

Tax Bulletin

SPECIAL TAX ADVISORY

IRS Announces Two-Year Moratorium on Employment Taxes and Withholding of Income Taxes with Respect to Statutory Stock Options

On January 19, 2001, the Internal Revenue Service released Notice 2001-14, which grants a two-year moratorium on employment taxes and the withholding of income taxes with respect to incentive stock options and options granted under employee stock purchase plans (collectively known as statutory stock options). In its Notice, the IRS acknowledged the current lack of clear administrative guidance regarding the application of FICA (Federal Insurance Contributions Act) and FUTA (Federal Unemployment Tax Act) taxes, as well as the application of income tax withholding to exercises of statutory stock options and to sales of stock acquired under those options. The moratorium, which is in effect until January 1, 2003, is therefore intended not only to provide a safe harbor for employers but also to provide the IRS with an opportunity to issue clear administrative guidance on these issues. Notice 2001-14 provides the following temporary guidance:

- No FICA or FUTA taxes will be assessed with respect to a statutory stock option that is exercised before January 1, 2003.
- No income tax withholding will be required upon the disposition of stock acquired under a statutory stock option that is exercised before January 1, 2003.
- An employer may, at its discretion, apply the above rules to exercises of statutory stock options and to dispositions of stock acquired under statutory stock options that occurred prior to January 19, 2001.
- The IRS will honor otherwise allowable adjustments and refund claims for employment taxes paid with respect to exercises of statutory stock options and dispositions of stock acquired under statutory stock options that occurred prior to the release of Notice 2001-14.
- An employer must continue to comply with all reporting obligations for income realized with respect to statutory stock options, including W-2 reporting and stock transfer notices.
- An optionee must still include in income any amount of compensation realized upon the disposition of stock acquired under a statutory stock option.

Notice 2001-14 applies solely to statutory stock options and does not alter an employer's employment tax or income tax withholding obligations with respect to nonstatutory stock options, restricted stock, or any other forms of compensation. Moreover, Notice 2001-14 has no effect on an employer's state employment tax and income tax withholding obligations with respect to statutory stock options, although most states, including Massachusetts, generally follow the federal rules with respect to the applicability of employment taxes and income tax withholding.

– A. William Caporizzo
– Michael J. Nathanson
– Kimberly B. Wethly

Tax Bulletin

This publication is not intended as legal advice. Readers should not act upon information contained in this publication without professional legal counseling. For more information, contact Hale and Dorr LLP's Executive Compensation Practice Group.

A. William Caporizzo, Co-Chair 617-526-6411 william.caporizzo@haledorr.com
Michael J. Nathanson, Co-Chair 617-526-6476 michael.nathanson@haledorr.com
William H. Schmidt, 617-526-6946 william.schmidt@haledorr.com
Linda K. Sherman, 617-526-6712 linda.sherman@haledorr.com

Hale and Dorr LLP is a founding partner in the independent law firm Brobeck Hale and Dorr in London, Munich and Oxford.

© 2001 Hale and Dorr LLP