STATEMENT OF SENATOR CARL LEVIN (D-MICH)
ON INTRODUCING
THE ENDING CORPORATE TAX FAVORS FOR STOCK OPTIONS ACT

September 28, 2007

Mr. President, there is a growing chasm in our country between the amount of money paid to our corporate executives and the earnings of the rank and file workers.

J.P. Morgan once said that executive pay should not exceed 20 times average worker pay. In the United States, in 1990, average pay for the chief executive officer (CEO) of a large U.S. corporation was 100 times average worker pay; in 2004, the difference was 300 times; today, it is nearly 400 times.

The single biggest factor responsible for this massive pay gap is stock options. Stock options are a huge contributor to executive pay. And a key factor encouraging companies to pay their executives with stock options is a set of outdated and misguided federal tax provisions that favor stock options over other types of compensation. That's why I am introducing today a bill to eliminate federal corporate tax breaks that give special tax treatment to corporations that pay their executives with stock options. It's called the "Ending Corporate Tax Favors for Stock Options Act."

This bill has been endorsed by the Consumer Federation of America, Citizens for Tax Justice, the Tax Justice Network-USA, OMBWatch, the Financial Policy Forum, and the AFL-CIO, each of which sees it as needed to eliminate federal tax breaks providing special tax favors for corporations that issue large stock option grants to their executives.

Stock options give employees the right to buy company stock at a set price for a specified period of time, typically ten years. Virtually every CEO in America is paid with stock options, which are a major contributor to sky-high executive pay.

According to Forbes magazine, in 2006, the average pay of CEOs at 500 of the largest U.S. companies was $15.2 million. Nearly half of that amount, 48%, came from stock options that had been cashed in for an average gain of about $7.3 million. In 2006, one CEO cashed in stock options for about $290 million; another cashed them in for about $270 million. Forbes also published a list of 30 CEOs who, in 2006, each had at least $100 million in vested stock options that had yet to be exercised. Corporate executives are, in short, showered with stock options and the millions of dollars they produce.

A key reason behind this flood of executive stock options is the tax code which, when combined with certain U.S. accounting rules, favors the issuance of stock option grants. Right now, U.S. accounting rules require companies to report their stock option expenses one way on the corporate books, while federal tax rules require them to report the same stock options a completely different way on their tax returns. In most cases, the resulting book expense is far smaller than the resulting tax deduction. That means, under current U.S.

accounting and tax rules, stock option tax deductions often far exceed the stock option expenses recorded by the companies.

Stock options are the only type of compensation where the federal tax code permits companies to claim a bigger deduction on their tax returns than the corresponding expense on their books. For all other types of compensation – cash, stock, bonuses, and more -- the tax return deduction equals the book expense. In fact, companies cannot deduct more than the compensation expense shown on their books, because that would be tax fraud. The sole exception to this rule is stock options. In the case of stock options, the tax code allows companies to claim a tax deduction that can be two, three, even ten times larger than the actual expense shown on their books.

When a company's compensation committee learns that stock options can produce a low compensation expense on the books, while generating a generous tax deduction that is multiple times larger, it's a pretty tempting proposition for the company to pay its executives with stock options instead of cash or stock. It's a classic case of U.S. tax policy creating an unintended incentive for corporations to act.

The problem is that these mismatched stock option accounting and tax rules also shortchange the Treasury to the tune of billions of dollars each year, while fueling the growing chasm between executive pay and average worker pay. This same mismatch also results in companies reporting one set of stock option compensation expenses to investors and the public through their public financial statements, and a completely different set of expenses to the Internal Revenue Service (IRS) on their tax returns. Such huge book-tax disparities breed confusion, distrust, and schemes to maximize the differences.

The bill I'm introducing today would put an end to these contradictions and to the harmful, unintended consequences that have resulted. It would put a stop to the stock option book-tax disparity, an end to the conflicting stock option expenses reported to investors and Uncle Sam, and an end to the special tax treatment that currently fuels excessive stock option compensation.

To understand why this bill is needed it helps to understand how stock option accounting and tax rules got so out of kilter with each other in the first place.

Accounting Battle. Calculating the cost of stock options may sound straightforward, but for years, companies and their accountants engaged the Financial Accounting Standards Board (FASB) in an all-out, knock-down battle over how companies should record stock option compensation expenses on their books.

