114TH CONGRESS
2d Session
HOUSE OF REPRESENTATIVES
REPORT
114–748

EMPOWERING EMPLOYEES THROUGH STOCK OWNERSHIP ACT

SEPTEMBER 16, 2016.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. BRADY of Texas, from the Committee on Ways and Means, submitted the following

R E P O R T

[To accompany H.R. 5719]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 5719) to amend the Internal Revenue Code of 1986 to modify the tax treatment of certain equity grants, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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59–006

The amendment is as follows:
Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Empowering Employees through Stock Ownership Act".

SEC. 2. TREATMENT OF QUALIFIED EQUITY GRANTS.

(a) IN GENERAL.—

(1) ELECTION TO DEFER INCOME.—Section 83 of the Internal Revenue Code of 1986 is amended by adding at the end the following new subsection:

"(i) QUALIFIED EQUITY GRANTS.—

"(1) IN GENERAL.—For purposes of this subtitle, if qualified stock is transferred to a qualified employee who makes an election with respect to such stock under this subsection—

"(A) except as provided in subparagraph (B), no amount shall be included in income under subsection (a) for the first taxable year in which the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable, and

"(B) an amount equal to the amount which would be included in income of the employee under subsection (a) (determined without regard to this subsection) shall be included in income for the taxable year of the employee which includes the earliest of—

"(i) the first date such qualified stock becomes transferable (including transferable to the employer),

"(ii) the date the employee first becomes an excluded employee,

"(iii) the first date on which any stock of the corporation which issued the qualified stock becomes readily tradable on an established securities market (as determined by the Secretary, but not including any market unless such market is recognized as an established securities market by the Secretary for purposes of a provision of this title other than this subsection),

"(iv) the date that is 7 years after the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, or

"(v) the date on which the employee revokes (at such time and in such manner as the Secretary may provide) the election under this subsection with respect to such stock.

"(2) QUALIFIED STOCK.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'qualified stock' means, with respect to any qualified employee, any stock in a corporation which is the employer of such employee, if—

"(i) such stock is received—

"(I) in connection with the exercise of an option, or

"(II) in settlement of a restricted stock unit, and

"(ii) such option or restricted stock unit was provided by the corporation—

"(I) in connection with the performance of services as an employee, and

"(II) during a calendar year in which such corporation was an eligible corporation.

"(B) LIMITATION.—The term 'qualified stock' shall not include any stock if the employee may sell such stock to, or otherwise receive cash in lieu of stock from, the corporation at the time that the rights of the employee in such stock first become transferable or not subject to a substantial risk of forfeiture.

"(C) ELIGIBLE CORPORATION.—For purposes of subparagraph (A)(ii)(II)—

"(i) IN GENERAL.—The term 'eligible corporation' means, with respect to any calendar year, any corporation if—

"(I) no stock of such corporation (or any predecessor of such corporation) is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) during any preceding calendar year, and

"(II) such corporation has a written plan under which, in such calendar year, not less than 80 percent of all employees who provide services to such corporation in the United States (or any possession of the United States) are granted stock options, or restricted stock units, with the same rights and privileges to receive qualified stock.

"(ii) SAME RIGHTS AND PRIVILEGES.—For purposes of clause (i)(II)—

"(I) except as provided in subclauses (II) and (III), the determination of rights and privileges with respect to stock shall be determined in a similar manner as provided under section 423(b)(5),

"(II) employees shall not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not equal in amount, so long as the number of shares available to each employee is more than a de minimis amount, and

"(III) rights and privileges with respect to the exercise of an option shall not be treated as the same as rights and privileges with respect to the settlement of a restricted stock unit.

"(iii) EMPLOYEE.—For purposes of clause (i)(II), the term 'employee' shall not include any employee described in section 4980E(d)(4) or any excluded employee.

"(iv) SPECIAL RULE FOR CALENDAR YEARS BEFORE 2017.—In the case of any calendar year beginning before January 1, 2017, clause (i)(II) shall be applied without regard to whether the rights and privileges with respect to the qualified stock are the same.

"(3) QUALIFIED EMPLOYEE; EXCLUDED EMPLOYEE.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified employee' means any individual who—

"(i) is not an excluded employee, and

"(ii) agrees in the election made under this subsection to meet such requirements as determined by the Secretary to be necessary to ensure that the withholding requirements of the corporation under chapter 24 with respect to the qualified stock are met.

"(B) EXCLUDED EMPLOYEE.—The term 'excluded employee' means, with respect to any corporation, any individual—

"(i) who was a 1-percent owner (within the meaning of section 416(i)(1)(B)(ii)) at any time during the 10 preceding calendar years,

"(ii) who is or has been at any prior time—

"(I) the chief executive officer of such corporation or an individual acting in such a capacity, or

"(II) the chief financial officer of such corporation or an individual acting in such a capacity,

"(iii) who bears a relationship described in section 318(a)(1) to any individual described in subclause (I) or (II) of clause (ii), or

"(iv) who has been for any of the 10 preceding taxable years one of the 4 highest compensated officers of such corporation determined with respect to each such taxable year on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934 (as if such rules applied to such corporation).

"(4) ELECTION.—

"(A) TIME FOR MAKING ELECTION.—An election with respect to qualified stock shall be made under this subsection no later than 30 days after the first time the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, and shall be made in a manner similar to the manner in which an election is made under subsection (b).

"(B) LIMITATIONS.—No election may be made under this section with respect to any qualified stock if—

"(i) the qualified employee has made an election under subsection (b) with respect to such qualified stock,

"(ii) any stock of the corporation which issued the qualified stock is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) at any time before the election is made, or

"(iii) such corporation purchased any of its outstanding stock in the calendar year preceding the calendar year which includes the first time the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, unless—

"(I) not less than 25 percent of the total dollar amount of the stock so purchased is deferral stock, and

"(II) the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.

"(C) DEFINITIONS AND SPECIAL RULES RELATED TO LIMITATION ON STOCK REDEMPTIONS.—

"(i) DEFERRAL STOCK.—For purposes of this paragraph, the term 'deferral stock' means stock with respect to which an election is in effect under this subsection

"(ii) DEFERRAL STOCK WITH RESPECT TO ANY INDIVIDUAL NOT TAKEN INTO ACCOUNT IF INDIVIDUAL HOLDS DEFERRAL STOCK WITH LONGER DEFERRAL PERIOD.—Stock purchased by a corporation from any individual shall not be treated as deferral stock for purposes of clause (iii) if such individual (immediately after such purchase) holds any deferral stock with respect to which an election has been in effect under this subsection for a longer period than the election with respect to the stock so purchased.

"(iii) PURCHASE OF ALL OUTSTANDING DEFERRAL STOCK.—The requirements of subclauses (I) and (II) of subparagraph (B)(iii) shall be treated as met if the stock so purchased includes all of the corporation's outstanding deferral stock.

"(iv) REPORTING.—Any corporation which has outstanding deferral stock as of the beginning of any calendar year and which purchases any of its outstanding stock during such calendar year shall include on its return of tax for the taxable year in which, or with which, such calendar year ends the total dollar amount of its outstanding stock so purchased during such calendar year and such other information as the Secretary may require for purposes of administering this paragraph.

"(5) CONTROLLED GROUPS.—For purposes of this subsection, all corporations which are members of the same controlled group of corporations (as defined in section 1563(a)) shall be treated as one corporation.

"(6) NOTICE REQUIREMENT.—Any corporation that transfers qualified stock to a qualified employee shall, at the time that (or a reasonable period before) an amount attributable to such stock would (but for this subsection) first be includible in the gross income of such employee—

"(A) certify to such employee that such stock is qualified stock, and

"(B) notify such employee—

"(i) that the employee may elect to defer income on such stock under this subsection, and

"(ii) that, if the employee makes such an election—

"(I) the amount of income recognized at the end of the deferral period will be based on the value of the stock at the time at which the rights of the employee in such stock first become transferable or not subject to substantial risk of forfeiture, notwithstanding whether the value of the stock has declined during the deferral period,

"(II) the amount of such income recognized at the end of the deferral period will be subject to withholding under section 3401(i) at the rate determined under section 3402(t), and

"(III) the responsibilities of the employee (as determined by the Secretary under paragraph (3)(A)(ii)) with respect to such withholding.".

(2) DEDUCTION BY EMPLOYER.—Subsection (h) of section 83 of the Internal Revenue Code of 1986 is amended by striking "or (d)(2)" and inserting "(d)(2), or (i)".

(b) WITHHOLDING.—

(1) TIME OF WITHHOLDING.—Section 3401 of the Internal Revenue Code of 1986 is amended by adding at the end the following new subsection:

"(i) QUALIFIED STOCK FOR WHICH AN ELECTION IS IN EFFECT UNDER SECTION 83(i).—For purposes of subsection (a), qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i) shall be treated as wages—

"(1) received on the earliest date described in section 83(i)(1)(B), and

"(2) in an amount equal to the amount included in income under section 83 for the taxable year which includes such date.".

(2) AMOUNT OF WITHHOLDING.—Section 3402 of such Code is amended by adding at the end the following new subsection:

"(t) RATE OF WITHHOLDING FOR CERTAIN STOCK.—In the case of any qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i)—

"(1) the rate of tax under subsection (a) shall not be less than the maximum rate of tax in effect under section 1, and

"(2) such stock shall be treated for purposes of section 3501(b) in the same manner as a non-cash fringe benefit.".

(c) COORDINATION WITH OTHER DEFERRED COMPENSATION RULES.—

(1) ELECTION TO APPLY DEFERRAL TO STATUTORY OPTIONS.—

(A) INCENTIVE STOCK OPTIONS.—Section 422(b) of the Internal Revenue Code of 1986 is amended by adding at the end the following: "Such term shall not include any option if an election is made under section 83(i) with respect to the stock received in connection with the exercise of such option.".

(B) EMPLOYEE STOCK PURCHASE PLANS.—Section 423(a) of such Code is amended by adding at the end the following flush sentence:

"The preceding sentence shall not apply to any share of stock with respect to which an election is made under section 83(i).".

(2) EXCLUSION FROM DEFINITION OF NONQUALIFIED DEFERRED COMPENSATION PLAN.—Subsection (d) of section 409A of the Internal Revenue Code of 1986 is amended by adding at the end the following new paragraph:

"(7) TREATMENT OF QUALIFIED STOCK.—An arrangement under which an employee may receive qualified stock (as defined in section 83(i)(2)) shall not be treated as a nonqualified deferred compensation plan solely because of an employee's ability to defer recognition of income pursuant to an election under section 83(i).".

(d) INFORMATION REPORTING.—Section 6051(a) of the Internal Revenue Code of 1986 is amended by striking "and" at the end of paragraph (13), by striking the period at the end of paragraph (14) and inserting a comma, and by inserting after paragraph (14) the following new paragraphs:

"(15) the amount excludable from gross income under subparagraph (A) of section 83(i)(1),

"(16) the amount includible in gross income under subparagraph (B) of section 83(i)(1) with respect to an event described in such subparagraph which occurs in such calendar year, and

"(17) the aggregate amount of income which is being deferred pursuant to elections under section 83(i), determined as of the close of the calendar year.".

(e) PENALTY FOR FAILURE OF EMPLOYER TO PROVIDE NOTICE OF TAX CONSEQUENCES.—Section 6652 of the Internal Revenue Code of 1986 is amended by adding at the end the following new subsection:

"(o) FAILURE TO PROVIDE NOTICE UNDER SECTION 83(i).—In the case of each failure to provide a notice as required by section 83(i)(6), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such notice, an amount equal to $100 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $50,000.".

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to stock attributable to options exercised, or restricted stock units settled, after December 31, 2016.

(2) REQUIREMENT TO PROVIDE NOTICE.—The amendments made by subsection (e) shall apply to failures after December 31, 2016.

(g) TRANSITION RULE.—Until such time as the Secretary (or the Secretary's delegate) issue regulations or other guidance for purposes of implementing the requirements of paragraph (2)(C)(i)(II) of section 83(i) of the Internal Revenue Code of 1986 (as added by this section), or the requirements of paragraph (6) of such section, a corporation shall be treated as being in compliance with such requirements (respectively) if such corporation complies with a reasonable good faith interpretation of such requirements.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

The bill, H.R. 5719, as reported by the Committee on Ways and Means, allows qualifying employees to elect to defer the tax on certain restricted stock attributable to stock options or restricted stock

units until there is an opportunity for the employee to liquidate the stock and pay the tax on such compensation, but no longer than seven years.

B. Background and Need for Legislation

Employees of companies that are not publicly traded may be required to include the value of stock-based compensation in income for tax purposes well before they generally have the ability to sell shares to pay the tax on such compensation. As a result, such employees may have significant taxable income upon receipt of such stock, but without sufficient cash to pay the taxes due. As a practical matter there is no formal market for stock of privately held companies, and there are limited opportunities for employees to liquidate their restricted stock. H.R. 5719 would make it easier for start-up companies to allow employees to share in the company's upside by including equity grants as part of their compensation while ensuring that income is deferred only until there is an opportunity for the employee to liquidate shares, which could provide cash sufficient to pay the tax on the stock-based compensation.

C. Legislative History

Background

H.R. 5719 was introduced on July 11, 2016, and was referred to the Committee on Ways and Means.

Committee action

The Committee on Ways and Means marked up H.R. 5719, the Empowering Employees through Stock Ownership Act, on September 14, 2016, and ordered the bill, as amended, favorably reported (with a quorum being present).

Committee hearings

The Committee discussed issues relating to employee stock ownership at the Committee Hearing on Tax Reform and Tax-Favored Retirement Accounts (April 17, 2012), the Select Revenue Measures Subcommittee Hearing on Small Business and Pass-through Entity Tax Reform Discussion Draft (May 15, 2013), and as part of the Committee's tax reform working groups in 2013.[1]

II. EXPLANATION OF THE BILL

A. Treatment of Qualified Equity Grants (sec. 2 of the Bill and secs. 83, 3401, 3402, and 6061 of the Code)

PRESENT LAW

Income tax treatment of employer stock transferred to an employee

Specific rules apply to property, including employer stock, transferred to an employee in connection with the performance of services.[2] These rules govern the amount and timing of income inclu-

[1] See Joint Committee on Taxation, *Report to the House Committee on Ways and Means on Present Law and Suggestions for Reform Submitted to the Tax Reform Working Groups* (JCS–3–13), May 6, 2013.

[2] Sec. 83. Section 83 applies generally to transfers of any property, not just employer stock, in connection with the performance of services by any service provider, not just an employee.

sion by the employee and the amount and timing of the employer's compensation deduction.

Under these rules, an employee generally must recognize income for the taxable year in which the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture (referred to herein as "substantially vested"). Thus, if the employee's right to the stock is substantially vested when the employee receives the stock, income is recognized for the taxable year in which received. If the employee's right to the stock is not substantially vested at the time of receipt, in general, income is recognized for the taxable year in which the employee's right becomes substantially vested.[3] The amount includible in the employee's income is the excess of the fair market value of the stock (at the time of receipt if substantially vested at that time or, if not, at the time of substantial vesting) over the amount, if any, paid by the employee for the stock.

In general, an employee's right to stock or other property is subject to a substantial risk of forfeiture if the employee's right to full enjoyment of the property is subject to a condition, such as the future performance of substantial services.[4] An employee's right to stock or other property is transferable if the employee can transfer an interest in the property to any person other than the transferor of the property.[5] Thus, generally, employer stock transferred to an employee by an employer is not transferable merely because the employee can sell it back to the employer.

In the case of stock transferred to an employee, the employer is allowed a deduction (to the extent a deduction for a business expense is otherwise allowable) equal to the amount included in the employee's income as a result of receipt of the stock.[6] The deduction is allowed for the employer's taxable year in which or with which ends the taxable year for which the amount is included in the employee's income.

These rules do not apply to the grant to an employee of a nonqualified option on employer stock unless the option has a readily ascertainable fair market value.[7] Instead, these rules apply to the receipt of employer stock by the employee on exercise of the option. That is, if the right to the stock is substantially vested on receipt, income recognition applies for the taxable year of receipt. If the right to the stock is not substantially vested on receipt, the timing of income inclusion is determined under the rules applicable to the receipt of nonvested stock. In either case, the amount includible in income by the employee is the excess of the fair market value of

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However, the provision described herein applies only with respect to certain employer stock transferred to employees.

[3] Under section 83(b), if an employee's right to the stock is not substantially vested at the time of receipt (nonvested stock), the employee may nevertheless elect within 30 days of receipt to recognize income for the taxable year of receipt, referred to as a "section 83(b)" election. Under Treas. Reg. sec. 1.83–2, the employee makes an election by filing with the Internal Revenue Service a written statement that includes the fair market value of the property at the time of receipt and the amount (if any) paid for the property. The employee must also provide a copy of the statement to the employer.

[4] See section 83(c)(1) and Treas. Reg. sec. 1.83–3(c) for the definition of substantial risk of forfeiture.

[5] Treas. Reg. sec. 1.83–3(d). In addition, under section 83(c)(2), the right to stock is transferable only if any transferee's right to the stock would not be subject to a substantial risk of forfeiture.

[6] Sec. 83(h).

[7] See section 83(e)(3) and Treas. Reg. sec. 1.83–7. A nonqualified option is an option on employer stock that is not a statutory option, discussed below.

the stock as of the time of income inclusion, less the exercise price paid by the employee and the amount, if any, paid by the employee for the option. The employer's deduction is also determined under these rules.

In some cases, the transfer of employer stock to an employee may be in settlement of restricted stock units. Restricted stock unit ("RSU") is a term used for an arrangement under which an employee has the right to receive at a specified time in the future an amount determined by reference to the value of one or more shares of employer stock. An employee's right to receive the future amount may be subject to a condition, such as continued employment for a certain period or the attainment of certain performance goals. The payment to the employee of the amount due under the arrangement is referred to as settlement of the RSU. The arrangement may provide for the settlement amount to be paid in cash or in employer stock (or either). The receipt of employer stock in settlement of an RSU is subject to the same rules as other receipts of employer stock with respect to the timing and amount of income inclusion by the employee and the employer's deduction.

Employment taxes and reporting

Employment taxes generally consist of taxes under the Federal Insurance Contributions Act ("FICA"), tax under the Federal Unemployment Tax Act ("FUTA"), and income taxes required to be withheld by employers from wages paid to employees ("income tax withholding").[8] Unless an exception applies under the applicable rules, compensation provided to an employee constitutes wages subject to these taxes.

FICA imposes tax on employers and employees, generally based on the amount of wages paid to an employee during the year. The tax imposed on the employer and on the employee is each composed of two parts: (1) the Social Security or old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the OASDI wage base ($118,500 for 2016); and (2) the Medicare or hospital insurance ("HI") tax equal to 1.45 percent of all covered wages.[9] The employee portion of FICA tax generally must be withheld and remitted to the Federal government by the employer. FICA tax withholding applies regardless of whether compensation is provided in the form of cash or a noncash form, such as a transfer of property (including employer stock) or in-kind benefits.[10]

FUTA imposes a tax on employers of six percent of wages up to the FUTA wage base of $7,000.

Income tax withholding generally applies when wages are paid by an employer to an employee, based on graduated withholding

[8] Secs. 3101–3128 (FICA), 3301–3311 (FUTA), and 3401–3404 (income tax withholding). Instead of FICA taxes, railroad employers and employees are subject, under the Railroad Retirement Tax Act ("RRTA"), sections 3201–3241, to taxes equivalent to FICA taxes with respect to compensation as defined for RRTA purposes. Sections 3501–3510 provide additional rules relating to all these taxes.

[9] The employee portion of the HI tax under FICA (not the employer portion) is increased by an additional tax of 0.9 percent on wages received in excess of a threshold amount. The threshold amount is $250,000 in the case of a joint return, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

[10] Under section 3501(b), employment taxes with respect to noncash fringe benefits are to be collected (or paid) by the employer at the time and in the manner prescribed by the Secretary of the Treasury ("Treasury"). Announcement 85–113, 1985–31 I.R.B. 31, provides guidance on the application of employment taxes with respect to noncash fringe benefits.

rates set out in tables published by the Internal Revenue Service ("IRS").[11] Like FICA tax withholding, income tax withholding applies regardless of whether compensation is provided in the form of cash or a noncash form, such as a transfer of property (including employer stock) or in-kind benefits.

An employer is required to furnish each employee with a statement of compensation information for a calendar year, including taxable compensation, FICA wages, and withheld income and FICA taxes.[12] In addition, information relating to certain nontaxable items must be reported, such as certain retirement and health plan contributions. The statement, made on Form W–2, Wage and Tax Statement, must be provided to each employee by January 31 of the succeeding year.[13]

Statutory options

Two types of statutory options apply with respect to employer stock: incentive stock options ("ISOs") and options provided under an employee stock purchase plan ("ESPP").[14] Stock received pursuant to a statutory option is subject to special rules, rather than the rules for nonqualified options, discussed above. No amount is includible in an employee's income on the grant or exercise of a statutory option.[15] In addition, no deduction is allowed to the employer with respect to the option or the stock transferred to an employee on exercise.

If a holding requirement is met with respect to the stock received on exercise of a statutory option and the employee later disposes of the stock, the employee's gain generally is treated as capital gain rather than ordinary income. Under the holding requirement, the employee must not dispose of the stock within two years after the date the option is granted or one year after the date the option is exercised. If a disposition occurs before the end of the required holding periods (a "disqualifying disposition"), statutory option treatment no longer applies. Instead, the income realized on the disqualifying disposition, up to the amount of income that would have applied if the option had been a nonqualified option, is includible in income by the employee as compensation received in the taxable year in which the disposition occurs and a corresponding deduction is allowable to the employer for the taxable year in which the disposition occurs.

Employment taxes do not apply with respect to the grant of a statutory option, the receipt of stock pursuant to the option, or a disqualifying disposition of the stock.[16]

Nonqualified deferred compensation

Compensation is generally includible in an employee's income when paid to the employee. However, in the case of a nonqualified

[11] Sec. 3402. Specific withholding rates apply in the case of supplemental wages.
[12] Secs. 6041 and 6051.
[13] Employers send Form W–2 information to the Social Security Administration, which records information relating to Social Security and Medicare and forwards the Form W–2 information to the IRS. Employees include a copy of Form W–2 with their income tax returns.
[14] Sections 421–424 govern statutory options.
[15] Under section 56(b)(3), this income tax treatment with respect to stock received on exercise of an ISO does not apply for purposes of the alternative minimum tax under section 55.
[16] Secs. 3121(a)(22), 3306(b)(19), and the last sentence of section 421(b).

deferred compensation plan,[17] unless the arrangement meets certain requirements, the amount of deferred compensation is includible in income for the taxable year when earned (or, if later, when not subject to a substantial risk of forfeiture) even if payment will not occur until a later year.[18] In general, under these requirements, the time when nonqualified deferred compensation will be paid must be specified at the time of deferral with limits on further deferral after the time for payment.

Nonqualified options on employer stock may be structured so as not to be considered nonqualified deferred compensation and thus not subject to these rules.[19] An arrangement providing RSUs is considered a nonqualified deferred compensation plan and is subject to these rules, including the limits on further deferral of the amount due in settlement of an RSU.

REASONS FOR CHANGE

Employer stock may provide a valuable form of employee compensation. In some cases, the receipt of employer stock with a high fairmarket value may result in compensation income, and a related tax liability, disproportionately large in comparison to an employee's regular salary or wages. In the case of publicly traded employer stock, an employee may sell some of the stock to provide funds to cover that tax liability. However, that approach often is not available in the case of a closely held company that restricts the transferability of its stock. This may make employer stock a less attractive form of compensation. In the case of stock options, the inability to pay the tax liability that would result from the stock received on exercise of the option may mean employees let options lapse, thus losing compensation they have already earned. The bill addresses these situations by allowing employees to elect to defer recognition of income attributable to stock received on exercise of an option or settlement of an RSU until an opportunity to sell some of the stock arises, but in no event longer than seven years from the date that the employee's right to the stock becomes substantially vested.

EXPLANATION OF PROVISION

In general

The provision allows a qualified employee to elect to defer, for income tax purposes, the inclusion in income of the amount of income attributable to qualified stock transferred to the employee by the employer.[20] An election to defer income inclusion ("inclusion deferral election") with respect to qualified stock must be made no later than 30 days after the first time the employee's right to the stock

[17] Compensation earned by an employee is generally paid to the employee shortly after being earned. However, in some cases, payment is deferred to a later period, referred to as "deferred compensation." Deferred compensation may be provided through a plan that receives tax-favored treatment, such as a qualified retirement plan under section 401(a). Deferred compensation provided through a plan that is not eligible for tax-favored treatment is referred to as "nonqualified" deferred compensation.

[18] Section 409A and the regulations thereunder provide rules for nonqualified deferred compensation.

[19] Treas. Reg. sec. 1.409A–1(b)(5). In addition, statutory option arrangements are not nonqualified deferred compensation arrangements.

