Internal Revenue Service

Department of the Treasury
Washington, DC 20224

200016022

Index Nos.: 423.00-00; 6039.00-00

Contact Person:

Telephone Number:

In Reference to:

CC:EBEO:4/PLR-112345-99

Date:

JAN 14 2000

LEGEND:

Company =

Plan =

Date X =

Date Y =

Date Z =

Dear

This is in reply to a letter dated July 13, 1999, and subsequent correspondence submitted on behalf of Company by its authorized representative, in which a ruling is requested that the Plan qualifies as an "employee stock purchase plan," as defined in section 423(b) of the Internal Revenue Code. Additional rulings are requested concerning the tax consequences of the Plan.

The facts submitted are that Company's board of directors adopted the Plan on Date X, its shareholders will vote to approve the Plan within 12 months after that date, and the Plan became effective as of Date Y. The aggregate maximum number of shares of Company common stock that may be purchased through the exercise of options granted under the Plan is 20,000,000. However, that maximum number will be reduced to the extent that Company shares are issued pursuant to the exercise of options granted under other Company-sponsored plans, and it may also be adjusted to reflect changes in the capitalization of Company.

Company is a "parent corporation," as defined in section 424(e) of the Code, of all of the other corporations participating in the Plan, and Company has no "parent corporation." Under the Plan, only employees of Company or of a participating "subsidiary corporation," as defined in section 424(f) of the Code, who are employed on

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an Enrollment Date and the corresponding Exercise Date will be eligible to participate in the corresponding Offering Period. However, employees whose customary employment is 20 hours per week or less or five months or less in the calendar year will be ineligible to participate. For this purpose, the employment status of participants will be determined in compliance with the requirements of section 1.421-7(h)(2) of the Income Tax Regulations.

Under the Plan, an otherwise eligible employee may not be granted an option if, immediately after the option is granted, the employee owns stock possessing five percent or more of the total combined voting power or value of all classes of stock of Company or of a "subsidiary corporation" (as defined in section 424(f) of the Code). For purposes of these determinations, the rules of section 424(d) of the Code will apply, and stock that the employee may purchase under outstanding options (whether issued pursuant to the Plan or otherwise) will be treated as owned by the employee. Additionally, no employee may be granted an option that permits the employee's rights to purchase stock under all employee stock purchase plans of Company and its subsidiary corporations to accrue at a rate that exceeds $25,000 of fair market value of such stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time.

Offering Periods under the Plan commence on the first day of the second month following the end of a calendar quarter and end on the last day of the first month following the end of a calendar quarter. However, the first Offering Period will begin on Date Y and will end on Date Z.

Employees who are eligible to participate in an Offering Period will be furnished an Enrollment Agreement. Employees who elect to participate in the Offering Period will complete the Agreement and file it with the Stock Administrator no later than 10 business days prior to the Enrollment Date for an Offering Period. The Agreement will authorize Company to deduct from the participant's compensation up to 10 percent of the employee's Eligible Compensation. In the Plan, "Eligible Compensation" is defined as the regular rate of compensation paid to a participant by an Employer during an Offering Period; here, wages, salary, bonuses, commission, and elective employer contributions made under certain qualified plans. It is represented that no amounts contributed by Plan participants pursuant to the provisions of any other stock purchase plans adopted by Company or by any of its subsidiary corporations will be used to purchase shares under the Plan.

Participants may not change their contribution rates during an Offering Period, except by withdrawing from the Plan. Participants who withdraw may not thereafter participate in the then-current Offering Period, must execute a Withdrawal Agreement,

must deliver a new Enrollment Agreement to participate in subsequent Offering Periods, and will be refunded their accumulated contributions to the Plan as soon as is practical thereafter.

On an Offering Period's Exercise Date (the last day of the Offering Period), participants will be granted options to purchase the maximum number of whole and fractional Company shares that may be bought with the funds withheld from their paychecks during that Offering Period. However, that maximum number will be reduced to the extent necessary to meet the requirements of section 423(b)(8) of the Code. The Exercise Price of options granted under the Plan will be 85 percent of the Fair Market Value of a Company share on the Exercise Date. On the Exercise Date, all options will be automatically exercised.

Stock transferred to a participant upon the exercise of an option may or may not be substantially vested upon transfer. However, upon transfer, the participants will have voting rights, dividend rights, and liquidation rights with respect to the shares purchased.

As soon as practical after the Exercise Date, a stock certificate for the shares purchased will be issued either to the participant or to the participant's nominee (agent), *e.g.*, the Plan Custodian. To identify the certificates representing shares purchased under the Plan, the Plan Custodian will use a unique symbol (unique certificate number) in its record keeping system. Contemporaneously, a statement will be sent to each participant in the Offering Period, which will include: (i) the total amount (in United States dollars or local currency) of all amounts credited to the participant's account under the Plan during the Offering Period; (ii) the number of Company shares purchased by the participant on each Exercise Date; (iii) the price per share price and the aggregate purchase price of the shares; and (iv) the cash balance remaining in the participant's account. Under the Plan, participants are deemed to consent to transmission of these statements through electronic delivery. All shares purchased under the Plan will be held by the Company or by the Plan Custodian until the earlier of the participant's request for delivery of the shares or termination of employment.