U.S. publicly traded corporations are required by law to follow Generally Accepted Accounting Principles (GAAP), issued by FASB, which is overseen by the Securities and Exchange Commission (SEC). For many years, GAAP allowed U.S. companies to issue stock options to employees and, unlike any other type of compensation, report a zero compensation expense on their books, so long as, on the grant date, the stock option's exercise price equaled the market price at which the stock could be sold.

Assigning a zero value to stock options that routinely produced millions of dollars in executive pay provoked deep disagreements within the accounting community. In 1993, FASB proposed assigning a "fair value" to stock options on the date they are granted to an employee, using a mathematical valuation tool such as the Black Scholes model. FASB proposed further that companies include that amount as a compensation expense on their financial statements. Critics responded that it was impossible accurately to estimate the value of executive stock options on their grant date. A bruising battle over stock option expensing followed, involving the accounting profession, corporate executives, FASB, the SEC, and Congress.

In the end, after years of fighting and negotiation, FASB issued a new accounting standard, Financial Accounting Standard (FAS) 123R, which was endorsed by the SEC and became mandatory for all publicly traded corporations in 2005. In essence, FAS 123R requires all companies to record a compensation expense equal to the fair value on grant date of all stock options provided to an employee in exchange for the employee's services.

The details of this accounting rule are complex, because they reflect an effort to accommodate varying viewpoints on the true cost of stock options. Companies are allowed to use a variety of mathematical models, for example, to calculate a stock option's fair value. Option grants that vest over time are expensed over the specified period so that, for example, a stock option which vests over four years results in 25% of the cost being expensed each year. If a stock option grant never vests, the rule allows any previously booked expense to be recovered. On the other hand, stock options that do vest are required to be fully expensed, even if never exercised, because the compensation was actually awarded. These and other provisions of this hard-fought accounting rule reflect painstaking judgments on how to show a stock option's value.

Opponents of the new accounting rule had predicted that, if implemented, it would severely damage U.S. capital markets. They warned that stock option expensing would eliminate corporate profits, discourage investment, depress stock prices, and stifle innovation. Last year, 2006, was the first year in which all U.S. publicly traded companies were required to expense stock options. Instead of tumbling, both the New York Stock Exchange and Nasdaq turned in strong performances, as did initial public offerings by new companies. The dire predictions were flat out wrong.

Tax Treatment. During the years the battle raged over stock option accounting, relatively little attention was paid to the taxation of stock options. Section 83 of the tax code, first enacted in 1969 and still in place after more than three decades, is the key statutory provision. It essentially provides that, when an employee exercises compensatory stock options, the employee must report as income the difference between what the employee paid to exercise the options and the market value of the stock received. The corporation can then take a mirror deduction for whatever amount of income the employee realized.

For example, suppose a company gave an executive options to buy 1 million shares of the company stock at $10 per share. Suppose, five years later, the executive exercised the options when the stock was selling at $30 per share. The executive's income would be $20 per share for a total of $20 million. The executive would declare $20 million as ordinary income, and in the same year, the company would take a corresponding tax deduction for $20 million. Although in 1993, Congress enacted a $1 million cap on the compensation that a corporation can deduct from its taxes, so taxpayers wouldn't be forced to subsidize millions of dollars in executive pay, the cap was not applied to stock options, allowing companies to deduct any amount of stock option compensation, without limit.

Book-Tax Differences. The stock option accounting and tax rules that evolved over the years are now at odds with each other. Accounting rules require companies to expense stock options on the grant date. Tax rules tell companies to deduct stock option expenses on the exercise date. Companies have to report grant date expenses to investors on their financial statements, and exercise date expenses on their tax returns. The financial statements report on all stock options granted during the year, while the tax returns report on all stock options exercised during the year. In short, company financial statements and tax returns report expenses for different groups of stock options, using different valuation methods, and resulting in widely divergent stock option expenses for the same year.

To examine the nature and consequences of the stock option book-tax differences, the Permanent Subcommittee on Investigations, which I chair, initiated an investigation and held a hearing on June 5, 2007. Here is what we found.

Company Data. To test just how far the book and tax figures for stock options diverge, the Subcommittee contacted a number of companies to compare the stock option expenses they reported for accounting and tax purposes. The Subcommittee asked each company to identify stock options that had been exercised by one or more of its executives from 2002 to 2006. The Subcommittee then asked each company to identify the compensation expense they reported on their financial statements versus the compensation expense on their tax returns. In addition, we asked the companies' help in estimating what effect the new accounting rule would have had on their book expense if it had been in place when their stock options were granted. At the hearing, we disclosed the resulting stock option data for nine companies, including three companies that were asked to testify. The Subcommittee very much appreciated the cooperation and assistance provided by the nine companies we worked with.

