

PRESS RELEASE

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HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS COMMITTEE

Carl Levin, Chairman



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**Levin-Brown Bill Would End Corporate Stock Option Tax Break,
Reduce Deficit by \$25 Billion**

WASHINGTON –Sen. Carl Levin, D-Mich., and Sen. Sherrod Brown, D-Ohio, introduced legislation on Thursday to end a corporate tax break allowing corporations to deduct stock option expenses on their tax returns in amounts greater than the expenses shown on their books, thereby making the tax code more fair and cutting the budget deficit by \$25 billion over 10 years.

“Current stock option accounting and tax rules are out of kilter, lead to corporations reporting inconsistent stock option expenses on their tax returns versus their financial books, and often produce huge tax windfalls for corporations that pay their executives with large stock option grants,” said Levin. “This windfall produces excess corporate tax deductions totaling as much as \$60 billion in a single year, which costs the U.S. treasury billions of dollars a year in lost tax revenue. In effect, it’s a taxpayer subsidy for the pay of corporate executives. It’s a tax break we can no longer afford and ought to end.”

“As middle class families struggle, corporations are sitting on record profits. If we’re going to ask working families to make sacrifices to reduce our deficit, then we should be willing to ask corporations to forgo excessive tax breaks for stock options,” Brown said. “It’s time to end these corporate earmarks and reduce our deficit.”

The Ending Excessive Corporate Deductions for Stock Options Act, S. 1375, would end excessive corporate tax deductions for stock options by requiring such deductions not to exceed the expense shown on corporate financial reports filed with the Securities and Exchange Commission. The Joint Committee on Taxation has estimated that ending this tax break would raise \$24.6 billion in corporate tax revenues over ten years.

The bill has been endorsed by the AFL-CIO, Citizens for Tax Justice, Consumer Federation of America, OMB Watch, and Tax Justice Network- USA.

Stock options give the recipient the right to buy corporate stock at a set price for a specified period of time, typically ten years. Most U.S. corporations pay their executives in part

with stock options. According to *Forbes* magazine, in 2010, the average pay of the chief executive officers at the 500 largest U.S. corporations was \$9 million. Thirty percent of that amount, on average, came from stock options that had been cashed in for an average gain of \$2.7 million. The highest-paid CEO in 2010, according to *Forbes*, was a United Health Group CEO who received \$102 million in total pay, including \$98 million from exercising stock options.

Current accounting rules require corporations to report stock option expenses on their financial statements using the value of the options on the date they are granted. These rules, which took effect in 2005, are the result of more than 15 years of work by the Financial Accounting Standards Board to devise a method for calculating stock option expenses. But federal tax law provides that corporations deducting stock option expenses on their tax returns use the amount realized when the stock options are exercised, which often occurs years after the options were granted. These tax rules, essentially unchanged since 1969, have yet to be coordinated with the new accounting rules.

Because current accounting rules value stock options on their grant date and the tax code values stock options on their exercise date, the two numbers do not match. Stock option data over the past five years shows that the resulting corporate tax deductions, taken as a whole, far exceed the expenses shown on corporate books.

IRS data released by Sen. Levin shows that, each year from 2005 to 2009, corporations as a whole took U.S. tax deductions for stock options that were billions of dollars greater than the expenses shown on their financial statements. The total amount of excess tax deductions ranged from \$12 billion to \$61 billion a year. The IRS data also showed that a relatively small number of corporations took the majority of those excess deductions: in 2005, 2007, and 2008, about three-quarters of all excess deductions were claimed by 250 corporations, out of the millions that filed corporate tax returns each year.

At a 2007 hearing before the Permanent Subcommittee on Investigations, which Sen. Levin chairs, data from nine corporations showed that they had claimed tax deductions totaling about five times more than the expenses they would have reported to the SEC if the new accounting rules had been in effect when the options were granted. Those nine corporations reported about \$1.2 billion in total tax deductions compared to a total of \$217 million in projected stock option expenses on their books, resulting in excess tax deductions at just those nine corporations totaling about \$1 billion.

Excessive stock option tax deductions allow U.S. corporations, as a whole, to reduce their tax payments by billions of dollars each year.

“Requiring corporations to limit their stock option tax deductions to the expenses shown on their books would eliminate billions of dollars in unwarranted corporate tax deductions,” Levin said. “It makes no sense to have two sets of rules for expensing stock options, one for accounting and another for tax purposes. It also makes no sense for taxpayers to subsidize pay for corporate executives. It is time to eliminate a federal tax policy that helps fuel sky-high executive pay, forces ordinary taxpayers to subsidize corporate paychecks, and deepens the deficit.”

The bill also would subject stock option pay for top corporate executives to the existing \$1 million cap on the tax deductions that publicly traded corporations can now claim for executive pay, in order to prevent taxpayer subsidies of outsized executive compensation.

Bill Summary. The Ending Excessive Corporate Deductions for Stock Options Act would:

- require the corporate tax deduction for stock option compensation not to exceed the stock option book expense shown on a corporation's financial statement;
- allow corporations to deduct stock option compensation on their tax returns in the same year it is recorded on the corporate books, without waiting for the options to be exercised;
- ensure research tax credits use the same method for calculating stock option pay expenses when computing wages eligible for the tax credit;
- make no changes to stock option compensation rules for individuals, or for incentive stock options under Section 422 of the tax code which may be used by start-up companies and other small businesses;
- create a transition rule to ensure stock options granted before the enactment date are tax deductible; and
- make stock option deductions subject to the existing \$1 million cap on corporate tax deductions for compensation paid to top executives of publicly held corporations.