

are applicable to all taxable years beginning after December 31, 1954.

Approved February 17, 1955.

CHAPTER 28—H. F. No. 190

An act relating to taxes on and measured by net income; amending Minnesota Statutes 1953, Section 290.078.

Be it enacted by the Legislature of the State of Minnesota :

Section 1. Minnesota Statutes 1953, Section 290.078, is amended to read :

290.078 Restricted stock options. Subdivision 1. If a share of stock is transferred to an individual pursuant to his exercise after 1950 of a restricted stock option, and no disposition of such share is made by him within two years from the date of the granting of the option nor within six months after the transfer of such share to him

(1) no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share;

(2) no deduction under section 290.09 shall be allowable at any time to the employer corporation of such individual or its parent or subsidiary corporation, *or a corporation issuing or assuming a stock option in a transaction to which subdivision 7 is applicable*, with respect to the share so transferred; and

(3) no amount other than the price *paid under the option* shall be considered as received by either of such corporations for the share so transferred.

This subdivision and subdivision 2 shall not apply unless (A) the individual, at the time he exercises the restricted stock option, is an employee of the corporation granting such option or of a parent or subsidiary corporation of such corporation, *or a corporation issuing or assuming a stock option in a transaction to which subdivision 7 is applicable*, or (B) the option is exercised by him within three months after the date he ceases to be an employee of any of such corporation.

Subd. 2. If no disposition of a share of stock acquired by an individual upon his exercise after 1950 of a restricted stock option is made by him within two years from the date of

the granting of the option nor within six months after the transfer of such share to him, but, at the time the restricted stock option was granted, the option price (*computed under subdivision 4 (1) (A)*) was less than 95 percent of the fair market value at such time of such share, then, in the event of any disposition of such share by him, or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or for the taxable year closing with his death, whichever is applicable—

(1) *in the case of a share of stock acquired under an option qualifying under clause (i) of subdivision 4 (1) (A), an amount equal to the amount (if any) by which the option price is exceeded by the lesser of*

(A) *the fair market value of the share at the time of such disposition or death, or*

(B) *the fair market value of the share at the time the option was granted; or*

(2) *in the case of stock acquired under an option qualifying under clause (ii) of subdivision 4 (1) (A), an amount equal to the lesser of—*

(A) *the excess of the fair market value of the share at the time of such disposition or death over the price paid under the option, or*

(B) *the excess of the fair market value of the share at the time the option was granted over the option price (computed as if the option had been exercised at such time).*

In the case of the disposition of such share by the individual, the basis of the share in his hands at the time of such disposition shall be increased by an amount equal to the amount so includible in his gross income.

Subd. 3. *If stock is received by an individual in a distribution to which other sections of this chapter apply and such distribution was made with respect to stock transferred to him upon his exercise of the option, such stock shall be considered as having been transferred to him upon his exercise of such option. A similar rule shall be applied in the case of a series of such exchanges or acquisitions.*

Subd. 4. As used in this section

(1) The term "restricted stock option" means an option granted after February 26, 1945, to an individual, for any rea-

son connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if

(A) At the time such option is granted

(i) the option price is at least 85 percent of the fair market value at such time of the stock subject to the option; or

(ii) *in case the purchase price of the stock under the option is fixed or determinable under a formula in which the only variable is the value of the stock at any time during a period of six months which includes the time the option is exercised, the option price (computed as if the option had been exercised when granted) is at least 85 percent of the value of the stock at the time such option is granted; and*

(B) Such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him; and

(C) Such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation or of its parent or subsidiary corporation. *This subparagraph shall not apply if at the time such option is granted the option price is, at least 110 percent of the fair market value of the stock subject to the option and such option either by its terms is not exercisable after the expiration of five years from the date such option is granted or is exercised within one year after the date of enactment of this chapter.* For the purposes of this subparagraph

(i) such individual shall be considered as owning the stock owned, directly or indirectly, by or for his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(ii) stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries; and—

(D) *such option by its terms is not exercisable after the expiration of 10 years from the date such option is granted, if such option has been granted on or after June 22, 1954.*

(2) The term "parent corporation" means any corporation (other than the employer corporation) is an unbroken

chain of corporations ending with the employer corporation if, at the time of granting of the option, each of the corporations other than the employer corporation owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(3) The term "subsidiary corporation" means any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

(4) *Except as provided in paragraph (5), the term "disposition" includes a sale, exchange, gift, or any transfer of legal title, but does not include*

(A) a transfer from a decedent to his estate or a transfer by bequest or inheritance;

(B) an exchange to which other sections of this chapter apply; or

(C) a mere pledge or hypothecation.