The data provided by the companies showed that, under then existing rules, the nine companies showed a zero expense on their books for the stock options that had been awarded to their executives, but claimed millions of dollars in tax deductions for the same compensation. The one exception was Occidental Petroleum which, in 2005, began voluntarily expensing its stock options, but even this company reported massively greater tax deductions than the stock option expenses shown on its books. When the Subcommittee asked the companies what their book expense would have been if the new FASB rule had been in effect, all nine calculated book expenses that remained dramatically lower than their tax deductions. Altogether, the nine companies calculated that they would have claimed $1 billion more in stock option tax deductions than they would have shown as book expenses, even using the tougher new accounting rule. Let me repeat that – just nine companies produced a stock option book-tax difference of more than $1 billion.

KB Home, for example, is a company that builds residential homes. Its stock price has more than quadrupled over the past 10 years. Over the same time period, it has repeatedly granted stock options to its then CEO. Company records show that, over the past five years, KB Home gave him 5.5 million stock options of which, by 2006, he had exercised more than 3 million.

With respect to those 3 million stock options, KB Home recorded a zero expense on its books. Had the new accounting rule been in effect, KB Home calculated that it would have reported on its books a compensation expense of about $11.5 million. KB Home also disclosed that the same 3 million stock options enabled it to claim compensation expenses on its tax returns totaling about $143.7 million. In other words, KB Home claimed a $143 million tax deduction for expenses that on its books, under current accounting rules, would have totaled $11.5 million. That's a tax deduction 12 times bigger than the book expense.

Occidental Petroleum disclosed a similar book-tax discrepancy. This company's stock price has also skyrocketed in recent years, dramatically increasing the value of the 16 million stock options granted to its CEO since 1993. Of the 12 million stock options the CEO actually exercised over the past five years, Occidental Petroleum claimed a $353 million tax deduction for a book expense that, under current accounting rules, would have totaled just $29 million. That's a book-tax difference of more than 1200%.

Similar book-tax discrepancies applied to the other companies we examined. Cisco System's CEO exercised nearly 19 million stock options over the past five years, and provided the company with a $169 million tax deduction for a book expense which, under current accounting rules, would have totaled about $21 million. UnitedHealth's former CEO exercised over 9 million stock options in the past five years, providing the company with a $318 million tax deduction for a book expense which would have totaled about $46 million. Safeway's CEO exercised over 2 million stock options, providing the company with a $39 million tax deduction for a book expense which would have totaled about $6.5 million.

Altogether, these nine companies took stock option tax deductions totaling $1.2 billion, a figure five times larger than the $217 million that their combined stock option book expenses would have been. The resulting $1 billion in excess tax deductions represents a windfall for these companies simply because they issued lots of stock options to their CEOs.

Tax rules that produce outsized tax deductions that are many times larger than the related stock option book expenses give companies an incentive to issue huge stock option grants, because they know the stock options will produce a relatively small hit to the profits shown on their books, while also knowing that they are likely to get a much larger tax deduction that can dramatically lower their taxes.

IRS Data. The data we gathered for nine companies alone disclosed stock option tax deductions that were five times larger than their book expenses, generating over $1 billion in excess tax deductions. To gauge whether the same tax gap applied to stock options across the country as a whole, the Subcommittee asked the IRS to perform an analysis of some newly obtained stock option data.

For the first time last year, large corporations were required to file a new tax Schedule M-3 with their tax returns. The M-3 Schedule asks companies to identify differences in how they report corporate income to investors versus what they report to Uncle Sam, so that the IRS can track and analyze significant book-tax differences. The first batch of M-3 data, which became available earlier this year, applies mostly to 2004 tax returns.

In analyzing this data, the IRS found that stock option compensation expenses were one of the biggest factors in the difference between book and tax income reported by U.S. corporations. The data shows that, in 2004, stock option compensation expenses produced a book-tax gap of about $43 billion, which is about 30% of the entire book-tax difference reported for the period. That means, as a whole, corporations took deductions on their tax returns for stock option compensation expenses which were $43 billion greater than the stock option expenses actually shown on their financial statements for the same year. Those massive tax deductions enabled the corporations, as a whole, to legally reduce their 2004 taxes by billions of dollars, perhaps by as much as $15 billion.

