IRS Issues Proposed Regulations under Section 6039 of the Internal Revenue Code

On July 17, 2008, the Internal Revenue Service (IRS) issued proposed regulations under Section 6039 of the Internal Revenue Code (the Code), which provide guidance on a corporation’s obligations to file returns with the IRS and deliver information statements to employees and former employees following the transfer of shares of stock pursuant to the exercise of an incentive stock option (ISO), or the transfer by the employee or former employee of shares of stock that were purchased under an employee stock purchase plan (ESPP).

What are the requirements of Section 6039?

Historically, Section 6039 required a corporation to provide a written information statement to each employee or former employee regarding: (i) the transfer of stock to the employee or former employee pursuant to the exercise of an ISO, and (ii) the transfer by the employee or former employee of stock purchased by the employee or former employee under an ESPP. Section 6039 applies to stock purchased under an ESPP if the option to purchase the stock was subject to Section 423(c) of the Code. Section 423(c) of the Code imposes special rules for certain options granted under an ESPP with exercise prices at grant between 85 percent and 100 percent of the fair market value of the stock subject to the option. Such information statements were required to be provided no later than the January 31 following the calendar year in which the transfer occurred.

Section 403 of the Tax Relief and Health Care Act of 2006 amended Section 6039, effective for transfers occurring on and after January 1, 2007, to require that the corporation file a return with the IRS in addition to delivering the information statement to the employee or former employee. The proposed regulations address the time and manner for delivering, and the information that must be included in, these returns and information statements.

What must be included in the returns and information statements?

The preamble to the proposed regulations indicates that the goal of the regulations is to require corporations to provide employees and former employees with sufficient information to enable them to calculate their tax obligations upon the sale or disposition of shares of stock acquired pursuant to the exercise of an ISO or a purchase under an ESPP. The IRS expects to issue two forms during 2008 to be used to satisfy the return and information statement requirements. Form 3921 will be used for the transfer of shares of stock acquired upon exercise of an ISO. Form 3922 will be used for the transfer of shares of stock purchased under an ESPP. The applicable Form will be used for both the return and information statement. The returns must be filed with the IRS and the information statements must be provided to the employees and former employees no later than the January 31 following the calendar year in which the transfer occurs. The instructions to the Forms will include rules regarding the delivery of the information statements to employees and former employees electronically or by mail.

Returns and Information Statements Related to ISOs

Under the proposed regulations, the information required to be reported to the IRS in the return with respect to the transfer of shares of stock pursuant to the exercise of an ISO is generally the same information that must be included in the information statement delivered to the employee pursuant to
existing regulations. The information will include: (i) the name, address and employer identification number of the corporation transferring the shares (and the corporation whose shares are being transferred, if different), (ii) the name, address and identifying number of the person to whom the shares are transferred, and (iii) with respect to the ISO, the grant date, the exercise price per share (note that the existing regulations only require the aggregate exercise price rather than the price per share), the date of exercise, the fair market value of a share on the date of exercise and the number of shares transferred upon exercise of the ISO.

Returns and Information Statements Related to ESPPs

The proposed regulations expand the information that must be included in the return filed with the IRS and in the information statement delivered to an employee or former employee with respect to the employee’s or former employee’s transfer of shares of stock purchased under an ESPP. The information will now include: (i) the name, address and identifying number of the employee or former employee transferring the shares of stock, (ii) the name, address and employer identification number of the corporation whose stock is being transferred, and (iii) with respect to the shares of stock transferred, the date the option to purchase the shares of stock under the ESPP was granted to the employee or former employee, the fair market value of the shares of stock on the date the option was granted, the exercise price per share of the option, the date the option was exercised by the employee under the ESPP, the fair market value of the shares of stock on the date of exercise, the date the legal title to the shares of stock was transferred by the employee or former employee, and the number of shares of stock to which legal title was transferred by the employee or former employee. Note that these return and information statement requirements apply only if the option to purchase the shares of stock was subject to Section 423(c) of the Code. Also, these requirements apply only to a share of stock with respect to the first transfer of such share. The corporation is required to identify shares of stock purchased pursuant to an option subject to Section 423(c) of the Code in a manner sufficient to enable the accurate reporting of the transfer of record title of such shares.

When would the requirements under the regulations be effective?

The final regulations under Section 6039 are expected to be effective for stock transfers occurring on or after January 1, 2007. Corporations will not be required to file returns with the IRS for stock transfers occurring during the 2007 or 2008 calendar years. However, corporations must comply with the requirements to deliver information statements to employees and former employees for stock transfers that occur during 2007 and 2008, and corporations may rely on either the existing regulations or the proposed regulations for such years with respect to the delivery of these information statements.

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