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BILL FOR NEW FORM OF TAX-FAVORED EMPLOYEE STOCK PURCHASE PLANS INTRODUCED

-- Puts Stock Purchase Plans on a Par with 401(k) Plans
but with More Favorable Terms for Employees --

Representative Amory Houghton (R. NY) introduced a bill into Congress on July 26, 2000, that would add a new form of employee stock purchase plan to the Internal Revenue Code.[*] Called the "Universal Employee Stock Option Act of 2000," the Houghton bill would encourage companies to establish broad-based stock purchase plans under which substantially all U.S. employees would receive stock options to purchase company stock. The minimum purchase price would be 100% of fair market value on the grant date, and the maximum option period would be five years. Those electing to participate could make pre-tax contributions of up to $10,000 a year.

The key differences between the Houghton bill and present IRC §423 employee stock purchase plans lie in taxation. Specifically, under the Houghton bill:

1. Employee contributions are made with pre-tax dollars, like 401(k) plans

2. At exercise of the option, there is no tax due from the employee, but the company gets a tax deduction for the full value of the stock at exercise (which includes the amount of the pre-tax employee contributions plus any gain in stock value)

3. At sale, the employee is taxed at ordinary income rates on the full value of the stock at exercise (the same amount deductible by the employer), with any excess gain taxed as a capital gain. There are no tax consequences to the employer at sale.

The purpose of the Houghton bill is to encourage companies to share wealth-creation opportunities in their own stock with all its employees in a way that encourages (but does not require) long-term ownership. Like 401(k) plans, employee contributions are pre-tax and there is no taxation until sale. Unlike 401(k) plans, the Houghton bill is not a "retirement plan." Employees can sell their stock and realize gains *during or after* active employment as they choose. The Attachment highlights the key features of the Houghton bill and contrasts them with current IRC §423 plan requirements.

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[*] HR 4972

Companies with active employee stock purchase plans would likely find the Houghton bill more attractive, except that short-term purchase opportunities at 85% of market price will not be available. Those without an employee stock purchase plan might find it attractive to add one as an adjunct to their 401(k) plan.

The downside from the government's perspective is a timing difference between the employer's tax deduction at exercise and the employees' recognition of income at sale. But this is similar to what happens currently under 401(k) plans. The "cost" to the U.S. Treasury of delayed tax revenue is offset by the social benefit of encouraging a sharing in value-creation opportunities through company stock with all employees. This is a great way for the government to address the growing "wage gap" between executives and the rank and file which is mainly caused by the growing use of stock options for key employees. Instead of "lowering the top," the Houghton bill encourages companies to "raise the bottom" through broad-based stock option participation on a tax-favored basis.

Questions about the Houghton bill may be addressed to Fred Cook, Jeff Kanter or David Cole at (212) 986-6330. Interested companies should contact their Congressperson to encourage co-sponsorship.

Copies of this letter and other published materials are available on our web site, www.fwcook.com

Comparison of Houghton Bill and
Current IRC §423 Plans

		423 Plans	Houghton Bill
1.	Applicability	Public companies only	Public and private companies
2.	Approval	Written plan approved by majority of shareholders	Written plan approved by majority of shareholders
3.	Eligibility	Substantially all full-time U.S. employees	Substantially all full-time U.S. employees
4.	Participation opportunity	Must be same for all participants, in dollar amounts or % of pay	Must be same for all participants, in dollar amounts or % of pay
5.	Discrimination testing	None	None
6.	Minimum purchase price	100% of fair market value when option is granted for option terms of up to 5 years	100% of fair market value when option is granted
		Lesser of 85% of market value at grant or exercise of option for option terms of up to 27 months	Not applicable
7.	Maximum option term	See above	5 years
8.	Employee contributions	Post-tax	Pre-tax
9.	Payroll deductions	Not required	Required
10.	Maximum employee contributions	$25,000 per year	$10,000 per year
11.	Exercise of option	Voluntary by employee; shares issued to employee	Voluntary by employee; shares held in trust for employee until sale

	423 Plans	**Houghton Bill**
12. Taxation to employee		
- at grant	None	None
- at exercise	None	None
- at sale	Gain above purchase price taxed as capital gain if minimum holding period for stock met (2 years from grant and 1 year from exercise); ordinary income if not; special rules if option price is 85% of market value	Fair market value of stock at *exercise* taxed as ordinary income; excess is capital gain
13. Tax deduction for employer		
- at grant	None	None
- at exercise	None	Fair market value of stock deductible
- at sale	None, unless holding-period requirements are not met	None