

Cooley

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This Alert serves 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 reporting requirements for incentive stock option exercises and transfers of stock acquired under employee stock purchase plans occurring on or after January 1, 2010.

Summary

For incentive stock option exercises and transfers of stock acquired under employee stock purchase plans occurring on or after January 1, 2010, corporations are required to provide an information statement to employees and file an information return with the IRS. The information statement and information return must be on Form 3921¹ (for incentive stock option exercises) or Form 3922² (for transfers of stock acquired under an employee stock purchase plan), although the corporation may provide the employee with an information statement on a "substitute form" that satisfies certain format and content requirements.

Background

Section 6039 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.

In November 2009, the Internal Revenue Service ("IRS") issued final regulations under Section 6039 of the Code, which must be followed for incentive stock option exercises and transfers of stock acquired under employee stock purchase plans occurring on or after January 1, 2010. The final regulations, which expand on proposed regulations previously issued in 2008, require enhanced disclosure in the employee information statements that corporations are required to furnish to employees. In addition, *beginning with options exercised or stock transferred during 2010, the final regulations require corporations to file an information return with the IRS.*³

For incentive stock option exercises and transfers of stock acquired under employee stock purchase plans in 2010, employee information statements must be furnished no later than January 31, 2011, and information returns must be filed with the IRS no later than February 28, 2011 (or March 31, 2011, if filing electronically).

Employee information statement—Incentive Stock Options (ISOs)

Every corporation that in 2010 *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 who exercised the option, on or before January 31, 2011, a written statement containing the following information:

1. The name, address and employer identification number (the "EIN") of the corporation issuing stock upon the exercise of the option;
2. The name, address and EIN of the corporation whose stock was issued upon the exercise of the option, if different from the corporation identified in (1);
3. The name, address and identifying number of the person to whom the stock was issued upon exercise of

the option;

4. The date the option was granted;
5. The date the option was exercised;
6. The exercise price per share;
7. The per share fair market value of the stock at the time of exercise; and
8. The number of shares of stock issued upon exercise of the option.

Employee information statement—Employee Stock Purchase Plans (ESPPs)

Similarly, every corporation that in 2010 records (or has recorded by its transfer agent) *the first transfer by an 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, if the purchase price is either less than one hundred percent of the value of the stock on the grant date or is not fixed or determinable on the grant date)⁴ must furnish to the employee transferring the stock, on or before January 31, 2011, a written statement containing the following information:

1. The name, address and EIN of the corporation whose stock was transferred;
2. The name, address and identifying number of the person who transferred stock originally acquired under the employee stock purchase plan (the "transferor");
3. The date the stock was purchased by the transferor;
4. The number of shares to which title was transferred by the transferor during the applicable year;
5. The date the purchase right was granted to the transferor (typically the offering date);
6. The fair market value of the stock on the date of grant of the purchase right;
7. The actual exercise price (or purchase price) per share at which the shares were purchased;
8. If the purchase price per share was not fixed or determinable on the date of grant, the exercise price (or purchase price) per share, determined as if the shares were purchased on the date of grant;⁵
9. The fair market value of the stock on the date the purchase right was exercised by the transferor (or the purchase date); and
10. The date the legal title of shares was transferred by the transferor.

The final regulations clarify that the "first transfer" that will trigger the reporting requirements for the transfer of shares acquired under an employee stock purchase plan includes a transfer of shares immediately deposited with a brokerage account established on behalf of the employee. If, however, the shares are issued directly to an employee or registered in the employee's name on the corporation's record books, the corporation does not have a reporting requirement under Section 6039 of the Code until the employee subsequently sells the shares or transfers them to a brokerage account.

Employee information statement—both ISOs and ESPPs

In addition, the final regulations provide that corporations do not have reporting requirements under Section 6039 of the Code with respect to employees who are non-resident aliens (defined under Section 7701(b) of the Code) and to whom the corporation is not required to provide a Form W-2 for any calendar year within the time period beginning with the first day of the calendar year in which the option (or purchase right) was granted and ending on the last day of the calendar year in which the option (or purchase right) is exercised or shares are transferred.

Employee information statements must be delivered in person or mailed to the recipient's last known address but are not filed with the IRS. Employee information statements may also be delivered electronically if the recipient properly consents to such a means of delivery.⁶ 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 colors, which in practice are typically determined by the transfer agent).

Form of employee information statement

Historically, we have advised that most stock administration software can generate these employee information statements. However, with the new information returns required, the employee information statement must either be (i) contained on the appropriate form (i.e., Form 3921 or Form 3922, as applicable), or (ii) contained on a "substitute form" that meets the format and content requirements contained in Publication 1179.⁷

In prior years for your convenience, we provided a form of employee information statement required by the rules then in effect. For exercises and stock transfers made in 2010 and thereafter, you should use Form 3921 or Form 3922, as applicable, as provided by the IRS. Alternatively, we will be happy to refer you to a stock administration service provider or software vendor who can help with creating substitute forms that comply with the rules (and that would allow you to report more than one transaction on an aggregate basis on one employee information statement).

