

## INTERNAL REVENUE SERVICE

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The Honorable Ed Bryant  
U.S. House of Representatives  
Washington, D.C. 20510

Dear Mr. Bryant:

This letter is in response to your inquiry (copy enclosed) dated August 23, 2001, on behalf of your constituent, [REDACTED]. [REDACTED] refers to a newspaper article about statutory stock option profits. He questions the fairness of an IRS proposal to impose Federal Insurance Contributions Act (FICA) tax on unrealized statutory stock option profits because he says taxpayers already pay an income tax on realized profits.

I have read the newspaper article and believe it alludes to the statement we make in Notice 2001-14, 2001-6 I.R.B. 516, published February 5, 2001 (copy enclosed). In that notice, we simply clarify current law that employment taxes apply to statutory stock options such as incentive stock options [described in section 422(b) of the Internal Revenue Code (Code)] and options granted under an employee stock purchase plan [described in section 423(b) of the Code]. The notice also provides relief to taxpayers regarding the application of these taxes. We disagree with any interpretation that we are proposing a new position on employment taxes. Rather, as stated in the notice, we are simply clarifying current law that employment taxes, including FICA tax, apply to statutory stock options.

### **FICA Tax on Statutory Stock Options**

The FICA tax is made up of social security and medicare taxes on the wages paid to an employee. The Congress enacted the Social Security Act and the FICA to provide for a federal system of old-age, survivors, disability, and hospital insurance. Under this system, the social security tax finances old-age, survivors, and disability insurance. The medicare tax finances hospital insurance. The FICA tax finances social security retirement benefits and medicare coverage that are important in the lives of many taxpayers.

The FICA tax is calculated as a percentage of an employee's wages. For FICA tax purposes, wages are defined generally as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. The Internal Revenue Code provisions provide no exceptions from wages for

remuneration paid in the form of stock; nor are there any provisions that exclude from wages remuneration received from the exercise of a statutory stock option. Accordingly, FICA tax applies to the payment of wages that arise when a statutory stock option is exercised (the wages paid being equal to the difference between the fair market value of the stock received and the price paid by the employee for the stock).

Notice 2001-14 provides generous relief on the application of employment taxes to statutory stock options. It provides that the IRS will not assess FICA tax or FUTA tax on the exercise of a statutory option exercised before January 1, 2003. The notice also provides some income tax withholding relief. Notice 2001-14 also includes a comment period that closed on May 7, 2001. We are considering all of the comments we received under this notice. They are important in developing any further guidance on applying employment taxes to statutory stock options.

I hope this information is helpful. Please call me or Elliot M. Rogers, [REDACTED], at (202) 622-6040, if you have any questions.

Sincerely,

MICHAEL A. SWIM  
Chief, Employment Tax Branch 1  
Office of the Division Counsel/  
Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosures (2)