When asked to look deeper into who benefited from these stock option deductions, the IRS was able to determine that the entire $43 billion book-tax difference was attributable to about 3,200 corporations nationwide, of which about 250 corporations accounted for 82% of the total difference. In other words, a relatively small number of corporations was able to generate $43 billion in tax deductions simply by handing out substantial stock options to their executives.

Missing and Delayed Deductions. There were other surprises in the data as well. One set of issues disclosed by the data involves what happens to unexercised stock options. Under the current mismatched set of accounting and tax rules, stock options which are granted, vested, but never exercised by the option holder turn out to produce a corporate book expense but no tax deduction.

Cisco Systems told the Subcommittee, for example, that in addition to the 19 million exercised stock options previously mentioned, their CEO holds about 8 million options that, due to a stock price drop, will likely expire without being exercised. Cisco calculated that, had FAS 123R been in effect at the time those options were granted, the company would have had to show a $139 million book expense, but would never be able to claim a tax deduction for this expense since the options would never be exercised. Apple made a similar point. It told the Subcommittee that, in 2003, it allowed its CEO to trade 17.5 million in underwater stock options for 5 million shares of restricted stock. That trade meant the stock options would never be exercised and, under current rules, would produce a book expense without ever producing a tax deduction.

In both of these cases, under FAS 123R, it is possible that the stock options given to a corporate executive would have produced a reported book expense greater than the company's tax deduction. While the M-3 data indicates that, overall, accounting expenses lag far behind claimed tax deductions, the possible financial impact on an individual company of a large number of unexercised stock options is additional evidence that existing stock option accounting and tax rules are out of kilter and should be brought into alignment. Under our bill, if a company incurred a stock option expense, it would always be able to claim a tax deduction for that expense.

A second set of issues brought to light by the data focuses on the fact that the current stock option tax deduction is typically claimed years later than the initial book expense. Normally, a corporation dispenses compensation to an employee and takes a tax deduction in the same year for the expense. The company controls the timing and amount of the compensation expense and the corresponding tax deduction. With respect to stock options, however, corporations may have to wait years to see if, when, and how much of a deduction can be taken. That's because the corporate tax deduction is wholly dependent upon when an individual corporate executive decides to exercise his or her stock options.

UnitedHealth, for example, told the Subcommittee that it gave its former CEO 8 million stock options in 1999, of which, by 2006, only about 730,000 had been exercised. It does not know if or when he will exercise the remaining 7 million options, and so cannot calculate when or how much of a tax deduction it will be able to claim for this compensation expense.

Right now, stock options are the only form of compensation in which the book expense and tax deduction often take place in different years, and the timing of the deduction is under the control of the employee, rather than the employer. Under current law, it is not unusual for a stock option tax deduction to be claimed 3, 5, or even 10 years after the year in which the stock option compensation was granted. Our bill would completely eliminate this delay and uncertainty, by requiring stock option expenses to be deducted in the same year as they appear on the company books.

If the rules for stock option tax deductions were changed as suggested in our bill, companies would typically be able to take the deduction years earlier than they do now, without waiting to see if and when particular options are exercised. Companies would also be allowed to deduct stock options that are vested but never exercised. In addition, by requiring stock option expenses to be deducted in the same year they appear on the company books, stock options would become more consistent with how other forms of compensation are treated in the tax code.

The Bill Provisions. Right now, U.S. stock option accounting and tax rules are mismatched, misaligned, and out of kilter. They allow companies collectively to deduct billions of dollars in stock option expenses in excess of the expenses that actually appear on the company books. They disallow tax deductions for stock options that are given as compensation but never exercised. They often force companies to wait years to claim a tax deduction for a compensation expense that could and should be claimed in the same year it appears on the company books.

The bill we are introducing today would cure these problems. It would bring stock option accounting and tax rules into alignment, so that the two sets of rules would apply in a consistent manner. It would accomplish that goal simply by requiring the corporate stock option tax deduction to equal the stock option expenses shown on the corporate books each year. Stock option deductions would no longer exceed the expenses recorded on a company's publicly available financial reports. Stock option expenses for both accounting and tax purposes would be the same.

Specifically, the bill would end use of the current stock option deduction under Section 83 of the tax code, which allows corporations to deduct stock option expenses when exercised in an amount equal to the income declared by the individual exercising the option, replacing it with a new Section 162(q), which would require companies to deduct the stock option expenses shown on their books each year.

