

107TH CONGRESS
2D SESSION

S. 2877

To amend the Internal Revenue Code of 1986 to ensure that stock options of public companies are granted to rank and file employees as well as officers and directors, and for other purposes.

IN THE SENATE OF THE UNITED STATES

AUGUST 1, 2002

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

A BILL

To amend the Internal Revenue Code of 1986 to ensure that stock options of public companies are granted to rank and file employees as well as officers and directors, and for other purposes.

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

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Rank and File Stock
5 Option Act of 2002”.

1 **SEC. 2. DENIAL OF DEDUCTION FOR STOCK OPTION PLANS**
 2 **DISCRIMINATING IN FAVOR OF HIGHLY COM-**
 3 **PENSATED EMPLOYEES.**

4 (a) IN GENERAL.—Section 162 of the Internal Rev-
 5 enue Code of 1986 (relating to deduction for trade and
 6 business expenses) is amended by redesignating subsection
 7 (p) as subsection (q) and by inserting after subsection (o)
 8 the following new subsection:

9 “(p) DEDUCTIBILITY OF STOCK OPTIONS NOT
 10 WIDELY AVAILABLE TO ALL EMPLOYEES.—

11 “(1) IN GENERAL.—If—

12 “(A) an applicable taxpayer grants stock
 13 options during any taxable year, and

14 “(B) the taxpayer fails to meet the overall
 15 concentration test of paragraph (2) or the indi-
 16 vidual concentration tests of paragraph (3) for
 17 such taxable year with respect to the granting
 18 of such options,

19 then the deduction allowable to such taxpayer for
 20 any taxable year in which any such option is exer-
 21 cised shall be limited as provided in this subsection.

22 “(2) OVERALL CONCENTRATION TEST.—If the
 23 total number of shares which may be acquired pur-
 24 suant to options granted to applicable highly com-
 25 pensated employees by an applicable taxpayer during
 26 a taxable year exceeds 50 percent of the aggregate

1 share amount, then the deduction allowable under
 2 this chapter with respect to the exercise of any op-
 3 tion granted by the applicable taxpayer during such
 4 taxable year to any employee shall be reduced by the
 5 product of—

6 “(A) the amount of such deduction com-
 7 puted without regard to this subsection, and

8 “(B) a percentage equal to the number of
 9 percentage points (including any fraction there-
 10 of) by which such total number exceeds 50 per-
 11 cent.

12 “(3) INDIVIDUAL CONCENTRATION TESTS.—

13 “(A) OPTIONS GRANTED TO SINGLE EM-
 14 PLOYEE.—If the total number of shares which
 15 may be acquired pursuant to options granted to
 16 any applicable highly compensated employee by
 17 an applicable taxpayer during a taxable year ex-
 18 ceeds 5 percent of the aggregate share amount,
 19 then no deduction shall be allowable under this
 20 chapter with respect to the exercise of any op-
 21 tions granted by the applicable taxpayer to such
 22 employee during such taxable year.

23 “(B) OPTIONS GRANTED TO TOP EMPLOY-
 24 EES.—

1 “(i) IN GENERAL.—If the total num-
 2 ber of shares which may be acquired pur-
 3 suant to options granted to employees who
 4 are members of the top group by an appli-
 5 cable taxpayer during a taxable year ex-
 6 ceeds 15 percent of the aggregate share
 7 amount, then no deduction shall be allow-
 8 able under this chapter with respect to the
 9 exercise of any options granted by the ap-
 10 plicable taxpayer to such employees during
 11 such taxable year.

12 “(ii) TOP GROUP.—For purposes of
 13 this subparagraph, an employee shall be
 14 treated as a member of the top group if
 15 the employee is a covered employee (within
 16 the meaning of section 162(m)(3)).

17 “(C) EXCEPTION.—Subparagraphs (A)
 18 and (B) shall not apply to any taxable year if
 19 the applicable taxpayer granted an equal num-
 20 ber of identical options to each employee with-
 21 out regard to whether the employee was highly
 22 compensated or not.

23 “(4) RULES RELATING TO TESTS.—For pur-
 24 poses of this subsection—

25 “(A) AGGREGATE SHARE AMOUNT.—

1 “(i) IN GENERAL.—The aggregate
2 share amount for any taxable year is the
3 total number of shares which may be ac-
4 quired pursuant to options granted to all
5 employees by an applicable taxpayer during
6 the taxable year.

7 “(ii) CERTAIN OPTIONS DIS-
8 REGARDED.—Except as provided in regula-
9 tions, if the terms of any option granted to
10 an employee other than a highly com-
11 pensated employee during any taxable year
12 are not substantially the same as, or more
13 favorable than, the terms of any option
14 granted to any highly compensated em-
15 ployee, then such option shall not be taken
16 into account in determining the aggregate
17 share amount.

18 “(B) OPTIONS GRANTED ON DIFFERENT
19 CLASSES OF STOCK.—Except as provided in
20 regulations, this subsection shall be applied sep-
21 arately with respect to each class of stock for
22 which options are granted.

