Internal Revenue Service

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Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:EC
PLR-106094-07

Date:
June 15, 2007

LEGEND

X =
Date 1 =
Date 2 =
Date 3 =
Amount =
Company =
Parent =

Dear :

This letter responds to your letter dated January 31, 2007, requesting a private letter ruling regarding the federal tax treatment of vested stock options you received incident to divorce. The facts, as submitted, are as follows.

Your marriage to X began on Date 1, and it was terminated by judicial judgment (Judgment) on Date 2. During the marriage, you and X lived in a community property state, and X was employed by Company, a wholly-owned subsidiary of Parent. On Date 3, Parent granted X compensatory stock options to purchase Amount shares of Parent stock. You represent that the options are incentive stock options (ISOs), as defined in section 422 of the Internal Revenue Code (Code). The Plan governing the ISOs prohibits X from transferring any of the ISOs, except as provided by the laws of descent and distribution, and it requires X to exercise the ISOs if he is alive at the time of exercise.

The Judgment awards 50 percent of the ISOs to X and the remaining 50 percent to you. The Judgment further provides that your ISOs will remain in X's name, and that you, as beneficial owner, must provide X with detailed, written exercise instructions and pay all costs, including taxes, attributable to your ISOs and, if the ISOs are exercised, the underlying stock.

You request rulings that X's exercise of your ISOs in accordance with your instructions will not violate the lifetime exercise requirement in section 422(b)(5) of the Code; that income realized if and when your ISOs are exercised will be includible in your income for federal income tax purposes, including for purposes of the alternative minimum tax; that the transfer of stock to you upon the exercise of your ISOs will not be a taxable event; that the transfer of stock to you upon exercise of your ISOs will not be a disposition of such stock, and that all subsequent tax consequences with respect to such stock will be yours; and that any gain or loss on the sale of any stock, or dividends paid on any stock, received by X on the exercise of your ISOs, will be includible in calculating your income for federal income tax purposes.

Community property earned through the efforts of one spouse is owned by the community from the time of acquisition. Poe v. Seaborn, 282 U.S. 101 (1930). Services rendered by one spouse are considered to be rendered by the community. Graham v. Commissioner, 95 P.2d 174 (9th Cir. 1938).

Section 83(a) of the Code provides, in general, that if property is transferred to any person in connection with the performance of services, the excess of the fair market value of the property over the amount, if any, paid for the property is included in the gross income of the person performing the services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable.

Section 83(e)(1) of the Code provides that section 83 does not apply to the transfer of an option to which section 421 applies.

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) or section 423(a) are met, then no income results at the time of the transfer of such share to the individual on exercise of the option, and no deduction under section 162(a) is allowable with respect to the transfer of such share.

Section 422(a) of the Code provides, in part, that section 421(a) applies with respect to the transfer of a share of stock to an individual pursuant to the exercise of an incentive stock option if no disposition of such share is made by the individual within two years from the date of the granting of the option or one year after the transfer of the share to the individual.

Under section 424(c)(1) of the Code, a disposition includes a sale, exchange, gift, or a transfer of legal title (with certain exceptions described in section 424(c)(1)). Under section 424(c)(4), in the case of any transfer described in section 1041(a), such transfer shall not be treated as a disposition of the stock for purposes of section 424,

and the same tax treatment with respect to the transferred property shall apply to the transferee as would have applied to the transferor.

Section 1041 of the Code provides, in part, that no gain or loss shall be recognized on a transfer of property from an individual to a former spouse, but only if the transfer is incident to the divorce. Incident to divorce is defined in section 1041(c) as a transfer of property within one year after the date on which the marriage ceases or a transfer of property that is related to the cessation of the marriage.