The bill would apply only to corporate stock option deductions; it would make no changes to the rules that apply to individuals who have been given stock options as part of their compensation. Individuals would still report their compensation on the day they exercised their stock options. They would still report as income the difference between what they paid to exercise the options and the fair market value of the stock they received upon exercise. The gain would continue to be treated as ordinary income rather than a capital gain, since the option holder did not invest any capital in the stock prior to exercising the stock option and the only reason the person obtained the stock was because of the services they performed for the corporation.

The amount of income declared by the individual after exercising a stock option will likely often be greater than the stock option expense booked and deducted by the corporation who employed that individual. That's in part because the individual's gain often comes years later than the original stock option grant, and the underlying stock will usually have gained in value. In addition, the individual's gain is typically provided, not by the corporation that supplied the stock options years earlier, but by third parties active in the stock market.

Consider, for example, an executive who exercises options to buy 1 million shares of stock at $10 per share, obtains the shares from the corporation, and then immediately sells them on the open market for $30 per share, making a total profit of $20 million. The individual's corporation didn't supply the $20 million. Just the opposite. Rather than paying cash to its executive, the corporation received a $10 million payment from the executive in exchange for the 1 million shares. The $20 million profit from selling the shares was paid, not by the corporation, but by third parties in the marketplace who purchased the stock. That's why it makes no sense for the company to declare as an expense the amount of profit that an employee (or sometimes a former employee) obtained from unrelated parties in the marketplace.

The bill we are introducing today would put an end to the current approach of using the stock option income declared by an individual as the tax deduction claimed by the corporation that supplied the stock options. It would break that old artificial symmetry and replace it with a new symmetry more consistent with other tax code provisions – one in which the corporation's stock option tax deduction would match its book expense.

I consider the current approach to corporate stock option tax deductions to be artificial, because it uses a construct in the tax code that, when first implemented over thirty years ago, enabled corporations to calculate their stock option expense on the exercise date, when there was no consensus on how to calculate stock option expenses on the grant date. The artificiality of the approach is demonstrated by the fact that it allows companies to claim a deductible expense for money that generally does not come from a company's coffers, but from third parties in the stock market. Now that U.S. accounting rules provide a detailed rule for calculating stock option expenses on the grant date, however, there is no longer any need to rely on an artificial construct that calculates corporate stock option expenses on the exercise date using third party funds.

Our bill would eliminate the existing grant date-exercise date disparity between U.S. accounting and tax rules, and eliminate the stock option double standard by ensuring that companies' stock option tax deductions are equal to, and not greater than, the actual stock option expenses shown on their books.

It is also important to note that the bill would not affect in any way current tax provisions that provide favored tax treatment to so-called Incentive Stock Options under Sections 421 and 422 of the tax code. Under these sections, in certain circumstances, corporations can surrender their stock option deductions in favor of allowing their employees with stock option gains to be taxed at a capital gains rate instead of ordinary income tax rates. Many start-up companies use these types of stock options, because they don't yet have taxable profits and don't need a stock option tax deduction. So they forfeit their stock option corporate deduction in favor of giving their employees more favorable treatment of their stock option income. Incentive Stock Options would not be affected by our legislation and would remain available to any corporation providing stock options to its employees.

And again, as mentioned earlier, the bill would have no effect on the tax treatment of stock options for individuals; the bill would affect only corporations.

The bill would make one other important change to the tax code as it relates to corporate stock option tax deductions. Right now, Section 162(m) of the tax code applies a $1 million cap on corporate deductions for the compensation paid to the top executives of publicly held corporations. The purpose of this cap is to eliminate any taxpayer subsidy for compensation that exceeds $1 million annually and is paid to a top corporate executive. As currently written, however, the cap does not apply to compensation paid in the form of stock options. By exempting stock option compensation from the $1 million cap, the provision creates a significant incentive for corporations to pay their executives with stock options. The bill would eliminate this favored treatment of executive stock options by making deductions for this type of compensation subject to the same $1 million cap that applies to other forms of compensation covered by Section 162(m).

The bill also contains several technical provisions. First, it would make a conforming change to the research tax credit so that stock option expenses claimed under that credit would match the stock option deductions taken under the new tax code section 162(q). Second, the bill would authorize the Secretary of the Treasury to adopt regulations governing how to calculate the deduction for stock options issued by a parent corporation to the employees of a subsidiary.