[20] The provision does not apply to income with respect to nonvested stock that is includible as a result of a section 83(b) election.

is substantially vested.[21] Absent an inclusion deferral election under the provision, the income is includable for the taxable year in which the qualified employee's right to the qualified stock is substantially vested under present law.

If an employee elects to defer income inclusion, the income must be included in the employee's income for the taxable year that includes the earliest of (1) the first date the qualified stock becomes transferable, including transferable to the employer;[22] (2) the date the employee first becomes an excluded employee (as described below); (3) the first date on which any stock of the employer becomes readily tradable on an established securities market;[23] (4) the date seven years after the date the employee's right to the stock becomes substantially vested; and (5) the date on which the employee revokes his or her inclusion deferral election.[24]

An employee may not make an inclusion deferral election for a year with respect to qualified stock if, in the preceding calendar year, the corporation purchased any of its outstanding stock unless at least 25 percent of the total dollar amount of the stock so purchased is stock with respect to which an inclusion deferral election is in effect ("deferral stock") and the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.[25] For purposes of this requirement, stock purchased from an individual is not treated as deferral stock (and the purchase is not treated as a purchase of deferral stock) if, immediately after the purchase, the individual holds any deferral stock with respect to which an inclusion deferral election has been in effect for a longer period than the election with respect to the purchased stock. Thus, in general, in applying the purchase requirement, an individual's deferral stock with respect to which an inclusion deferral election has been in effect for the longest periods must be purchased first. A corporation that has deferral stock outstanding as of the beginning of any calendar year and that purchases any of its outstanding stock during the calendar year must report on its income tax return for the taxable year in which, or with which, the calendar year ends the total dollar amount of the outstanding stock purchased during the calendar year and such other information as the Secretary may require for purposes of administering this requirement.

A qualified employee may make an inclusion deferral election with respect to qualified stock attributable to a statutory option. In that case, the option is not treated as a statutory option and the rules relating to statutory options and related stock do not apply. In addition, an arrangement under which an employee may receive qualified stock is not treated as a nonqualified deferred compensation plan solely because of an employee's ability to make an inclusion deferral election.

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[21] An inclusion deferral election is made in a manner similar to the manner in which a section 83(b) election is made. Thus, as in the case of a section 83(b) election under present law, the employee must provide a copy of the inclusion deferral election to the employer.

[22] Thus, for this purpose, the qualified stock is considered transferable if the employee has the ability to sell the stock to the employer (or any other person).

[23] An established securities market is determined for this purpose by the Secretary, but does not include any market unless the market is recognized as an established securities market for purposes of another Code provision.

[24] An inclusion deferral election is revoked at the time and in the manner as the Secretary provides.

[25] This requirement is met if the stock purchased by the corporation includes all the corporation's outstanding deferral stock.

Deferred income inclusion applies also for purposes of the employer's deduction of the amount of income attributable to the qualified stock. That is, if an employee makes an inclusion deferral election, the employer's deduction is deferred until the employer's taxable year in which or with which ends the taxable year of the employee for which the amount is included in the employee's income as described in (1)–(5) above.

Qualified employee and qualified stock

Under the provision, a qualified employee means an individual who is not an excluded employee and who agrees, in the inclusion deferral election, to meet the requirements necessary (as determined by the Secretary) to ensure the income tax withholding requirements of the employer corporation with respect to the qualified stock (as described below) are met. For this purpose, an excluded employee with respect to a corporation is any individual (1) who is, or has been at any time during the 10 preceding calendar years, a one-percent owner of the corporation,[26] (2) who is, or has been at any prior time, the chief executive officer or chief financial officer of the corporation or an individual acting in either capacity, (3) who is a family member of an individual described in (1) or (2),[27] or (4) who is, or has been for any of the 10 preceding taxable years, one of the four highest compensated officers of the corporation.[28]

Qualified stock is any stock of a corporation if—

- an employee receives the stock in connection with the exercise of an option or in settlement of an RSU, and
- the option or RSU was provided by the corporation to the employee in connection with the performance of services and in a year in which the corporation was an eligible corporation (as described below).

However, qualified stock does not include any stock if, at the time the employee's right to the stock becomes substantially vested, the employee may sell the stock to, or otherwise receive cash in lieu of stock from, the corporation.

A corporation is an eligible corporation with respect to a calendar year if (1) no stock of the employer corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year,[29] and (2) the corporation has a written plan under which, in the calendar year, not less than 80 percent of all employees who provide services to the corporation in the United States (or any U.S. possession) are granted stock options, or RSUs, with the same rights and privileges to receive qualified stock ("80-percent requirement").[30] For this purpose, in general,

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[26] One-percent owner status is determined under the top-heavy rules for qualified retirement plans, that is, section 416(i)(1)(B)(ii).

[27] In the case of one-percent owners, this results from application of the attribution rules of section 318 under section 416(i)(1)(B)(i)(II). Family members are determined under section 318(a)(1) and generally include an individual's spouse, children, grandchildren and parents.

[28] Highest paid employee status is determined at the close of the corporation's taxable year.

[29] This requirement continues to apply up to the time an inclusion deferral election is made. That is, under the provision, no inclusion deferral election may be made with respect to qualified stock if any stock of the corporation is readily tradable on an established securities market at any time before the election is made.

[30] In applying the requirement that 80 percent of employees receive stock options or RSUs, excluded employees and part-time employees are not taken into account. For this purpose, part-time employee is defined as under section 4980E(d)(4), that is, an employee customarily employed for fewer than 30 hours per week.

the determination of rights and privileges with respect to stock is determined in a similar manner as provided under the present-law ESPP rules.[31] However, employees will not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not equal in amount, provided that the number of shares available to each employee is more than a de minimis amount. In addition, rights and privileges with respect to the exercise of a stock option are not treated for this purpose as the same as rights and privileges with respect to the settlement of an RSU.[32]

For purposes of the provision, corporations that are members of the same controlled group are treated as one corporation.

Notice, withholding and reporting requirements

Under the provision, a corporation that transfers qualified stock to a qualified employee must provide a notice to the qualified employee at the time (or a reasonable period before) the employee's right to the qualified stock is substantially vested (and income attributable to the stock would be includible absent an inclusion deferral election). The notice must (1) certify to the employee that the stock is qualified stock, and (2) notify the employee (a) that the employee may elect to defer income inclusion with respect to the stock and (b) that, if the employee makes an inclusion deferral election, the amount of income required to be included at the end of the deferral period will be based on the value of the stock at the time the employee's right to the stock is substantially vested, notwithstanding whether the value of the stock has declined during the deferral period, and the amount of income to be included at the end of the deferral period will be subject to withholding as provided under the provision, as well as of the employee's responsibilities with respect to required withholding. Failure to provide the notice may result in the imposition of a penalty of $100 for each failure, subject to a maximum penalty of $50,000 for all failures during any calendar year.

An inclusion deferral election applies only for income tax purposes. The application of FICA and FUTA are not affected. The provision includes specific income tax withholding and reporting requirements with respect to income subject to an inclusion deferral election.

For the taxable year for which income subject to an inclusion deferral election is required to be included in income by the employee (as described above), the amount required to be included in income is treated as wages with respect to which the employer is required to withhold income tax at a rate not less than the highest income tax rate applicable to individual taxpayers.[33] The employer must report on Form W–2 the amount of income covered by an inclusion deferral election (1) for the year of deferral and (2) for the year the income is required to be included in income by the employee. In addition, for any calendar year, the employer must report on Form

[31] Sec. 423(b)(5).

[32] Under a transition rule, in the case of a calendar year beginning before January 1, 2017, the 80-percent requirement is applied without regard to whether the rights and privileges with respect to the qualified stock are the same.

[33] That is, the maximum rate of tax in effect for the year under section 1. The provision specifies that qualified stock is treated as a noncash fringe benefit for income tax withholding purposes.

W–2 the aggregate amount of income covered by inclusion deferral elections, determined as of the close of the calendar year.

EFFECTIVE DATE

The provision generally applies with respect to stock attributable to options exercised or RSUs settled after December 31, 2016. Under a transition rule, until the Secretary (or the Secretary's delegate) issues regulations or other guidance implementing the 80-percent and employer notice requirements under the provision, a corporation will be treated as complying with those requirements (respectively) if it complies with a reasonable good faith interpretation of the requirements. The penalty for a failure to provide the notice required under the provision applies to failures after December 31, 2016.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means in its consideration of H.R. 5719, the "Empowering Employees through Stock Ownership Act," on September 14, 2016.

The vote on the motion by Mr. Reichert to table Mr. Crowley's motion to appeal the ruling of the Chair that the amendment offered by Mr. Crowley was not germane was agreed to by a roll call vote of 21 yeas to 12 nays (with a quorum bring present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	X			Mr. Levin		X	
Mr. Johnson				Mr. Rangel		X	
Mr. Nunes				Mr. McDermott		X	
Mr. Tiberi	X			Mr. Lewis			
Mr. Reichert	X			Mr. Neal		X	
Mr. Boustany				Mr. Becerra			
Mr. Roskam	X			Mr. Doggett			
Mr. Price	X			Mr. Thompson		X	
Mr. Buchanan	X			Mr. Larson		X	
Mr. Smith (NE)	X			Mr. Blumenauer		X	
Ms. Jenkins	X			Mr. Kind		X	
Mr. Paulsen	X			Mr. Pascrell		X	
Mr. Marchant	X			Mr. Crowley		X	
Ms. Black	X			Mr. Davis		X	
Mr. Reed	X			Ms. Sanchez		X	
Mr. Young	X						
Mr. Kelly	X						
Mr. Renacci	X						
Mr. Meehan	X						
Ms. Noem	X						
Mr. Holding	X						
Mr. Smith (MO)	X						
Mr. Dold	X						
Mr. Rice	X						

The Chairman's amendment in the nature of a substitute was adopted by a voice vote (with a quorum being present).

The bill, H.R. 5719, as amended, was ordered favorably reported to the House of Representatives by a voice vote (with a quorum being present).

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 5719, as reported.

The bill, as reported, is estimated to have the following effect on Federal fiscal year budget receipts for the period 2017–2026:

Fiscal years [millions of dollars]											
2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2017–21	2017–26
−116	−160	−166	−159	−142	−115	−81	−48	−32	−13	−744	−1,031

Note: Details do not add to totals due to rounding.

Pursuant to clause 8 of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986: The gross budgetary effect (before incorporating macroeconomic effects) in any fiscal year is less than 0.25 percent of the current projected gross domestic product of the United States for that fiscal year; therefore, the bill is not "major legislation" for purposes of requiring that the estimate include the budgetary effects of changes in economic output, employment, capital stock and other macroeconomic variables.

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue-reducing provisions of the bill involve increased tax expenditures. See amounts shown in the table in Part IV.A. above.

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. Congress,
Congressional Budget Office,
Washington, DC, September 16, 2016.

Hon. Kevin Brady,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 5719, the Empowering Employees through Stock Ownership Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Peter Huether.

Sincerely,

Keith Hall.

Enclosure.

H.R. 5719—Empowering Employees through Stock Ownership Act

H.R. 5719 would amend the Internal Revenue Code to allow certain employees to defer for up to seven years the recognition of income on compensation paid to them in the form of certain company restricted stock units or stock options. Under current law, employees must generally include such compensation in taxable income for both income and payroll tax purposes, in the case of stock grants, when they become substantially vested or, in the case of nonqualified stock options, when they exercise the option. At the same time, the business can take an equal deduction for compensation paid.

Under H.R. 5719, a company's employees would be eligible for the deferral, for income tax purposes only, if the company provides the stock compensation to at least 80 percent of its workforce and the stock of the company has not been traded on a securities market in any preceding year. The income deferral period would end upon any of several events, such as the sale of the stock or the stock becoming tradable on securities markets, and the period would be limited to seven years after the employee exercises an option and is vested in the stock, or becomes vested in the restricted unit. The income deferral would not be available to certain individuals, including highly-paid employees and top management. In addition, as under current law, businesses would take a deduction at the same time as the employee would recognize the income. The changes under HR. 5719 would be effective for options exercised and restricted stock units settled after December 31, 2016.

The staff of the Joint Committee on Taxation (JCT) estimates that the legislation would reduce revenues by about $1.0 billion over the 2016–2026 period.

The Statutory Pay-As-You Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting revenues and direct spending. The net changes in revenues that are subject to those pay-as-you-go procedures are shown in the following table. Enacting the bill would not affect direct spending.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R 5719, AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON WAYS AND MEANS ON SEPTEMBER 14, 2016

	By fiscal year, in millions of dollars—												
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2016–2021	2016–2026
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Effects	0	116	160	166	159	142	115	81	48	32	13	744	1,031

Source: Staff of the Joint Committee on Taxation.
Note: Components do not add to totals due to rounding.

JCT and CBO estimate that enacting the bill would not increase net direct spending in any of the four consecutive 10-year periods beginning in 2027 and would not increase on-budget deficits by more than $5 billion in any of those periods.

JCT has determined that the bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act

The CBO staff contact for this estimate is Peter Huether. The estimate was approved by John McClelland, Assistant Director for Tax Analysis.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was as a result of the Committee's review of the provisions of H.R. 5719 that the Committee concluded that it is appropriate to report the bill, as amended, favorably to the House of Representatives with the recommendation that the bill do pass.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. Applicability of House Rule XXI 5(b)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that "A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present." The Committee has carefully reviewed the bill and states that the bill does not involve any Federal income tax rate increases within the meaning of the rule.

E. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 ("IRS Reform Act") requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code of 1986 and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, the staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Internal Revenue Code of 1986 and that have "widespread applicability" to individuals or small businesses, within the meaning of the rule.

F. Congressional Earmarks, Limited Tax Benefits, and Limited Tariff Benefits

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

G. Duplication of Federal Programs

In compliance with Sec. 3(g)(2) of H. Res. 5 (114th Congress), the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program, (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Public Law 95–220, as amended by Public Law 98–169).

H. Disclosure of Directed Rule Makings

In compliance with Sec. 3(i) of H. Res. 5 (114th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires no directed rule makings within the meaning of such section.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

A. Text of Existing Law Amended or Repealed by the Bill, as Reported

In compliance with clause 3(e)(1)(A) of rule XIII of the Rules of the House of Representatives, the text of each section proposed to be amended or repealed by the bill, as reported, is shown below:

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3(e)(1)(A) of rule XIII of the Rules of the House of Representatives, the text of each section proposed to be amended or repealed by the bill, as reported, is shown below:

INTERNAL REVENUE CODE OF 1986

* * * * * * *

Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter B—Computation of Taxable Income

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PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

* * * * * * *

SEC. 83. PROPERTY TRANSFERRED IN CONNECTION WITH PERFORMANCE OF SERVICES.

(a) GENERAL RULE.—If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property, shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

(b) ELECTION TO INCLUDE IN GROSS INCOME IN YEAR OF TRANSFER.—

(1) IN GENERAL.— Any person who performs services in connection with which property is transferred to any person may elect to include in his gross income for the taxable year in which such property is transferred, the excess of—

(A) the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), over

(B) the amount (if any) paid for such property.

If such election is made, subsection (a) shall not apply with respect to the transfer of such property, and if such property is subsequently forfeited, no deduction shall be allowed in respect of such forfeiture.

(2) ELECTION.— An election under paragraph (1) with respect to any transfer of property shall be made in such manner as the Secretary prescribes and shall be made not later than

30 days after the date of such transfer. Such election may not be revoked except with the consent of the Secretary.

(c) SPECIAL RULES.—For purposes of this section—

(1) SUBSTANTIAL RISK OF FORFEITURE.— The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

(2) TRANSFERABILITY OF PROPERTY.— The rights of a person in property are transferable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.

(3) SALES WHICH MAY GIVE RISE TO SUIT UNDER SECTION 16(B) OF THE SECURITIES EXCHANGE ACT OF 1934.— So long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in such property are—

(A) subject to a substantial risk of forfeiture, and

(B) not transferable.

(4) For purposes of determining an individual's basis in property transferred in connection with the performance of services, rules similar to the rules of section 72(w) shall apply.

(d) CERTAIN RESTRICTIONS WHICH WILL NEVER LAPSE.—

(1) VALUATION.— In the case of property subject to a restriction which by its terms will never lapse, and which allows the transferee to sell such property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property unless established to the contrary by the Secretary, and the burden of proof shall be on the Secretary with respect to such value.

(2) CANCELLATION.— If, in the case of property subject to a restriction which by its terms will never lapse, the restriction is canceled, then, unless the taxpayer establishes—

(A) that such cancellation was not compensatory, and

(B) that the person, if any, who would be allowed a deduction if the cancellation were treated as compensatory, will treat the transaction as not compensatory, as evidenced in such manner as the Secretary shall prescribe by regulations,

the excess of the fair market value of the property (computed without regard to the restrictions) at the time of cancellation over the sum of—

(C) the fair market value of such property (computed by taking the restriction into account) immediately before the cancellation, and

(D) the amount, if any, paid for the cancellation, shall be treated as compensation for the taxable year in which such cancellation occurs.

(e) APPLICABILITY OF SECTION.—This section shall not apply to—

(1) a transaction to which section 421 applies,

(2) a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2),

(3) the transfer of an option without a readily ascertainable fair market value,

(4) the transfer of property pursuant to the exercise of an option with a readily ascertainable fair market value at the date of grant, or

(5) group-term life insurance to which section 79 applies.

(f) HOLDING PERIOD.—In determining the period for which the taxpayer has held property to which subsection (a) applies, there shall be included only the period beginning at the first time his rights in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier.

(g) CERTAIN EXCHANGES.—If property to which subsection (a) applies is exchanged for property subject to restrictions and conditions substantially similar to those to which the property given in such exchange was subject, and if section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applied to such exchange, or if such exchange was pursuant to the exercise of a conversion privilege—

(1) such exchange shall be disregarded for purposes of subsection (a), and

(2) the property received shall be treated as property to which subsection (a) applies.

(h) DEDUCTION BY EMPLOYER.—In the case of a transfer of property to which this section applies or a cancellation of a restriction described in subsection (d), there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

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Subchapter D—Deferred Compensation, Etc

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PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC

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Subpart A—General Rule

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SEC. 409A. INCLUSION IN GROSS INCOME OF DEFERRED COMPENSATION UNDER NONQUALIFIED DEFERRED COMPENSATION PLANS.

(a) RULES RELATING TO CONSTRUCTIVE RECEIPT.—

(1) PLAN FAILURES.—

(A) GROSS INCOME INCLUSION.—

(i) IN GENERAL.— If at any time during a taxable year a nonqualified deferred compensation plan—

(I) fails to meet the requirements of paragraphs (2), (3), and (4), or

(II) is not operated in accordance with such requirements, all compensation deferred under the plan for the taxable year and all preceding taxable years shall be includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income.

(ii) APPLICATION ONLY TO AFFECTED PARTICIPANTS.— Clause (i) shall only apply with respect to all compensation deferred under the plan for participants with respect to whom the failure relates.

(B) INTEREST AND ADDITIONAL TAX PAYABLE WITH RESPECT TO PREVIOUSLY DEFERRED COMPENSATION.—

(i) IN GENERAL.— If compensation is required to be included in gross income under subparagraph (A) for a taxable year, the tax imposed by this chapter for the taxable year shall be increased by the sum of—

(I) the amount of interest determined under clause (ii), and

(II) an amount equal to 20 percent of the compensation which is required to be included in gross income.

(ii) INTEREST.— For purposes of clause (i), the interest determined under this clause for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the deferred compensation been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture.

(2) DISTRIBUTIONS.—

(A) IN GENERAL.— The requirements of this paragraph are met if the plan provides that compensation deferred under the plan may not be distributed earlier than—

(i) separation from service as determined by the Secretary (except as provided in subparagraph (B)(i)),

(ii) the date the participant becomes disabled (within the meaning of subparagraph (C)),

(iii) death,

(iv) a specified time (or pursuant to a fixed schedule) specified under the plan at the date of the deferral of such compensation,

(v) to the extent provided by the Secretary, a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation, or

(vi) the occurrence of an unforeseeable emergency.

(B) SPECIAL RULES.—

(i) SPECIFIED EMPLOYEES.— In the case of any specified employee, the requirement of subparagraph (A)(i) is met only if distributions may not be made before the date which is 6 months after the date of separation from service (or, if earlier, the date of death of the employee). For purposes of the preceding sentence, a

specified employee is a key employee (as defined in section 416(i) without regard to paragraph (5) thereof) of a corporation any stock in which is publicly traded on an established securities market or otherwise.

(ii) UNFORESEEABLE EMERGENCY.— For purposes of subparagraph (A)(vi)—

(I) IN GENERAL.— The term "unforeseeable emergency" means a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, or a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

(II) LIMITATION ON DISTRIBUTIONS.— The requirement of subparagraph (A)(vi) is met only if, as determined under regulations of the Secretary, the amounts distributed with respect to an emergency do not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

(C) DISABLED.— For purposes of subparagraph (A)(ii), a participant shall be considered disabled if the participant—

(i) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or

(ii) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering employees of the participant's employer.

(3) ACCELERATION OF BENEFITS.— The requirements of this paragraph are met if the plan does not permit the acceleration of the time or schedule of any payment under the plan, except as provided in regulations by the Secretary.

(4) ELECTIONS.—

(A) IN GENERAL.— The requirements of this paragraph are met if the requirements of subparagraphs (B) and (C) are met.

(B) INITIAL DEFERRAL DECISION.—

(i) IN GENERAL.— The requirements of this subparagraph are met if the plan provides that compensation

for services performed during a taxable year may be deferred at the participant's election only if the election to defer such compensation is made not later than the close of the preceding taxable year or at such other time as provided in regulations.

(ii) FIRST YEAR OF ELIGIBILITY.— In the case of the first year in which a participant becomes eligible to participate in the plan, such election may be made with respect to services to be performed subsequent to the election within 30 days after the date the participant becomes eligible to participate in such plan.

(iii) PERFORMANCE-BASED COMPENSATION.— In the case of any performance-based compensation based on services performed over a period of at least 12 months, such election may be made no later than 6 months before the end of the period.

(C) CHANGES IN TIME AND FORM OF DISTRIBUTION.— The requirements of this subparagraph are met if, in the case of a plan which permits under a subsequent election a delay in a payment or a change in the form of payment—

(i) the plan requires that such election may not take effect until at least 12 months after the date on which the election is made,

(ii) in the case of an election related to a payment not described in clause (ii), (iii), or (vi) of paragraph (2)(A), the plan requires that the payment with respect to which such election is made be deferred for a period of not less than 5 years from the date such payment would otherwise have been made, and

(iii) the plan requires that any election related to a payment described in paragraph (2)(A)(iv) may not be made less than 12 months prior to the date of the first scheduled payment under such paragraph.

(b) RULES RELATING TO FUNDING.—

(1) OFFSHORE PROPERTY IN A TRUST.— In the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary) for purposes of paying deferred compensation under a nonqualified deferred compensation plan, for purposes of section 83 such assets shall be treated as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors—

(A) at the time set aside if such assets (or such trust or other arrangement) are located outside of the United States, or

(B) at the time transferred if such assets (or such trust or other arrangement) are subsequently transferred outside of the United States.

This paragraph shall not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in such jurisdiction.

(2) EMPLOYER'S FINANCIAL HEALTH.— In the case of compensation deferred under a nonqualified deferred compensation

plan, there is a transfer of property within the meaning of section 83 with respect to such compensation as of the earlier of—

(A) the date on which the plan first provides that assets will become restricted to the provision of benefits under the plan in connection with a change in the employer's financial health, or

(B) the date on which assets are so restricted, whether or not such assets are available to satisfy claims of general creditors.

(3) TREATMENT OF EMPLOYER'S DEFINED BENEFIT PLAN DURING RESTRICTED PERIOD.—

(A) IN GENERAL.— If—

(i) during any restricted period with respect to a single-employer defined benefit plan, assets are set aside or reserved (directly or indirectly) in a trust (or other arrangement as determined by the Secretary) or transferred to such a trust or other arrangement for purposes of paying deferred compensation of an applicable covered employee under a nonqualified deferred compensation plan of the plan sponsor or member of a controlled group which includes the plan sponsor, or

(ii) a nonqualified deferred compensation plan of the plan sponsor or member of a controlled group which includes the plan sponsor provides that assets will become restricted to the provision of benefits under the plan to an applicable covered employee in connection with such restricted period (or other similar financial measure determined by the Secretary) with respect to the defined benefit plan, or assets are so restricted,

such assets shall, for purposes of section 83, be treated as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors. Clause (i) shall not apply with respect to any assets which are so set aside before the restricted period with respect to the defined benefit plan.

(B) RESTRICTED PERIOD.— For purposes of this section, the term "restricted period" means, with respect to any plan described in subparagraph (A)—

(i) any period during which the plan is in at-risk status (as defined in section 430(i));

(ii) any period the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law, and

(iii) the 12-month period beginning on the date which is 6 months before the termination date of the plan if, as of the termination date, the plan is not sufficient for benefit liabilities (within the meaning of section 4041 of the Employee Retirement Income Security Act of 1974).

