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## New IRS Reporting Required in Early 2011 for 2010 Exercises of Incentive Stock Options and Transfers of Stock Purchased Under ESPP

by Howard L. Clemons and Grace Chen

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*Corporations that award incentive stock options to employees or sponsor an employee stock purchase plan are now required to use the Internal Revenue Service's newly issued Forms 3921 and 3922 in order to comply with the participant information statement and IRS information return requirements of Section 6039 of the Internal Revenue Code.*

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### Background

Section 6039 of the Internal Revenue Code of 1986, as amended (the "Code") requires issuers of incentive stock options ("ISOs") under Section 422 of the Code and sponsors of employee stock purchase plans ("ESPPs") under Section 423 of the Code to comply with both a written participant information statement requirement and an IRS information return requirements ([see also our December 9, 2009 Advisory Final Regulations Issued for Employee Stock Purchase Plans](#)). On November 16, 2009, the IRS released final regulations on these information statement and information return requirements. The final regulations require that public and private corporations provide information statements and file returns with the IRS after the corporation:

- issues shares to an optionee who exercises ISOs; or
- initially transfers legal title of shares of stock acquired under its ESPP if the purchase price of the shares was either (1) less than the fair market value of the stock on the date of grant or (2) the purchase price was not fixed or determinable on the date of grant.

Section 6039 has for many years required that corporations provide a written information statement to participants on or before January 31 of the year following the year in which the applicable ISO or ESPP transaction occurred. In 2006, the law was amended to also require that an information return be filed with the IRS. However, until the issuance of the new final regulations and forms, corporations were required to provide the information statement to participants but were exempt from having to make information return

filings with the IRS. Beginning for transactions that occur during 2010, corporations must now comply with both the participant information statement requirement and the IRS information return requirements. The new Form 3921 for ISOs and Form 3922 for ESPPs are now used to comply with both of these requirements.

### Information Needed and Filing Requirements

Reporting on the Form 3921 is triggered by the exercise of an ISO. Form 3921 requires that the company provide information related to an employee's ISO exercise.

Unlike reporting for an ISO, which in all cases is triggered by the exercise of the option, reporting on Form 3922 for an ESPP transaction is triggered upon the initial transfer of the legal title of the shares subsequent to purchase under the ESPP if the purchase price of the shares was (1) less than the fair market value of the stock on the date of grant or (2) the purchase price is not fixed or determinable on the date of grant. Form 3922 requires that the company provide information related to an employee's share purchase under the ESPP. Many public companies arrange for shares to be purchased under the company's ESPP to be transferred directly to a brokerage account for ESPP participants. Such transfer of legal title to a broker will trigger the Section 6039 reporting obligations. However, if the company issues stock certificates or the company's shares are registered in the participant's name, then an information statement will not be required under Section 6039 until a subsequent legal transfer of title.

In addition, Form 3921 and 3922 provide for the creation of an account number for an employee. The instructions to the forms refer to the General Instructions for Certain Information Returns which describe the instances in which an account number will be required. For example, an account number will be required if the company will be filing more than one information return of the same type for an employee (e.g., if the employee exercised his ISOs more than once in 2010). Generally, the account number may be a bank account number, serial number or any other unique number that the company may assign the employee.

### Filing

Only one transaction may be reported on each Form 3921 and 3922. Thus, if an employee exercises ISO's twice during a year or the ISO exercise is for options with different exercise prices the company must file two Form 3921s with the IRS for the employee and provide the employee with two information statements. Companies which file less than 250 of either Form 3921 or 3922 may make a paper filing with the IRS, but companies which file 250 or more of either Form 3921 or 3922 must electronically file.

### Action Required

Companies should review the final Form 3921 and 3922 and be aware of the applicable due dates. 2010 information returns must be filed with the IRS by February 28 for paper filings and March 31 for all electronic filings. Participant information statements for 2010 transactions must be sent to participants by January 31, 2011.

If you have any questions about the content of this publication, please contact the Pillsbury attorney with whom you regularly work or the Executive Compensation & Benefits group.

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