

103<sup>D</sup> CONGRESS  
1<sup>ST</sup> 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.

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## 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

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## 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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