

News from our Compensation & Benefits Group

## Special Reporting Requirements Regarding Incentive Stock Options and Employee Stock Purchase Plans

*This Alert will serve as a reminder of certain year-end reporting requirements imposed with respect to incentive stock options and employee stock purchase plans and as a notification of changes in future reporting requirements.*

### Background

Section 6039(a) of the Internal Revenue Code of 1986, as amended (the "Code") imposes reporting requirements on corporations with respect to the exercise of incentive stock options and the transfer of stock acquired under employee stock purchase plans. Section 6039(a) currently requires a corporation to furnish an information statement to each employee exercising such options or transferring such stock. The Tax Relief and Health Care Act of 2006 changed this by adding a requirement that an employer additionally file an information return with the Internal Revenue Service (the "IRS"), however the IRS waived this requirement for exercises and transfers in 2007 and 2008.

In 2008, the IRS issued proposed regulations under Section 6039(a) of the Code. The proposed regulations require enhanced disclosure in information statements to employees and require corporations to file an information return with the IRS beginning with transactions made in 2009.<sup>1</sup> The new rules aim to provide employees with more accurate information to enable them to calculate their tax obligations upon disposition of shares acquired by the exercise of a statutory option and transfer of shares.

Because the proposed regulations need not be followed until next year, we recommend companies continue to follow the current regulations for their reporting requirements due on or before January 31, 2009. However, this alert explains the changes under the proposed regulations to inform companies of their future reporting requirements for exercises and transfers made in 2009, which must be completed by January 31, 2010.

### Information statement reporting requirement

Under Section 6039(a) of the Code, every corporation that in 2008 issued stock upon the exercise of an incentive stock option (meaning a stock option described in Section 422 of the Code) must furnish to the employee exercising the option, on or before January 31, 2009, a written statement containing certain specified information.

Similarly, every corporation that in 2008 records (or has recorded by its transfer agent) the initial transfer by the employee or former employee of stock acquired by such employee under an employee stock purchase plan (meaning a plan that is established under Section 423 of the Code) must furnish to the employee transferring the stock, on or before January 31, 2009, a written statement containing certain specified information.

These information statements must be delivered in person or mailed to the recipient's last known address but are not filed with the IRS. Currently, these information

statements may be delivered electronically if the recipient consents to such a means of delivery. In order to satisfy the requirement relating to employee stock purchase plans, the Code also requires that a corporation issuing stock under an employee stock purchase plan identify the stock in a manner sufficient to enable it to carry out its reporting obligation (e.g., by use of special serial numbers or codes, which in practice are typically determined by the transfer agent).

In general, a penalty of \$50 is imposed for each statement not timely furnished or containing incomplete or incorrect information,

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up to a maximum of \$100,000 per calendar year.

The information required to be contained in each information statement is specified in the IRS regulations. For purposes of information statements filed on or before January 31, 2009, corporations have the option of following the requirements of the current regulations or the proposed regulations. We suggest corporations continue to follow the current regulations by using the forms provided below, because the proposed regulations involve enhanced disclosure.<sup>2</sup> For information statements filed on or before January 31, 2010, we will provide new forms compliant with the proposed regulations.

Most stock administration software can generate these information statements. However, as we have provided in prior years for your convenience, the following forms, when completed and delivered on or before January 31, 2009, will satisfy the foregoing information statement reporting obligation:

**ISO information statement (MS Word):**

[www.cooley.com/files/tbl\\_s5SiteRepository/FileUpload21/1554/Notice\\_ISO\\_Exercises2009.doc](http://www.cooley.com/files/tbl_s5SiteRepository/FileUpload21/1554/Notice_ISO_Exercises2009.doc)

**ESPP information statement (MS Word):**

[www.cooley.com/files/tbl\\_s5SiteRepository/FileUpload21/1552/Notice\\_ESPP\\_Shares2009.doc](http://www.cooley.com/files/tbl_s5SiteRepository/FileUpload21/1552/Notice_ESPP_Shares2009.doc)

**IRS information return reporting requirement**

Beginning with exercises and transfers in 2009, the proposed regulations under Section 6039(a) of the Code require a corporation to file an information return with the IRS in addition to providing an information statement to the employee. Thus, the first information returns must be filed on or before January 31, 2010.

Information returns with respect to incentive stock options require the corporation to report generally the same information

required to be furnished to employees under the existing regulations for information statements, with the main exception that the corporation must report the exercise price per share instead of the total cost of all shares acquired. Information returns must be made on Form 3921, which the IRS expects to release this year.

Information returns with respect to stock purchased under an employee stock purchase plan require the corporation to report additional information than previously required in the information statement, such as the option grant date (*i.e.* the offering date), the fair market value of the stock on the option grant date, the exercise price (or purchase price) per share, the date the option was exercised by the transferor, and the fair market value of the stock on the date the option was exercised by the transferor (or the purchase date). Such returns must be made on Form 3922, which the IRS expects to release this year.

These reporting obligations are in addition to any reporting obligations that arise upon the disqualifying disposition of stock acquired under either an incentive stock option or an employee stock purchase plan. In particular, the IRS generally requires that the income of an employee from a disqualifying disposition be reported as “other compensation” on Form W-2 in order for the corporation to take a federal income tax deduction for the amount of income recognized by the employee upon a disqualifying disposition as well as to satisfy the corporation’s reporting obligations.

As an aside, amounts includible in income as a result of the exercise of a nonstatutory stock option (meaning a stock option that is not an incentive stock option for purposes of Section 422 of the Code) should be reported on a Form W-2 in the case of employees or Form 1099 in the case of non-employees, along with appropriate withholding. For Forms W-2 issued for the

2008 tax year, it is mandatory to report this income in Box 12 using code “V.”

If you have any questions about this *Alert*, please contact one of the attorneys listed above. ■

**Notes**

<sup>1</sup> A detailed explanation of the proposed regulations can be found in the IRS notice of proposed rulemaking, available at [docs.cpamerica.org/wtu/reg-103146-08.pdf](http://docs.cpamerica.org/wtu/reg-103146-08.pdf).

<sup>2</sup> For statements relating to the exercise of an incentive stock option, the proposed regulations require disclosure of the exercise price per share instead of the total cost of all shares. For transfers of stock acquired under an employee stock purchase plan, the proposed regulations require five additional items of disclosure: the option grant date, the fair market value of the stock on the option grant date, the exercise price per share, the date the option was exercised by the transferor, and the fair market value of the stock on the date the option was exercised by the transferor.