(C) SPECIAL RULE FOR PAYMENT OF TAXES ON DEFERRED COMPENSATION INCLUDED IN INCOME.— If an employer provides directly or indirectly for the payment of any Federal, State, or local income taxes with respect to any compensation required to be included in gross income by reason of this paragraph—

(i) interest shall be imposed under subsection (a)(1)(B)(i)(I) on the amount of such payment in the same manner as if such payment was part of the deferred compensation to which it relates,

(ii) such payment shall be taken into account in determining the amount of the additional tax under subsection (a)(1)(B)(i)(II) in the same manner as if such payment was part of the deferred compensation to which it relates, and

(iii) no deduction shall be allowed under this title with respect to such payment.

(D) OTHER DEFINITIONS.— For purposes of this section—

(i) APPLICABLE COVERED EMPLOYEE.— The term "applicable covered employee" means any—

(I) covered employee of a plan sponsor,

(II) covered employee of a member of a controlled group which includes the plan sponsor, and

(III) former employee who was a covered employee at the time of termination of employment with the plan sponsor or a member of a controlled group which includes the plan sponsor.

(ii) COVERED EMPLOYEE.— The term "covered employee" means an individual described in section 162(m)(3) or an individual subject to the requirements of section 16(a) of the Securities Exchange Act of 1934.

(4) INCOME INCLUSION FOR OFFSHORE TRUSTS AND EMPLOYER'S FINANCIAL HEALTH.— For each taxable year that assets treated as transferred under this subsection remain set aside in a trust or other arrangement subject to paragraph (1), (2), or (3), any increase in value in, or earnings with respect to, such assets shall be treated as an additional transfer of property under this subsection (to the extent not previously included in income).

(5) INTEREST ON TAX LIABILITY PAYABLE WITH RESPECT TO TRANSFERRED PROPERTY.—

(A) IN GENERAL.— If amounts are required to be included in gross income by reason of paragraph (1), (2), or (3) for a taxable year, the tax imposed by this chapter for such taxable year shall be increased by the sum of—

(i) the amount of interest determined under subparagraph (B), and

(ii) an amount equal to 20 percent of the amounts required to be included in gross income.

(B) INTEREST.— For purposes of subparagraph (A), the interest determined under this subparagraph for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the amounts so required to be included in gross income by paragraph (1), (2), or (3) been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such amounts are not subject to a substantial risk of forfeiture.

(c) NO INFERENCE ON EARLIER INCOME INCLUSION OR REQUIREMENT OF LATER INCLUSION.—Nothing in this section shall be con-

strued to prevent the inclusion of amounts in gross income under any other provision of this chapter or any other rule of law earlier than the time provided in this section. Any amount included in gross income under this section shall not be required to be included in gross income under any other provision of this chapter or any other rule of law later than the time provided in this section.

(d) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section:

(1) NONQUALIFIED DEFERRED COMPENSATION PLAN.— The term "nonqualified deferred compensation plan" means any plan that provides for the deferral of compensation, other than—

(A) a qualified employer plan, and

(B) any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.

(2) QUALIFIED EMPLOYER PLAN.— The term "qualified employer plan" means—

(A) any plan, contract, pension, account, or trust described in subparagraph (A) or (B) of section 219(g)(5) (without regard to subparagraph (A)(iii)),

(B) any eligible deferred compensation plan (within the meaning of section 457(b)), and

(C) any plan described in section 415(m).

(3) PLAN INCLUDES ARRANGEMENTS, ETC..— The term "plan" includes any agreement or arrangement, including an agreement or arrangement that includes one person.

(4) SUBSTANTIAL RISK OF FORFEITURE.— The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual.

(5) TREATMENT OF EARNINGS.— References to deferred compensation shall be treated as including references to income (whether actual or notional) attributable to such compensation or such income.

(6) AGGREGATION RULES.— Except as provided by the Secretary, rules similar to the rules of subsections (b) and (c) of section 414 shall apply.

(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

(1) providing for the determination of amounts of deferral in the case of a nonqualified deferred compensation plan which is a defined benefit plan,

(2) relating to changes in the ownership and control of a corporation or assets of a corporation for purposes of subsection (a)(2)(A)(v),

(3) exempting arrangements from the application of subsection (b) if such arrangements will not result in an improper deferral of United States tax and will not result in assets being effectively beyond the reach of creditors,

(4) defining financial health for purposes of subsection (b)(2), and

(5) disregarding a substantial risk of forfeiture in cases where necessary to carry out the purposes of this section.

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PART II—CERTAIN STOCK OPTIONS

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SEC. 422. INCENTIVE STOCK OPTIONS.

(a) IN GENERAL.—Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an incentive stock option if—

(1) no disposition of such share is made by him within 2 years from the date of the granting of the option nor within 1 year after the transfer of such share to him, and

(2) at all times during the period beginning on the date of the granting of the option and ending on the day 3 months before the date of such exercise, such individual was 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 corporation of such corporation issuing or assuming a stock option in a transaction to which section 424(a) applies.

(b) INCENTIVE STOCK OPTION.—For purposes of this part, the term "incentive stock option" means an option granted to an individual for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—

(1) the option is granted pursuant to a plan which includes the aggregate number of shares which may be issued under options and the employees (or class of employees) eligible to receive options, and which is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

(2) such option is granted within 10 years from the date such plan is adopted, or the date such plan is approved by the stockholders, whichever is earlier;

(3) such option by its terms is not exercisable after the expiration of 10 years from the date such option is granted;

(4) the option price is not less than the fair market value of the stock at the time such option is granted;

(5) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him; and

(6) such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation or of its parent or subsidiary corporation.

Such term shall not include any option if (as of the time the option is granted) the terms of such option provide that it will not be treated as an incentive stock option.

(c) SPECIAL RULES.—

(1) GOOD FAITH EFFORTS TO VALUE OF STOCK.— If a share of stock is transferred pursuant to the exercise by an individual

of an option which would fail to qualify as an incentive stock option under subsection (b) because there was a failure in an attempt, made in good faith, to meet the requirement of subsection (b)(4), the requirement of subsection (b)(4) shall be considered to have been met. To the extent provided in regulations by the Secretary, a similar rule shall apply for purposes of subsection (d).

(2) CERTAIN DISQUALIFYING DISPOSITIONS WHERE AMOUNT REALIZED IS LESS THAN VALUE AT EXERCISE.— If—

(A) an individual who has acquired a share of stock by the exercise of an incentive stock option makes a disposition of such share within either of the periods described in subsection (a)(1), and

(B) such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to such individual,

then the amount which is includible in the gross income of such individual, and the amount which is deductible from the income of his employer corporation, as compensation attributable to the exercise of such option shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of such share.

(3) CERTAIN TRANSFERS BY INSOLVENT INDIVIDUALS.— If an insolvent individual holds a share of stock acquired pursuant to his exercise of an incentive stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary in any proceeding under title 11 or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of his creditors in such proceeding, shall constitute a disposition of such share for purposes of subsection (a)(1).

(4) PERMISSIBLE PROVISIONS.— An option which meets the requirements of subsection (b) shall be treated as an incentive stock option even if—

(A) the employee may pay for the stock with stock of the corporation granting the option,

(B) the employee has a right to receive property at the time of exercise of the option, or

(C) the option is subject to any condition not inconsistent with the provisions of subsection (b).

Subparagraph (B) shall apply to a transfer of property (other than cash) only if section 83 applies to the property so transferred.

(5) 10-PERCENT SHAREHOLDER RULE.— Subsection (b)(6) shall not apply if at the time such option is granted the option price is at least 110 percent of the fair market value of the stock subject to the option and such option by its terms is not exercisable after the expiration of 5 years from the date such option is granted.

(6) SPECIAL RULE WHEN DISABLED.— For purposes of subsection (a)(2), in the case of an employee who is disabled (within the meaning of section 22(e)(3)), the 3-month period of subsection (a)(2) shall be 1 year.

(7) FAIR MARKET VALUE.— For purposes of this section, the fair market value of stock shall be determined without regard

to any restriction other than a restriction which, by its terms, will never lapse.

(d) $100,000 per year limitation

(1) IN GENERAL.— To the extent that the aggregate fair market value of stock with respect to which incentive stock options (determined without regard to this subsection) are exercisable for the 1st time by any individual during any calendar year (under all plans of the individual's employer corporation and its parent and subsidiary corporations) exceeds $100,000, such options shall be treated as options which are not incentive stock options.

(2) ORDERING RULE.— Paragraph (1) shall be applied by taking options into account in the order in which they were granted.

(3) DETERMINATION OF FAIR MARKET VALUE.— For purposes of paragraph (1), the fair market value of any stock shall be determined as of the time the option with respect to such stock is granted.

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SEC. 423. EMPLOYEE STOCK PURCHASE PLANS.

(a) GENERAL RULE.—Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an option granted under an employee stock purchase plan (as defined in subsection (b)) if—

(1) no disposition of such share is made by him within 2 years after the date of the granting of the option nor within 1 year after the transfer of such share to him; and

(2) at all times during the period beginning with the date of the granting of the option and ending on the day 3 months before the date of such exercise, he is an employee of the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 424(a) applies.

(b) EMPLOYEE STOCK PURCHASE PLAN.—For purposes of this part, the term "employee stock purchase plan" means a plan which meets the following requirements:

(1) the plan provides that options are to be granted only to employees of the employer corporation or of its parent or subsidiary corporation to purchase stock in any such corporation;

(2) such plan is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

(3) under the terms of the plan, no employee can be granted an option if such employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation. For purposes of this paragraph, the rules of section 424(d) shall apply in determining the stock ownership of an individual, and stock which the employee may purchase under outstanding options shall be treated as stock owned by the employee;

(4) under the terms of the plan, options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation, except that there may be excluded—

(A) employees who have been employed less than 2 years,

(B) employees whose customary employment is 20 hours or less per week,

(C) employees whose customary employment is for not more than 5 months in any calendar year, and

(D) highly compensated employees (within the meaning of section 414(q));

(5) under the terms of the plan, all employees granted such options shall have the same rights and privileges, except that the amount of stock which may be purchased by any employee under such option may bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of employees, and the plan may provide that no employee may purchase more than a maximum amount of stock fixed under the plan;

(6) under the terms of the plan, the option price is not less than the lesser of—

(A) an amount equal to 85 percent of the fair market value of the stock at the time such option is granted, or

(B) an amount which under the terms of the option may not be less than 85 percent of the fair market value of the stock at the time such option is exercised;

(7) under the terms of the plan, such option cannot be exercised after the expiration of—

(A) 5 years from the date such option is granted if, under the terms of such plan, the option price is to be not less than 85 percent of the fair market value of such stock at the time of the exercise of the option, or

(B) 27 months from the date such option is granted, if the option price is not determinable in the manner described in subparagraph (A) (8) under the terms of the plan, no employee may be granted an option which permits his rights to purchase stock under all such plans of his employer corporation and its parent and subsidiary corporations to accrue at a rate which exceeds $25,000 of fair market value of such stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time. For purposes of this paragraph—

(A) the right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year;

(B) the right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed $25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and

(C) a right to purchase stock which has accrued under one option granted pursuant to the plan may not be carried over to any other option; and

(9) under the terms of the plan, such option is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him.

For purposes of paragraphs (3) to (9), inclusive, where additional terms are contained in an offering made under a plan, such additional terms shall, with respect to options exercised under such offering, be treated as a part of the terms of such plan.

(c) SPECIAL RULE WHERE OPTION PRICE IS BETWEEN 85 PERCENT AND 100 PERCENT OF VALUE OF STOCK.—If the option price of a share of stock acquired by an individual pursuant to a transfer to which subsection (a) applies was less than 100 percent of the fair market value of such share at the time such option was granted, then, in the event of any disposition of such share by him which meets the holding period requirements of subsection (a), or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or for the taxable year closing with his death, whichever applies, an amount equal to the lesser of—

(1) the excess of the fair market value of the share at the time of such disposition or death over the amount paid for the share under the option, or

(2) the excess of the fair market value of the share at the time the option was granted over the option price.

If the option price is not fixed or determinable at the time the option is granted, then for purposes of this subsection, the option price shall be determined as if the option were exercised at such time. In the case of the disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income. No amount shall be required to be deducted and withheld under chapter 24 with respect to any amount treated as compensation under this subsection.

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Subtitle C—Employment Taxes

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CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

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SEC. 3401. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid—

(1) for active service performed in a month for which such employee is entitled to the benefits of section 112 (relating to certain combat zone compensation of members of the Armed Forces of the United States) to the extent remuneration for such service is excludable from gross income under such section; or

(2) for agricultural labor (as defined in section 3121(g)) unless the remuneration paid for such labor is wages (as defined in section 3121(a)); or

(3) for domestic service in a private home, local college club, or local chapter of a college fraternity or sorority; or

(4) for service not in the course of the employer's trade or business performed in any calendar quarter by an employee, unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly employed by such employer to perform such service. For purposes of this paragraph, an individual shall be deemed to be regularly employed by an employer during a calendar quarter only if—

(A) on each of some 24 days during such quarter such individual performs for such employer for some portion of the day service not in the course of the employer's trade or business; or

(B) such individual was regularly employed (as determined under subparagraph (A)) by such employer in the performance of such service during the preceding calendar quarter; or

(5) for services by a citizen or resident of the United States for a foreign government or an international organization; or

(6) for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary; or

(8)(A) for services for an employer (other than the United States or any agency thereof)—

(i) performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under section 911; or

(ii) performed in a foreign country or in a possession of the United States by such a citizen if, at the time of the payment of such remuneration, the employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration; or

(B) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within a possession of the United States (other than Puerto Rico), if it is reasonable to believe that at least 80 percent of the remuneration to be paid to the employee by such employer during the calendar year will be for such services; or

(C) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within Puerto Rico, if it is reasonable to be-

lieve that during the entire calendar year the employee will be a bona fide resident of Puerto Rico; or

(D) for services for the United States (or any agency thereof) performed by a citizen of the United States within a possession of the United States to the extent the United States (or such agency) withholds taxes on such remuneration pursuant to an agreement with such possession; or

(9) for services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(10)(A) for services performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution; or

(B) for services performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such services, or is entitled to be credited with the unsold newspapers or magazines turned back; or

(11) for services not in the course of the employer's trade or business, to the extent paid in any medium other than cash; or

(12) to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust; or

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a); or

(C) for a payment described in section 402(h)(1) and (2) if, at the time of such payment, it is reasonable to believe that the employee will be entitled to an exclusion under such section for payment; or

(D) under an arrangement to which section 408(p) applies; or

(13) pursuant to any provision of law other than section 5(c) or 6(1) of the Peace Corps Act, for service performed as a volunteer or volunteer leader within the meaning of such Act; or

(E) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A), or

(14) in the form of group-term life insurance on the life of an employee; or

(15) to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable

under section 217 (determined without regard to section 274(n)); or

(16)(A) as tips in any medium other than cash;

(B) as cash tips to an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is $20 or more;

(17) for service described in section 3121(b)(20);

(18) for any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127, 129, 134(b)(4), or 134(b)(5);

(19) for any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 108(f)(4), 117, or 132;

(20) for any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan (within the meaning of section 105(h)(6));

(21) for any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(b);

(22) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d); or

(23) for any benefit or payment which is excludable from the gross income of the employee under section 139B(b).

The term "wages" includes any amount includible in gross income of an employee under section 409A and payment of such amount shall be treated as having been made in the taxable year in which the amount is so includible.

(b) PAYROLL PERIOD.—For purposes of this chapter, the term "payroll period" means a period for which a payment of wages is ordinarily made to the employee by his employer, and the term "miscellaneous payroll period" means a payroll period other than a daily, weekly, biweekly, semimonthly, monthly, quarterly, semiannual or annual payroll period.

(c) EMPLOYEE.—For purposes of this chapter, the term "employee" includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "employee" also includes an officer of a corporation.

(d) EMPLOYER.—For purposes of this chapter, the term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—

(1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of subsection (a)) means the person having control of the payment of such wages, and

(2) in the case of a person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the term "employer" (except for purposes of subsection (a)) means such person.

(e) NUMBER OF WITHHOLDING EXEMPTIONS CLAIMED.—For purposes of this chapter, the term "number of withholding exemptions claimed" means the number of withholding exemptions claimed in a withholding exemption certificate in effect under section 3402(f), or in effect under the corresponding section of prior law, except that if no such certificate is in effect, the number of withholding exemptions claimed shall be considered to be zero.

(f) TIPS.—For purposes of subsection (a), the term "wages" includes tips received by an employee in the course of his employment. Such wages shall be deemed to be paid at the time a written statement including such tips is furnished to the employer pursuant to section 6053(a) or (if no statement including such tips is so furnished) at the time received.

(g) CREW LEADER RULES TO APPLY.—Rules similar to the rules of section 3121(o) shall apply for purposes of this chapter.

(h) DIFFERENTIAL WAGE PAYMENTS TO ACTIVE DUTY MEMBERS OF THE UNIFORMED SERVICES.—

(1) IN GENERAL.— For purposes of subsection (a), any differential wage payment shall be treated as a payment of wages by the employer to the employee.

(2) DIFFERENTIAL WAGE PAYMENT.— For purposes of paragraph (1), the term "differential wage payment" means any payment which—

(A) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code) while on active duty for a period of more than 30 days, and

(B) represents all or a portion of the wages the individual would have received from the employer if the individual were performing service for the employer.

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) REQUIREMENT OF WITHHOLDING.—

(1) IN GENERAL.— Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall—

(A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and

(B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter and to reflect the provisions of chapter 1 applicable to such periods.

(2) AMOUNT OF WAGES.— For purposes of applying tables or procedures prescribed under paragraph (1), the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed multiplied

by the amount of one such exemption. The amount of each withholding exemption shall be equal to the amount of one personal exemption provided in section 151(b), prorated to the payroll period. The maximum number of withholding exemptions permitted shall be calculated in accordance with regulations prescribed by the Secretary under this section, taking into account any reduction in withholding to which an employee is entitled under this section.

(b) PERCENTAGE METHOD OF WITHHOLDING.—

(1) If wages are paid with respect to a period which is not a payroll period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(2) In any case in which wages are paid by an employer without regard to any payroll period or other period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(3) In any case in which the period, or the time described in paragraph (2), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to compute the tax to be deducted and withheld as if the aggregate of the wages paid to the employee during the calendar week were paid for a weekly payroll period.

(4) In determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(c) WAGE BRACKET WITHHOLDING.—

(1) At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee a tax (in lieu of the tax required to be deducted and withheld under subsection (a)) determined in accordance with tables prescribed by the Secretary in accordance with paragraph (6).

(2) If wages are paid with respect to a period which is not a payroll period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(3) In any case in which wages are paid by an employer without regard to any payroll period or other period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last

payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(4) In any case in which the period, or the time described in paragraph (3), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to determine the amount to be deducted and withheld under the tables applicable in the case of a weekly payroll period, in which case the aggregate of the wages paid to the employee during the calendar week shall be considered the weekly wages.

(5) If the wages exceed the highest wage bracket, in determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(6) In the case of wages paid after December 31, 1969, the amount deducted and withheld under paragraph (1) shall be determined in accordance with tables prescribed by the Secretary. In the tables so prescribed, the amounts set forth as amounts of wages and amounts of income tax to be deducted and withheld shall be computed on the basis of the table for an annual payroll period prescribed pursuant to subsection (a).

(d) TAX PAID BY RECIPIENT.—If the employer, in violation of the provisions of this chapter, fails to deduct and withhold the tax under this chapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

(e) INCLUDED AND EXCLUDED WAGES.—If the remuneration paid by an employer to an employee for services performed during one-half or more of any payroll period of not more than 31 consecutive days constitutes wages, all the remuneration paid by such employer to such employee for such period shall be deemed to be wages; but if the remuneration paid by an employer to an employee for services performed during more than one-half of any such payroll period does not constitute wages, then none of the remuneration paid by such employer to such employee for such period shall be deemed to be wages.

(f) WITHHOLDING EXEMPTIONS.—

(1) IN GENERAL.— An employee receiving wages shall on any day be entitled to the following withholding exemptions:

(A) an exemption for himself unless he is an individual described in section 151(d)(2);

(B) if the employee is married, any exemption to which his spouse is entitled, or would be entitled if such spouse were an employee receiving wages, under subparagraph (A) or (D), but only if such spouse does not have in effect a withholding exemption certificate claiming such exemption;

(C) an exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allow-

able an exemption under section 151(c) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

(D) any allowance to which he is entitled under subsection (m), but only if his spouse does not have in effect a withholding exemption certificate claiming such allowance; and

(E) a standard deduction allowance which shall be an amount equal to one exemption (or more than one exemption if so prescribed by the Secretary) unless (i) he is married (as determined under section 7703) and his spouse is an employee receiving wages subject to withholding or (ii) he has withholding exemption certificates in effect with respect to more than one employer.

For purposes of this title, any standard deduction allowance under subparagraph (E) shall be treated as if it were denominated a withholding exemption.

(2) EXEMPTION CERTIFICATES.—

(A) ON COMMENCEMENT OF EMPLOYMENT.— On or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding exemption certificate relating to the number of withholding exemptions which he claims, which shall in no event exceed the number to which he is entitled.

(B) CHANGE OF STATUS.— If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is less than the number of withholding exemptions claimed by the employee on the withholding exemption certificate then in effect with respect to him, the employee shall within 10 days thereafter furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day. If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is greater than the number of withholding exemptions claimed, the employee may furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day.

(C) CHANGE OF STATUS WHICH AFFECTS NEXT CALENDAR YEAR.— If on any day during the calendar year the number of withholding exemptions to which the employee will be, or may reasonably be expected to be, entitled at the beginning of his next taxable year under subtitle A is different from the number to which the employee is entitled on such day, the employee shall, in such cases and at such times as the Secretary may by regulations prescribe, furnish the employer with a withholding exemption certificate relating to the number of withholding exemptions which he claims with respect to such next taxable year, which

shall in no event exceed the number to which he will be, or may reasonably be expected to be, so entitled.

(3) WHEN CERTIFICATE TAKES EFFECT.—

(A) FIRST CERTIFICATE FURNISHED.— A withholding exemption certificate furnished the employer in cases in which no previous such certificate is in effect shall take effect as of the beginning of the first payroll period ending, or the first payment of wages made without regard to a payroll period, on or after the date on which such certificate is so furnished.

(B) FURNISHED TO TAKE PLACE OF EXISTING CERTIFICATE.—

(i) IN GENERAL.— Except as provided in clauses (ii) and (iii), a withholding exemption certificate furnished to the employer in cases in which a previous such certificate is in effect shall take effect as of the beginning of the 1st payroll period ending (or the 1st payment of wages made without regard to a payroll period) on or after the 30th day after the day on which such certificate is so furnished.

(ii) EMPLOYER MAY ELECT EARLIER EFFECTIVE DATE.— At the election of the employer, a certificate described in clause (i) may be made effective beginning with any payment of wages made on or after the day on which the certificate is so furnished and before the 30th day referred to in clause (i).

(iii) CHANGE OF STATUS WHICH AFFECTS NEXT YEAR.— Any certificate furnished pursuant to paragraph (2)(C) shall not take effect, and may not be made effective, with respect to any payment of wages made in the calendar year in which the certificate is furnished.

(4) PERIOD DURING WHICH CERTIFICATE REMAINS IN EFFECT.— A withholding exemption certificate which takes effect under this subsection, or which on December 31, 1954, was in effect under the corresponding subsection of prior law, shall continue in effect with respect to the employer until another such certificate takes effect under this subsection.

(5) FORM AND CONTENTS OF CERTIFICATE.— Withholding exemption certificates shall be in such form and contain such information as the Secretary may by regulations prescribe.

(6) EXEMPTION OF CERTAIN NONRESIDENT ALIENS.— Notwithstanding the provisions of paragraph (1), a nonresident alien individual (other than an individual described in section 3401(a)(6)(A) or (B)) shall be entitled to only one withholding exemption.

(7) EXEMPTION WHERE CERTIFICATE WITH ANOTHER EMPLOYER IS IN EFFECT.— If a withholding exemption certificate is in effect with respect to one employer, an employee shall not be entitled under a certificate in effect with any other employer to any withholding exemption which he has claimed under such first certificate.

(g) OVERLAPPING PAY PERIODS, AND PAYMENT BY AGENT OR FIDUCIARY.—If a payment of wages is made to an employee by an employer—

(1) with respect to a payroll period or other period, any part of which is included in a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(2) without regard to any payroll period or other period, but on or prior to the expiration of a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(3) with respect to a period beginning in one and ending in another calendar year, or

(4) through an agent, fiduciary, or other person who also has the control, receipt, custody, or disposal of, or pays, the wages payable by another employer to such employee,

the manner of withholding and the amount to be deducted and withheld under this chapter shall be determined in accordance with regulations prescribed by the Secretary under which the withholding exemption allowed to the employee in any calendar year shall approximate the withholding exemption allowable with respect to an annual payroll period.

