

INTERNAL REVENUE SERVICE

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CC:TEGE:EOEG:ET1

[REDACTED]

Dear [REDACTED]:

I apologize for the delay in responding to your letter of May 29, 2002 to the Internal Revenue Service, on behalf of your constituent, [REDACTED]. [REDACTED] asked about recent guidance concerning the application of employment taxes to options granted under an employee stock purchase plan.

As you request, I responded directly to [REDACTED]. I enclosed a copy of my response.

I hope the information we provided [REDACTED] is helpful. If you need further assistance, please call me or (202) 622-6040.

Sincerely,
Michael A. Swim
Senior Technician Reviewer, Employment Tax
Branch 1
Office of Associate Chief Counsel
Division Counsel
(Tax Exempt and Government Entities)

Enclosure

[REDACTED]

Dear [REDACTED]:

I am writing in response to your May 2, 2002 correspondence to [REDACTED] concerning the application of employment taxes to options granted under a qualifying employee stock purchase plan. [REDACTED] asked that we respond directly to you.

You specifically inquired about the recently issued proposed guidance that concerns the application of employment taxes to statutory stock options, which include incentive stock options and options granted under qualifying employee stock purchase plans. For these purposes, employment taxes refer to the Federal Insurance Contributions Act (FICA) tax, the Federal Unemployment Tax Act (FUTA) tax, and income tax withholding obligations.

The application of employment taxes to statutory stock options has been a longstanding issue. On January 18, 2001, the IRS issued Notice 2001-14 (2001-6 I.R.B. 516), providing a temporary moratorium on the application of employment taxes to statutory stock options. It also announced the intent of the Department of the Treasury (Treasury) and the IRS to issue formal guidance in this area. The moratorium applies to exercises of statutory stock options occurring before January 1, 2003, and the sale or disposition of stock acquired pursuant to such exercises.

On November 13, 2001, the IRS issued proposed regulations which would apply the FICA and FUTA taxes at the time of exercise of a statutory stock option, but not impose income tax withholding obligations (66 Fed. Reg. 57023, Nov. 14, 2001). In response to concerns about the administrative burdens that some employers may face in fulfilling their employment tax obligations, the IRS simultaneously issued two notices containing proposed administrative rules.

The first notice, Notice 2001-72 (2001-49 I.R.B. 548), proposed to waive any income tax withholding obligations that may arise at the time of sale or disposition of the stock acquired pursuant to the exercise of a statutory stock option. Employers would continue to be required to make reasonable efforts to report any ordinary income arising at that time on the employee's Form W-2.

The second notice, Notice 2001-73 (2001-49 I.R.B. 549), proposed rules of administrative convenience intended to ease the burdens on employers and employees in administering the FICA and FUTA taxes at the time of exercise of a statutory stock option. For example, the proposed rules would allow the employer to deem all the

wages paid during the calendar year due to exercises of statutory stock options to occur on one date during the calendar year, resulting in one annual tax calculation and one annual payment.

The proposed guidance also requested comments. The IRS received over one hundred comments on a variety of topics, including whether the application of employment taxes to statutory stock options was a correct interpretation of the Internal Revenue Code. Additional comments concerned the potential administrative burdens employers and employees may face in administering the payment of the taxes.

To give Treasury and the IRS adequate time to consider these comments, the IRS issued Notice 2002-47 (2002-28 I.R.B. 97), copy enclosed. Notice 2002-47, issued on June 25, 2002, extends the moratorium on the application of employment taxes indefinitely. Therefore, until further guidance, the IRS will not enforce the application of FICA or FUTA taxes, or impose income tax withholding obligations, upon either the exercise of a statutory stock option or the sale of stock acquired pursuant to the exercise of a statutory stock option. However, this does not change an individual's obligation to include appropriate amounts in income, or an employer's obligation to report such income to the individual.

Notice 2002-47 also announces that Treasury and the IRS intend that any issuance of final regulations that would apply employment taxes to statutory stock options would not be effective until at earliest the January 1 following the second anniversary of the date of publication. This means that if Treasury and the IRS issue final regulations, employers and employees will have at least two years to prepare to administer these taxes.

I hope that this information is helpful. If you have any further questions about the proposed guidance, please contact me or Stephen Tackney of my staff at (202) 622-6040.

Sincerely,
Michael A. Swim
Senior Technician Reviewer, Employment Tax Branch
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Office of Associate Chief Counsel / Division Counsel
(Tax Exempt and Government Entities)

cc: 

Enclosure