and at times when others were being laid off.

How can we address this wage gap issue without imposing Government mandates, etc. at the upper end? There is presently a \$1 million limit on the tax deductibility of nonperformance based executive compensation for a publicly-traded corporation. The limit can be exceeded if compensation is based on performance goals or stock options tied to the market, therefore this limit has not slowed the increase in total compensation of executives during the past few years.

This Employee Stock Option Act of 1997 takes a different approach. Rather than putting a lid on the top, it gives a lift to the bottom. This legislation will benefit employees, whose hard work has enhanced the companies overall performance. In other words, employees through a broad-based stock option program ought to be able to build their wealth beyond what they would ordinarily receive from a salary. Furthermore, this act would give employees with limited disposable income the luxury of cashing in the option to pay education cost, putting a down payment on a home, or maintaining savings for the future.

### PROPOSAL

Provides a special stock option provision for employee stock options [ESO's], if companies offered at least 50 percent of the total options under the special stock option provision in a given year to non-highly compensated employees [NHCE's].

The idea is to provide a simple stock option approach for all employees. Such an option could be easily converted into cash, with minimum taxes, and would therefore put funds immediately in the employees' pockets. Of course, it is recognized that some holding period of the option or stock is appropriate for consistent tax policy.

This proposal would encourage employee participation in the growth of the enterprise

and provide a tangible benefit through an increase in the stock price.

### DETAILS

A new subsection (e) would be added to Internal Revenue Code section 422. The new subsection would provide that highly compensated employees could be awarded stock options, up to a new dollar limitation of \$200,000, if half or more of the options granted in a particular year go to non-highly compensated employees, [NHCE's]. Under current law, section 422(d) mandates a dollar limitation of \$100,000. It is believed that raising the cap for these special options will encourage corporations to grant more options to lower level employees as further explained below.

NHCE's comprise those employees who are not defined in section 414(q) as a "highly compensated employee", the latter being an employee who generally earns \$80,000 or more, adjusted annually for cost-of-living changes. Amount increased under H.R. 3448.

If the employee either holds the subsection (e) option for 2 years or holds the stock for at least a 1-year period, then no income would be recognized by the employee upon grant or exercise of the option. Upon sale, any gain would be treated as a long-term capital gain and could be eligible for the new reduced capital gain rate of 20 percent if the employee holds the stock longer than 18 months, otherwise it would be subject to the current maximum rate of 28 percent or treated as ordinary income if that resulted in a lesser tax. The present law requires a holding period of at least 2 years from date of grant and 1 year for the stock, so it is necessary to add a provision to cover the subsection (e) options as the option could be exercised after 2 years and the stock immediately sold.

In addition, the excess of the fair market value at exercise of the subsection (e) option shares over the option price, would not be subject to the alternative minimum tax [AMT], as under current law. This exception would only apply to the new subsection (e) options. Although the current AMT on incentive stock options normally might not apply to individual NHCE's because of the annual exemption, this exception would eliminate the burden of complexity and recordkeeping requirements related to such calculations. This change would also encourage corporations to make greater use of the stock options for employees and executives.

If the employer offers subsection (e) options to employees who qualify as NHCE employees, and such options represent at least 50 percent of the total subsection (e) options granted to all employees in a given year, then highly compensated paid employees could receive the identical tax benefit as the NHCE's. This test would be applied on a yearly basis. The combination of first, a shorter minimum holding period of 1 year, second, elimination of the AMT, and third, raising the annual cap, all applicable only to subsection (e) stock options, should be a powerful incentive for corporations to offer these options to regular employees in order to be able to offer them to executives.

It is anticipated that a cashless exercise system would be used for exercising such the NHCE options. This is not unlike the system widely used today.

The current rules regarding corporate deductibility and disqualifying dispositions would apply, except for changes in the holding period. For example, if the employee exercises the option, and disposes of the stock in 9 months from date of grant, then the employee has ordinary income as compensation, and the employer is entitled to a deduction for the same amount. However, in cases where the option is held for 2 years or more before exercise or holds the stock 1 year or longer after exercise, then the gain at exercise is not deductible by the employer.

Other provisions applicable to the current incentive stock option plans, and identical to those in section 422(b), would also apply to subsection (e) stock options. Generally the provisions are:

An option plan approved by the shareholders is required.

Option price no less than the fair market value at date of grant.

Option granted with 10 years from the date plan is adopted.

Option period no longer than the shorter of 10 years or 1 year after termination of employment.

Option not transferable except at death, etc. Grantee does not own stock possessing more than 10 percent of the voting power.

In addition, non-employee directors, independent contractors, and consultants would be ineligible to receive subsection (e) stock options.

It is not the intention of this proposal to change the provisions relating to incentive stock options under section 422, other than adding a new special option under section 422 (e), or employee stock options under section 423.

The proposal is not limited to publicly-traded companies, although that is where the wage gap issue has been highlighted because of the compensation information available to the public. Private companies should be able to participate as well.

I urge my colleagues to join me in support of this legislation.

A TRIBUTE TO HAROLD  
MALKMES—1997 CITIZEN OF THE  
YEAR

**HON. MICHAEL P. FORBES**

OF NEW YORK

IN THE HOUSE OF REPRESENTATIVES

Friday, October 31, 1997

Mr. FORBES. Mr. Speaker, I rise today in this hallowed Chamber to join the Patchogue-Medford Youth & Community Services of Patchogue, Long Island as they honor Mr. Harold Malkmes, of Stony Brook, Long Island, as 1997 Citizen of the Year.

A native of Port Jefferson, on Suffolk County's north shore, Harold Malkmes has served

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