

**INTERNAL REVENUE SERVICE**

October 3, 2002

Number: **INFO 2002-0215**  
Release Date: 12/31/2002  
UIL:3121.01-22

CONEX 150221-02  
CC:TEGE:EOEG:ET1

[REDACTED]

Dear [REDACTED]:

We apologize for the delay in responding to your July 25, 2002 letter to Mr. David C. Williams, Inspector General, Department of Treasury, on behalf of your constituent, [REDACTED] [REDACTED] asked about recent guidance on the application of employment taxes to incentive stock options and options granted under an employee stock purchase plan.

As you requested, we responded directly to [REDACTED]. We have enclosed a copy of our response.

We hope the information given to [REDACTED] is helpful. If you need further assistance, please call [REDACTED] at [REDACTED]

Sincerely,

Marie Cashman  
Acting Assistant Chief Counsel  
(Exempt Organizations / Employment Tax /  
Government Entities)  
Office of Division Counsel /  
Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosure (1)

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[REDACTED]

Dear [REDACTED]:

We apologize for the delay in responding to your May 13, 2002 letter to [REDACTED] about the application of employment taxes to incentive stock options and options granted under a qualifying employee stock purchase plan. [REDACTED] asked us to respond directly to you.

You specifically asked about the recently issued proposed guidance on 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. This notice 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 that 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 that described proposed administrative rules.

The first notice 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. [Notice 2001-72 (2001-49 I.R.B. 548)] Employers would continue to be required to make reasonable efforts to report any ordinary income arising at that time on employees' Forms W-2.

The second notice 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. [Notice 2001-73 (2001-49 I.R.B. 549)] For example, one of 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 the Treasury and the IRS adequate time to consider these comments, we issued another notice on June 25, 2002, extending the moratorium on the application of employment taxes indefinitely. [Notice 2002-47 (2002-28 I.R.B. 97), copy enclosed] 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 the income to the individual.

Notice 2002-47 also announces that if the Treasury and the IRS issue final regulations, employers and employees will have at least two years to prepare to administer these taxes.

We hope this information is helpful. If you have any further questions about the proposed guidance, please contact [REDACTED], [REDACTED], at [REDACTED]  
[REDACTED]

Sincerely,

Marie Cashman  
Acting Assistant Chief Counsel  
(Exempt Organizations / Employment Tax /  
Government Entities)  
Office of Division Counsel /  
Associate Chief Counsel  
(Tax Exempt and Government Entities)

cc: [REDACTED]

Enclosure (1)