

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
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PLR-150521-04

Date:
January 27, 2005

Corporation =

Date 1 =

Date 2 =

Date 3 =

This letter is in response to your request dated September 14, 2004, requesting a ruling under section 422 of the Internal Revenue Code. Specifically, you request a ruling that options granted under Corporation's Share Option Plan (Plan) satisfy the requirements of section 422(b)(2) of the Code if such options are granted more than 10 years from the Plan's initial adoption but within 10 years of the date the Plan was last amended with shareholder consent to increase the number of shares that may be issued under the Plan.

The facts, as submitted, are as follows. As part of its compensation package on Date 1, Corporation adopted and its shareholders approved the Plan. The plan permits the board of directors of Corporation to grant incentive stock options (ISOs) to certain employees. On Date 2 (almost 10 years after Date 1), the board adopted, contingent on shareholder approval, an amendment to increase the maximum number of shares that may be issued under the Plan. On Date 3, the shareholders approved the amendment.

Corporation plans to amend Plan to extend the period during which ISOs may be granted under the Plan. Specifically, Corporation plans to amend section 4.14 of the Plan to provide that, among other things, no ISOs may be granted after 10 years from the date of the adoption of the Plan or the date such plan is approved by the stockholders (whichever is earlier).

Section 421(a) of the Code provides that, if a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a) are met, (i) no income results to the individual at the time of the transfer of the share to individual on exercise of the option; (ii) no deduction under section 162 is allowable at any time to the employer corporation or its parent or subsidiary corporations with respect to the share transferred; and (iii) no amount other than the price paid under the option is considered as received by such corporations for the share transferred.

Section 422 of the Code provides that section 421 applies to the transfer of stock to an individual pursuant to the exercise of an ISO if (i) no disposition of the stock is made by the employee within two years from the date of the grant of the option or within one year from the date the stock is transferred to the individual; and (ii) at all times during the period beginning on the date the option is granted and ending three months before the date of its exercise, the optionee was an employee of either the corporation granting the option, a parent or subsidiary of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming an option in a transaction to which section 424(a) applies.

Section 422(b)(2) defines an ISO as an option granted to an individual for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if, among other requirements, such option is granted within 10 years from the date such plan is adopted, or the date such plan is approved by the stockholders, whichever is earlier.

Section 1.422-2(a)(2)(ii) of the Income Tax Regulations provides that to qualify as an ISO, an option must be granted within 10 years from the date of the adoption of the plan or the date such plan is approved by the stockholders, whichever is earlier. In addition to this rule, section 1.422-2(c) of the regulations provides that to grant an ISO after the expiration of the 10-year period, a new plan must be adopted and approved.

Section 1.422-2(b)(2)(i) of the regulations provides that the plan must be approved by the stockholders of the corporation granting the ISO within 12 months before or after the date such plan is adopted. Ordinarily, a plan is adopted when it is approved by the granting corporation's board of directors, and the date of the board's action is the reference point for determining whether the stockholder approval occurs within the 24-month period. However, if the board's action is subject to a condition (such as stockholder approval) or the happening of a specific event, the plan is adopted on the date the condition is met or the event occurs, unless the board's resolution fixes the date of approval as the date of the board's action.

Section 1.422-2(b)(2)(iii) of the regulations provides that the provisions relating the maximum aggregate number of shares to be issued under the plan and the employees (or class or classes of employees) eligible to receive options under the plan are the only provisions of a stock option plan that, if changed, must be re-approved by

stockholders for purposes of section 422(b)(1). Any increase in the maximum number of shares that may be issued under the plan (other than an increase merely reflecting a change in the number of outstanding shares, such as a stock dividend or stock split), or a change in the designation of the employees (or class or classes of employees) eligible to receive options under the plan is considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period.

In this situation, the board adopted, contingent on shareholder approval, an increase in the maximum aggregate number of shares to be issued under the Plan. This increase was approved by the shareholders on Date 3. Because an increase in the maximum aggregate number of shares is considered the adoption of a new plan and shareholder approval was obtained, the Plan is considered adopted as of Date 3. ISOs granted within 10 years from the date of the adoption of the Plan or the date such plan is approved by the stockholders (whichever is earlier) will satisfy the requirements of section 422(b)(2).

Based solely on the information submitted, the Date 3 amendment, approved by Corporation's shareholders, results in the deemed re-adoption of the Plan as a new plan such that options granted under the Plan, at any time within 10 years from the date of the adoption of the Plan, satisfy the 10-year period limitation of section 422(b)(2) of the Code.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

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