



New Requirements No Longer "Option"-al! February 1, 2010 Deadline and Final Regulations on Return and Information Statement Requirements for ISOs and ESPPs

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The Internal Revenue Service recently issued new final regulations addressing the return and information statement requirements applicable to exercises of incentive stock options, or ISOs, and transfers of shares purchased under an employee stock purchase plan, or ESPP. The IRS has waived the requirements under the new regulations for ISO exercises and transfers of ESPP shares that occur during 2009. However, for 2009 ISO exercises and transfers of ESPP shares, companies generally must provide a written statement that contains the information required under either existing information statement requirements or the new requirements by February 1, 2010. This Update summarizes key highlights from the existing and new final regulations and offers practical guidance.

Existing 2004 Regulations Require an Information Statement for 2009 ISO Exercises and Transfers of ESPP Shares by February 1, 2010

Under existing regulations, companies must provide each person who exercised an ISO or transferred ESPP shares in 2009 a written statement that contains certain information described below. Companies may (but are not required to) instead provide the information required under the new regulations (or, alternatively, related proposed regulations) rather than provide the information required under the existing regulations. There is no specific IRS form required for the written statement, and the statement is not required to be filed with the IRS.

ISO Exercises During 2009. By February 1, 2010, the existing regulations generally state that companies must provide each person who exercised an ISO in 2009 a written statement that includes the following information:

- Name, address and Employer Identification Number of the corporation transferring the stock upon exercise of the ISO;
- Name and address of the corporation whose stock was transferred upon exercise of the ISO (if different from the corporation named in the first bullet point);
- Name, address and Social Security Number of the person who received stock upon exercise of the ISO;
- Option grant date;
- Date of issuance of the stock to the person who exercised the ISO;
- Total fair market value (at time of exercise) of the issued stock;
- Number of shares issued on exercise of the ISO; and
- Aggregate option exercise price paid.

Transfers of ESPP Shares During 2009. Section 423(c) of the Internal Revenue Code contains special rules for options granted under an ESPP with exercise prices that are less than 100% of the fair market value of the underlying shares on the date of grant. By February 1, 2010, the existing regulations generally provide that companies that record (or have by their agent recorded) a transfer of the title of shares that were acquired upon exercise of these options must provide the person who exercised the option a written statement that includes the following information:

- Name and address of the corporation whose stock is being transferred;

- Name, address and Social Security Number of the person who transferred stock acquired under the ESPP;
- Date the stock was originally transferred to the person; and
- Number of shares the person transferred in 2009.

In general, this written statement is required only with respect to the first transfer of the ESPP shares (as determined under the existing regulations) by the person who exercised the option.

Highlights of the 2009 Regulations

In general, the new regulations require companies to file an information return with the IRS following a person's exercise of an ISO or transfer of ESPP shares. This return requirement is new and is in addition to the requirement that companies provide a written statement to the person on or before January 31 of the calendar year immediately following the year in which the exercise or transfer occurred. Both the return and the information statement generally must be on a specified form, either IRS Form 3921 or Form 3922 (as applicable), neither of which the IRS has released yet. Compliance with the new regulations is required for ISO exercises and transfers of ESPP shares that occur during 2010 and future years, although an exception to these requirements may apply in the case of certain nonresident alien individuals.

ISO Exercises During 2010 and Future Years. Each return and information statement related to an ISO exercise that occurs in 2010 or later generally must be made on IRS Form 3921 (Exercise of an Incentive Stock Option Under Section 422(b)) in accordance with the guidelines and procedures set forth in the instructions to that form. Under the new regulations, companies must generally provide the following information:

- Name, address and Employer Identification Number of the corporation transferring the stock upon exercise of the ISO;
- Name, address and Employer Identification Number of the corporation whose stock was transferred upon exercise of the ISO (if different from the corporation named in the first bullet point);
- Name, address and Social Security Number of the person who received stock upon exercise of the ISO;
- Option grant date;
- Option exercise date;
- Fair market value of a share of stock on the date the option was exercised;
- Number of shares issued upon exercise of the ISO; and
- Exercise price per share.

Transfers of ESPP Shares During 2010 and Future Years. Each return and information statement related to a transfer of shares acquired upon exercise of an option described under Section 423(c) of the Internal Revenue Code generally must be made on IRS Form 3922 (Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)) in accordance with the guidelines and procedures set forth in the instructions to that form. Under the new regulations, companies must generally provide the following information:

- Name, address and Employer Identification Number of the corporation whose stock is being transferred
- Name, address and Social Security Number of the person transferring the stock;
- Option grant date;
- Fair market value of the stock on the date the option was granted;
- Actual exercise price paid per share;
- Exercise price per share determined as if the option was exercised on the grant date (to be provided only in certain circumstances);

- Option exercise date;
- Fair market value of the stock on the date the option was exercised;
- Date the person transferred legal title of the shares; and
- Number of shares to which the person transferred legal title.

The new regulations provide that the return and information statement requirements apply only with respect to the first transfer of the ESPP shares by the person who exercised the option. The new regulations also contain rules that address when the first transfer of ESPP shares occurs and clarify that an immediate transfer of legal title to a recognized broker or financial institution maintaining a brokerage account established for an individual ESPP participant generally can be treated as the first transfer of the ESPP shares for purposes of the foregoing rules.

Practical Tips

- **Don't Forget the Upcoming February 1, 2010 Deadline!** Companies should take steps to ensure that by February 1, 2010 they provide each person who exercised an ISO or transferred ESPP shares in 2009 a written statement that contains the required information.
- **Review Existing Policies, Procedures and Resources.** Companies should take steps to determine whether any changes need to be made to their existing policies, procedures and resources to address the new return and information statement requirements that are applicable in 2010 and future years. Companies that use an outsourcing company to assist with their plan administration should confirm the services that the outsourcing company provides to address the requirements under the new regulations and whether their current engagement includes preparation of IRS Forms 3921 and 3922.

Additional Information

This Update is only intended to provide a general summary of the return and information statement requirements under Section 6039 of the Internal Revenue Code and the 2004 and 2009 final regulations issued thereunder.

You can read the full text of the 2009 final regulations at http://www.irs.gov/irb/2009-49_IRB/ar10.html. Minor corrections to the 2009 final regulations and the related preamble were issued on December 22, 2009. You can read the corrections at <http://edocket.access.gpo.gov/2009/E9-30348.htm> and <http://edocket.access.gpo.gov/2009/E9-30349.htm>. You can read the full text of the existing 2004 regulations at http://www.irs.gov/irb/2004-36_IRB/ar06.html#d0e3278. You can find discussions of other recent cases, laws, regulations and rule proposals of interest on our Web site.

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