(h) ALTERNATIVE METHODS OF COMPUTING AMOUNT TO BE WITHHELD.—The Secretary may, under regulations prescribed by him, authorize—

(1) WITHHOLDING ON BASIS OF AVERAGE WAGES.— An employer—

(A) to estimate the wages which will be paid to any employee in any quarter of the calendar year,

(B) to determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter as if the appropriate average of the wages so estimated constituted the actual wages paid, and

(C) to deduct and withhold upon any payment of wages to such employee during such quarter (and, in the case of tips referred to in subsection (k), within 30 days thereafter) such amount as may be necessary to adjust the amount actually deducted and withheld upon the wages of such employee during such quarter to the amount required to be deducted and withheld during such quarter without regard to this subsection.

(2) WITHHOLDING ON BASIS OF ANNUALIZED WAGES.— An employer to determine the amount of tax to be deducted and withheld upon a payment of wages to an employee for a payroll period by—

(A) multiplying the amount of an employee's wages for a payroll period by the number of such payroll periods in the calendar year,

(B) determining the amount of tax which would be required to be deducted and withheld upon the amount determined under subparagraph (A) if such amount constituted the actual wages for the calendar year and the payroll period of the employee were an annual payroll period, and

(C) dividing the amount of tax determined under subparagraph (B) by the number of payroll periods (described in subparagraph (A)) in the calendar year.

(3) WITHHOLDING ON BASIS OF CUMULATIVE WAGES.— An employer, in the case of any employee who requests to have the amount of tax to be withheld from his wages computed on the basis of his cumulative wages, to—

(A) add the amount of the wages to be paid to the employee for the payroll period to the total amount of wages paid by the employer to the employee during the calendar year,

(B) divide the aggregate amount of wages computed under subparagraph (A) by the number of payroll periods to which such aggregate amount of wages relates,

(C) compute the total amount of tax that would have been required to be deducted and withheld under subsection (a) if the average amount of wages (as computed under subparagraph (B)) had been paid to the employee for the number of payroll periods to which the aggregate amount of wages (computed under subparagraph (A)) relates,

(D) determine the excess, if any, of the amount of tax computed under subparagraph (C) over the total amount of tax deducted and withheld by the employer from wages paid to the employee during the calendar year, and

(E) deduct and withhold upon the payment of wages (referred to in subparagraph (A)) to the employee an amount equal to the excess (if any) computed under subparagraph (D).

(4) OTHER METHODS.— An employer to determine the amount of tax to be deducted and withheld upon the wages paid to an employee by any other method which will require the employer to deduct and withhold upon such wages substantially the same amount as would be required to be deducted and withheld by applying subsection (a) or (c), either with respect to a payroll period or with respect to the entire taxable year.

(i) CHANGES IN WITHHOLDING.—

(1) IN GENERAL.— The Secretary may by regulations provide for increases in the amount of withholding otherwise required under this section in cases where the employee requests such changes.

(2) TREATMENT AS TAX.— Any increased withholding under paragraph (1) shall for all purposes be considered tax required to be deducted and withheld under this chapter.

(j) NONCASH REMUNERATION TO RETAIL COMMISSION SALESMAN.—In the case of remuneration paid in any medium other than cash for services performed by an individual as a retail salesman for a person, where the service performed by such individual for such person is ordinarily performed for remuneration solely by way of cash commission an employer shall not be required to deduct or withhold any tax under this subchapter with respect to such remuneration, provided that such employer files with the Secretary such information with respect to such remuneration as the Secretary may by regulation prescribe.

(k) TIPS.—In the case of tips which constitute wages, subsection (a) shall be applicable only to such tips as are included in a written statement furnished to the employer pursuant to section 6053(a),

and only to the extent that the tax can be deducted and withheld by the employer, at or after the time such statement is so furnished and before the close of the calendar year in which such statement is furnished, from such wages of the employee (excluding tips, but including funds turned over by the employee to the employer for the purpose of such deduction and withholding) as are under the control of the employer; and an employer who is furnished by an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) to which paragraph (16)(B) of section 3401(a) is applicable may deduct and withhold the tax with respect to such tips from any wages of the employee (excluding tips) under his control, even though at the time such statement is furnished the total amount of the tips included in statements furnished to the employer as having been received by the employee in such calendar month in the course of his employment by such employer is less than $20. Such tax shall not at any time be deducted and withheld in an amount which exceeds the aggregate of such wages and funds (including funds turned over under section 3102(c)(2) or section 3202(c)(2)) minus any tax required by section 3102(a) or section 3202(a) to be collected from such wages and funds.

(l) DETERMINATION AND DISCLOSURE OF MARITAL STATUS.—

(1) DETERMINATION OF STATUS BY EMPLOYER.— For purposes of applying the tables in subsections (a) and (c) to a payment of wages, the employer shall treat the employee as a single person unless there is in effect with respect to such payment of wages a withholding exemption certificate furnished to the employer by the employee after the date of the enactment of this subsection indicating that the employee is married.

(2) DISCLOSURE OF STATUS BY EMPLOYEE.— An employee shall be entitled to furnish the employer with a withholding exemption certificate indicating he is married only if, on the day of such furnishing, he is married (determined with the application of the rules in paragraph (3)). An employee whose marital status changes from married to single shall, at such time as the Secretary may by regulations prescribe, furnish the employer with a new withholding exemption certificate.

(3) DETERMINATION OF MARITAL STATUS.— For purposes of paragraph (2), an employee shall on any day be considered—

(A) as not married, if (i) he is legally separated from his spouse under a decree of divorce or separate maintenance, or (ii) either he or his spouse is, or on any preceding day within the calendar year was, a nonresident alien; or

(B) as married, if (i) his spouse (other than a spouse referred to in subparagraph (A)) died within the portion of his taxable year which precedes such day, or (ii) his spouse died during one of the two taxable years immediately preceding the current taxable year and, on the basis of facts existing at the beginning of such day, the employee reasonably expects, at the close of his taxable year, to be a surviving spouse (as defined in section 2(a)).

(m) WITHHOLDING ALLOWANCES.—Under regulations prescribed by the Secretary, an employee shall be entitled to additional withholding allowances or additional reductions in withholding under this subsection. In determining the number of additional with-

holding allowances or the amount of additional reductions in withholding under this subsection, the employee may take into account (to the extent and in the manner provided by such regulations)—

(1) estimated itemized deductions allowable under chapter 1 (other than the deductions referred to in section 151 and other than the deductions required to be taken into account in determining adjusted gross income under section 62(a) (other than paragraph (10) thereof)),

(2) estimated tax credits allowable under chapter 1, and

(3) such additional deductions (including the additional standard deduction under section 63(c)(3) for the aged and blind) and other items as may be specified by the Secretary in regulations.

(n) EMPLOYEES INCURRING NO INCOME TAX LIABILITY.—Notwithstanding any other provision of this section, an employer shall not be required to deduct and withhold any tax under this chapter upon a payment of wages to an employee if there is in effect with respect to such payment a withholding exemption certificate (in such form and containing such other information as the Secretary may prescribe) furnished to the employer by the employee certifying that the employee—

(1) incurred no liability for income tax imposed under subtitle A for his preceding taxable year, and

(2) anticipates that he will incur no liability for income tax imposed under subtitle A for his current taxable year.

The Secretary shall by regulations provide for the coordination of the provisions of this subsection with the provisions of subsection (f).

(o) EXTENSION OF WITHHOLDING TO CERTAIN PAYMENTS OTHER THAN WAGES.—

(1) GENERAL RULE.— For purposes of this chapter (and so much of subtitle F as relates to this chapter)—

(A) any supplemental unemployment compensation benefit paid to an individual,

(B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter is in effect, and

(C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection), if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect,

shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

(2) DEFINITIONS.—

(A) SUPPLEMENTAL UNEMPLOYMENT COMPENSATION BENEFITS.— For purposes of paragraph (1), the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the ex-

tent such benefits are includible in the employee's gross income.

(B) ANNUITY.— For purposes of this subsection, the term "annuity" means any amount paid to an individual as a pension or annuity.

(C) SICK PAY.— For purposes of this subsection, the term "sick pay" means any amount which—

(i) is paid to an employee pursuant to a plan to which the employer is a party, and

(ii) constitutes remuneration or a payment in lieu of remuneration for any period during which the employee is temporarily absent from work on account of sickness or personal injuries.

(3) AMOUNT WITHHELD FROM ANNUITY PAYMENTS OR SICK PAY.— If a payee makes a request that an annuity or any sick pay be subject to withholding under this chapter, the amount to be deducted and withheld under this chapter from any payment to which such request applies shall be an amount (not less than a minimum amount determined under regulations prescribed by the Secretary) specified by the payee in such request. The amount deducted and withheld with respect to a payment which is greater or less than a full payment shall bear the same relation to the specified amount as such payment bears to a full payment.

(4) REQUEST FOR WITHHOLDING.— A request that an annuity or any sick pay be subject to withholding under this chapter—

(A) shall be made by the payee in writing to the person making the payments and shall contain the social security number of the payee,

(B) shall specify the amount to be deducted and withheld from each full payment, and

(C) shall take effect—

(i) in the case of sick pay, with respect to payments made more than 7 days after the date on which such request is furnished to the payor, or

(ii) in the case of an annuity, at such time (after the date on which such request is furnished to the payor) as the Secretary shall by regulations prescribe.

Such a request may be changed or terminated by furnishing to the person making the payments a written statement of change or termination which shall take effect in the same manner as provided in subparagraph (C). At the election of the payor, any such request (or statement of change or revocation) may take effect earlier than as provided in subparagraph (C).

(5) SPECIAL RULE FOR SICK PAY PAID PURSUANT TO CERTAIN COLLECTIVE-BARGAINING AGREEMENTS.— In the case of any sick pay paid pursuant to a collective-bargaining agreement between employee representatives and one or more employers which contains a provision specifying that this paragraph is to apply to sick pay paid pursuant to such agreement and contains a provision for determining the amount to be deducted and withheld from each payment of such sick pay—

(A) the requirement of paragraph (1)(C) that a request for withholding be in effect shall not apply, and

(B) except as provided in subsection (n), the amounts to be deducted and withheld under this chapter shall be determined in accordance with such agreement.

The preceding sentence shall not apply with respect to sick pay paid pursuant to any agreement to any individual unless the social security number of such individual is furnished to the payor and the payor is furnished with such information as is necessary to determine whether the payment is pursuant to the agreement and to determine the amount to be deducted and withheld.

(6) COORDINATION WITH WITHHOLDING ON DESIGNATED DISTRIBUTIONS UNDER SECTION 3405.— This subsection shall not apply to any amount which is a designated distribution (within the meaning of section 3405(e)(1)).

(p) VOLUNTARY WITHHOLDING AGREEMENTS.—

(1) CERTAIN FEDERAL PAYMENTS.—

(A) IN GENERAL.— If, at the time a specified Federal payment is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee.

(B) AMOUNT WITHHELD.— The amount to be deducted and withheld under this chapter from any payment to which any request under subparagraph (A) applies shall be an amount equal to the percentage of such payment specified in such request. Such a request shall apply to any payment only if the percentage specified is 7 percent, any percentage applicable to any of the 3 lowest income brackets in the table under section 1(c), or such other percentage as is permitted under regulations prescribed by the Secretary.

(C) SPECIFIED FEDERAL PAYMENTS.— For purposes of this paragraph, the term "specified Federal payment" means—

(i) any payment of a social security benefit (as defined in section 86(d)),

(ii) any payment referred to in the second sentence of section 451(d) which is treated as insurance proceeds,

(iii) any amount which is includible in gross income under section 77(a), and

(iv) any other payment made pursuant to Federal law which is specified by the Secretary for purposes of this paragraph.

(D) REQUESTS FOR WITHHOLDING.— Rules similar to the rules that apply to annuities under subsection (o)(4) shall apply to requests under this paragraph and paragraph (2).

(2) VOLUNTARY WITHHOLDING ON UNEMPLOYMENT BENEFITS.— If, at the time a payment of unemployment compensation (as defined in section 85(b)) is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter,

such payment shall be treated as if it were a payment of wages by an employer to an employee. The amount to be deducted and withheld under this chapter from any payment to which any request under this paragraph applies shall be an amount equal to 10 percent of such payment.

(3) AUTHORITY FOR OTHER VOLUNTARY WITHHOLDING.— The Secretary is authorized by regulations to provide for withholding—

(A) from remuneration for services performed by an employee for the employee's employer which (without regard to this paragraph) does not constitute wages, and

(B) from any other type of payment with respect to which the Secretary finds that withholding would be appropriate under the provisions of this chapter,

if the employer and employee, or the person making and the person receiving such other type of payment, agree to such withholding. Such agreement shall be in such form and manner as the Secretary may by regulations prescribe. For purposes of this chapter (and so much of subtitle F as relates to this chapter), remuneration or other payments with respect to which such agreement is made shall be treated as if they were wages paid by an employer to an employee to the extent that such remuneration is paid or other payments are made during the period for which the agreement is in effect.

(q) EXTENSION OF WITHHOLDING TO CERTAIN GAMBLING WINNINGS.—

(1) GENERAL RULE.— Every person, including the Government of the United States, a State, or a political subdivision thereof, or any instrumentalities of the foregoing, making any payment of winnings which are subject to withholding shall deduct and withhold from such payment a tax in an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment.

(2) EXEMPTION WHERE TAX OTHERWISE WITHHELD.— In the case of any payment of winnings which are subject to withholding made to a nonresident alien individual or a foreign corporation, the tax imposed under paragraph (1) shall not apply to any such payment subject to tax under section 1441(a) (relating to withholding on nonresident aliens) or tax under section 1442(a) (relating to withholding on foreign corporations).

(3) WINNINGS WHICH ARE SUBJECT TO WITHHOLDING.— For purposes of this subsection, the term "winnings which are subject to withholding" means proceeds from a wager determined in accordance with the following:

(A) IN GENERAL.— Except as provided in subparagraphs (B) and (C), proceeds of more than $5,000 from a wagering transaction, if the amount of such proceeds is at least 300 times as large as the amount wagered.

(B) STATE-CONDUCTED LOTTERIES.— Proceeds of more than $5,000 from a wager placed in a lottery conducted by an agency of a State acting under authority of State law, but only if such wager is placed with the State agency conducting such lottery, or with its authorized employees or agents.

(C) SWEEPSTAKES, WAGERING POOLS, CERTAIN PARIMUTUEL POOLS, JAI ALAI, AND LOTTERIES.— Proceeds of more than $5,000 from—

(i) a wager placed in a sweepstakes, wagering pool, or lottery (other than a wager described in subparagraph (B)), or

(ii) a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered.

(4) RULES FOR DETERMINING PROCEEDS FROM A WAGER.— For purposes of this subsection—

(A) proceeds from a wager shall be determined by reducing the amount received by the amount of the wager, and

(B) proceeds which are not money shall be taken into account at their fair market value.

(5) EXCEPTION FOR BINGO, KENO, AND SLOT MACHINES.— The tax imposed under paragraph (1) shall not apply to winnings from a slot machine, keno, and bingo.

(6) STATEMENT BY RECIPIENT.— Every person who is to receive a payment of winnings which are subject to withholding shall furnish the person making such payment a statement, made under the penalties of perjury, containing the name, address, and taxpayer identification number of the person receiving the payment and of each person entitled to any portion of such payment.

(7) COORDINATION WITH OTHER SECTIONS.— For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person of winnings which are subject to withholding shall be treated as if they were wages paid by an employer to an employee.

(r) EXTENSION OF WITHHOLDING TO CERTAIN TAXABLE PAYMENTS OF INDIAN CASINO PROFITS.—

(1) IN GENERAL.— Every person, including an Indian tribe, making a payment to a member of an Indian tribe from the net revenues of any class II or class III gaming activity conducted or licensed by such tribe shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

(2) EXCEPTION.— The tax imposed by paragraph (1) shall not apply to any payment to the extent that the payment, when annualized, does not exceed an amount equal to the sum of—

(A) the basic standard deduction (as defined in section 63(c)) for an individual to whom section 63(c)(2)(C) applies, and

(B) the exemption amount (as defined in section 151(d)).

(3) ANNUALIZED TAX.— For purposes of paragraph (1), the term "annualized tax" means, with respect to any payment, the amount of tax which would be imposed by section 1(c) (determined without regard to any rate of tax in excess of the fourth lowest rate of tax applicable under section 1(c)) on an amount of taxable income equal to the excess of—

(A) the annualized amount of such payment, over

(B) the amount determined under paragraph (2).

(4) CLASSES OF GAMING ACTIVITIES, ETC..— For purposes of this subsection, terms used in paragraph (1) which are defined in section 4 of the Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.), as in effect on the date of the enactment of this subsection, shall have the respective meanings given such terms by such section.

(5) ANNUALIZATION.— Payments shall be placed on an annualized basis under regulations prescribed by the Secretary.

(6) ALTERNATE WITHHOLDING PROCEDURES.— At the election of an Indian tribe, the tax imposed by this subsection on any payment made by such tribe shall be determined in accordance with such tables or computational procedures as may be specified in regulations prescribed by the Secretary (in lieu of in accordance with paragraphs (2) and (3)).

(7) COORDINATION WITH OTHER SECTIONS.— For purposes of this chapter and so much of subtitle F as relates to this chapter, payments to any person which are subject to withholding under this subsection shall be treated as if they were wages paid by an employer to an employee.

(s) EXEMPTION FROM WITHHOLDING FOR ANY VEHICLE FRINGE BENEFIT.—

(1) EMPLOYER ELECTION NOT TO WITHHOLD.— The employer may elect not to deduct and withhold any tax under this chapter with respect to any vehicle fringe benefit provided to any employee if such employee is notified by the employer of such election (at such time and in such manner as the Secretary shall by regulations prescribe). The preceding sentence shall not apply to any vehicle fringe benefit unless the amount of such benefit is included by the employer on a statement timely furnished under section 6051.

(2) EMPLOYER MUST FURNISH W-2.— Any vehicle fringe benefit shall be treated as wages from which amounts are required to be deducted and withheld under this chapter for purposes of section 6051.

(3) VEHICLE FRINGE BENEFIT.— For purposes of this subsection, the term "vehicle fringe benefit" means any fringe benefit—

(A) which constitutes wages (as defined in section 3401), and

(B) which consists of providing a highway motor vehicle for the use of the employee.

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—Returns and Records

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PART III—INFORMATION RETURNS

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Subpart C—Information Regarding Wages Paid Employees

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SEC. 6051. RECEIPTS FOR EMPLOYEES.

(a) REQUIREMENT.—Every person required to deduct and withhold from an employee a tax under section 3101 or 3402, or who would have been required to deduct and withhold a tax under section 3402 (determined without regard to subsection (n)) if the employee had claimed no more than one withholding exemption, or every employer engaged in a trade or business who pays remuneration for services performed by an employee, including the cash value of such remuneration paid in any medium other than cash, shall furnish to each such employee in respect of the remuneration paid by such person to such employee during the calendar year, on or before January 31 of the succeeding year, or, if his employment is terminated before the close of such calendar year, within 30 days after the date of receipt of a written request from the employee if such 30-day period ends before January 31, a written statement showing the following:

(1) the name of such person,

(2) the name of the employee (and an identifying number for the employee if wages as defined in section 3121(a) have been paid),

(3) the total amount of wages as defined in section 3401(a),

(4) the total amount deducted and withheld as tax under section 3402,

(5) the total amount of wages as defined in section 3121(a),

(6) the total amount deducted and withheld as tax under section 3101,

(8) the total amount of elective deferrals (within the meaning of section 402(g)(3)) and compensation deferred under section 457, including the amount of designated Roth contributions (as defined in section 402A),

(9) the total amount incurred for dependent care assistance with respect to such employee under a dependent care assistance program described in section 129(d),

(10) in the case of an employee who is a member of the Armed Forces of the United States, such employee's earned income as determined for purposes of section 32 (relating to earned income credit),

(11) the amount contributed to any Archer MSA (as defined in section 220(d)) of such employee or such employee's spouse,

(12) the amount contributed to any health savings account (as defined in section 223(d)) of such employee or such employee's spouse,

(13) the total amount of deferrals for the year under a nonqualified deferred compensation plan (within the meaning of section 409A(d)), and

(14) the aggregate cost (determined under rules similar to the rules of section 4980B(f)(4)) of applicable employer-sponsored coverage (as defined in section 4980I(d)(1)), except that this paragraph shall not apply to—

(A) coverage to which paragraphs (11) and (12) apply, or

(B) the amount of any salary reduction contributions to a flexible spending arrangement (within the meaning of section 125).

In the case of compensation paid for service as a member of a uniformed service, the statement shall show, in lieu of the amount required to be shown by paragraph (5), the total amount of wages as defined in section 3121(a), computed in accordance with such section and section 3121(i)(2). In the case of compensation paid for service as a volunteer or volunteer leader within the meaning of the Peace Corps Act, the statement shall show, in lieu of the amount required to be shown by paragraph (5), the total amount of wages as defined in section 3121(a), computed in accordance with such section and section 3121(i)(3). In the case of tips received by an employee in the course of his employment, the amounts required to be shown by paragraphs (3) and (5) shall include only such tips as are included in statements furnished to the employer pursuant to section 6053(a). The amounts required to be shown by paragraph (5) shall not include wages which are exempted pursuant to sections 3101(c) and 3111(c) from the taxes imposed by sections 3101 and 3111. In the case of the amounts required to be shown by paragraph (13), the Secretary may (by regulation) establish a minimum amount of deferrals below which paragraph (13) does not apply.

(b) SPECIAL RULE AS TO COMPENSATION OF MEMBERS OF ARMED FORCES.—In the case of compensation paid for service as a member of the Armed Forces, the statement required by subsection (a) shall be furnished if any tax was withheld during the calendar year under section 3402, or if any of the compensation paid during such year is includible in gross income under chapter 1, or if during the calendar year any amount was required to be withheld as tax under section 3101. In lieu of the amount required to be shown by paragraph (3) of subsection (a), such statement shall show as wages paid during the calendar year the amount of such compensation paid during the calendar year which is not excluded from gross income under chapter 1 (whether or not such compensation constituted wages as defined in section 3401(a)).

(c) ADDITIONAL REQUIREMENTS.—The statements required to be furnished pursuant to this section in respect of any remuneration shall be furnished at such other times, shall contain such other information, and shall be in such form as the Secretary may by regulations prescribe. The statements required under this section shall also show the proportion of the total amount withheld as tax under section 3101 which is for financing the cost of hospital insurance benefits under part A of title XVIII of the Social Security Act.

(d) STATEMENTS TO CONSTITUTE INFORMATION RETURNS.—A duplicate of any statement made pursuant to this section and in accordance with regulations prescribed by the Secretary shall, when required by such regulations, be filed with the Secretary.

(e) RAILROAD EMPLOYEES.—

(1) ADDITIONAL REQUIREMENT.— Every person required to deduct and withhold tax under section 3201 from an employee shall include on or with the statement required to be furnished such employee under subsection (a) a notice concerning the provisions of this title with respect to the allowance of a credit or refund of the tax on wages imposed by section 3101(b) and the tax on compensation imposed by section 3201 or 3211 which is treated as a tax on wages imposed by section 3101(b).

(2) INFORMATION TO BE SUPPLIED TO EMPLOYEES.— Each person required to deduct and withhold tax under section 3201 during any year from an employee who has also received wages during such year subject to the tax imposed by section 3101(b) shall, upon request of such employee, furnish to him a written statement showing—

(A) the total amount of compensation with respect to which the tax imposed by section 3201 was deducted,

(B) the total amount deducted as tax under section 3201, and

(C) the portion of the total amount deducted as tax under section 3201 which is for financing the cost of hospital insurance under part A of title XVIII of the Social Security Act.

(f) STATEMENTS REQUIRED IN CASE OF SICK PAY PAID BY THIRD PARTIES.—

(1) STATEMENTS REQUIRED FROM PAYOR.—

(A) IN GENERAL.— If, during any calendar year, any person makes a payment of third-party sick pay to an employee, such person shall, on or before January 15 of the succeeding year, furnish a written statement to the employer in respect of whom such payment was made showing—

(i) the name and, if there is withholding under section 3402(o), the social security number of such employee,

(ii) the total amount of the third-party sick pay paid to such employee during the calendar year, and

(iii) the total amount (if any) deducted and withheld from such sick pay under section 3402.

For purposes of the preceding sentence, the term "third-party sick pay" means any sick pay (as defined in section 3402(o)(2)(C)) which does not constitute wages for purposes of chapter 24 (determined without regard to section 3402(o)(1)).

