

TAX ALERT

FINAL REGULATIONS DEFER REPORTING FOR INCENTIVE STOCK OPTIONS AND EMPLOYEE STOCK PURCHASE PLAN EXERCISES UNTIL 2010

Recently adopted final regulations under Section 6039 of the Internal Revenue Code of 1986, as amended (the “Code”), implement new reporting requirements for stock transferred after 2009 pursuant to the exercise of an incentive stock option (ISO) or stock transfers under an employee stock purchase plan (ESPP). The final regulations implement provisions under the 2006 Tax Relief and Health Care Act (TRHCA), which required employers to file an information return with IRS, in addition to providing information to the employee. Prior to the TRHCA and the adoption of the final regulations, Code Sec. 6039 required corporations to furnish a written statement to each employee, in a manner prescribed in regulations, regarding: (i) the corporation’s transfer of stock pursuant to the exercise of an ISO; and (ii) transfers of stock by the employee under an ESPP where the stock was acquired pursuant to the exercise of an option where the option price was between 85 percent and 100 percent of the fair market value of the stock. However, there was no prior IRS reporting requirement, and there was no form issued for reporting to employees. The recently adopted final regulations explain the new IRS information return requirement and postpone it for an additional year until 2010. However, employers must continue to supply the required information to employees. Corporations must furnish the statements required by Code Section 6039 on or before Jan. 31 of the year following the year in which the stock transfer occurs.

In prior notices, the IRS waived the obligation to make an information return for stock transfers governed by Code Sec. 6039, but said corporations should continue to furnish to employees the information required by, and in accordance with, the then-existing regulations, with respect to such stock transfers. Under the final regulations, information must be reported to IRS and the employee on Form 3921, *Exercise of an Incentive Stock Option Under Section 422(b)*, or a qualifying substitute form.¹ The regulations provide that the Form 3921 reporting is required for all transfers of stock by the corporation to any person pursuant to the exercise of an incentive stock option described in Code Section 422(b). Form 3922, *Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)*, or a qualifying substitute form must be filed with respect to the “first transfer” of stock by the person who exercises an option under an ESPP. Neither Form 3921 nor 3922 has been issued, but the forms are expected to be released in the near future.

¹ Reg. § 1.6039-1(a)(2), Reg. § 1.6039-2(a)(2).

The regulations provide that a transfer of legal title to a recognized broker or financial institution immediately following the exercise of an option is treated as the first transfer of legal title for purposes of the ESPP filing requirement.² However, issuance of a stock certificate directly to an employee who purchases stock pursuant to an employee stock purchase plan, or registration of the shares in the employee's name on the employer's record books where the shares are held in book-entry form, is not considered the first transfer of legal title of the stock acquired by the employee, and no IRS reporting is required.

The final regulations are effective as of January 1, 2007. However, issuers do not have to comply with the IRS return filing requirements for stock transfers that occurred during 2007, 2008 and 2009.³ For purposes of furnishing information statements for stock transfers that occur during 2009, issuers may rely on the prior version of the final regulations, the proposed regulations or the final regulations.⁴

² Reg. § 1.6039-1(b)(3).

³ Reg. § 1.6039-1(f).

⁴ Reg. § 1.6039-2(e).

CONTACT INFORMATION

If you have any questions regarding this alert, the information required to be reported under the new final regulations, or other executive compensation or employee benefits issues, please contact—

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