

United States Senate

WASHINGTON, DC 20510

March 26, 2003

The Honorable Chuck Grassley
Chairman
Senate Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Max Baucus
Ranking Democratic Member
Senate Committee on Finance
United States Senate
Washington, DC 20510

Dear Chuck and Max:

You will recall that the Chairman's mark for the pension bill passed by the Finance Committee last July (S. 1971, the National Employee Savings and Trust Equity Guarantee Act) included a provision to exclude from employee FICA and FUTA wages the value of incentive stock options and employee stock purchase plan stock options. We appreciate both of your efforts in ensuring this important provision was included in the pension bill.

We ask that you consider including this same provision in the first appropriate tax bill that the Finance Committee marks up this year. As you will recall, this provision would clarify, once and for all, that the purchase of stock through an employer-sponsored stock purchase plans ("ESPP") and the exercise of incentive stock options ("ISOs") are not subject to federal payroll withholding tax.

Many companies use ESPPs and ISOs as incentives to attract and motivate employees. The use of these programs enhances corporate performance, while also strengthening management and worker relations. Moreover, under these plans, workers are able to receive an equity stake in their efforts and thus may share in the benefits of increased business performance.

For more than 30 years, Treasury's policy was that ESPPs and ISOs were *not* subject to federal payroll tax withholding. Then on November 14, 2001, the IRS issued proposed regulations that would abrogate this standard practice and require employers to collect payroll taxes from employees. However, on June 25, 2002, the Treasury Department delayed implementation of the regulations indefinitely. According to the

Joint Committee on Taxation, this delay effectively eliminated the budget impact of legislatively clarifying that ESPPs and ISOs are not subject to federal payroll withholding tax. Thus, the cost of clarifying the law is negligible.

Should the Treasury moratorium lapse, rank-and-file workers who participate in statutory stock options programs would bear a significant tax increase. For many, the new tax would create a substantial financial burden because workers only realize paper gains when they exercise these statutory stock options. Thus, these workers would have to provide the cash to pay the new tax from other sources. Alternatively, imposition of such a tax could force many employees to sell some of the stock just to pay the tax due. Finally, the imposition of payroll taxes on these stock plans would discourage employers from offering ESPP and ISO plans. Rank-and-file employees would be the losers if that were to happen.

We look forward to working with you again this year to resolve this significant problem.

Sincerely,




