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HOUSE OF REPRESENTATIVES
REPORT
114–

EMPOWERING EMPLOYEES THROUGH STOCK OWNERSHIP ACT

SEPTEMBER --, 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

together with

_____ VIEWS

[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, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

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.

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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]

[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.

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 inclusion 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

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[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. 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.

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 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

[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.

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 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

[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.

[11] Sec. 3402. Specific withholding rates apply in the case of supplemental wages.

[12] Secs. 6041 and 6051.

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 deferred compensation plan,[17] unless the

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[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).

[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.

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 fair market 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 is substantially vested.[21] Absent an inclusion deferral election

[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.

[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.

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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[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

[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.

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, 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.

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[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.

[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.

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 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.

[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.

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

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.

[Insert A – CBO letter/estimate]

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:

[Insert B – Ramseyer entire-text]

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):

[Insert C – Ramseyer comparative-print]

CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Keith Hall, Director

September 16, 2016

Honorable Kevin Brady
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

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, who can be reached at 226-2680.

Sincerely,

Keith Hall

Enclosure

cc: Honorable Sander M. Levin
Ranking Member

CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 16, 2016

H.R. 5719
Empowering Employees through Stock Ownership Act

As ordered reported by the House Committee on Ways and Means on September 14, 2016

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 H.R. 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.