

## AMENDMENT OF SECTION 421 (a) OF THE INTERNAL REVENUE CODE OF 1954

JULY 29, 1955.—Ordered to be printed

Mr. BYRD, from the Committee on Finance, submitted the following

### R E P O R T

[To accompany H. R. 7064]

The Committee on Finance, to whom was referred the bill (H. R. 7064) to amend section 421 (a) of the Internal Revenue Code of 1954 to extend the period for exercise of restricted stock options after termination of employment, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

#### PURPOSE OF THE BILL

This bill as reported amends the stock option provision contained in section 421 of the Internal Revenue Code of 1954. It provides that an employee who has been separated from the service of an employer issuing a stock option is to have until 6 months after such separation, instead of 3 months as is provided by present law, to exercise such option if he is to obtain the tax deferral and capital-gains treatment provided for "restricted stock options." The change made by this bill is to be effective with respect to stock options exercised after December 31, 1954, in the case of years ending after that date.

#### REASON FOR THE BILL

Both the 1939 and the 1954 codes provide a special set of rules for the tax treatment of employee "restricted stock options." If stock obtained under a restricted stock option is not disposed of until 2 years or more after the date on which the option was granted, and until 6 months or more after the exercise of the option, any tax imposed is deferred until the stock is sold. However, to receive this treatment the taxpayer must be an employee of the company (or a related company) or have been an employee within the 3 months of the time the option was exercised. Where these and other conditions are met, any gain realized at the time the stock is disposed of is taxed as a capital gain if the option price was between 95 and 100 percent of the value of the stock at the time the option was granted. If the option price was between 85 and 95 percent of the value of the stock at the time the option was issued, capital-gain treatment is accorded the portion of the gain in excess of the difference between the price and the fair

market value of the stock at the time the option was issued. Any remaining gain is treated as ordinary gain but is not taxed until the stock is sold.

Frequently employees who are separated from service find it necessary to devote their entire attention for some time after the separation to the finding of a new job or to adjusting themselves to their new position. Thus, they may overlook the necessity of exercising their stock option within the 3-month period in order to receive the benefits of "restricted stock option" treatment. Moreover, the individual may be short of funds in the period immediately after his separation from a job either because of unemployment or because of expenses incurred in moving to the location of his new employment. Either of these factors may make it difficult for him to exercise a stock option within 3 months after severing his employment.

For the reasons given above, your committee extends from 3 months to 6 months the period after ceasing employment in which an option must be exercised in order to qualify as restricted. It is desirable to give such an individual this additional time to adjust himself to his new circumstances before requiring him to make a decision as to the exercise of an option.

It is believed that the revenue loss resulting from the enactment of this bill will be negligible.

#### CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

#### SECTION 421 (a) OF THE INTERNAL REVENUE CODE OF 1954

##### SEC. 421. EMPLOYEE STOCK OPTIONS.

(a) TREATMENT OF RESTRICTED STOCK OPTIONS.—If a share of stock is transferred to an individual pursuant to his exercise after 1949 of a restricted stock option, and no disposition of such share is made by him within 2 years from the date of the granting of the option nor within 6 months after the transfer of such share to him—

(1) no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share;

(2) no deduction under section 162 (relating to trade or business expenses) shall be allowable at any time to the employer corporation, a parent or subsidiary corporation of such corporation, or a corporation issuing or assuming a stock option in a transaction to which subsection (g) is applicable, with respect to the share so transferred; and

(3) no amount other than the price paid under the option shall be considered as received by any of such corporations for the share so transferred.

This subsection and subsection (b) shall not apply unless (A) the individual, at the time he exercises the restricted stock option, is an employee of either the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary of such corporation issuing or assuming a stock option in a transaction to which subsection (g) is applicable, or (B) the option is exercised by him within [3] six months after the date he ceases to be an employee of such corporations.