(5) *The acquisition of a share of stock in the name of the employee and another jointly with the right of survivorship or a subsequent transfer of a share of stock into such joint ownership shall not be deemed a disposition, but a termination of such joint tenancy (except to the extent such employee acquires ownership of such stock) shall be treated as a disposition by him occurring at the time such joint tenancy is terminated.*

(6) *If the grant of an option is subject to approval by stockholders, the date of grant of the option shall be determined as if the option had not been subject to such approval.*

(7) *If a restricted stock option is exercised subsequent to the death of the employee by the estate of the decedent, or by a person who acquired the right to exercise such option by bequest or inheritance or by reason of the death of the decedent, the provisions of this section shall apply to the same extent as if the option had been exercised by the decedent, except that*

(A) *the holding period and employment requirements of subdivision 1 shall not apply, and*

(B) *any transfer by the estate of stock acquired shall be considered a disposition of such stock for purposes of subdivision 2.*

Subd. 5. (1) For the purposes of subdivision 4, if the terms of any option to purchase stock are modified, extended, or renewed, the following rules shall be applied with respect to transfers of stocks made upon an exercise of the option after the making of such modification, extension, or renewal:

(A) Such modification, extension, or renewal shall be considered as the granting of a new option;

(B) The fair market value of such stock at the time of the granting of such option shall be considered as (i) the fair market value of such stock on the date of the original granting of the option, (ii) the fair market value of such stock on the date of the making of such modification, extension, or renewal, or (iii) the fair market value of such stock at the time of the making of any intervening modification, extension, or renewal, whichever is the highest.

Subparagraph (B) shall not apply if the aggregate of the monthly average fair market values, of the stock subject to the option for the 12 consecutive calendar months before the date of the modification, extension, or renewal, divided by 12, is an amount less than 80 percent of the fair market value of such stock on the date of the original granting of the option or the date of the making of any intervening modification, extension, or renewal, whichever is the highest.

(2) *The term "modification" means any change in the terms of the option which gives the employee additional benefits under the option, but such term shall not include a change in the terms of the option—*

(A) *attributable to the issuance or assumption of an option under subdivision 7; or*

(B) *to permit the option to qualify under subdivision 4 (1) (B).*

If an option is exercisable after the expiration of 10 years from the date such option is granted, subparagraph (B) shall not apply unless the terms of the option are also changed to make it not exercisable after the expiration of such period.

Subd. 6. *If a share of stock, acquired by an individual pursuant to his exercise of a restricted stock option, is disposed of by him within two years from the date of the granting of the option or within six months after the transfer of such share to him, then any increase in the income of such individual or deduction from the income of his employer corporation for the taxable year in which such exercise occurred attributable to such disposition, shall be treated as an increase in income*

or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred.

Subd. 7. For purposes of this section, the term "issuing or assuming a stock option in a transaction to which subdivision 7 is applicable" means a substitution of a new option for the old option, or an assumption of the old option, by an employer corporation, or a parent or subsidiary of such corporation, by reason of a corporate merger, consolidation, acquisition of property or stock separation, reorganization, or liquidation, if

(1) the excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and

(2) the new option or the assumption of the old option does not give the employee additional benefits which he did not have under the old option.

For purposes of this subdivision, the parent-subsidiary relationship shall be determined at the time of any such transaction under this subdivision.

Sec. 2. Application. *The provisions of this chapter are applicable to all taxable years beginning after December 31, 1954.*

Approved February 17, 1955.

CHAPTER 29—H. F. No. 194

An act relating to taxes on and measured by net income; amending Minnesota Statutes 1953, Section 290.09.

Be it enacted by the Legislature of the State of Minnesota:

Section 1. Minnesota Statutes 1953, Section 290.09, is amended to read:

290.09 Deductions from gross income. The following deductions from gross income shall be allowed in computing net income:

(1) Ordinary and necessary expenses paid or incurred in conducting the activity or in carrying on the trade, profes-