(B) SPECIAL RULES.—

(i) STATEMENTS ARE IN LIEU OF OTHER REPORTING REQUIREMENTS.— The reporting requirements of subparagraph (A) with respect to any payments shall, with respect to such payments, be in lieu of the requirements of subsection (a) and of section 6041.

(ii) PENALTIES MADE APPLICABLE.— For purposes of sections 6674 and 7204, the statements required to be furnished by subparagraph (A) shall be treated as statements required under this section to be furnished to employees.

(2) INFORMATION REQUIRED TO BE FURNISHED BY EMPLOYER.— Every employer who receives a statement under paragraph (1)(A) with respect to sick pay paid to any employee during any calendar year shall, on or before January 31 of the succeeding year, furnish a written statement to such employee showing—

(A) the information shown on the statement furnished under paragraph (1)(A), and

(B) if any portion of the sick pay is excludable from gross income under section 104(a)(3), the portion which is not so excludable and the portion which is so excludable.

To the extent practicable, the information required under the preceding sentence shall be furnished on or with the statement (if any) required under subsection (a).

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CHAPTER 68—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

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Subchapter A—Additions to the Tax and Additional Amounts

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PART I—GENERAL PROVISIONS

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SEC. 6652. FAILURE TO FILE CERTAIN INFORMATION RETURNS, REGISTRATION STATEMENTS, ETC.

(a) RETURNS WITH RESPECT TO CERTAIN PAYMENTS AGGREGATING LESS THAN $10.—In the case of each failure to file a statement of a payment to another person required under the authority of—

(1) section 6042(a)(2) (relating to payments of dividends aggregating less than $10), or

(2) section 6044(a)(2) (relating to payments of patronage dividends aggregating less than $10),

on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid (upon notice and demand by the Secretary and in the same manner as tax) by the person failing to so file the statement, $1 for each such statement not so filed, but the total amount imposed on the delinquent person for all such failures during the calendar year shall not exceed $1,000.

(b) FAILURE TO REPORT TIPS.—In the case of failure by an employee to report to his employer on the date and in the manner prescribed therefor any amount of tips required to be so reported by section 6053(a) which are wages (as defined in section 3121(a)) or which are compensation (as defined in section 3231(e)), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be paid by the employee, in addition to

the tax imposed by section 3101 or section 3201 (as the case may be) with respect to the amount of tips which he so failed to report, an amount equal to 50 percent of such tax.

(c) RETURNS BY EXEMPT ORGANIZATIONS AND BY CERTAIN TRUSTS.—

(1) ANNUAL RETURNS UNDER SECTION 6033(A)(1) OR 6012(A)(6).—

(A) PENALTY ON ORGANIZATION.— In the case of—

(i) a failure to file a return required under section 6033(a)(1) (relating to returns by exempt organizations) or section 6012(a)(6) (relating to returns by political organizations) on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), or

(ii) a failure to include any of the information required to be shown on a return filed under section 6033(a)(1) or section 6012(a)(6) or to show the correct information,

there shall be paid by the exempt organization $20 for each day during which such failure continues. The maximum penalty under this subparagraph on failures with respect to any 1 return shall not exceed the lesser of $10,000 or 5 percent of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding $1,000,000 for any year, with respect to the return required under section 6033(a)(1) or section 6012(a)(6) for such year, in applying the first sentence of this subparagraph, the amount of the penalty for each day during which a failure continues shall be $100 in lieu of the amount otherwise specified, and, in lieu of applying the second sentence of this subparagraph, the maximum penalty under this subparagraph shall not exceed $50,000.

(B) MANAGERS.—

(i) IN GENERAL.— The Secretary may make a written demand on any organization subject to penalty under subparagraph (A) specifying therein a reasonable future date by which the return shall be filed (or the information furnished) for purposes of this subparagraph.

(ii) FAILURE TO COMPLY WITH DEMAND.— If any person fails to comply with any demand under clause (i) on or before the date specified in such demand, there shall be paid by the person failing to so comply $10 for each day after the expiration of the time specified in such demand during which such failure continues. The maximum penalty imposed under this subparagraph on all persons for failures with respect to any 1 return shall not exceed $5,000.

(C) PUBLIC INSPECTION OF ANNUAL RETURNS AND REPORTS.— In the case of a failure to comply with the requirements of section 6104(d) with respect to any annual return on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing) or report required under section 527(j), there shall be paid

by the person failing to meet such requirements $20 for each day during which such failure continues. The maximum penalty imposed under this subparagraph on all persons for failures with respect to any 1 return or report shall not exceed $10,000.

(D) PUBLIC INSPECTION OF APPLICATIONS FOR EXEMPTION AND NOTICE OF STATUS.— In the case of a failure to comply with the requirements of section 6104(d) with respect to any exempt status application materials (as defined in such section) or notice materials (as defined in such section) on the date and in the manner prescribed therefor, there shall be paid by the person failing to meet such requirements $20 for each day during which such failure continues.

(E) NO PENALTY FOR CERTAIN ANNUAL NOTICES.— This paragraph shall not apply with respect to any notice required under section 6033(i).

(2) RETURNS UNDER SECTION 6034 OR 6043(B).—

(A) PENALTY ON ORGANIZATION OR TRUST.— In the case of a failure to file a return required under section 6034 (relating to returns by certain trusts) or section 6043(b) (relating to terminations, etc., of exempt organizations), on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), there shall be paid by the exempt organization or trust failing so to file $10 for each day during which such failure continues, but the total amount imposed under this subparagraph on any organization or trust for failure to file any 1 return shall not exceed $5,000.

(B) MANAGERS.— The Secretary may make written demand on an organization or trust failing to file under subparagraph (A) specifying therein a reasonable future date by which such filing shall be made for purposes of this subparagraph. If such filing is not made on or before such date, there shall be paid by the person failing so to file $10 for each day after the expiration of the time specified in the written demand during which such failure continues, but the total amount imposed under this subparagraph on all persons for failure to file any 1 return shall not exceed $5,000.

(C) SPLIT-INTEREST TRUSTS.— In the case of a trust which is required to file a return under section 6034(a), subparagraphs (A) and (B) of this paragraph shall not apply and paragraph (1) shall apply in the same manner as if such return were required under section 6033, except that—

(i) the 5 percent limitation in the second sentence of paragraph (1)(A) shall not apply,

(ii) in the case of any trust with gross income in excess of $250,000, in applying the first sentence of paragraph (1)(A), the amount of the penalty for each day during which a failure continues shall be $100 in lieu of the amount otherwise specified, and in lieu of applying the second sentence of paragraph (1)(A), the

maximum penalty under paragraph (1)(A) shall not exceed $50,000, and

(iii) the third sentence of paragraph (1)(A) shall be disregarded.

In addition to any penalty imposed on the trust pursuant to this subparagraph, if the person required to file such return knowingly fails to file the return, such penalty shall also be imposed on such person who shall be personally liable for such penalty.

(3) DISCLOSURE UNDER SECTION 6033(A)(2).—

(A) PENALTY ON ENTITIES.— In the case of a failure to file a disclosure required under section 6033(a)(2), there shall be paid by the tax-exempt entity (the entity manager in the case of a tax-exempt entity described in paragraph (4), (5), (6), or (7) of section 4965(c)) $100 for each day during which such failure continues. The maximum penalty under this subparagraph on failures with respect to any 1 disclosure shall not exceed $50,000.

(B) WRITTEN DEMAND.—

(i) IN GENERAL.— The Secretary may make a written demand on any entity or manager subject to penalty under subparagraph (A) specifying therein a reasonable future date by which the disclosure shall be filed for purposes of this subparagraph.

(ii) FAILURE TO COMPLY WITH DEMAND.— If any entity or manager fails to comply with any demand under clause (i) on or before the date specified in such demand, there shall be paid by such entity or manager failing to so comply $100 for each day after the expiration of the time specified in such demand during which such failure continues. The maximum penalty imposed under this subparagraph on all entities and managers for failures with respect to any 1 disclosure shall not exceed $10,000.

(C) DEFINITIONS.— Any term used in this section which is also used in section 4965 shall have the meaning given such term under section 4965.

(4) NOTICES UNDER SECTION 506.—

(A) PENALTY ON ORGANIZATION.— In the case of a failure to submit a notice required under section 506(a) (relating to organizations required to notify Secretary of intent to operate as 501(c)(4)) on the date and in the manner prescribed therefor, there shall be paid by the organization failing to so submit $20 for each day during which such failure continues, but the total amount imposed under this subparagraph on any organization for failure to submit any one notice shall not exceed $5,000.

(B) MANAGERS.— The Secretary may make written demand on an organization subject to penalty under subparagraph (A) specifying in such demand a reasonable future date by which the notice shall be submitted for purposes of this subparagraph. If such notice is not submitted on or before such date, there shall be paid by the person failing to so submit $20 for each day after the expiration of the time specified in the written demand during which

such failure continues, but the total amount imposed under this subparagraph on all persons for failure to submit any one notice shall not exceed $5,000.

(5) REASONABLE CAUSE EXCEPTION.— No penalty shall be imposed under this subsection with respect to any failure if it is shown that such failure is due to reasonable cause.

(6) OTHER SPECIAL RULES.—

(A) TREATMENT AS TAX.— Any penalty imposed under this subsection shall be paid on notice and demand of the Secretary and in the same manner as tax.

(B) JOINT AND SEVERAL LIABILITY.— If more than 1 person is liable under this subsection for any penalty with respect to any failure, all such persons shall be jointly and severally liable with respect to such failure.

(C) PERSON.— For purposes of this subsection, the term "person" means any officer, director, trustee, employee, or other individual who is under a duty to perform the act in respect of which the violation occurs.

(7) ADJUSTMENT FOR INFLATION.—

(A) IN GENERAL.— In the case of any failure relating to a return required to be filed in a calendar year beginning after 2014, each of the dollar amounts under paragraphs (1), (2), and (3) shall be increased by such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) determined by substituting "calendar year 2013" for "calendar year 1992" in subparagraph (B) thereof.

(B) ROUNDING.— If any amount adjusted under subparagraph (A)—

(i) is not less than $5,000 and is not a multiple of $500, such amount shall be rounded to the next lowest multiple of $500, and

(ii) is not described in clause (i) and is not a multiple of $5, such amount shall be rounded to the next lowest multiple of $5.

(d) ANNUAL REGISTRATION AND OTHER NOTIFICATION BY PENSION PLAN.—

(1) REGISTRATION.— In the case of any failure to file a registration statement required under section 6057(a) (relating to annual registration of certain plans) which includes all participants required to be included in such statement, on the date prescribed therefor (determined without regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, an amount equal to $1 for each participant with respect to whom there is a failure to file, multiplied by the number of days during which such failure continues, but the total amount imposed under this paragraph on any person for any failure to file with respect to any plan year shall not exceed $5,000.

(2) NOTIFICATION OF CHANGE OF STATUS.— In the case of failure to file a notification required under section 6057(b) (relating to notification of change of status) on the date prescribed therefor (determined without regard to any extension of time

for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, $1 for each day during which such failure continues, but the total amounts imposed under this paragraph on any person for failure to file any notification shall not exceed $1,000.

(e) INFORMATION REQUIRED IN CONNECTION WITH CERTAIN PLANS OF DEFERRED COMPENSATION, ETC..—In the case of failure to file a return or statement required under section 6058 (relating to information required in connection with certain plans of deferred compensation), 6047 (relating to information relating to certain trusts and annuity and bond purchase plans), or 6039D (relating to returns and records with respect to certain fringe benefit plans) on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, $25 for each day during which such failure continues, but the total amount imposed under this subsection on any person for failure to file any return shall not exceed $15,000. This subsection shall not apply to any return or statement which is an information return described in section 6724(d)(1)(C)(ii) or a payee statement described in section 6724(d)(2)(Y).

(f) RETURNS REQUIRED UNDER SECTION 6039C.—

(1) IN GENERAL.— In the case of each failure to make a return required by section 6039C which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not to willful neglect, the amount determined under paragraph (2) shall be paid (upon notice and demand by the Secretary and in the same manner as tax) by the person failing to make such return.

(2) AMOUNT OF PENALTY.— For purposes of paragraph (1), the amount determined under this paragraph with respect to any failure shall be $25 for each day during which such failure continues.

(3) LIMITATION.— The amount determined under paragraph (2) with respect to any person for failing to meet the requirements of section 6039C for any calendar year shall not exceed the lesser of—

(A) $25,000, or

(B) 5 percent of the aggregate of the fair market value of the United States real property interests owned by such person at any time during such year.

For purposes of the preceding sentence, fair market value shall be determined as of the end of the calendar year (or, in the case of any property disposed of during the calendar year, as of the date of such disposition).

(h) FAILURE TO GIVE NOTICE TO RECIPIENTS OF CERTAIN PENSION, ETC., DISTRIBUTIONS.—In the case of each failure to provide notice as required by section 3405(e)(10)(B), at the time prescribed therefor, unless it is shown that such failure is due to reasonable

cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such notice, an amount equal to $10 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $5,000.

(i) FAILURE TO GIVE WRITTEN EXPLANATION TO RECIPIENTS OF CERTAIN QUALIFYING ROLLOVER DISTRIBUTIONS.—In the case of each failure to provide a written explanation as required by section 402(f), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such written explanation, an amount equal to $100 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $50,000.

(j) FAILURE TO FILE CERTIFICATION WITH RESPECT TO CERTAIN RESIDENTIAL RENTAL PROJECTS.—In the case of each failure to provide a certification as required by section 142(d)(7) at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such certification, an amount equal to $100 for each such failure.

(k) FAILURE TO MAKE REPORTS REQUIRED UNDER SECTION 1202.—

In the case of a failure to make a report required under section 1202(d)(1)(C) which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to make such report, an amount equal to $50 for each report with respect to which there was such a failure. In the case of any failure due to negligence or intentional disregard, the preceding sentence shall be applied by substituting "$100" for "$50". In the case of a report covering periods in 2 or more years, the penalty determined under preceding provisions of this subsection shall be multiplied by the number of such years. No penalty shall be imposed under this subsection on any failure which is shown to be due to reasonable cause and not willful neglect.

(l) FAILURE TO FILE RETURN WITH RESPECT TO CERTAIN CORPORATE TRANSACTIONS.—In the case of any failure to make a return required under section 6043(c) containing the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to file such return, an amount equal to $500 for each day during which such failure continues, but the total amount imposed under this subsection with respect to any return shall not exceed $100,000.

(m) ALCOHOL AND TOBACCO TAXES FOR PENALTIES FOR FAILURE TO FILE CERTAIN INFORMATION RETURNS.—with respect to alcohol and tobacco taxes, see, generally, subtitle E.

(n) FAILURE TO MAKE REPORTS REQUIRED UNDER SECTIONS 3511, 6053(C)(8), AND 7705.—In the case of a failure to make a report re-

quired under section 3511, 6053(c)(8), or 7705 which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to make such report, an amount equal to $50 for each report with respect to which there was such a failure. In the case of any failure due to negligence or intentional disregard the preceding sentence shall be applied by substituting "$100" for "$50".

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B. CHANGES IN EXISTING LAW PROPOSED BY THE BILL, AS REPORTED

In compliance with clause 3(e)(1)(B) of rule XIII of the Rules of the House of Representatives, changes in existing law proposed by the bill, as reported, 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):

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e)(1)(B) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, and existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter B—Computation of Taxable Income

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PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

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SEC. 83. PROPERTY TRANSFERRED IN CONNECTION WITH PERFORMANCE OF SERVICES.

(a) GENERAL RULE.—If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by

its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property, shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

(b) ELECTION TO INCLUDE IN GROSS INCOME IN YEAR OF TRANSFER.—

(1) IN GENERAL.—Any person who performs services in connection with which property is transferred to any person may elect to include in his gross income for the taxable year in which such property is transferred, the excess of—

(A) the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), over

(B) the amount (if any) paid for such property.

If such election is made, subsection (a) shall not apply with respect to the transfer of such property, and if such property is subsequently forfeited, no deduction shall be allowed in respect of such forfeiture.

(2) ELECTION.—An election under paragraph (1) with respect to any transfer of property shall be made in such manner as the Secretary prescribes and shall be made not later than 30 days after the date of such transfer. Such election may not be revoked except with the consent of the Secretary.

(c) SPECIAL RULES.—For purposes of this section—

(1) SUBSTANTIAL RISK OF FORFEITURE.—The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

(2) TRANSFERABILITY OF PROPERTY.—The rights of a person in property are transferable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.

(3) SALES WHICH MAY GIVE RISE TO SUIT UNDER SECTION 16(B) OF THE SECURITIES EXCHANGE ACT OF 1934.—So long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in such property are—

(A) subject to a substantial risk of forfeiture, and

(B) not transferable.

(4) For purposes of determining an individual's basis in property transferred in connection with the performance of services, rules similar to the rules of section 72(w) shall apply.

(d) CERTAIN RESTRICTIONS WHICH WILL NEVER LAPSE.—

(1) VALUATION.—In the case of property subject to a restriction which by its terms will never lapse, and which allows the transferee to sell such property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property unless established to the contrary by the Secretary, and the burden of proof shall be on the Secretary with respect to such value.

(2) CANCELLATION.—If, in the case of property subject to a restriction which by its terms will never lapse, the restriction is canceled, then, unless the taxpayer establishes—

(A) that such cancellation was not compensatory, and

(B) that the person, if any, who would be allowed a deduction if the cancellation were treated as compensatory, will treat the transaction as not compensatory, as evidenced in such manner as the Secretary shall prescribe by regulations,

the excess of the fair market value of the property (computed without regard to the restrictions) at the time of cancellation over the sum of—

(C) the fair market value of such property (computed by taking the restriction into account) immediately before the cancellation, and

(D) the amount, if any, paid for the cancellation, shall be treated as compensation for the taxable year in which such cancellation occurs.

(e) APPLICABILITY OF SECTION.—This section shall not apply to—

(1) a transaction to which section 421 applies,

(2) a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2),

(3) the transfer of an option without a readily ascertainable fair market value,

(4) the transfer of property pursuant to the exercise of an option with a readily ascertainable fair market value at the date of grant, or

(5) group-term life insurance to which section 79 applies.

(f) HOLDING PERIOD.—In determining the period for which the taxpayer has held property to which subsection (a) applies, there shall be included only the period beginning at the first time his rights in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier.

(g) CERTAIN EXCHANGES.—If property to which subsection (a) applies is exchanged for property subject to restrictions and conditions substantially similar to those to which the property given in such exchange was subject, and if section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applied to such exchange, or if such exchange was pursuant to the exercise of a conversion privilege—

(1) such exchange shall be disregarded for purposes of subsection (a), and

(2) the property received shall be treated as property to which subsection (a) applies.

(h) DEDUCTION BY EMPLOYER.—In the case of a transfer of property to which this section applies or a cancellation of a restriction described in subsection (d), there shall be allowed as a deduction

under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a), (b), [or (d)(2)] *(d)(2), or (i)* in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

(i) QUALIFIED EQUITY GRANTS.—

(1) IN GENERAL.—For purposes of this subtitle, if qualified stock is transferred to a qualified employee who makes an election with respect to such stock under this subsection—

(A) except as provided in subparagraph (B), no amount shall be included in income under subsection (a) for the first taxable year in which the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable, and

(B) an amount equal to the amount which would be included in income of the employee under subsection (a) (determined without regard to this subsection) shall be included in income for the taxable year of the employee which includes the earliest of—

(i) the first date such qualified stock becomes transferable (including transferable to the employer),

(ii) the date the employee first becomes an excluded employee,

(iii) the first date on which any stock of the corporation which issued the qualified stock becomes readily tradable on an established securities market (as determined by the Secretary, but not including any market unless such market is recognized as an established securities market by the Secretary for purposes of a provision of this title other than this subsection),

(iv) the date that is 7 years after the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, or

(v) the date on which the employee revokes (at such time and in such manner as the Secretary may provide) the election under this subsection with respect to such stock.

(2) QUALIFIED STOCK.—

(A) IN GENERAL.—For purposes of this subsection, the term "qualified stock" means, with respect to any qualified employee, any stock in a corporation which is the employer of such employee, if—

(i) such stock is received—

(I) in connection with the exercise of an option, or

(II) in settlement of a restricted stock unit, and

(ii) such option or restricted stock unit was provided by the corporation—

(I) in connection with the performance of services as an employee, and

(II) during a calendar year in which such corporation was an eligible corporation.

(B) LIMITATION.—The term "qualified stock" shall not include any stock if the employee may sell such stock to, or otherwise receive cash in lieu of stock from, the corporation at the time that the rights of the employee in such stock first become transferable or not subject to a substantial risk of forfeiture.

(C) ELIGIBLE CORPORATION.—For purposes of subparagraph (A)(ii)(II)—

(i) IN GENERAL.—The term "eligible corporation" means, with respect to any calendar year, any corporation if—

(I) no stock of such corporation (or any predecessor of such corporation) is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) during any preceding calendar year, and

(II) such corporation has a written plan under which, in such calendar year, not less than 80 percent of all employees who provide services to such corporation in the United States (or any possession of the United States) are granted stock options, or restricted stock units, with the same rights and privileges to receive qualified stock.

(ii) SAME RIGHTS AND PRIVILEGES.—For purposes of clause (i)(II)—

(I) except as provided in subclauses (II) and (III), the determination of rights and privileges with respect to stock shall be determined in a similar manner as provided under section 423(b)(5),

(II) employees shall not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not equal in amount, so long as the number of shares available to each employee is more than a de minimis amount, and

(III) rights and privileges with respect to the exercise of an option shall not be treated as the same as rights and privileges with respect to the settlement of a restricted stock unit.

(iii) EMPLOYEE.—For purposes of clause (i)(II), the term "employee" shall not include any employee described in section 4980E(d)(4) or any excluded employee.

(iv) SPECIAL RULE FOR CALENDAR YEARS BEFORE 2017.—In the case of any calendar year beginning before January 1, 2017, clause (i)(II) shall be applied without regard to whether the rights and privileges with respect to the qualified stock are the same.

(3) QUALIFIED EMPLOYEE; EXCLUDED EMPLOYEE.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified employee" means any individual who—

(i) is not an excluded employee, and

(ii) agrees in the election made under this subsection to meet such requirements as determined by the Secretary to be necessary to ensure that the withholding requirements of the corporation under chapter 24 with respect to the qualified stock are met.

(B) EXCLUDED EMPLOYEE.—The term "excluded employee" means, with respect to any corporation, any individual—

(i) who was a 1-percent owner (within the meaning of section 416(i)(1)(B)(ii)) at any time during the 10 preceding calendar years,

(ii) who is or has been at any prior time—

(I) the chief executive officer of such corporation or an individual acting in such a capacity, or

(II) the chief financial officer of such corporation or an individual acting in such a capacity,

(iii) who bears a relationship described in section 318(a)(1) to any individual described in subclause (I) or (II) of clause (ii), or

(iv) who has been for any of the 10 preceding taxable years one of the 4 highest compensated officers of such corporation determined with respect to each such taxable year on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934 (as if such rules applied to such corporation).

(4) ELECTION.—

(A) TIME FOR MAKING ELECTION.—An election with respect to qualified stock shall be made under this subsection no later than 30 days after the first time the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, and shall be made in a manner similar to the manner in which an election is made under subsection (b).

(B) LIMITATIONS.—No election may be made under this section with respect to any qualified stock if—

(i) the qualified employee has made an election under subsection (b) with respect to such qualified stock,

(ii) any stock of the corporation which issued the qualified stock is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) at any time before the election is made, or

(iii) such corporation purchased any of its outstanding stock in the calendar year preceding the calendar year which includes the first time the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, unless—

(I) not less than 25 percent of the total dollar amount of the stock so purchased is deferral stock, and

(II) the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.

(C) DEFINITIONS AND SPECIAL RULES RELATED TO LIMITATION ON STOCK REDEMPTIONS.—

(i) DEFERRAL STOCK.—For purposes of this paragraph, the term "deferral stock" means stock with respect to which an election is in effect under this subsection

(ii) DEFERRAL STOCK WITH RESPECT TO ANY INDIVIDUAL NOT TAKEN INTO ACCOUNT IF INDIVIDUAL HOLDS DEFERRAL STOCK WITH LONGER DEFERRAL PERIOD.—Stock purchased by a corporation from any individual shall not be treated as deferral stock for purposes of clause (iii) if such individual (immediately after such purchase) holds any deferral stock with respect to which an election has been in effect under this subsection for a longer period than the election with respect to the stock so purchased.

(iii) PURCHASE OF ALL OUTSTANDING DEFERRAL STOCK.—The requirements of subclauses (I) and (II) of subparagraph (B)(iii) shall be treated as met if the stock so purchased includes all of the corporation's outstanding deferral stock.