IRS information return

Beginning with exercises and transfers in 2010, the final regulations under Section 6039 of the Code require a corporation to file an information return with the IRS in addition to providing information statements to employees. *The first information returns must be filed no later than February 28, 2011 (or March 31, 2011 if filing electronically).*⁸

The information returns must contain the same information required by the final regulations with respect to employee information statements, as described above. Information returns with respect to incentive stock options must be made on Form 3921, and information returns with respect to stock purchased under an employee stock purchase plan must be made on Form 3922.

These reporting obligations are in addition to any reporting obligations that arise upon the 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 disposition be reported as "other compensation" on Form W-2.

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 2010 tax year, it is mandatory to report this income in Box 12 using code "V."

As noted above, a company is exempt from the information return requirements with respect to any non-resident aliens for whom the company was not required to issue a Form W-2 for any year beginning with the date of grant and ending on the date of purchase or exercise.

Preparing for Form 3921 and 3922 filing

Unfortunately, filing information returns with the IRS can be a complicated and time-consuming process. Companies will need to

extract information from their equity compensation databases and upload it into software designed specifically to handle form creation and/or electronic filings. Fortunately, there are a number of vendors who provide products or services that may assist companies in filing information returns generally.⁹ Several vendors will offer the following:

- Electronic filing capabilities (with the IRS);
- Ability to print official forms to be submitted to the IRS and distributed to participants
- Print and mail services (to participants)
- Ability to assist with requesting a Transmitter Control Code from the IRS

Companies that are required to file 250 or more forms must do so electronically (through the IRS's Filing Electronic Returns Electronically (FIRE) process).¹⁰ The "250 or more" requirement applies to each form (i.e., Form 3921 and 3922) individually, not the sum of both together. Before submitting through the FIRE process, a company must first obtain a Transmitter Control Code from the IRS (if the company does not already have one) by submitting Form 4419 to the IRS.¹¹ A company should allow at least 30 days for this process.

Penalties

There are penalties for late/incomplete information statements and information returns. In general, a *penalty* is imposed for each information statement not timely furnished or containing incomplete or incorrect information and for each information return not timely filed or containing incomplete or incorrect information. For exercises and transfers made in 2010, the due date for employee information statements is January 31, 2011 and the due date for IRS information returns is February 28, 2011 (if not filed electronically) or March 31, 2011 (if filed electronically).

- If the information statement or information return is late by 30 days or less, then the penalty is \$30 per statement or return, up to a maximum of \$250,000 per form¹²;
- If the statement or information return is late by more than 30 days, but provided (or filed) by August 1 of the year due, then the penalty is \$60 per statement or return up to a maximum penalty of \$500,000 per form; and
- If the statement is provided (or filed) after August 1 of the year due, then the penalty is \$100 per statement or return up to a maximum penalty of \$1,500,000 per form.

What to do now

There are a number of steps that companies should take now in light of the new information return filing requirements:

- Establish a project plan for both the participant communication and the IRS filing;
- Research and engage external vendor(s), if necessary;
- Establish an internal and participant communication plan;
- Create any additional participant communication documents;¹³ and
- Obtain a Transmitter Control Code from the IRS by submitting Form 4419.

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

Notes

1 A copy of Form 3921 may be found on the [IRS website](#)

2 A copy of the Form 3922 may be found on the [IRS website](#)

3 A summary of the changes to the current and proposed regulations and the complete text of the final regulations is available [here](#).

4 For example, the purchase price is not "fixed or determinable" on the date of grant if the exercise price is equal to the lesser of 85 percent of the fair market value of the stock on the date of grant or 85 percent of the fair market value of the stock on the date of exercise. In addition, the exercise price will not be known on the date of grant if the exercise price is calculated based on a certain percentage (not less than 85 percent) of the fair market of the stock on the purchase date.

5 To determine the tax liability resulting from a qualifying disposition (which is calculated based on the grant date discount), the employee needs to know the exercise price determined as if the stock was purchased on the date of grant.

6 Consent to electronic delivery must be obtained by following the requirements under Treasury Regulations §31.6051(j)(2)(i), which requires, among other things, that an individual affirmatively consents in a manner that demonstrates that the individual can access the same electronic format in which the Section 6039 notices will ultimately be furnished.

7 www.irs.gov/pub/irs-pdf/i1099gi.pdf

8 It is possible to file Form 8809 to get automatic 30-day extension of the due date for filing information returns. A copy of the Form 8809 may be found on the [IRS website](#)

9 See, for example, [here](#) and [here](#) (Note: These publications are to provide filers with information only and in no way implies an endorsement of these products or services by the Internal Revenue Service (or by Cooley LLP).

10 See [Publication 1220](#)

11 Form 4419 may be found [here](#)

12 The penalty provisions are applied separately to Form 3921 and Form 3922.

13 For a sample, please download a MS Word version [here](#)

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