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February 1, 2010 Deadline Approaching for Furnishing Employees with Information Statements Regarding ISOs and ESPPs – New Reporting Requirements to Begin in 2010

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Section 6039 of the Internal Revenue Code of 1986, as amended (the "Code") requires corporations to furnish their employees (including former employees) with information statements by February 1, 2010[1] with regard to (i) the exercise of an incentive stock option ("ISO") described in Code Section 422(b) and (ii) the transfer of shares granted under certain employee stock purchase plans meeting the requirements of Code Section 423 ("ESPP") during calendar year 2009. The Internal Revenue Service (the "IRS") recently issued final regulations under Code Section 6039 addressing the employer return and employee information statement requirements for transfers of stock pursuant to the exercise of ISOs and ESPPs and clarifying certain reporting requirements.

The final regulations are effective on November 17, 2009, apply as of January 1, 2007 and provide that the return and information statements must be completed using Form 3921, Exercise of an Incentive Stock Option under Section 422(b), or Form 3922, Transfer of Stock Acquired Through an Employee Stock Plan under Section 423(c). The IRS indicated that it expects to release Form 3921 and Form 3922 soon. In addition, the IRS has waived the employer return requirements for 2007, 2008 and 2009 and for purposes of furnishing information statements for transfers that occur in 2009 taxpayers may rely on the 2004 final regulations, the 2008 proposed regulations (a more detailed explanation of the proposed regulations may be found in our January 2009 Client Alert, which is available here) or the final regulations.

EMPLOYEE INFORMATION REQUIREMENTS UNDER FINAL REGULATIONS

ISO Requirements

A corporation that transfers stock pursuant to an employee's exercise of an ISO is required to furnish to such employee, by January 31 of the following year, a written statement that includes:

(i) The name, address, and employer identification number of the corporation transferring the stock;
(ii) The name and address of the corporation whose stock is the subject of the option (if other than the corporation transferring the stock);
(iii) The name, address, and social security number of the person to whom the shares were transferred pursuant to the exercise of the ISO;
(iv) The date the ISO was granted;
(v) The exercise price per share;
(vi) The date the ISO was exercised;
(vii) The fair market value of the stock at the time the ISO was exercised; and
(viii) The number of shares transferred pursuant to the exercise of the ISO.

ESPP Requirements

A corporation that records (or has its transfer agent record) a transfer of stock to an employee pursuant to an ESPP where, on the date of grant, the exercise price is (i) less than 100 percent of the value of the stock or (ii) is not fixed or determinable, is required to furnish to such employee, by January 31 of the following year, a written statement that includes:

(i) The name, address, and identifying number of the transferor (that is, the employee who transferred the stock);
(ii) The name, address and employer identification number of the corporation whose stock is being transferred;
(iii) The date the option was granted to the transferor;
(iv) The fair market value of the stock on the date of grant;
(v) The actual exercise price per share;
(vi) The exercise price per share determined as if the shares were purchased on the date of grant (required only if the purchase price per share is not fixed or determinable on the date of grant);
(vii) The date the option was exercised by the transferor;
(viii) The fair market value of the stock on the date on the exercise date;
(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 information statements to be furnished to employees under the final regulations relating to the transfer of ISO and ESPP shares must be furnished on either Form 3921 or Form 3922.

EMPLOYER RETURN REQUIREMENTS UNDER FINAL REGULATIONS

The IRS requires corporations to provide the IRS with the information described above by filing Form 3921 or Form 3922 for transfers that occur in calendar year 2010, no later than January 31, 2011.

CLARIFICATIONS

The final regulations clarify the following reporting requirements with regard to ESPPs:

- The return and information statement requirements apply only to the first “transfer” and are not required in the event that the stock certificate is issued directly to an employee who purchased the stock pursuant to an ESPP or where the corporation registers the stock in the employee’s name on the corporation’s record

books and the employer or its transfer agent holds the shares in book entry form. In this situation, the corporation will be required to file a return and information statement when the employee subsequently sells the stock or transfers the stock to a brokerage account.

- The return and information statement are required in the event that legal title to the stock purchased by an employee pursuant to an ESPP is transferred to a broker or financial institution when deposited directly into a brokerage account on behalf of the employee.

The final regulations clarify the following reporting requirements with regard to both ISOs and ESPPs:

- All Dispositions: The return and information statement requirements are not dependent on whether such transfer is a qualifying or disqualifying disposition.

- Non-Resident Aliens: A corporation is not required to file a return and information statement if the employee is a non-resident alien and where 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 was granted and the last day of the calendar year that the ISO was exercised or stock transfer occurred.

PENALTIES FOR FAILURE TO TIMELY FILE

A corporation (including private and public corporations) may be subject to penalties if it fails to furnish the information statement in a timely manner, fails to include all the required information, or includes incorrect information in the filing. The penalty is $50 for each statement the corporation fails to furnish or furnish correctly, up to a maximum of $100,000 for the calendar year. No more than one penalty is imposed for a single statement even if there is more than one failure relating to the statement. Where the failure to furnish accurate statements was due to an intentional disregard of the requirement, higher penalties may be imposed.

OTHER REPORTING OBLIGATIONS

The new reporting rules do not replace the existing rules requiring a corporation to report and withhold on any taxable income recognized by an employee on the exercise of an option. The final regulations only provide for enhanced reporting requirements with respect to return and information statements.

[1] Information statements must be furnished by February 1 instead of January 31 because January 31 falls on a Sunday in 2010.

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