Finally, the bill contains a transition rule for applying the new Section 162(q) stock option tax deduction to existing and future stock option grants. This transition rule would make it clear that the new tax deduction would not apply to any stock option exercised prior to the date of enactment of the bill.

The bill would also allow the old Section 83 deduction rules to apply to any option which was vested prior to the effective date of Financial Accounting Standard (FAS) 123R, and exercised after the date of enactment of the bill. The effective date of FAS 123R is June 15, 2005 for most corporations, and December 31, 2005 for most small businesses. Prior to the effective date of FAS 123R, most corporations would have shown a zero expense on their books for the stock options issued to their executives and, thus, would be unable to claim a tax deduction under the new Section 162(q). For that reason, the bill would allow these corporations to continue to use Section 83 to claim stock option deductions on their tax returns.

For stock options that vested after the effective date of FAS 123R and were exercised after the date of enactment, the bill takes another tack. Under FAS 123R, these corporations would have had to show the appropriate stock option expense on their books, but would have been unable to take a tax deduction until the executive actually exercised the option. For these options, the bill would allow corporations to take an immediate tax deduction – in the first year that the bill was in effect -- for all of the expenses shown on their books with respect to these options. This "catch-up deduction" in the first year after enactment would enable corporations, in the following years, to begin with a clean slate so that their tax returns the next year would reflect their actual stock option book expenses for that same year.

After that catch-up year, all stock option expenses incurred by a company each year would be reflected in their annual tax deductions under the new Section 162(q).

Conclusion. The current differences between stock option accounting and tax rules make no sense. They require companies to show one stock option expense on their books and a completely different expense on their tax returns. They require corporations to report one set of figures to their investors and a different set of figures to the IRS.

The current book-tax difference is the historical product of accounting and tax policies that have not been coordinated or integrated. The resulting mismatch has allowed companies to take tax deductions that, usually, are many times larger than the actual stock option book expenses shown on their books, which not only shortchanges the Treasury, but also provides a windfall to companies doling out huge stock options, and creates an incentive for those companies to keep right on doling out those options and producing outsized executive pay.

Right now, stock options are the only compensation expense where the tax code allows companies to deduct more than their actual expenses. In 2004, companies used the existing book-tax disparity to claim $43 billion more in stock option tax deductions than the expenses shown on their books. We cannot afford this multi-billion dollar loss to the Treasury, not only because of deep federal deficits, but also because this stock option book-tax difference contributes to the ever deepening chasm between the pay of executives and the pay of average workers.

I urge my colleagues to join me in enacting this bill into law this year.

I ask unanimous consent to include in the record following these remarks a summary of the bill and the actual bill text.

Summary of
Ending Corporate Tax Favors for Stock Options Act

September 28, 2007

Section 1 – Short Title

- "Ending Corporate Tax Favors for Stock Options Act"

Section 2 – Consistent Treatment of Stock Options by Corporations

- Eliminates favored tax treatment of corporate stock option deductions, in which corporations are currently allowed to deduct a higher stock option compensation expense on their tax returns than shown on their financial books — (1) creates a new corporate stock option deduction under a new tax code section 162(q) requiring the tax deduction to be consistent with the book expense, and (2) eliminates the existing corporate stock option deduction under tax code section 83(h) allowing excess deductions.

- Allows corporations to deduct stock option compensation in the same year it is recorded on the company books, without waiting for the options to be exercised.

- Makes a conforming change to the research tax credit so that stock option expenses under that credit will match the deductions taken under the new tax code section 162(q).

- Authorizes Treasury to issue regulations applying the new deduction to stock options issued by a parent corporation to subsidiary employees.

- Establishes a transition rule applying the new deduction to stock options exercised after enactment, permitting deductions under the old rule for options vested prior to adoption of Financial Accounting Standard (FAS) 123R (on expensing stock options) on June 15, 2005, and allowing a catch-up deduction in the first year after enactment for options that vested between adoption of FAS 123R and the date of enactment.

- Makes no change to stock option compensation rules for individuals.

Section 3 – Application of Executive Pay Deduction Limit

- Eliminates favored treatment of corporate executive stock options under tax code section 162(m) by making executive stock option compensation deductions subject to the same $1 million cap on corporate deductions that applies to other types of compensation paid to the top executives of publicly held corporations.

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