

## INTERNAL REVENUE SERVICE

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October 13, 2000.

Taxpayer =

date a =

date b =

This is in reply to your letter requesting certain rulings with respect to Taxpayer's Employee Stock Purchase Plan (the "Plan") under section 423(b) of the Internal Revenue Code.

The Plan was adopted by Taxpayer's board of directors on date a and approved by its shareholders on date b. It is administered by a committee of the board of directors. The purpose of the Plan is to provide eligible employees of Taxpayer and its designated subsidiaries with an opportunity to purchase common stock of Taxpayer through accumulated payroll deductions.

Under the Plan, no employee can be granted an option if such employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of Taxpayer or of its parent or subsidiary corporation. The Plan further provides that options to acquire common stock are to be granted to all eligible employees of Taxpayer and designated subsidiaries by reason of their employment. The Plan excludes from participation employees who have been employed less than 2 years, employees whose customary employment is 20 hours or less per week and employees whose customary employment is for not more than 5 months in any calendar year.

All employees granted options under the Plan to acquire common stock of taxpayer have the same rights and privileges, except that the amount of common stock purchased by any employee under the option bears a uniform relationship to the total compensation, or the basic or regular rate of compensation, of employees. The Plan provides that no employee may purchase more than a maximum amount of stock fixed under the Plan.

Pursuant to the Plan, the option price for the common stock is not less than the

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lesser of an amount equal to 85% of the fair market value of the common stock at the time the option is granted, or an amount equal to 85% of the fair market value of the common stock at the time the option is exercised. Furthermore under the Plan, options will be exercised within the plan year which consists of approximately 12 months beginning on the first trading day on or after January 1 of each calendar year and ending on the last trading day of the same calendar year.

The Plan provides that no employee of Taxpayer or any designated subsidiary may be granted an option to acquire common stock which permits his rights to purchase common stock under all employee stock purchase plans of his employer corporation and its parent and subsidiary corporations to accrue at a rate which exceeds \$25,000 of fair market value of such stock (determined at the time the option is granted) for each calendar year in which the option is outstanding at any time. For these purposes, the right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year; the right to purchase stock under an option accrues at the rate provided in the option, but in no case may the rate exceed \$25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and a right to purchase stock which has accrued under one option granted pursuant to the Plan may not be carried over to any other option.

An option to acquire common stock is not transferable by a participant otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him. In addition, the Plan contains a "repurchase option" that provides that if a participant or former participant proposes to dispose of a share of common stock obtained under the Plan (i) prior to 2 years after the date on which the option to purchase such share of common stock was granted, or (ii) prior to one year after the exercise date on which the option to purchase such share of common stock was exercised, that participant or former participant must immediately deliver to the committee written notice of such proposed disposition. Upon receipt of the notice, Taxpayer will have the exclusive option, for a period of 10 days after receipt of the notice, to purchase the common stock for a price equal to the lesser of (i) the purchase price for the shares or (ii) the fair market value of the common stock on the date of such repurchase. If Taxpayer does not elect to exercise its option to purchase the common stock, then the participant or former participant may proceed with the proposed disposition.

Taxpayer represents that the "repurchase option" does not in any way relate to any requirement or condition that the participant perform any future services for the Taxpayer. Neither termination of employment of the participant nor failure to render future services by the participant triggers the "repurchase option". During the period that the "repurchase option" is in effect, the participant is the owner of the shares of common stock subject to the "repurchase option", and as such, is entitled to dividends,

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participation in the assets on liquidation and is entitled to vote as any other holder of shares of common stock of the Taxpayer.

Section 421(a) of the Code provides, in part, that if a share of stock is transferred to an individual in a transfer in which the requirements of section 423(a) are met, no income shall result to the individual at the time of the transfer, no deduction shall be allowable to the employer corporation at any time with respect to the share transferred, and no amount other than the price paid under the option shall be considered as received by the issuing corporation for the share transferred.