(iv) REPORTING.—Any corporation which has outstanding deferral stock as of the beginning of any calendar year and which purchases any of its outstanding stock during such calendar year shall include on its return of tax for the taxable year in which, or with which, such calendar year ends the total dollar amount of its outstanding stock so purchased during such calendar year and such other information as the Secretary may require for purposes of administering this paragraph.

(5) CONTROLLED GROUPS.—For purposes of this subsection, all corporations which are members of the same controlled group of corporations (as defined in section 1563(a)) shall be treated as one corporation.

(6) NOTICE REQUIREMENT.—Any corporation that transfers qualified stock to a qualified employee shall, at the time that (or a reasonable period before) an amount attributable to such stock would (but for this subsection) first be includible in the gross income of such employee—

(A) certify to such employee that such stock is qualified stock, and

(B) notify such employee—

(i) that the employee may elect to defer income on such stock under this subsection, and

(ii) that, if the employee makes such an election—

(I) the amount of income recognized at the end of the deferral period will be based on the value of the stock at the time at which the rights of the employee in such stock first become transferable or not subject to substantial risk of forfeiture, notwithstanding whether the value of the stock has declined during the deferral period,

(II) the amount of such income recognized at the end of the deferral period will be subject to withholding under section 3401(i) at the rate determined under section 3402(t), and

(III) the responsibilities of the employee (as determined by the Secretary under paragraph (3)(A)(ii)) with respect to such withholding.

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Subchapter D—Deferred Compensation, Etc

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PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC

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Subpart A—General Rule

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SEC. 409A. INCLUSION IN GROSS INCOME OF DEFERRED COMPENSATION UNDER NONQUALIFIED DEFERRED COMPENSATION PLANS.

(a) RULES RELATING TO CONSTRUCTIVE RECEIPT.—

(1) PLAN FAILURES.—

(A) GROSS INCOME INCLUSION.—

(i) IN GENERAL.—If at any time during a taxable year a nonqualified deferred compensation plan—

(I) fails to meet the requirements of paragraphs (2), (3), and (4), or

(II) is not operated in accordance with such requirements, all compensation deferred under the plan for the taxable year and all preceding taxable years shall be includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income.

(ii) APPLICATION ONLY TO AFFECTED PARTICIPANTS.—Clause (i) shall only apply with respect to all compensation deferred under the plan for participants with respect to whom the failure relates.

(B) INTEREST AND ADDITIONAL TAX PAYABLE WITH RESPECT TO PREVIOUSLY DEFERRED COMPENSATION.—

(i) IN GENERAL.—If compensation is required to be included in gross income under subparagraph (A) for a taxable year, the tax imposed by this chapter for the taxable year shall be increased by the sum of—

(I) the amount of interest determined under clause (ii), and

(II) an amount equal to 20 percent of the compensation which is required to be included in gross income.

(ii) INTEREST.—For purposes of clause (i), the interest determined under this clause for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the deferred compensation been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year

in which such deferred compensation is not subject to a substantial risk of forfeiture.

(2) DISTRIBUTIONS.—

(A) IN GENERAL.—The requirements of this paragraph are met if the plan provides that compensation deferred under the plan may not be distributed earlier than—

(i) separation from service as determined by the Secretary (except as provided in subparagraph (B)(i)),

(ii) the date the participant becomes disabled (within the meaning of subparagraph (C)),

(iii) death,

(iv) a specified time (or pursuant to a fixed schedule) specified under the plan at the date of the deferral of such compensation,

(v) to the extent provided by the Secretary, a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation, or

(vi) the occurrence of an unforeseeable emergency.

(B) SPECIAL RULES.—

(i) SPECIFIED EMPLOYEES.—In the case of any specified employee, the requirement of subparagraph (A)(i) is met only if distributions may not be made before the date which is 6 months after the date of separation from service (or, if earlier, the date of death of the employee). For purposes of the preceding sentence, a specified employee is a key employee (as defined in section 416(i) without regard to paragraph (5) thereof) of a corporation any stock in which is publicly traded on an established securities market or otherwise.

(ii) UNFORESEEABLE EMERGENCY.—For purposes of subparagraph (A)(vi)—

(I) IN GENERAL.—The term "unforeseeable emergency" means a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, or a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

(II) LIMITATION ON DISTRIBUTIONS.—The requirement of subparagraph (A)(vi) is met only if, as determined under regulations of the Secretary, the amounts distributed with respect to an emergency do not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

(C) DISABLED.—For purposes of subparagraph (A)(ii), a participant shall be considered disabled if the participant—

(i) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or

(ii) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering employees of the participant's employer.

(3) ACCELERATION OF BENEFITS.—The requirements of this paragraph are met if the plan does not permit the acceleration of the time or schedule of any payment under the plan, except as provided in regulations by the Secretary.

(4) ELECTIONS.—

(A) IN GENERAL.—The requirements of this paragraph are met if the requirements of subparagraphs (B) and (C) are met.

(B) INITIAL DEFERRAL DECISION.—

(i) IN GENERAL.—The requirements of this subparagraph are met if the plan provides that compensation for services performed during a taxable year may be deferred at the participant's election only if the election to defer such compensation is made not later than the close of the preceding taxable year or at such other time as provided in regulations.

(ii) FIRST YEAR OF ELIGIBILITY.—In the case of the first year in which a participant becomes eligible to participate in the plan, such election may be made with respect to services to be performed subsequent to the election within 30 days after the date the participant becomes eligible to participate in such plan.

(iii) PERFORMANCE-BASED COMPENSATION.—In the case of any performance-based compensation based on services performed over a period of at least 12 months, such election may be made no later than 6 months before the end of the period.

(C) CHANGES IN TIME AND FORM OF DISTRIBUTION.—The requirements of this subparagraph are met if, in the case of a plan which permits under a subsequent election a delay in a payment or a change in the form of payment—

(i) the plan requires that such election may not take effect until at least 12 months after the date on which the election is made,

(ii) in the case of an election related to a payment not described in clause (ii), (iii), or (vi) of paragraph (2)(A), the plan requires that the payment with respect to which such election is made be deferred for a period of not less than 5 years from the date such payment would otherwise have been made, and

(iii) the plan requires that any election related to a payment described in paragraph (2)(A)(iv) may not be made less than 12 months prior to the date of the first scheduled payment under such paragraph.

(b) RULES RELATING TO FUNDING.—

(1) OFFSHORE PROPERTY IN A TRUST.—In the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary) for purposes of paying deferred compensation under a nonqualified deferred compensation plan, for purposes of section 83 such assets shall be treated as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors—

(A) at the time set aside if such assets (or such trust or other arrangement) are located outside of the United States, or

(B) at the time transferred if such assets (or such trust or other arrangement) are subsequently transferred outside of the United States.

This paragraph shall not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in such jurisdiction.

(2) EMPLOYER'S FINANCIAL HEALTH.—In the case of compensation deferred under a nonqualified deferred compensation plan, there is a transfer of property within the meaning of section 83 with respect to such compensation as of the earlier of—

(A) the date on which the plan first provides that assets will become restricted to the provision of benefits under the plan in connection with a change in the employer's financial health, or

(B) the date on which assets are so restricted, whether or not such assets are available to satisfy claims of general creditors.

(3) TREATMENT OF EMPLOYER'S DEFINED BENEFIT PLAN DURING RESTRICTED PERIOD.—

(A) IN GENERAL.—If—

(i) during any restricted period with respect to a single-employer defined benefit plan, assets are set aside or reserved (directly or indirectly) in a trust (or other arrangement as determined by the Secretary) or transferred to such a trust or other arrangement for purposes of paying deferred compensation of an applicable covered employee under a nonqualified deferred compensation plan of the plan sponsor or member of a controlled group which includes the plan sponsor, or

(ii) a nonqualified deferred compensation plan of the plan sponsor or member of a controlled group which includes the plan sponsor provides that assets will become restricted to the provision of benefits under the plan to an applicable covered employee in connection with such restricted period (or other similar financial measure determined by the Secretary) with respect to the defined benefit plan, or assets are so restricted,

such assets shall, for purposes of section 83, be treated as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors. Clause (i) shall not apply with respect to any assets which are so set aside before the restricted period with respect to the defined benefit plan.

(B) RESTRICTED PERIOD.—For purposes of this section, the term "restricted period" means, with respect to any plan described in subparagraph (A)—

(i) any period during which the plan is in at-risk status (as defined in section 430(i));

(ii) any period the plan sponsor is a debtor in a case under title 11, United States Code, or similar Federal or State law, and

(iii) the 12-month period beginning on the date which is 6 months before the termination date of the plan if, as of the termination date, the plan is not sufficient for benefit liabilities (within the meaning of section 4041 of the Employee Retirement Income Security Act of 1974).

(C) SPECIAL RULE FOR PAYMENT OF TAXES ON DEFERRED COMPENSATION INCLUDED IN INCOME.—If an employer provides directly or indirectly for the payment of any Federal, State, or local income taxes with respect to any compensation required to be included in gross income by reason of this paragraph—

(i) interest shall be imposed under subsection (a)(1)(B)(i)(I) on the amount of such payment in the same manner as if such payment was part of the deferred compensation to which it relates,

(ii) such payment shall be taken into account in determining the amount of the additional tax under subsection (a)(1)(B)(i)(II) in the same manner as if such payment was part of the deferred compensation to which it relates, and

(iii) no deduction shall be allowed under this title with respect to such payment.

(D) OTHER DEFINITIONS.—For purposes of this section—

(i) APPLICABLE COVERED EMPLOYEE.—The term "applicable covered employee" means any—

(I) covered employee of a plan sponsor,

(II) covered employee of a member of a controlled group which includes the plan sponsor, and

(III) former employee who was a covered employee at the time of termination of employment with the plan sponsor or a member of a controlled group which includes the plan sponsor.

(ii) COVERED EMPLOYEE.—The term "covered employee" means an individual described in section 162(m)(3) or an individual subject to the requirements of section 16(a) of the Securities Exchange Act of 1934.

(4) INCOME INCLUSION FOR OFFSHORE TRUSTS AND EMPLOYER'S FINANCIAL HEALTH.—For each taxable year that assets treated as transferred under this subsection remain set aside in a trust or other arrangement subject to paragraph (1), (2),

or (3), any increase in value in, or earnings with respect to, such assets shall be treated as an additional transfer of property under this subsection (to the extent not previously included in income).

(5) INTEREST ON TAX LIABILITY PAYABLE WITH RESPECT TO TRANSFERRED PROPERTY.—

(A) IN GENERAL.—If amounts are required to be included in gross income by reason of paragraph (1), (2), or (3) for a taxable year, the tax imposed by this chapter for such taxable year shall be increased by the sum of—

(i) the amount of interest determined under subparagraph (B), and

(ii) an amount equal to 20 percent of the amounts required to be included in gross income.

(B) INTEREST.—For purposes of subparagraph (A), the interest determined under this subparagraph for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the amounts so required to be included in gross income by paragraph (1), (2), or (3) been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such amounts are not subject to a substantial risk of forfeiture.

(c) NO INFERENCE ON EARLIER INCOME INCLUSION OR REQUIREMENT OF LATER INCLUSION.—Nothing in this section shall be construed to prevent the inclusion of amounts in gross income under any other provision of this chapter or any other rule of law earlier than the time provided in this section. Any amount included in gross income under this section shall not be required to be included in gross income under any other provision of this chapter or any other rule of law later than the time provided in this section.

(d) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section:

(1) NONQUALIFIED DEFERRED COMPENSATION PLAN.—The term "nonqualified deferred compensation plan" means any plan that provides for the deferral of compensation, other than—

(A) a qualified employer plan, and

(B) any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.

(2) QUALIFIED EMPLOYER PLAN.—The term "qualified employer plan" means—

(A) any plan, contract, pension, account, or trust described in subparagraph (A) or (B) of section 219(g)(5) (without regard to subparagraph (A)(iii)),

(B) any eligible deferred compensation plan (within the meaning of section 457(b)), and

(C) any plan described in section 415(m).

(3) PLAN INCLUDES ARRANGEMENTS, ETC..—The term "plan" includes any agreement or arrangement, including an agreement or arrangement that includes one person.

(4) SUBSTANTIAL RISK OF FORFEITURE.—The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are condi-

tioned upon the future performance of substantial services by any individual.

(5) TREATMENT OF EARNINGS.—References to deferred compensation shall be treated as including references to income (whether actual or notional) attributable to such compensation or such income.

(6) AGGREGATION RULES.—Except as provided by the Secretary, rules similar to the rules of subsections (b) and (c) of section 414 shall apply.

(7) TREATMENT OF QUALIFIED STOCK.—An arrangement under which an employee may receive qualified stock (as defined in section 83(i)(2)) shall not be treated as a nonqualified deferred compensation plan solely because of an employee's ability to defer recognition of income pursuant to an election under section 83(i).

(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

(1) providing for the determination of amounts of deferral in the case of a nonqualified deferred compensation plan which is a defined benefit plan,

(2) relating to changes in the ownership and control of a corporation or assets of a corporation for purposes of subsection (a)(2)(A)(v),

(3) exempting arrangements from the application of subsection (b) if such arrangements will not result in an improper deferral of United States tax and will not result in assets being effectively beyond the reach of creditors,

(4) defining financial health for purposes of subsection (b)(2), and

(5) disregarding a substantial risk of forfeiture in cases where necessary to carry out the purposes of this section.

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PART II—CERTAIN STOCK OPTIONS

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SEC. 422. INCENTIVE STOCK OPTIONS.

(a) IN GENERAL.—Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an incentive stock option if—

(1) no disposition of such share is made by him within 2 years from the date of the granting of the option nor within 1 year after the transfer of such share to him, and

(2) at all times during the period beginning on the date of the granting of the option and ending on the day 3 months before the date of such exercise, such individual was 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 corporation of such corporation issuing or assuming a stock option in a transaction to which section 424(a) applies.

(b) INCENTIVE STOCK OPTION.—For purposes of this part, the term "incentive stock option" means an option granted to an individual for any reason connected with his employment by a corpora-

tion, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—

(1) the option is granted pursuant to a plan which includes the aggregate number of shares which may be issued under options and the employees (or class of employees) eligible to receive options, and which is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

(2) such option is granted within 10 years from the date such plan is adopted, or the date such plan is approved by the stockholders, whichever is earlier;

(3) such option by its terms is not exercisable after the expiration of 10 years from the date such option is granted;

(4) the option price is not less than the fair market value of the stock at the time such option is granted;

(5) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him; and

(6) such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation or of its parent or subsidiary corporation.

Such term shall not include any option if (as of the time the option is granted) the terms of such option provide that it will not be treated as an incentive stock option. *Such term shall not include any option if an election is made under section 83(i) with respect to the stock received in connection with the exercise of such option.*

(c) SPECIAL RULES.—

(1) GOOD FAITH EFFORTS TO VALUE OF STOCK.—If a share of stock is transferred pursuant to the exercise by an individual of an option which would fail to qualify as an incentive stock option under subsection (b) because there was a failure in an attempt, made in good faith, to meet the requirement of subsection (b)(4), the requirement of subsection (b)(4) shall be considered to have been met. To the extent provided in regulations by the Secretary, a similar rule shall apply for purposes of subsection (d).

(2) CERTAIN DISQUALIFYING DISPOSITIONS WHERE AMOUNT REALIZED IS LESS THAN VALUE AT EXERCISE.—If—

(A) an individual who has acquired a share of stock by the exercise of an incentive stock option makes a disposition of such share within either of the periods described in subsection (a)(1), and

(B) such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to such individual,

then the amount which is includible in the gross income of such individual, and the amount which is deductible from the income of his employer corporation, as compensation attributable to the exercise of such option shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of such share.

(3) CERTAIN TRANSFERS BY INSOLVENT INDIVIDUALS.—If an insolvent individual holds a share of stock acquired pursuant to his exercise of an incentive stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary in any proceeding under title 11 or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of his creditors in such proceeding, shall constitute a disposition of such share for purposes of subsection (a)(1).

(4) PERMISSIBLE PROVISIONS.—An option which meets the requirements of subsection (b) shall be treated as an incentive stock option even if—

(A) the employee may pay for the stock with stock of the corporation granting the option,

(B) the employee has a right to receive property at the time of exercise of the option, or

(C) the option is subject to any condition not inconsistent with the provisions of subsection (b).

Subparagraph (B) shall apply to a transfer of property (other than cash) only if section 83 applies to the property so transferred.

(5) 10-PERCENT SHAREHOLDER RULE.—Subsection (b)(6) shall not apply if at the time such option is granted the option price is at least 110 percent of the fair market value of the stock subject to the option and such option by its terms is not exercisable after the expiration of 5 years from the date such option is granted.

(6) SPECIAL RULE WHEN DISABLED.—For purposes of subsection (a)(2), in the case of an employee who is disabled (within the meaning of section 22(e)(3)), the 3-month period of subsection (a)(2) shall be 1 year.

(7) FAIR MARKET VALUE.—For purposes of this section, the fair market value of stock shall be determined without regard to any restriction other than a restriction which, by its terms, will never lapse.

(d) $100,000 per year limitation

(1) IN GENERAL.—To the extent that the aggregate fair market value of stock with respect to which incentive stock options (determined without regard to this subsection) are exercisable for the 1st time by any individual during any calendar year (under all plans of the individual's employer corporation and its parent and subsidiary corporations) exceeds $100,000, such options shall be treated as options which are not incentive stock options.

(2) ORDERING RULE.—Paragraph (1) shall be applied by taking options into account in the order in which they were granted.

(3) DETERMINATION OF FAIR MARKET VALUE.—For purposes of paragraph (1), the fair market value of any stock shall be determined as of the time the option with respect to such stock is granted.

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SEC. 423. EMPLOYEE STOCK PURCHASE PLANS.

(a) GENERAL RULE.—Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an option granted under an employee stock purchase plan (as defined in subsection (b)) if—

(1) no disposition of such share is made by him within 2 years after the date of the granting of the option nor within 1 year after the transfer of such share to him; and

(2) at all times during the period beginning with the date of the granting of the option and ending on the day 3 months before the date of such exercise, he is an employee of the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 424(a) applies.

The preceding sentence shall not apply to any share of stock with respect to which an election is made under section 83(i).

(b) EMPLOYEE STOCK PURCHASE PLAN.—For purposes of this part, the term "employee stock purchase plan" means a plan which meets the following requirements:

(1) the plan provides that options are to be granted only to employees of the employer corporation or of its parent or subsidiary corporation to purchase stock in any such corporation;

(2) such plan is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

(3) under the terms of the plan, no employee can be granted an option if such employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation. For purposes of this paragraph, the rules of section 424(d) shall apply in determining the stock ownership of an individual, and stock which the employee may purchase under outstanding options shall be treated as stock owned by the employee;

(4) under the terms of the plan, options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation, except that there may be excluded—

(A) employees who have been employed less than 2 years,

(B) employees whose customary employment is 20 hours or less per week,

(C) employees whose customary employment is for not more than 5 months in any calendar year, and

(D) highly compensated employees (within the meaning of section 414(q));

(5) under the terms of the plan, all employees granted such options shall have the same rights and privileges, except that the amount of stock which may be purchased by any employee under such option may bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of employees, and the plan may provide that no employee may

purchase more than a maximum amount of stock fixed under the plan;

(6) under the terms of the plan, the option price is not less than the lesser of—

(A) an amount equal to 85 percent of the fair market value of the stock at the time such option is granted, or

(B) an amount which under the terms of the option may not be less than 85 percent of the fair market value of the stock at the time such option is exercised;

(7) under the terms of the plan, such option cannot be exercised after the expiration of—

(A) 5 years from the date such option is granted if, under the terms of such plan, the option price is to be not less than 85 percent of the fair market value of such stock at the time of the exercise of the option, or

(B) 27 months from the date such option is granted, if the option price is not determinable in the manner described in subparagraph (A) (8) under the terms of the plan, no employee may be granted an option which permits his rights to purchase stock under all such plans of his employer corporation and its parent and subsidiary corporations to accrue at a rate which exceeds $25,000 of fair market value of such stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time. For purposes of this paragraph—

(A) the right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year;

(B) the right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed $25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and

(C) a right to purchase stock which has accrued under one option granted pursuant to the plan may not be carried over to any other option; and

(9) under the terms of the plan, such option is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him.

For purposes of paragraphs (3) to (9), inclusive, where additional terms are contained in an offering made under a plan, such additional terms shall, with respect to options exercised under such offering, be treated as a part of the terms of such plan.

(c) SPECIAL RULE WHERE OPTION PRICE IS BETWEEN 85 PERCENT AND 100 PERCENT OF VALUE OF STOCK.—If the option price of a share of stock acquired by an individual pursuant to a transfer to which subsection (a) applies was less than 100 percent of the fair market value of such share at the time such option was granted, then, in the event of any disposition of such share by him which meets the holding period requirements of subsection (a), or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the tax-

able year in which falls the date of such disposition or for the taxable year closing with his death, whichever applies, an amount equal to the lesser of—

(1) the excess of the fair market value of the share at the time of such disposition or death over the amount paid for the share under the option, or

(2) the excess of the fair market value of the share at the time the option was granted over the option price.

If the option price is not fixed or determinable at the time the option is granted, then for purposes of this subsection, the option price shall be determined as if the option were exercised at such time. In the case of the disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income. No amount shall be required to be deducted and withheld under chapter 24 with respect to any amount treated as compensation under this subsection.

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Subtitle C—Employment Taxes

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CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SEC. 3401. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid—

(1) for active service performed in a month for which such employee is entitled to the benefits of section 112 (relating to certain combat zone compensation of members of the Armed Forces of the United States) to the extent remuneration for such service is excludable from gross income under such section; or

(2) for agricultural labor (as defined in section 3121(g)) unless the remuneration paid for such labor is wages (as defined in section 3121(a)); or

(3) for domestic service in a private home, local college club, or local chapter of a college fraternity or sorority; or

(4) for service not in the course of the employer's trade or business performed in any calendar quarter by an employee, unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly employed by such employer to perform such service. For purposes of this paragraph, an individual shall be deemed to be regularly employed by an employer during a calendar quarter only if—

(A) on each of some 24 days during such quarter such individual performs for such employer for some portion of the day service not in the course of the employer's trade or business; or

(B) such individual was regularly employed (as determined under subparagraph (A)) by such employer in the performance of such service during the preceding calendar quarter; or

(5) for services by a citizen or resident of the United States for a foreign government or an international organization; or

(6) for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary; or

(8)(A) for services for an employer (other than the United States or any agency thereof)—

(i) performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under section 911; or

(ii) performed in a foreign country or in a possession of the United States by such a citizen if, at the time of the payment of such remuneration, the employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration; or

(B) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within a possession of the United States (other than Puerto Rico), if it is reasonable to believe that at least 80 percent of the remuneration to be paid to the employee by such employer during the calendar year will be for such services; or

(C) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within Puerto Rico, if it is reasonable to believe that during the entire calendar year the employee will be a bona fide resident of Puerto Rico; or

(D) for services for the United States (or any agency thereof) performed by a citizen of the United States within a possession of the United States to the extent the United States (or such agency) withholds taxes on such remuneration pursuant to an agreement with such possession; or

(9) for services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(10)(A) for services performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution; or

(B) for services performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the ex-

cess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such services, or is entitled to be credited with the unsold newspapers or magazines turned back; or

(11) for services not in the course of the employer's trade or business, to the extent paid in any medium other than cash; or

(12) to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust; or

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a); or

(C) for a payment described in section 402(h)(1) and (2) if, at the time of such payment, it is reasonable to believe that the employee will be entitled to an exclusion under such section for payment; or

(D) under an arrangement to which section 408(p) applies; or

(13) pursuant to any provision of law other than section 5(c) or 6(1) of the Peace Corps Act, for service performed as a volunteer or volunteer leader within the meaning of such Act; or

(E) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A), or

(14) in the form of group-term life insurance on the life of an employee; or

(15) to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217 (determined without regard to section 274(n)); or

(16)(A) as tips in any medium other than cash;

(B) as cash tips to an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is $20 or more;

(17) for service described in section 3121(b)(20);

(18) for any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127, 129, 134(b)(4), or 134(b)(5);

(19) for any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 108(f)(4), 117, or 132;

(20) for any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan (within the meaning of section 105(h)(6));

(21) for any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe

that the employee will be able to exclude such payment from income under section 106(b);

(22) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(d); or

(23) for any benefit or payment which is excludable from the gross income of the employee under section 139B(b).

The term "wages" includes any amount includible in gross income of an employee under section 409A and payment of such amount shall be treated as having been made in the taxable year in which the amount is so includible.

(b) PAYROLL PERIOD.—For purposes of this chapter, the term "payroll period" means a period for which a payment of wages is ordinarily made to the employee by his employer, and the term "miscellaneous payroll period" means a payroll period other than a daily, weekly, biweekly, semimonthly, monthly, quarterly, semiannual or annual payroll period.

(c) EMPLOYEE.—For purposes of this chapter, the term "employee" includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "employee" also includes an officer of a corporation.