Options granted under the Plan are not assignable or transferable by the participant other than by will or by the laws of descent and distribution and are exercisable during the participant's lifetime only by the optionee. The Plan provides that all participants granted options under the Plan will have the same rights and privileges.

In pertinent portion, section 421(a) of the Code provides 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 under section 162 shall be allowable at any time to the employer corporation with respect to the share transferred, and no amount other than the price paid under the option shall be considered as received by the employer corporation for the share transferred.

Under section 421(b), if the transfer of a share of stock to an individual pursuant to his or her exercise of an option would otherwise meet the requirements of section 423(a) except that there is a failure to meet any of the holding period requirements of section 423(a)(1), then any increase in the income of such individual or deduction from the income of his 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.

Section 423(a) of the Code provides that section 421 will apply to the transfer of a share of stock to an individual pursuant to the exercise of an option granted under an employee stock purchase plan if (1) no disposition of the stock is made by the individual within two years after the date of grant of the option nor within one year after the transfer of such share to him or her, and (2) at all times during the period beginning with the date that the option is granted and ending 3 months before the date of its exercise, the optionee remains an employee of the granting corporation, a parent or subsidiary corporation of such corporation, or a corporation (or parent or subsidiary corporation of such corporation) issuing or assuming a stock option in a transaction to which section 424(a) applies.

For purposes of these determinations, section 424(e) of the Code defines "parent corporation" as any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations (other than the employer corporation) owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain. Section 424(f) defines "subsidiary corporation" as any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Section 423(b) of the Code defines an "employee stock purchase plan" as a plan that meets the requirements set forth in paragraphs (1) through (9) of that section.

Section 1.421-7(c)(1) of the regulations provides, in part, that, for purposes of sections 421 and 423 of the Code, the words "the date of the granting of the option" and "the time such option is granted" (and similar phrases) refer to the date or time when the corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. For purposes of determining when an option is granted, a corporation "completes corporate action," within the meaning of section 1.421-7(c)(1) of the regulations, when, pursuant to the terms of its offer, the number of shares of stock that may be purchased is fixed and determinable. If an offer to sell stock does not designate a fixed and determinable maximum number of shares that an employee may purchase, corporate action has not been completed. See Revenue Ruling 68-317, 1968-1 C.B. 186, and Revenue Ruling 70-358, 1970-2 C.B. 96, both of which are clarified by Revenue Ruling 73-223, 1973-1 C.B. 206.

Section 83 of the Code governs the tax consequences resulting from disqualifying dispositions of Plan stock to the extent that section 421 does not apply. (Compare section 1.422A-1(b) of the Proposed Income Tax Regulations relating to "incentive stock options" described in section 422(b) of the Code).

Under section 83(a), if, in connection with the performance of services, property is transferred to any person other than the service recipient, the excess of the fair market value of the property, determined on the first day that the transferee's rights in the property are not subject to a substantial risk of forfeiture, over the amount paid for the property is included in the service provider's gross income for the taxable year which includes that day. Under section 1.83-7(a) of the regulations, if an option that was not taxable when granted is exercised, section 83(a) applies to the shares acquired pursuant to the exercise.

Under section 6039(a)(2) of the Code, every corporation which in any calendar year records (or has recorded by its agent) a transfer of the legal title of a share of stock acquired by the transferor pursuant to the exercise of an option described in section 423(c) of the Code (options having an exercise price between 85 percent and 100 percent of the fair market value of the stock on the date of grant of the option), must, on or before January 31 of the following calendar year, furnish a written statement to the transferor in such manner and setting forth such information as the Secretary by regulations prescribes. The information required to appear in the written statement is found in section 1.6039-2(b)(2) of the Proposed Income Tax Regulations. Under section 6039(b)(2) of the Code, the statement is required only for the transferor's

first transfer of the stock. For example, if, upon exercise of a described option, the stock is initially transferred directly to a nominee (agent) of the optionee, such transfer would not be considered a "first transfer" for purposes of section 6039(b)(2), and the written statement described in section 6039(a) would not be required.

Section 6039(b)(3) of the Code requires that a corporation identify in a unique manner those shares of stock which are transferred to a plan participant pursuant to the exercise of an option described in section 6039(a).

Applying the above law to the information submitted, we rule as follows:

(1) The Plan qualifies as an "employee stock purchase plan" under section 423 of the Code.

(2) For purposes of sections 421 and 423 of the Code, the date on which an option granted under the Plan will be considered to be "granted" will be that option's Exercise Date, which is also the date to be used to determine whether the requirements of section 423(b)(3) have been satisfied and whether the valuations required under section 423(b)(8) have been appropriately made.