Section 423(a) of the Code, dealing with employee stock purchase plans, provides that section 421 will apply to the transfer of stock pursuant to the exercise of an option if no disposition of the stock is made by the employee within 2 years after the date the option is granted nor 1 year after the exercise of such option, and at all times during the period beginning with the date of granting the options and ending 3 months before the date of exercising the option, the individual to whom the options are granted remains an employee of the granting corporation.

Section 423(b) of the Code sets forth nine requirements which a plan must meet in order to qualify as an employee stock purchase plan. Section 423(b)(1) provides that only employees of the employer corporation or a participating subsidiary are eligible to participate in the plan. Section 423(b)(2) requires the stockholders of the plan sponsor to approve the plan within 12 months before or after the date the plan is adopted. Section 423(b)(3) and 423(b)(4) restrict the employees who may be granted options under an employee stock purchase plan. Section 423(b)(5) requires that all employees granted options under the plan shall have the same rights and privileges. Section 423(b)(6) restricts the price of each option. Section 423(b)(7) limits the period within which an option may be exercised. Section 423(b)(8) limits an employee's rate of accrual under all employee stock purchase plans maintained by his employer and its related corporations to \$25,000 of fair market value of the stock for each calendar year in which such option is outstanding at any time. Section 423(b)(9) precludes an employee from transferring an option except by will or by the laws of descent and distribution.

Section 421(b) of the Code provides that if the transfer of a share of stock to an individual pursuant to the exercise of an option would otherwise meet the requirements of section 423(a) except that there is a failure to meet the holding period requirements of section 423(a)(1), then any increase in the income of such individual or deduction from the income of the employer corporation for the taxable year in which such exercise occurred attributable to such disposition is treated as an increase in income or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred.

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The disposition of a share of stock acquired by the exercise of a statutory option before the expiration of the holding period described in section 423(a)(1) makes section 421(a) inapplicable to the transfer of such share. Section 1.421-8(b)(1) of the Income Tax Regulations. Income attributable to such transfer shall be treated by the individual as income received in the taxable year in which the disposition occurs.

Section 83 of the Code governs the tax consequences resulting from dispositions of plan stock held by employees if section 421 does not apply to such disposition.

Section 83(a) of the Code provides the general rule that the excess of the fair market value of property transferred to an employee in connection with the performance of services over the amount paid for such property shall be included in the gross income of the employee in the first taxable year in which the rights of such person are transferable or are not subject to a substantial risk of forfeiture.

Based on the information submitted, the following rulings are issued:

1. The Plan constitutes an "employee stock purchase plan" within the meaning of section 423(b) of the Code.
2. No income will be recognized by a participant upon the grant or exercise of an option granted under the Plan.
3. No income will be recognized by a participant upon the termination of the transfer restriction with respect to common stock acquired upon the exercise of options granted under the Plan.
4. For purposes of section 423 of the Code, the fair market value of common stock subject to the repurchase option will be the price determined under the repurchase option.
5. If a participant disposes of common stock purchased under the Plan before the expiration of the holding periods set forth in section 423(a)(1) of the Code, and assuming that the Taxpayer exercises the repurchase option, the income to the participant and the deduction from income for Taxpayer or designated subsidiary shall be measured by the difference between the purchase price and price paid by Taxpayer under the repurchase option.

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provisions of the Code. Specifically, no inference should be drawn concerning the tax consequences under the Federal Insurance Contributions Act or the Federal Unemployment Tax Act upon the exercise of options

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granted under the Plan. Moreover, if the Plan is amended, this ruling may not remain in effect.

A copy of this letter should be attached to X's federal income tax return for the year in which the Plan is implemented. A reproduced copy may be used for that purpose.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,  
CHARLES T. DELIEE  
Chief, Executive  
Compensation Branch  
Office of Division Counsel/  
Associate Chief Counsel  
(Tax Exempt and Government  
Entities)

Enclosure:

Copy for section 6110 purposes