



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

December 07, 2004

Number: **INFO 2005-0031**
Release Date: 3/31/2005
UIL: 424.01-00

CC:TEGE:EB:EC
GENIN-144256-04

Dear :

This letter responds to your request for information dated June 22, 2004, concerning the law applicable to an incentive stock option (ISO). You asked whether an employer may amend outstanding ISOs to grant additional benefits for a select group of employees and thereby cause them to lose their qualification without affecting the status of all outstanding ISOs granted by the employer.

Section 424 of the Internal Revenue Code contains definitions and special rules applicable to ISOs. There, in subsection (h), it is provided that if the terms of an ISO are modified, extended, or renewed, such modification, extension, or renewal is considered the grant of a new option.

Pursuant to section 1.424-1(e)(5)(i) of the Income Tax Regulations, a modification is any change in the terms of the option which gives the optionee additional benefits under the option. For example, a change in the terms of an option that shortens the period during which an option is exercisable is not a modification. However, a change which provides more favorable terms for the payment for the stock purchased under the option is a modification.

Therefore, if an employer were, for example, to extend the date that any ISO remains exercisable, that change would be regarded as modification of that option, and thus, the grant of a new option on the date of the change. That new option must then meet all of the requirements in order for it to qualify as an ISO. There is no indication in the Code or regulations that a modification of any outstanding ISO affects other outstanding ISO's.

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2004-1, §2.04, 2004-1 IRB 7. We apologize for the delay in responding to your

request for information concerning ISO plans. If you have any additional questions,
please contact _____ in our office at _____ .

Sincerely,

Robert B. Misner
Senior Technician Reviewer
Executive Compensation Branch
Office of the Division Counsel/Chief
Counsel (Tax Exempt & Government
Entities