



JOINT COMMITTEE ON TAXATION  
September 13, 2016  
JCX-75-16

**DESCRIPTION OF THE CHAIRMAN’S AMENDMENT IN THE NATURE  
OF A SUBSTITUTE TO THE PROVISIONS OF H.R. 5719,  
THE “EMPOWERING EMPLOYEES THROUGH  
STOCK OWNERSHIP ACT”**

Under the Chairman’s amendment in the nature of a substitute, if an employee elects to defer income inclusion (“inclusion deferral election”), 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;<sup>1</sup> (2) the date the employee first becomes an excluded employee; (3) the first date on which any stock of the employer becomes readily tradable on an established securities market;<sup>2</sup> (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.<sup>3</sup>

The definition of eligible corporation is revised to require that no stock of the employer corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year. In addition, the corporation must have 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 restricted stock units (“RSUs”), with the same rights and privileges to receive qualified stock (“80-percent requirement”).

The definition of excluded employee is revised to include any individual (1) who is, or has been at any time during the 10 preceding calendar years, a one-percent owner of the corporation, (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

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<sup>1</sup> 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).

<sup>2</sup> Under the amendment in the nature of a substitute, an established securities market is determined for this purpose by the Secretary of the Treasury (“Secretary”), but does not include any market unless the market is recognized as an established securities market for purposes of another Code provision.

<sup>3</sup> An inclusion deferral election is revoked at the time and in the manner as the Secretary provides.

member of an individual described in (1) or (2),<sup>4</sup> 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.<sup>5</sup>

Under the amendment in the nature of a substitute, 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.<sup>6</sup> 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.

The amendment in the nature of a substitute revises the contents of the notice an employer must provide with respect to qualified stock and requires the notice to be provided to a 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 proposal, as well as of the employee’s responsibilities with respect to required withholding.

With respect to Form W-2, in addition to reporting the amount of income covered by an inclusion deferral election both for the year of deferral and for the year the income is required to be included in income by the employee, for any calendar year the employer must report on

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<sup>4</sup> As under the original proposal, 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).

<sup>5</sup> Highest paid employee status is determined at the close of the corporation’s taxable year.

<sup>6</sup> This requirement is met if the stock purchased by the corporation includes all the corporation’s outstanding deferral stock.

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

The amendment in the nature of a substitute also makes various technical clarifications to the proposal, for example, with respect to the definition of qualified stock and a qualified employee's ability to make an inclusion deferral election with respect to qualified stock attributable to a statutory option (and the effect of such an election).

Under the Chairman's amendment in the nature of a substitute, the proposal generally applies with respect to stock attributable to options exercised or RSUs settled after December 31, 2016.<sup>7</sup> 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 proposal, a corporation will be treated as complying with those requirements (respectively) if it complies with a reasonable good faith interpretation of the requirements.

The following presents the estimated Federal fiscal year budget effects of the Chairman's amendment:

<b>Fiscal Years</b>											
<b>[Millions of Dollars]</b>											
<b><u>2017</u></b>	<b><u>2018</u></b>	<b><u>2019</u></b>	<b><u>2020</u></b>	<b><u>2021</u></b>	<b><u>2022</u></b>	<b><u>2023</u></b>	<b><u>2024</u></b>	<b><u>2025</u></b>	<b><u>2026</u></b>	<b><u>2017-21</u></b>	<b><u>2017-26</u></b>
-116	-160	-166	-159	-142	-115	-81	-48	-32	-13	-744	-1,031

**NOTE:** Details do not add to totals due to rounding.

<sup>7</sup> The penalty for a failure to provide the notice required under the proposal continues to apply to failures after December 31, 2016.