23 “(5) DEFINITIONS AND SPECIAL RULES.—For
24 purposes of this subsection—

“(A) APPLICABLE TAXPAYER.—The term ‘applicable taxpayer’ means any taxpayer which is an issuer (as defined in section 3 of the Securities Exchange Act of 1934; 15 U.S.C. 78c)—

“(i) the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or

“(ii) which—

“(I) is required to file reports pursuant to section 15(d) of that Act (15 U.S.C. 78o(d)), or

“(II) will be required to file such reports at the end of a fiscal year of the issuer in which a registration statement filed by such issuer has become effective pursuant to the Securities Act of 1933 (15 U.S.C. 77a et seq.), unless its securities are registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78c) on or before the end of such fiscal year.

“(B) APPLICABLE HIGHLY COMPENSATED EMPLOYEE.—The term ‘applicable highly compensated employee’ means—

1 “(i) any highly compensated employee
2 who is described in subparagraph (B) of
3 section 414(q)(1), and

4 “(ii) any director of the applicable
5 taxpayer.

6 “(C) INCENTIVE STOCK OPTIONS NOT
7 TAKEN INTO ACCOUNT.—An incentive stock op-
8 tion (as defined in section 422(b)) shall not be
9 taken into account for purposes of applying this
10 section.

11 “(D) AGGREGATION.—All corporations
12 which are members of an affiliated group of
13 corporations filing a consolidated return shall
14 be treated as 1 taxpayer.

15 “(6) REGULATIONS.—The Secretary shall pre-
16 scribe such regulations as may be necessary to carry
17 out the purposes of this subsection, including regula-
18 tions to prevent the avoidance of this subsection
19 through the use of phantom stock, restricted stock,
20 or similar instruments.”

21 (b) EFFECTIVE DATE.—The amendments made by
22 this section shall apply to taxable years beginning after
23 December 31, 2002.

1 **SEC. 3. SHAREHOLDER APPROVAL.**

2 (a) RULES REQUIRED.—Not later than 1 year after
3 the date of enactment of this Act, the Securities and Ex-
4 change Commission shall finalize rules pursuant to the Se-
5 curities Exchange Act of 1934 to ensure that—

6 (1) shareholder approval is required for stock
7 option plans and grants, stock purchase plans, and
8 other arrangements by public companies by which
9 any person may acquire an equity interest in the
10 company in exchange for consideration that is less
11 than the fair market value of the equity interest at
12 the time of the exchange; and

13 (2) prior to submission of such plans to share-
14 holders for approval, such shareholders are given de-
15 tailed information about the stock option plans and
16 grants, including—

17 (A) the economic rationale and interest of
18 shareholders in the plan or grant;

19 (B) a detailed description of the antici-
20 pated distribution of the plan or grant among
21 directors, officers, and employees and the ra-
22 tionale of such distribution;

23 (C) the total number of options reserved or
24 intended for grants to each director and officer,
25 and to different classes of employees;

1 (D) the maximum potential future earn-
2 ings per share dilution of investors'
3 shareholdings, assuming the exercise of all in-
4 the-money options with no adjustment for the
5 use of the Treasury stock method, as stock
6 price varies;

7 (E) the terms under which stock option
8 grants may be canceled or reissued; and

9 (F) the number, weighted average exercise
10 prices, and vesting schedule of all options pre-
11 viously approved or outstanding.

12 (b) RELIABILITY AND ACCURACY.—The Commission
13 shall ensure that all disclosures required by this section
14 shall increase the reliability and accuracy of information
15 provided to shareholders and investors.

16 (c) EXEMPTION AUTHORITY.—Shareholder approval
17 rules issued in accordance with this section—

18 (1) may exempt stock option grants to indi-
19 vidual employees under terms and conditions speci-
20 fied by the Commission, except that such exemptions
21 shall be available only in cases in which the grant—

22 (A) is made to an individual who is not a
23 director or officer of the company at the time
24 the grant is approved;

1 (B) is necessary, based on business judgment;
2

3 (C) represents a de minimus potential dilution of future earnings per share of investors' shareholdings; and

4 (D) is made on terms disclosed to shareholders in the next filing with the Commission;
5 and

6 (2) may exempt stock option plans and grants
7 of any registrant that qualifies as a small business
8 issuer under applicable securities laws and regulations,
9 or to such additional small issuers as the
10 Commission determines would be unduly burdened
11 by such requirements as compared to the benefit to
12 shareholders, except that such exemption may be
13 phased in, both as to applicability and to its effective
14 date, so that the Commission may determine the size
15 of issuer to which such exemptions will apply and
16 the extent to which the rule should apply to plans
17 that exclude officers and directors.

18 **SEC. 4. HOLDING PERIOD FOR EXECUTIVES.**

19 Not later than 1 year after the date of enactment
20 of this Act, the Securities and Exchange Commission shall
21 conduct an analysis of, and make regulatory and legisla-

1 tive recommendations on, the need for new stock holding
2 period requirements for senior executives, including—

3 (1) recommendations to set minimum holding
4 periods after the exercise of options to purchase
5 stock and to set a maximum percentage of stock
6 purchased through options that may be sold; and

7 (2) an analysis of sales to company, sales on
8 public markets, and derivative sales.

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