

Executive Compensation Alert: IRS Tax Notice – Final Regulations Under Section 6039

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On November 16, 2009, the IRS issued final regulations relating to the return and information statement requirements under Section 6039 of the Internal Revenue Code of 1986, as amended (the “Code”). Section 6039 and the new final regulations require that employers provide certain information to their employees (or former employees) who in 2009 either exercised “incentive stock options” (“ISOs”) or transferred shares purchased under an “employee stock purchase plan” (an “ESPP”) and file such information with the IRS. The IRS will issue two forms (with instructions) that corporations must use to satisfy the return and information statement requirements under Section 6039. These requirements are discussed below.

ISOs - Corporations that in the last calendar year issued stock upon the exercise of an ISO, must furnish, by January 31, 2010, to the person exercising the ISO a written statement that includes:

- (i) The name, address, and employer identification number of the corporation transferring the stock;
- (ii) If other than the corporation identified in (i) above, the name, address and employer identification number of the corporation whose stock is being transferred;
- (iii) The name, address, and social security number of the person (for privacy reasons, the social security number may be limited to the last four digits) to whom the share or shares of stock were transferred pursuant to the exercise of the ISO;
- (iv) The date the ISO was granted to the person;
- (v) The exercise price per share;
- (vi) The date in 2009 the ISO was exercised by the person;
- (vii) The fair market value of a share of stock on the date the ISO was exercised; and
- (viii) The number of shares of stock transferred pursuant to exercise of the ISO.

Each return filed by a corporation, shall be filed on Form 3921 – Exercise of an ISO (a form to be provided by the IRS in the future). The IRS has waived the requirement that corporations provide Form 3921 with the information described above for ISO exercises, that occurred in 2009. However, corporations will be required to provide the IRS with completed Forms 3921 for ISO exercises that occur in calendar year 2010, no later than January 31, 2011.

ESPPs - Corporations that in the last calendar year recorded (or had recorded by their transfer agent) a transfer of the legal title of stock purchased pursuant to an ESPP, if the purchase price of the stock was (a) less than 100% of the fair market value on the date of grant or (b) not fixed or determinable on the date of grant, must furnish, by January 31, 2010, to the employee a written statement that includes:

- (i) The name, address, and social security number of the transferor;
- (ii) The name, address and employer identification number of the corporation whose stock is being transferred;
- (iii) The date of grant of the purchase right (typically the offering date for the offering period of the ESPP) under which the shares were issued to the transferor;
- (iv) The fair market value of the stock on the date of grant;
- (v) The price per share at which the shares were purchased under the ESPP;
- (vi) The price per share determined as if the shares were purchased on the date of grant (to be provided only if the purchase price per share is not fixed or determinable on the date of grant);
- (vii) The date the shares were purchased by the transferor;
- (viii) The fair market value of the stock on the date of purchase by the transferor;
- (ix) The date the legal title of the shares was transferred by the transferor; and
- (x) The number of shares to which legal title was transferred by the transferor.

The final regulations clarify that if stock purchased by an employee pursuant to an ESPP is issued directly to an employee or is registered in the employee’s name on the corporation’s record books in book-entry form, then no information statement or IRS return is required. However, if the stock purchased by an employee pursuant to an ESPP is issued directly to a brokerage account on behalf of the employee (including, but not limited to, registration of the shares in “street name”), or subsequently transferred to a brokerage account or sold, then the information statement and IRS return will be required if the purchase price of the stock was (a) less than 100% of the fair market value on the date of grant or (b) not fixed or determinable on the date of grant.

Each return to be filed by a corporation, shall be filed on Form 3922 – Transfer of Stock Acquired Through an ESPP (a form to be provided by the IRS in the future). The IRS has waived the requirement that corporations provide Form 3922 with the information described above for stock transfers which occurred in 2009. However, corporations will be required to provide the IRS with completed Forms 3922 for stock transfers that occur in calendar year 2010, no later than January 31, 2011.

All Dispositions – The information statement and return requirements under Section 6039 are not dependent on whether the exercise or stock transfer constitutes a qualifying or disqualifying disposition.

Non-Resident Aliens – A corporation is not required to file a return with respect to, or provide an information statement to, an employee who is a non-resident alien and to whom the corporation is not required to provide a Form W-2 for any calendar year beginning with the first day of the calendar year that the ISO or purchase right (typically the offering date for the offering period of the ESPP) was granted and the last day of the calendar year that the ISO was exercised or stock transfer occurred.

Non-Compliance - A penalty of \$50 is imposed for each statement not timely furnished or containing incomplete or incorrect information (an intentional failure to report is subject to a greater penalty).

Important Note for Private Corporations - *The IRS reporting requirements described above do not relieve a corporation from (I) its obligations to discuss with its employees the fair market value of common stock throughout the year to assist with estimated tax determinations upon the exercise of an ISO, or (II) the necessity to value common stock delivered upon exercise of non-qualified stock options for withholding tax purposes. This will require the corporation to value its common stock more frequently than annually and possibly at times other than when the corporation has a recent 409A valuation.*

We encourage corporations to discuss with any attorney in the Fenwick & West Executive Compensation and Employee Benefits Group in deciding on the best course of action in these situations.

For more information on this, or related matters, you may wish to contact any attorney in the Executive Compensation and Employee Benefits Group:

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