(3) Because participants who exercise options under the Plan will not recognize taxable income at the time of exercise, the exercise of an option does not result in a payment of "wages" for federal income tax withholding purposes.

(4) If a participant disposes of shares purchased under the Plan before satisfying the holding period requirements of section 423(a)(1) of the Code ("disqualifying disposition") and the shares received upon exercise of the option were substantially vested when transferred to the participant:

(a) The participant must include in gross income, as compensation, an amount equal to the excess of the fair market value of the shares on the applicable Exercise Date over the amount paid for those shares. Such amount will be includible in the participant's gross income for the taxable year in which the disposition occurs.

(b) Company will be allowed a compensation expense deduction for its taxable year in which the disposition occurs in an amount equal to the amount included in the participant's gross income as a result of the disqualifying disposition.

(c) The participant's basis in such shares will consist of the amount paid for the shares plus the amount (if any) included in the participant's gross income as compensation as a result of the disqualifying disposition, and the holding period for such shares will commence on the Exercise Date. Gain in excess of the basis will be short-term or long-term capital gain as determined under the Code provisions applicable at the time of the disposition. If the participant's basis is greater than the amount received for the shares, the excess of that basis over the amount received will be short-term or long-term capital loss as determined under the Code provisions applicable at the time of the disposition.

(5) If a participant disposes of shares purchased under the Plan after satisfying the holding period requirements of section 423(a)(1) of the Code ("qualifying disposition"), or if a participant dies while holding shares purchased under the Plan:

(a) The participant must include in income, as compensation, in his or her taxable year in which the disposition or death occurs, an amount equal to the lesser of (i) the excess of the fair market value of the shares at the time of disposition or death over the amount paid for the shares, or (ii) the excess of the fair market value of the shares on the Exercise Date over the amount paid for the shares. See section 423(c) of the Code.

(b) Except in the case of death, the participant's basis in such shares at the time of their disposition will be the price paid for the shares increased by the amount included in the participant's gross income as compensation. Gain in excess of the participant's basis will be short-term or long-term capital gain as determined under the Code provisions applicable at the time of the disposition. In the case of death, a participant's estate's basis in the shares will be determined under section 1014 of the Code. See section 1.423-2(k)(2) of the regulations.

(c) If the fair market value of shares on the date of their disposition or the participant's death is less than the option price, then no amount is includible in the participant's gross income as compensation, and the full amount of any loss recognized (assuming that the stock was sold in a arm's length transaction) will be treated as short-term or long-term capital loss as determined under the Code provisions applicable at the time of the disposition. Compare Example (2) under section 1.423-2(k)(3) of the regulations.

(6) In the event of (i) a qualifying disposition, (ii) a disqualifying disposition, or (iii) a participant's death while owning stock acquired under the Plan, amounts includible in gross income as a result thereof are not "wages" for purposes of the Federal Insurance Contributions Act (FICA) or the Federal Insurance Contributions Act (FUTA).

(7) Section 6039(a) of the Code does not require that a written statement be furnished to a Plan participant either (i) when shares are issued in the name of the Plan Custodian (or another nominee) on behalf of the Participant on an Exercise Date, or (ii) when the transfer of record title of the Shares from the Plan Custodian (or other nominee) to the participant is accomplished through the issuance of a certificate registered in the name of that participant.

(8) The Plan Custodian's use of a unique certificate number in its record keeping system, in order to identify certificates of shares issued to Plan participants, meets the requirements of section 6039(b)(3) of the Code.

(9) The information statements furnished to participants contemporaneously with the exercise of their options will constitute compliance by Company with the requirements of section 6039(a) of the Code, provided that (i) such statements contain all of the information required by section 1.6039-2(b) of the Proposed Income Tax Regulations and (ii) all such reports are given to participants by January 31st of the year following the year for which the statement is required.

(10) If shares are issued on the Exercise Date in the name of the participant (as opposed to being issued in the name of a nominee), the Plan's requirement that notices to Eligible Associates be made by electronic transmission satisfies the "written statement" requirement of sections 6039(a) and (b)of the Code.

Except as ruled above, no opinion is expressed regarding the federal tax consequences of the transaction described above under any provision of the Internal Revenue Code. In particular, we specifically note that no opinion is expressed regarding: (1) the effects of computing the fair market value of shares; (2) in what circumstances the issuance of stock certificates under the terms of section 3.5(a) of the Plan will result in either a "disposition" of the stock or a "disqualifying disposition"; (3) the effects of any actions taken under section 4.4(a) of the Plan; (4) the effect of any adjustments made under section 5.2(a) of the Plan; and (5) the withdrawn requests concerning the Federal employment tax treatment of either the grant of options, the exercise of options, or the disposition of shares acquired under the Plan. Finally, please note that, if the Plan is amended, the above rulings may not remain in effect.

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.

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

Sincerely yours,

Robert B. Misner

ROBERT B. MISNER
Assistant Chief, Branch 4
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosures: 2
Copy of this letter
Copy for section 6110 purposes