(d) EMPLOYER.—For purposes of this chapter, the term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—

(1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of subsection (a)) means the person having control of the payment of such wages, and

(2) in the case of a person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the term "employer" (except for purposes of subsection (a)) means such person.

(e) NUMBER OF WITHHOLDING EXEMPTIONS CLAIMED.—For purposes of this chapter, the term "number of withholding exemptions claimed" means the number of withholding exemptions claimed in a withholding exemption certificate in effect under section 3402(f), or in effect under the corresponding section of prior law, except that if no such certificate is in effect, the number of withholding exemptions claimed shall be considered to be zero.

(f) TIPS.—For purposes of subsection (a), the term "wages" includes tips received by an employee in the course of his employment. Such wages shall be deemed to be paid at the time a written statement including such tips is furnished to the employer pursuant to section 6053(a) or (if no statement including such tips is so furnished) at the time received.

(g) CREW LEADER RULES TO APPLY.—Rules similar to the rules of section 3121(o) shall apply for purposes of this chapter.

(h) DIFFERENTIAL WAGE PAYMENTS TO ACTIVE DUTY MEMBERS OF THE UNIFORMED SERVICES.—

(1) IN GENERAL.—For purposes of subsection (a), any differential wage payment shall be treated as a payment of wages by the employer to the employee.

(2) DIFFERENTIAL WAGE PAYMENT.—For purposes of paragraph (1), the term "differential wage payment" means any payment which—

(A) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code) while on active duty for a period of more than 30 days, and

(B) represents all or a portion of the wages the individual would have received from the employer if the individual were performing service for the employer.

(i) QUALIFIED STOCK FOR WHICH AN ELECTION IS IN EFFECT UNDER SECTION 83(i).—For purposes of subsection (a), qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i) shall be treated as wages—

(1) received on the earliest date described in section 83(i)(1)(B), and

(2) in an amount equal to the amount included in income under section 83 for the taxable year which includes such date.

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) REQUIREMENT OF WITHHOLDING.—

(1) IN GENERAL.—Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall—

(A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and

(B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter and to reflect the provisions of chapter 1 applicable to such periods.

(2) AMOUNT OF WAGES.—For purposes of applying tables or procedures prescribed under paragraph (1), the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption. The amount of each withholding exemption shall be equal to the amount of one personal exemption provided in section 151(b), prorated to the payroll period. The maximum number of withholding exemptions permitted shall be calculated in accordance with regulations prescribed by the Secretary under this section, taking into account any reduction in withholding to which an employee is entitled under this section.

(b) PERCENTAGE METHOD OF WITHHOLDING.—

(1) If wages are paid with respect to a period which is not a payroll period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number

of days in the period with respect to which such wages are paid.

(2) In any case in which wages are paid by an employer without regard to any payroll period or other period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(3) In any case in which the period, or the time described in paragraph (2), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to compute the tax to be deducted and withheld as if the aggregate of the wages paid to the employee during the calendar week were paid for a weekly payroll period.

(4) In determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(c) WAGE BRACKET WITHHOLDING.—

(1) At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee a tax (in lieu of the tax required to be deducted and withheld under subsection (a)) determined in accordance with tables prescribed by the Secretary in accordance with paragraph (6).

(2) If wages are paid with respect to a period which is not a payroll period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(3) In any case in which wages are paid by an employer without regard to any payroll period or other period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(4) In any case in which the period, or the time described in paragraph (3), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to determine the amount to be deducted and withheld under the tables applicable in the case of a weekly payroll period, in which case the aggregate of the wages paid to the employee during the calendar week shall be considered the weekly wages.

(5) If the wages exceed the highest wage bracket, in determining the amount to be deducted and withheld under this

subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(6) In the case of wages paid after December 31, 1969, the amount deducted and withheld under paragraph (1) shall be determined in accordance with tables prescribed by the Secretary. In the tables so prescribed, the amounts set forth as amounts of wages and amounts of income tax to be deducted and withheld shall be computed on the basis of the table for an annual payroll period prescribed pursuant to subsection (a).

(d) TAX PAID BY RECIPIENT.—If the employer, in violation of the provisions of this chapter, fails to deduct and withhold the tax under this chapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

(e) INCLUDED AND EXCLUDED WAGES.—If the remuneration paid by an employer to an employee for services performed during one-half or more of any payroll period of not more than 31 consecutive days constitutes wages, all the remuneration paid by such employer to such employee for such period shall be deemed to be wages; but if the remuneration paid by an employer to an employee for services performed during more than one-half of any such payroll period does not constitute wages, then none of the remuneration paid by such employer to such employee for such period shall be deemed to be wages.

(f) WITHHOLDING EXEMPTIONS.—

(1) IN GENERAL.—An employee receiving wages shall on any day be entitled to the following withholding exemptions:

(A) an exemption for himself unless he is an individual described in section 151(d)(2);

(B) if the employee is married, any exemption to which his spouse is entitled, or would be entitled if such spouse were an employee receiving wages, under subparagraph (A) or (D), but only if such spouse does not have in effect a withholding exemption certificate claiming such exemption;

(C) an exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(c) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

(D) any allowance to which he is entitled under subsection (m), but only if his spouse does not have in effect a withholding exemption certificate claiming such allowance; and

(E) a standard deduction allowance which shall be an amount equal to one exemption (or more than one exemption if so prescribed by the Secretary) unless (i) he is married (as determined under section 7703) and his spouse is an employee receiving wages subject to withholding or (ii)

he has withholding exemption certificates in effect with respect to more than one employer.

For purposes of this title, any standard deduction allowance under subparagraph (E) shall be treated as if it were denominated a withholding exemption.

(2) EXEMPTION CERTIFICATES.—

(A) ON COMMENCEMENT OF EMPLOYMENT.—On or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding exemption certificate relating to the number of withholding exemptions which he claims, which shall in no event exceed the number to which he is entitled.

(B) CHANGE OF STATUS.—If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is less than the number of withholding exemptions claimed by the employee on the withholding exemption certificate then in effect with respect to him, the employee shall within 10 days thereafter furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day. If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is greater than the number of withholding exemptions claimed, the employee may furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day.

(C) CHANGE OF STATUS WHICH AFFECTS NEXT CALENDAR YEAR.—If on any day during the calendar year the number of withholding exemptions to which the employee will be, or may reasonably be expected to be, entitled at the beginning of his next taxable year under subtitle A is different from the number to which the employee is entitled on such day, the employee shall, in such cases and at such times as the Secretary may by regulations prescribe, furnish the employer with a withholding exemption certificate relating to the number of withholding exemptions which he claims with respect to such next taxable year, which shall in no event exceed the number to which he will be, or may reasonably be expected to be, so entitled.

(3) WHEN CERTIFICATE TAKES EFFECT.—

(A) FIRST CERTIFICATE FURNISHED.—A withholding exemption certificate furnished the employer in cases in which no previous such certificate is in effect shall take effect as of the beginning of the first payroll period ending, or the first payment of wages made without regard to a payroll period, on or after the date on which such certificate is so furnished.

(B) FURNISHED TO TAKE PLACE OF EXISTING CERTIFICATE.—

(i) IN GENERAL.—Except as provided in clauses (ii) and (iii), a withholding exemption certificate furnished to the employer in cases in which a previous such certificate is in effect shall take effect as of the beginning of the 1st payroll period ending (or the 1st payment of wages made without regard to a payroll period) on or after the 30th day after the day on which such certificate is so furnished.

(ii) EMPLOYER MAY ELECT EARLIER EFFECTIVE DATE.—At the election of the employer, a certificate described in clause (i) may be made effective beginning with any payment of wages made on or after the day on which the certificate is so furnished and before the 30th day referred to in clause (i).

(iii) CHANGE OF STATUS WHICH AFFECTS NEXT YEAR.—Any certificate furnished pursuant to paragraph (2)(C) shall not take effect, and may not be made effective, with respect to any payment of wages made in the calendar year in which the certificate is furnished.

(4) PERIOD DURING WHICH CERTIFICATE REMAINS IN EFFECT.—A withholding exemption certificate which takes effect under this subsection, or which on December 31, 1954, was in effect under the corresponding subsection of prior law, shall continue in effect with respect to the employer until another such certificate takes effect under this subsection.

(5) FORM AND CONTENTS OF CERTIFICATE.—Withholding exemption certificates shall be in such form and contain such information as the Secretary may by regulations prescribe.

(6) EXEMPTION OF CERTAIN NONRESIDENT ALIENS.—Notwithstanding the provisions of paragraph (1), a nonresident alien individual (other than an individual described in section 3401(a)(6)(A) or (B)) shall be entitled to only one withholding exemption.

(7) EXEMPTION WHERE CERTIFICATE WITH ANOTHER EMPLOYER IS IN EFFECT.—If a withholding exemption certificate is in effect with respect to one employer, an employee shall not be entitled under a certificate in effect with any other employer to any withholding exemption which he has claimed under such first certificate.

(g) OVERLAPPING PAY PERIODS, AND PAYMENT BY AGENT OR FIDUCIARY.—If a payment of wages is made to an employee by an employer—

(1) with respect to a payroll period or other period, any part of which is included in a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(2) without regard to any payroll period or other period, but on or prior to the expiration of a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(3) with respect to a period beginning in one and ending in another calendar year, or

(4) through an agent, fiduciary, or other person who also has the control, receipt, custody, or disposal of, or pays, the wages payable by another employer to such employee,

the manner of withholding and the amount to be deducted and withheld under this chapter shall be determined in accordance with regulations prescribed by the Secretary under which the withholding exemption allowed to the employee in any calendar year shall approximate the withholding exemption allowable with respect to an annual payroll period.

(h) ALTERNATIVE METHODS OF COMPUTING AMOUNT TO BE WITHHELD.—The Secretary may, under regulations prescribed by him, authorize—

(1) WITHHOLDING ON BASIS OF AVERAGE WAGES.—An employer—

(A) to estimate the wages which will be paid to any employee in any quarter of the calendar year,

(B) to determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter as if the appropriate average of the wages so estimated constituted the actual wages paid, and

(C) to deduct and withhold upon any payment of wages to such employee during such quarter (and, in the case of tips referred to in subsection (k), within 30 days thereafter) such amount as may be necessary to adjust the amount actually deducted and withheld upon the wages of such employee during such quarter to the amount required to be deducted and withheld during such quarter without regard to this subsection.

(2) WITHHOLDING ON BASIS OF ANNUALIZED WAGES.—An employer to determine the amount of tax to be deducted and withheld upon a payment of wages to an employee for a payroll period by—

(A) multiplying the amount of an employee's wages for a payroll period by the number of such payroll periods in the calendar year,

(B) determining the amount of tax which would be required to be deducted and withheld upon the amount determined under subparagraph (A) if such amount constituted the actual wages for the calendar year and the payroll period of the employee were an annual payroll period, and

(C) dividing the amount of tax determined under subparagraph (B) by the number of payroll periods (described in subparagraph (A)) in the calendar year.

(3) WITHHOLDING ON BASIS OF CUMULATIVE WAGES.—An employer, in the case of any employee who requests to have the amount of tax to be withheld from his wages computed on the basis of his cumulative wages, to—

(A) add the amount of the wages to be paid to the employee for the payroll period to the total amount of wages paid by the employer to the employee during the calendar year,

(B) divide the aggregate amount of wages computed under subparagraph (A) by the number of payroll periods to which such aggregate amount of wages relates,

(C) compute the total amount of tax that would have been required to be deducted and withheld under subsection (a) if the average amount of wages (as computed under subparagraph (B)) had been paid to the employee for the number of payroll periods to which the aggregate amount of wages (computed under subparagraph (A)) relates,

(D) determine the excess, if any, of the amount of tax computed under subparagraph (C) over the total amount of tax deducted and withheld by the employer from wages paid to the employee during the calendar year, and

(E) deduct and withhold upon the payment of wages (referred to in subparagraph (A)) to the employee an amount equal to the excess (if any) computed under subparagraph (D).

(4) OTHER METHODS.—An employer to determine the amount of tax to be deducted and withheld upon the wages paid to an employee by any other method which will require the employer to deduct and withhold upon such wages substantially the same amount as would be required to be deducted and withheld by applying subsection (a) or (c), either with respect to a payroll period or with respect to the entire taxable year.

(i) CHANGES IN WITHHOLDING.—

(1) IN GENERAL.—The Secretary may by regulations provide for increases in the amount of withholding otherwise required under this section in cases where the employee requests such changes.

(2) TREATMENT AS TAX.—Any increased withholding under paragraph (1) shall for all purposes be considered tax required to be deducted and withheld under this chapter.

(j) NONCASH REMUNERATION TO RETAIL COMMISSION SALESMAN.—In the case of remuneration paid in any medium other than cash for services performed by an individual as a retail salesman for a person, where the service performed by such individual for such person is ordinarily performed for remuneration solely by way of cash commission an employer shall not be required to deduct or withhold any tax under this subchapter with respect to such remuneration, provided that such employer files with the Secretary such information with respect to such remuneration as the Secretary may by regulation prescribe.

(k) TIPS.—In the case of tips which constitute wages, subsection (a) shall be applicable only to such tips as are included in a written statement furnished to the employer pursuant to section 6053(a), and only to the extent that the tax can be deducted and withheld by the employer, at or after the time such statement is so furnished and before the close of the calendar year in which such statement is furnished, from such wages of the employee (excluding tips, but including funds turned over by the employee to the employer for the purpose of such deduction and withholding) as are under the control of the employer; and an employer who is furnished by an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) to which paragraph (16)(B) of section 3401(a) is applicable may deduct and withhold the tax with respect to such tips from any wages of the employee (excluding tips) under his control, even though at the time such

statement is furnished the total amount of the tips included in statements furnished to the employer as having been received by the employee in such calendar month in the course of his employment by such employer is less than $20. Such tax shall not at any time be deducted and withheld in an amount which exceeds the aggregate of such wages and funds (including funds turned over under section 3102(c)(2) or section 3202(c)(2)) minus any tax required by section 3102(a) or section 3202(a) to be collected from such wages and funds.

(l) DETERMINATION AND DISCLOSURE OF MARITAL STATUS.—

(1) DETERMINATION OF STATUS BY EMPLOYER.—For purposes of applying the tables in subsections (a) and (c) to a payment of wages, the employer shall treat the employee as a single person unless there is in effect with respect to such payment of wages a withholding exemption certificate furnished to the employer by the employee after the date of the enactment of this subsection indicating that the employee is married.

(2) DISCLOSURE OF STATUS BY EMPLOYEE.—An employee shall be entitled to furnish the employer with a withholding exemption certificate indicating he is married only if, on the day of such furnishing, he is married (determined with the application of the rules in paragraph (3)). An employee whose marital status changes from married to single shall, at such time as the Secretary may by regulations prescribe, furnish the employer with a new withholding exemption certificate.

(3) DETERMINATION OF MARITAL STATUS.—For purposes of paragraph (2), an employee shall on any day be considered—

(A) as not married, if (i) he is legally separated from his spouse under a decree of divorce or separate maintenance, or (ii) either he or his spouse is, or on any preceding day within the calendar year was, a nonresident alien; or

(B) as married, if (i) his spouse (other than a spouse referred to in subparagraph (A)) died within the portion of his taxable year which precedes such day, or (ii) his spouse died during one of the two taxable years immediately preceding the current taxable year and, on the basis of facts existing at the beginning of such day, the employee reasonably expects, at the close of his taxable year, to be a surviving spouse (as defined in section 2(a)).

(m) WITHHOLDING ALLOWANCES.—Under regulations prescribed by the Secretary, an employee shall be entitled to additional withholding allowances or additional reductions in withholding under this subsection. In determining the number of additional withholding allowances or the amount of additional reductions in withholding under this subsection, the employee may take into account (to the extent and in the manner provided by such regulations)—

(1) estimated itemized deductions allowable under chapter 1 (other than the deductions referred to in section 151 and other than the deductions required to be taken into account in determining adjusted gross income under section 62(a) (other than paragraph (10) thereof)),

(2) estimated tax credits allowable under chapter 1, and

(3) such additional deductions (including the additional standard deduction under section 63(c)(3) for the aged and

blind) and other items as may be specified by the Secretary in regulations.

(n) EMPLOYEES INCURRING NO INCOME TAX LIABILITY.—Notwithstanding any other provision of this section, an employer shall not be required to deduct and withhold any tax under this chapter upon a payment of wages to an employee if there is in effect with respect to such payment a withholding exemption certificate (in such form and containing such other information as the Secretary may prescribe) furnished to the employer by the employee certifying that the employee—

(1) incurred no liability for income tax imposed under subtitle A for his preceding taxable year, and

(2) anticipates that he will incur no liability for income tax imposed under subtitle A for his current taxable year.

The Secretary shall by regulations provide for the coordination of the provisions of this subsection with the provisions of subsection (f).

(o) EXTENSION OF WITHHOLDING TO CERTAIN PAYMENTS OTHER THAN WAGES.—

(1) GENERAL RULE.—For purposes of this chapter (and so much of subtitle F as relates to this chapter)—

(A) any supplemental unemployment compensation benefit paid to an individual,

(B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter is in effect, and

(C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection), if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect,

shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

(2) DEFINITIONS.—

(A) SUPPLEMENTAL UNEMPLOYMENT COMPENSATION BENEFITS.—For purposes of paragraph (1), the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

(B) ANNUITY.—For purposes of this subsection, the term "annuity" means any amount paid to an individual as a pension or annuity.

(C) SICK PAY.—For purposes of this subsection, the term "sick pay" means any amount which—

(i) is paid to an employee pursuant to a plan to which the employer is a party, and

(ii) constitutes remuneration or a payment in lieu of remuneration for any period during which the em-

ployee is temporarily absent from work on account of sickness or personal injuries.

(3) AMOUNT WITHHELD FROM ANNUITY PAYMENTS OR SICK PAY.—If a payee makes a request that an annuity or any sick pay be subject to withholding under this chapter, the amount to be deducted and withheld under this chapter from any payment to which such request applies shall be an amount (not less than a minimum amount determined under regulations prescribed by the Secretary) specified by the payee in such request. The amount deducted and withheld with respect to a payment which is greater or less than a full payment shall bear the same relation to the specified amount as such payment bears to a full payment.

(4) REQUEST FOR WITHHOLDING.—A request that an annuity or any sick pay be subject to withholding under this chapter—

(A) shall be made by the payee in writing to the person making the payments and shall contain the social security number of the payee,

(B) shall specify the amount to be deducted and withheld from each full payment, and

(C) shall take effect—

(i) in the case of sick pay, with respect to payments made more than 7 days after the date on which such request is furnished to the payor, or

(ii) in the case of an annuity, at such time (after the date on which such request is furnished to the payor) as the Secretary shall by regulations prescribe.

Such a request may be changed or terminated by furnishing to the person making the payments a written statement of change or termination which shall take effect in the same manner as provided in subparagraph (C). At the election of the payor, any such request (or statement of change or revocation) may take effect earlier than as provided in subparagraph (C).

(5) SPECIAL RULE FOR SICK PAY PAID PURSUANT TO CERTAIN COLLECTIVE-BARGAINING AGREEMENTS.—In the case of any sick pay paid pursuant to a collective-bargaining agreement between employee representatives and one or more employers which contains a provision specifying that this paragraph is to apply to sick pay paid pursuant to such agreement and contains a provision for determining the amount to be deducted and withheld from each payment of such sick pay—

(A) the requirement of paragraph (1)(C) that a request for withholding be in effect shall not apply, and

(B) except as provided in subsection (n), the amounts to be deducted and withheld under this chapter shall be determined in accordance with such agreement.

The preceding sentence shall not apply with respect to sick pay paid pursuant to any agreement to any individual unless the social security number of such individual is furnished to the payor and the payor is furnished with such information as is necessary to determine whether the payment is pursuant to the agreement and to determine the amount to be deducted and withheld.

(6) COORDINATION WITH WITHHOLDING ON DESIGNATED DISTRIBUTIONS UNDER SECTION 3405.—This subsection shall not

apply to any amount which is a designated distribution (within the meaning of section 3405(e)(1)).

(p) VOLUNTARY WITHHOLDING AGREEMENTS.—

(1) CERTAIN FEDERAL PAYMENTS.—

(A) IN GENERAL.—If, at the time a specified Federal payment is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee.

(B) AMOUNT WITHHELD.—The amount to be deducted and withheld under this chapter from any payment to which any request under subparagraph (A) applies shall be an amount equal to the percentage of such payment specified in such request. Such a request shall apply to any payment only if the percentage specified is 7 percent, any percentage applicable to any of the 3 lowest income brackets in the table under section 1(c), or such other percentage as is permitted under regulations prescribed by the Secretary.

(C) SPECIFIED FEDERAL PAYMENTS.—For purposes of this paragraph, the term "specified Federal payment" means—

(i) any payment of a social security benefit (as defined in section 86(d)),

(ii) any payment referred to in the second sentence of section 451(d) which is treated as insurance proceeds,

(iii) any amount which is includible in gross income under section 77(a), and

(iv) any other payment made pursuant to Federal law which is specified by the Secretary for purposes of this paragraph.

(D) REQUESTS FOR WITHHOLDING.—Rules similar to the rules that apply to annuities under subsection (o)(4) shall apply to requests under this paragraph and paragraph (2).

(2) VOLUNTARY WITHHOLDING ON UNEMPLOYMENT BENEFITS.—If, at the time a payment of unemployment compensation (as defined in section 85(b)) is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee. The amount to be deducted and withheld under this chapter from any payment to which any request under this paragraph applies shall be an amount equal to 10 percent of such payment.

(3) AUTHORITY FOR OTHER VOLUNTARY WITHHOLDING.—The Secretary is authorized by regulations to provide for withholding—

(A) from remuneration for services performed by an employee for the employee's employer which (without regard to this paragraph) does not constitute wages, and

(B) from any other type of payment with respect to which the Secretary finds that withholding would be appropriate under the provisions of this chapter,

if the employer and employee, or the person making and the person receiving such other type of payment, agree to such withholding. Such agreement shall be in such form and manner as the Secretary may by regulations prescribe. For purposes of this chapter (and so much of subtitle F as relates to this chapter), remuneration or other payments with respect to which such agreement is made shall be treated as if they were wages paid by an employer to an employee to the extent that such remuneration is paid or other payments are made during the period for which the agreement is in effect.

(q) EXTENSION OF WITHHOLDING TO CERTAIN GAMBLING WINNINGS.—

(1) GENERAL RULE.—Every person, including the Government of the United States, a State, or a political subdivision thereof, or any instrumentalities of the foregoing, making any payment of winnings which are subject to withholding shall deduct and withhold from such payment a tax in an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment.

(2) EXEMPTION WHERE TAX OTHERWISE WITHHELD.—In the case of any payment of winnings which are subject to withholding made to a nonresident alien individual or a foreign corporation, the tax imposed under paragraph (1) shall not apply to any such payment subject to tax under section 1441(a) (relating to withholding on nonresident aliens) or tax under section 1442(a) (relating to withholding on foreign corporations).

(3) WINNINGS WHICH ARE SUBJECT TO WITHHOLDING.—For purposes of this subsection, the term "winnings which are subject to withholding" means proceeds from a wager determined in accordance with the following:

(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), proceeds of more than $5,000 from a wagering transaction, if the amount of such proceeds is at least 300 times as large as the amount wagered.

(B) STATE-CONDUCTED LOTTERIES.—Proceeds of more than $5,000 from a wager placed in a lottery conducted by an agency of a State acting under authority of State law, but only if such wager is placed with the State agency conducting such lottery, or with its authorized employees or agents.

(C) SWEEPSTAKES, WAGERING POOLS, CERTAIN PARIMUTUEL POOLS, JAI ALAI, AND LOTTERIES.—Proceeds of more than $5,000 from—

(i) a wager placed in a sweepstakes, wagering pool, or lottery (other than a wager described in subparagraph (B)), or

(ii) a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered.

(4) RULES FOR DETERMINING PROCEEDS FROM A WAGER.—For purposes of this subsection—

(A) proceeds from a wager shall be determined by reducing the amount received by the amount of the wager, and

(B) proceeds which are not money shall be taken into account at their fair market value.

(5) EXCEPTION FOR BINGO, KENO, AND SLOT MACHINES.—The tax imposed under paragraph (1) shall not apply to winnings from a slot machine, keno, and bingo.

(6) STATEMENT BY RECIPIENT.—Every person who is to receive a payment of winnings which are subject to withholding shall furnish the person making such payment a statement, made under the penalties of perjury, containing the name, address, and taxpayer identification number of the person receiving the payment and of each person entitled to any portion of such payment.

(7) COORDINATION WITH OTHER SECTIONS.—For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person of winnings which are subject to withholding shall be treated as if they were wages paid by an employer to an employee.