The term "related to the cessation of the marriage" is explained in Question and Answer 7 in section 1.1041-1T(b) of the Temporary Income Tax Regulations (temporary regulations). Under the regulation, a transfer of property is treated as related to the cessation of the marriage if the transfer is pursuant to a divorce or separation instrument, as defined in section 71(b)(2) of the Code, and the transfer occurs not more than six years after the date on which the marriage ceases. The regulation further provides that any transfer occurring more than six years after the cessation of the marriage is presumed to be not related to the cessation of the marriage. This presumption may be rebutted only by showing that the transfer was made to effect the division of property owned by the former spouses at the time of the cessation of the marriage.

In Rev. Rul. 2002-22, 2002-1 C.B. 849, A and B resided in a non-community property state prior to having their marriage terminated by divorce. During the marriage, A was employed by Corporation Y, and Corporation Y granted A nonstatutory stock options in connection with A's performance of services for Corporation Y. Pursuant to the property settlement incorporated into their divorce, A transferred one-third of the options to B. The ruling concludes that the transferred options are property within the meaning of section 1041 of the Code, and that section 1041 confers nonrecognition treatment on any gain that A may realize from the transfer. The ruling further concludes that A does not have any income resulting from B's subsequent exercise of the options. Instead, the ruling provides, when B exercises the options, B must include in income an amount determined under section 83(a) as if B were the person who performed the services for Corporation Y. The ruling further provides that the same conclusions would apply if A and B resided in a community property state and all or some of these income rights constituted community property that was divided between A and B as part of their divorce.

Rev. Rul. 2002-22 also concludes that the transfer of a statutory option to a spouse in connection with a divorce disqualifies the option as a statutory option under sections 422(b)(5) and 423(b)(9) of the Code.

The alternative minimum tax is imposed by section 55 of the Code. The alternative minimum tax is the excess (if any) of the tentative minimum tax for the taxable year over the regular tax for the taxable year.

Section 1.55-1 of the Income Tax Regulations (regulations) provides a general rule for the computation of alternative minimum taxable income. The rule in section 1.55-1(a) states that, except as otherwise provided by statute, regulations, or other published guidance issued by the Commissioner, all Internal Revenue Code provisions that apply in determining the regular taxable income of a taxpayer also apply in determining the alternative minimum taxable income of the taxpayer.

Section 56(b) of the Code contains the alternative minimum tax adjustments applicable to individuals. Section 56(b)(3) sets forth the treatment of incentive stock options under the alternative minimum tax. This section provides that section 421 shall not apply to the transfer of stock acquired pursuant to the exercise of an incentive stock option, as defined in section 422.

Section 56(b)(3) of the Code further provides that section 422(c)(2) shall apply in any case where the disposition of stock obtained pursuant to the exercise of an ISO, and the alternative minimum tax inclusion of ISO income, are within the same taxable year, and such section shall not apply in any other case.

Finally, section 56(b)(3) of the Code also provides that the adjusted basis of any stock acquired pursuant to an ISO shall be determined on the basis of the treatment specified in section 56(b)(3).

Based solely on the information submitted, we rule as follows:

1. The Judgment terms requiring X to comply with your exercise instructions will not violate the lifetime exercise requirement of section 422(b)(5) of the Code.

2. The income attributable to the exercise of your ISOs is includible in your gross income for federal income tax purposes, including for purposes of the alternative minimum tax.

3. The transfer of stock from X or Parent to you after the exercise by X of any of your options will not be a taxable event under principles regarding taxation of equal division of community property.

4. A transfer from X to you (or directly from Parent to you) of stock received upon the exercise of your ISOs will not be a disposition of such stock under section 424(c) of the Code, and all subsequent tax consequences with respect to such stock will be yours.

5. Gain or loss on the sale of stock, or dividends paid on such stock, received by X on exercise of any of your ISOs is includible in your

gross income, regardless of whether such stock is first registered in your name.

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

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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a properly executed penalty of perjury statement. 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.

Sincerely yours,

KENNETH M. GRIFFIN
Senior Technician Reviewer
Executive Compensation Branch
Office of Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)