(r) EXTENSION OF WITHHOLDING TO CERTAIN TAXABLE PAYMENTS OF INDIAN CASINO PROFITS.—

(1) IN GENERAL.—Every person, including an Indian tribe, making a payment to a member of an Indian tribe from the net revenues of any class II or class III gaming activity conducted or licensed by such tribe shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

(2) EXCEPTION.—The tax imposed by paragraph (1) shall not apply to any payment to the extent that the payment, when annualized, does not exceed an amount equal to the sum of—

(A) the basic standard deduction (as defined in section 63(c)) for an individual to whom section 63(c)(2)(C) applies, and

(B) the exemption amount (as defined in section 151(d)).

(3) ANNUALIZED TAX.—For purposes of paragraph (1), the term "annualized tax" means, with respect to any payment, the amount of tax which would be imposed by section 1(c) (determined without regard to any rate of tax in excess of the fourth lowest rate of tax applicable under section 1(c)) on an amount of taxable income equal to the excess of—

(A) the annualized amount of such payment, over

(B) the amount determined under paragraph (2).

(4) CLASSES OF GAMING ACTIVITIES, ETC..—For purposes of this subsection, terms used in paragraph (1) which are defined in section 4 of the Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.), as in effect on the date of the enactment of this subsection, shall have the respective meanings given such terms by such section.

(5) ANNUALIZATION.—Payments shall be placed on an annualized basis under regulations prescribed by the Secretary.

(6) ALTERNATE WITHHOLDING PROCEDURES.—At the election of an Indian tribe, the tax imposed by this subsection on any payment made by such tribe shall be determined in accordance

with such tables or computational procedures as may be specified in regulations prescribed by the Secretary (in lieu of in accordance with paragraphs (2) and (3)).

(7) COORDINATION WITH OTHER SECTIONS.—For purposes of this chapter and so much of subtitle F as relates to this chapter, payments to any person which are subject to withholding under this subsection shall be treated as if they were wages paid by an employer to an employee.

(s) EXEMPTION FROM WITHHOLDING FOR ANY VEHICLE FRINGE BENEFIT.—

(1) EMPLOYER ELECTION NOT TO WITHHOLD.—The employer may elect not to deduct and withhold any tax under this chapter with respect to any vehicle fringe benefit provided to any employee if such employee is notified by the employer of such election (at such time and in such manner as the Secretary shall by regulations prescribe). The preceding sentence shall not apply to any vehicle fringe benefit unless the amount of such benefit is included by the employer on a statement timely furnished under section 6051.

(2) EMPLOYER MUST FURNISH W-2.—Any vehicle fringe benefit shall be treated as wages from which amounts are required to be deducted and withheld under this chapter for purposes of section 6051.

(3) VEHICLE FRINGE BENEFIT.—For purposes of this subsection, the term "vehicle fringe benefit" means any fringe benefit—

(A) which constitutes wages (as defined in section 3401), and

(B) which consists of providing a highway motor vehicle for the use of the employee.

(t) RATE OF WITHHOLDING FOR CERTAIN STOCK.—In the case of any qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i)—

(1) the rate of tax under subsection (a) shall not be less than the maximum rate of tax in effect under section 1, and

(2) such stock shall be treated for purposes of section 3501(b) in the same manner as a non-cash fringe benefit.

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—Returns and Records

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PART III—INFORMATION RETURNS

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Subpart C—Information Regarding Wages Paid Employees

SEC. 6051. RECEIPTS FOR EMPLOYEES.

(a) REQUIREMENT.—Every person required to deduct and withhold from an employee a tax under section 3101 or 3402, or who would have been required to deduct and withhold a tax under section 3402 (determined without regard to subsection (n)) if the employee had claimed no more than one withholding exemption, or every employer engaged in a trade or business who pays remuneration for services performed by an employee, including the cash value of such remuneration paid in any medium other than cash, shall furnish to each such employee in respect of the remuneration paid by such person to such employee during the calendar year, on or before January 31 of the succeeding year, or, if his employment is terminated before the close of such calendar year, within 30 days after the date of receipt of a written request from the employee if such 30-day period ends before January 31, a written statement showing the following:

(1) the name of such person,

(2) the name of the employee (and an identifying number for the employee if wages as defined in section 3121(a) have been paid),

(3) the total amount of wages as defined in section 3401(a),

(4) the total amount deducted and withheld as tax under section 3402,

(5) the total amount of wages as defined in section 3121(a),

(6) the total amount deducted and withheld as tax under section 3101,

(8) the total amount of elective deferrals (within the meaning of section 402(g)(3)) and compensation deferred under section 457, including the amount of designated Roth contributions (as defined in section 402A),

(9) the total amount incurred for dependent care assistance with respect to such employee under a dependent care assistance program described in section 129(d),

(10) in the case of an employee who is a member of the Armed Forces of the United States, such employee's earned income as determined for purposes of section 32 (relating to earned income credit),

(11) the amount contributed to any Archer MSA (as defined in section 220(d)) of such employee or such employee's spouse,

(12) the amount contributed to any health savings account (as defined in section 223(d)) of such employee or such employee's spouse,

(13) the total amount of deferrals for the year under a nonqualified deferred compensation plan (within the meaning of section 409A(d)), **[**and**]**

(14) the aggregate cost (determined under rules similar to the rules of section 4980B(f)(4)) of applicable employer-sponsored coverage (as defined in section 4980I(d)(1)), except that this paragraph shall not apply to—

(A) coverage to which paragraphs (11) and (12) apply, or

(B) the amount of any salary reduction contributions to a flexible spending arrangement (within the meaning of section 125)**[**.**]**,

(15) the amount excludable from gross income under subparagraph (A) of section 83(i)(1),

(16) the amount includible in gross income under subparagraph (B) of section 83(i)(1) with respect to an event described in such subparagraph which occurs in such calendar year, and

(17) the aggregate amount of income which is being deferred pursuant to elections under section 83(i), determined as of the close of the calendar year.

In the case of compensation paid for service as a member of a uniformed service, the statement shall show, in lieu of the amount required to be shown by paragraph (5), the total amount of wages as defined in section 3121(a), computed in accordance with such section and section 3121(i)(2). In the case of compensation paid for service as a volunteer or volunteer leader within the meaning of the Peace Corps Act, the statement shall show, in lieu of the amount required to be shown by paragraph (5), the total amount of wages as defined in section 3121(a), computed in accordance with such section and section 3121(i)(3). In the case of tips received by an employee in the course of his employment, the amounts required to be shown by paragraphs (3) and (5) shall include only such tips as are included in statements furnished to the employer pursuant to section 6053(a). The amounts required to be shown by paragraph (5) shall not include wages which are exempted pursuant to sections 3101(c) and 3111(c) from the taxes imposed by sections 3101 and 3111. In the case of the amounts required to be shown by paragraph (13), the Secretary may (by regulation) establish a minimum amount of deferrals below which paragraph (13) does not apply.

(b) SPECIAL RULE AS TO COMPENSATION OF MEMBERS OF ARMED FORCES.—In the case of compensation paid for service as a member of the Armed Forces, the statement required by subsection (a) shall be furnished if any tax was withheld during the calendar year under section 3402, or if any of the compensation paid during such year is includible in gross income under chapter 1, or if during the calendar year any amount was required to be withheld as tax under section 3101. In lieu of the amount required to be shown by paragraph (3) of subsection (a), such statement shall show as wages paid during the calendar year the amount of such compensation paid during the calendar year which is not excluded from gross income under chapter 1 (whether or not such compensation constituted wages as defined in section 3401(a)).

(c) ADDITIONAL REQUIREMENTS.—The statements required to be furnished pursuant to this section in respect of any remuneration shall be furnished at such other times, shall contain such other information, and shall be in such form as the Secretary may by regulations prescribe. The statements required under this section shall also show the proportion of the total amount withheld as tax under section 3101 which is for financing the cost of hospital insurance benefits under part A of title XVIII of the Social Security Act.

(d) STATEMENTS TO CONSTITUTE INFORMATION RETURNS.—A duplicate of any statement made pursuant to this section and in accordance with regulations prescribed by the Secretary shall, when required by such regulations, be filed with the Secretary.

(e) RAILROAD EMPLOYEES.—

(1) ADDITIONAL REQUIREMENT.—Every person required to deduct and withhold tax under section 3201 from an employee shall include on or with the statement required to be furnished such employee under subsection (a) a notice concerning the provisions of this title with respect to the allowance of a credit or refund of the tax on wages imposed by section 3101(b) and the tax on compensation imposed by section 3201 or 3211 which is treated as a tax on wages imposed by section 3101(b).

(2) INFORMATION TO BE SUPPLIED TO EMPLOYEES.—Each person required to deduct and withhold tax under section 3201 during any year from an employee who has also received wages during such year subject to the tax imposed by section 3101(b) shall, upon request of such employee, furnish to him a written statement showing—

(A) the total amount of compensation with respect to which the tax imposed by section 3201 was deducted,

(B) the total amount deducted as tax under section 3201, and

(C) the portion of the total amount deducted as tax under section 3201 which is for financing the cost of hospital insurance under part A of title XVIII of the Social Security Act.

(f) STATEMENTS REQUIRED IN CASE OF SICK PAY PAID BY THIRD PARTIES.—

(1) STATEMENTS REQUIRED FROM PAYOR.—

(A) IN GENERAL.—If, during any calendar year, any person makes a payment of third-party sick pay to an employee, such person shall, on or before January 15 of the succeeding year, furnish a written statement to the employer in respect of whom such payment was made showing—

(i) the name and, if there is withholding under section 3402(o), the social security number of such employee,

(ii) the total amount of the third-party sick pay paid to such employee during the calendar year, and

(iii) the total amount (if any) deducted and withheld from such sick pay under section 3402.

For purposes of the preceding sentence, the term "third-party sick pay" means any sick pay (as defined in section 3402(o)(2)(C)) which does not constitute wages for purposes of chapter 24 (determined without regard to section 3402(o)(1)).

(B) SPECIAL RULES.—

(i) STATEMENTS ARE IN LIEU OF OTHER REPORTING REQUIREMENTS.—The reporting requirements of subparagraph (A) with respect to any payments shall, with respect to such payments, be in lieu of the requirements of subsection (a) and of section 6041.

(ii) PENALTIES MADE APPLICABLE.—For purposes of sections 6674 and 7204, the statements required to be furnished by subparagraph (A) shall be treated as statements required under this section to be furnished to employees.

(2) INFORMATION REQUIRED TO BE FURNISHED BY EMPLOYER.—Every employer who receives a statement under paragraph (1)(A) with respect to sick pay paid to any employee during any calendar year shall, on or before January 31 of the succeeding year, furnish a written statement to such employee showing—

(A) the information shown on the statement furnished under paragraph (1)(A), and

(B) if any portion of the sick pay is excludable from gross income under section 104(a)(3), the portion which is not so excludable and the portion which is so excludable.

To the extent practicable, the information required under the preceding sentence shall be furnished on or with the statement (if any) required under subsection (a).

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CHAPTER 68—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

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Subchapter A—Additions to the Tax and Additional Amounts

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PART I—GENERAL PROVISIONS

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SEC. 6652. FAILURE TO FILE CERTAIN INFORMATION RETURNS, REGISTRATION STATEMENTS, ETC.

(a) RETURNS WITH RESPECT TO CERTAIN PAYMENTS AGGREGATING LESS THAN $10.—In the case of each failure to file a statement of a payment to another person required under the authority of—

(1) section 6042(a)(2) (relating to payments of dividends aggregating less than $10), or

(2) section 6044(a)(2) (relating to payments of patronage dividends aggregating less than $10),

on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid (upon notice and demand by the Secretary and in the same manner as tax) by the person failing to so file the statement, $1 for each such statement not so filed, but the total amount imposed on the delinquent person for all such failures during the calendar year shall not exceed $1,000.

(b) FAILURE TO REPORT TIPS.—In the case of failure by an employee to report to his employer on the date and in the manner prescribed therefor any amount of tips required to be so reported by section 6053(a) which are wages (as defined in section 3121(a)) or which are compensation (as defined in section 3231(e)), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be paid by the employee, in addition to

the tax imposed by section 3101 or section 3201 (as the case may be) with respect to the amount of tips which he so failed to report, an amount equal to 50 percent of such tax.

(c) RETURNS BY EXEMPT ORGANIZATIONS AND BY CERTAIN TRUSTS.—

(1) ANNUAL RETURNS UNDER SECTION 6033(A)(1) OR 6012(A)(6).—

(A) PENALTY ON ORGANIZATION.—In the case of—

(i) a failure to file a return required under section 6033(a)(1) (relating to returns by exempt organizations) or section 6012(a)(6) (relating to returns by political organizations) on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), or

(ii) a failure to include any of the information required to be shown on a return filed under section 6033(a)(1) or section 6012(a)(6) or to show the correct information,

there shall be paid by the exempt organization $20 for each day during which such failure continues. The maximum penalty under this subparagraph on failures with respect to any 1 return shall not exceed the lesser of $10,000 or 5 percent of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding $1,000,000 for any year, with respect to the return required under section 6033(a)(1) or section 6012(a)(6) for such year, in applying the first sentence of this subparagraph, the amount of the penalty for each day during which a failure continues shall be $100 in lieu of the amount otherwise specified, and, in lieu of applying the second sentence of this subparagraph, the maximum penalty under this subparagraph shall not exceed $50,000.

(B) MANAGERS.—

(i) IN GENERAL.—The Secretary may make a written demand on any organization subject to penalty under subparagraph (A) specifying therein a reasonable future date by which the return shall be filed (or the information furnished) for purposes of this subparagraph.

(ii) FAILURE TO COMPLY WITH DEMAND.—If any person fails to comply with any demand under clause (i) on or before the date specified in such demand, there shall be paid by the person failing to so comply $10 for each day after the expiration of the time specified in such demand during which such failure continues. The maximum penalty imposed under this subparagraph on all persons for failures with respect to any 1 return shall not exceed $5,000.

(C) PUBLIC INSPECTION OF ANNUAL RETURNS AND REPORTS.—In the case of a failure to comply with the requirements of section 6104(d) with respect to any annual return on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing) or report required under section 527(j), there shall be paid by the person failing to meet such requirements $20 for each

day during which such failure continues. The maximum penalty imposed under this subparagraph on all persons for failures with respect to any 1 return or report shall not exceed $10,000.

(D) PUBLIC INSPECTION OF APPLICATIONS FOR EXEMPTION AND NOTICE OF STATUS.—In the case of a failure to comply with the requirements of section 6104(d) with respect to any exempt status application materials (as defined in such section) or notice materials (as defined in such section) on the date and in the manner prescribed therefor, there shall be paid by the person failing to meet such requirements $20 for each day during which such failure continues.

(E) NO PENALTY FOR CERTAIN ANNUAL NOTICES.—This paragraph shall not apply with respect to any notice required under section 6033(i).

(2) RETURNS UNDER SECTION 6034 OR 6043(B).—

(A) PENALTY ON ORGANIZATION OR TRUST.—In the case of a failure to file a return required under section 6034 (relating to returns by certain trusts) or section 6043(b) (relating to terminations, etc., of exempt organizations), on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), there shall be paid by the exempt organization or trust failing so to file $10 for each day during which such failure continues, but the total amount imposed under this subparagraph on any organization or trust for failure to file any 1 return shall not exceed $5,000.

(B) MANAGERS.—The Secretary may make written demand on an organization or trust failing to file under subparagraph (A) specifying therein a reasonable future date by which such filing shall be made for purposes of this subparagraph. If such filing is not made on or before such date, there shall be paid by the person failing so to file $10 for each day after the expiration of the time specified in the written demand during which such failure continues, but the total amount imposed under this subparagraph on all persons for failure to file any 1 return shall not exceed $5,000.

(C) SPLIT-INTEREST TRUSTS.—In the case of a trust which is required to file a return under section 6034(a), subparagraphs (A) and (B) of this paragraph shall not apply and paragraph (1) shall apply in the same manner as if such return were required under section 6033, except that—

(i) the 5 percent limitation in the second sentence of paragraph (1)(A) shall not apply,

(ii) in the case of any trust with gross income in excess of $250,000, in applying the first sentence of paragraph (1)(A), the amount of the penalty for each day during which a failure continues shall be $100 in lieu of the amount otherwise specified, and in lieu of applying the second sentence of paragraph (1)(A), the maximum penalty under paragraph (1)(A) shall not exceed $50,000, and

(iii) the third sentence of paragraph (1)(A) shall be disregarded.

In addition to any penalty imposed on the trust pursuant to this subparagraph, if the person required to file such return knowingly fails to file the return, such penalty shall also be imposed on such person who shall be personally liable for such penalty.

(3) DISCLOSURE UNDER SECTION 6033(A)(2).—

(A) PENALTY ON ENTITIES.—In the case of a failure to file a disclosure required under section 6033(a)(2), there shall be paid by the tax-exempt entity (the entity manager in the case of a tax-exempt entity described in paragraph (4), (5), (6), or (7) of section 4965(c)) $100 for each day during which such failure continues. The maximum penalty under this subparagraph on failures with respect to any 1 disclosure shall not exceed $50,000.

(B) WRITTEN DEMAND.—

(i) IN GENERAL.—The Secretary may make a written demand on any entity or manager subject to penalty under subparagraph (A) specifying therein a reasonable future date by which the disclosure shall be filed for purposes of this subparagraph.

(ii) FAILURE TO COMPLY WITH DEMAND.—If any entity or manager fails to comply with any demand under clause (i) on or before the date specified in such demand, there shall be paid by such entity or manager failing to so comply $100 for each day after the expiration of the time specified in such demand during which such failure continues. The maximum penalty imposed under this subparagraph on all entities and managers for failures with respect to any 1 disclosure shall not exceed $10,000.

(C) DEFINITIONS.—Any term used in this section which is also used in section 4965 shall have the meaning given such term under section 4965.

(4) NOTICES UNDER SECTION 506.—

(A) PENALTY ON ORGANIZATION.—In the case of a failure to submit a notice required under section 506(a) (relating to organizations required to notify Secretary of intent to operate as 501(c)(4)) on the date and in the manner prescribed therefor, there shall be paid by the organization failing to so submit $20 for each day during which such failure continues, but the total amount imposed under this subparagraph on any organization for failure to submit any one notice shall not exceed $5,000.

(B) MANAGERS.—The Secretary may make written demand on an organization subject to penalty under subparagraph (A) specifying in such demand a reasonable future date by which the notice shall be submitted for purposes of this subparagraph. If such notice is not submitted on or before such date, there shall be paid by the person failing to so submit $20 for each day after the expiration of the time specified in the written demand during which such failure continues, but the total amount imposed

under this subparagraph on all persons for failure to submit any one notice shall not exceed $5,000.

(5) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under this subsection with respect to any failure if it is shown that such failure is due to reasonable cause.

(6) OTHER SPECIAL RULES.—

(A) TREATMENT AS TAX.—Any penalty imposed under this subsection shall be paid on notice and demand of the Secretary and in the same manner as tax.

(B) JOINT AND SEVERAL LIABILITY.—If more than 1 person is liable under this subsection for any penalty with respect to any failure, all such persons shall be jointly and severally liable with respect to such failure.

(C) PERSON.—For purposes of this subsection, the term "person" means any officer, director, trustee, employee, or other individual who is under a duty to perform the act in respect of which the violation occurs.

(7) ADJUSTMENT FOR INFLATION.—

(A) IN GENERAL.—In the case of any failure relating to a return required to be filed in a calendar year beginning after 2014, each of the dollar amounts under paragraphs (1), (2), and (3) shall be increased by such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) determined by substituting "calendar year 2013" for "calendar year 1992" in subparagraph (B) thereof.

(B) ROUNDING.—If any amount adjusted under subparagraph (A)—

(i) is not less than $5,000 and is not a multiple of $500, such amount shall be rounded to the next lowest multiple of $500, and

(ii) is not described in clause (i) and is not a multiple of $5, such amount shall be rounded to the next lowest multiple of $5.

(d) ANNUAL REGISTRATION AND OTHER NOTIFICATION BY PENSION PLAN.—

(1) REGISTRATION.—In the case of any failure to file a registration statement required under section 6057(a) (relating to annual registration of certain plans) which includes all participants required to be included in such statement, on the date prescribed therefor (determined without regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, an amount equal to $1 for each participant with respect to whom there is a failure to file, multiplied by the number of days during which such failure continues, but the total amount imposed under this paragraph on any person for any failure to file with respect to any plan year shall not exceed $5,000.

(2) NOTIFICATION OF CHANGE OF STATUS.—In the case of failure to file a notification required under section 6057(b) (relating to notification of change of status) on the date prescribed therefor (determined without regard to any extension of time for filing), unless it is shown that such failure is due to reason-

able cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, $1 for each day during which such failure continues, but the total amounts imposed under this paragraph on any person for failure to file any notification shall not exceed $1,000.

(e) INFORMATION REQUIRED IN CONNECTION WITH CERTAIN PLANS OF DEFERRED COMPENSATION, ETC..—In the case of failure to file a return or statement required under section 6058 (relating to information required in connection with certain plans of deferred compensation), 6047 (relating to information relating to certain trusts and annuity and bond purchase plans), or 6039D (relating to returns and records with respect to certain fringe benefit plans) on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, $25 for each day during which such failure continues, but the total amount imposed under this subsection on any person for failure to file any return shall not exceed $15,000. This subsection shall not apply to any return or statement which is an information return described in section 6724(d)(1)(C)(ii) or a payee statement described in section 6724(d)(2)(Y).

(f) RETURNS REQUIRED UNDER SECTION 6039C.—

(1) IN GENERAL.—In the case of each failure to make a return required by section 6039C which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not to willful neglect, the amount determined under paragraph (2) shall be paid (upon notice and demand by the Secretary and in the same manner as tax) by the person failing to make such return.

(2) AMOUNT OF PENALTY.—For purposes of paragraph (1), the amount determined under this paragraph with respect to any failure shall be $25 for each day during which such failure continues.

(3) LIMITATION.—The amount determined under paragraph (2) with respect to any person for failing to meet the requirements of section 6039C for any calendar year shall not exceed the lesser of—

(A) $25,000, or

(B) 5 percent of the aggregate of the fair market value of the United States real property interests owned by such person at any time during such year.

For purposes of the preceding sentence, fair market value shall be determined as of the end of the calendar year (or, in the case of any property disposed of during the calendar year, as of the date of such disposition).

(h) FAILURE TO GIVE NOTICE TO RECIPIENTS OF CERTAIN PENSION, ETC., DISTRIBUTIONS.—In the case of each failure to provide notice as required by section 3405(e)(10)(B), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and

demand of the Secretary and in the same manner as tax, by the person failing to provide such notice, an amount equal to $10 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $5,000.

(i) FAILURE TO GIVE WRITTEN EXPLANATION TO RECIPIENTS OF CERTAIN QUALIFYING ROLLOVER DISTRIBUTIONS.—In the case of each failure to provide a written explanation as required by section 402(f), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such written explanation, an amount equal to $100 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $50,000.

(j) FAILURE TO FILE CERTIFICATION WITH RESPECT TO CERTAIN RESIDENTIAL RENTAL PROJECTS.—In the case of each failure to provide a certification as required by section 142(d)(7) at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such certification, an amount equal to $100 for each such failure.

(k) FAILURE TO MAKE REPORTS REQUIRED UNDER SECTION 1202.—

In the case of a failure to make a report required under section 1202(d)(1)(C) which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to make such report, an amount equal to $50 for each report with respect to which there was such a failure. In the case of any failure due to negligence or intentional disregard, the preceding sentence shall be applied by substituting "$100" for "$50". In the case of a report covering periods in 2 or more years, the penalty determined under preceding provisions of this subsection shall be multiplied by the number of such years. No penalty shall be imposed under this subsection on any failure which is shown to be due to reasonable cause and not willful neglect.

(l) FAILURE TO FILE RETURN WITH RESPECT TO CERTAIN CORPORATE TRANSACTIONS.—In the case of any failure to make a return required under section 6043(c) containing the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to file such return, an amount equal to $500 for each day during which such failure continues, but the total amount imposed under this subsection with respect to any return shall not exceed $100,000.

(m) ALCOHOL AND TOBACCO TAXES FOR PENALTIES FOR FAILURE TO FILE CERTAIN INFORMATION RETURNS.—with respect to alcohol and tobacco taxes, see, generally, subtitle E.

(n) FAILURE TO MAKE REPORTS REQUIRED UNDER SECTIONS 3511, 6053(C)(8), AND 7705.—In the case of a failure to make a report required under section 3511, 6053(c)(8), or 7705 which contains the

information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to make such report, an amount equal to $50 for each report with respect to which there was such a failure. In the case of any failure due to negligence or intentional disregard the preceding sentence shall be applied by substituting "$100" for "$50".

(o) FAILURE TO PROVIDE NOTICE UNDER SECTION 83(i).—In the case of each failure to provide a notice as required by section 83(i)(6), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such notice, an amount equal to $100 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $50,000.

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