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## Incentive Stock Option (ISO) and ESPP Reporting Regulations Finalized - Section 6039

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In tandem with its recent release of the final employee stock purchase plan (ESPP) regulations under Section 423 of the Internal Revenue Code (for our related alert, click [here](#)), the Internal Revenue Service released final regulations on the return and information statement ("reports") requirements of Code Section 6039. Section 6039 requires companies to (i) provide optionees and employee stock purchase plan participants with information that should be helpful in determining their taxes and (ii) beginning in future years provide the IRS with the same information. The reports are required after the corporation (i) issues shares to an individual who exercises an incentive stock option (ISO) or (ii) transfers legal title of shares of stock acquired at a discount under an ESPP. The regulations apply both to private and public corporations, although relatively few private companies will have ESPPs. Click [here](#) for the final regulations.

**Statements to Participants.** The regulations continue the existing requirement that companies provide at least annual notice (an information statement) to persons who exercised incentive stock options or bought shares under an ESPP regarding number of shares purchased, purchase or exercise price, and value of the shares transferred, among other specifics. Information statements must be furnished to employees for stock transfers that occur in 2009 by January 31, 2010.

**Return Requirements for 2010.** The regulations provide that corporations must begin filing reports with the IRS for stock transfers that occur after 2009. No filings with the IRS are required for prior years.

**New Forms.** The regulations require the reports to both individuals and the IRS to be made on IRS forms that are expected to be released soon - Form 3921 for ISOs and Form 3922 for ESPPs - but the use of those particular forms for information statements to individuals is optional for transfers before 2010, and the IRS has indicated that there will be some flexibility even after that as to the exact format of the information statements.

**Changes to the 2004 Proposed Regulations.** Generally, the final regulations follow the proposed regulations, with a few revisions of the ESPP rules. Most notably the final regulations provide that:

- a transfer of legal title to a recognized broker or financial institution immediately following the exercise of an option is treated as the first transfer of legal title for purposes of Section 6039 and thus requires that the return and information statement requirements be satisfied. (This also means that there will not be a new required report when those shares are sold or otherwise transferred.) By contrast, the issuance of a stock certificate directly to an employee or the registration of stock ownership on the employer's books and the holding of shares in book-entry form, is not considered the first transfer of legal title of the stock acquired by the employee and no return or information statement is required to be filed or furnished. This clarification is helpful because prior guidance has not made clear when a report was due in this situation. On the other hand, we note that the transfer to the broker described above will generally not be a disposition and so the tax report will not reflect a real sale;
- if the ESPP purchase price is not fixed or determinable on the date of grant (because, for example, the price could be based on a discount from the price at the end of the purchase period), then the report must provide the price on the date of grant; and
- the returns and information statement requirements of Section 6039 must be satisfied regardless of whether the shares are disposed of in a qualifying or disqualifying disposition (i.e., without regard to whether the ESPP participant held the shares long enough to obtain favorable tax treatment). No report is required if the price is at least equal to 100% of the grant price, unless the price cannot be determined at the date of grant.

In addition, the final regulations add a provision that provides an exception to the return requirements of Section 6039 for certain nonresident aliens, but the exception will be unavailable if the individuals received W-2s in any of the years the ISO was outstanding or during the ESPP purchase period at issue.

For more information on this or other executive compensation matters, contact [R. Scott Kilgore](#), [Amy A. Null](#), [Linda K. Sherman](#) and [Kimberly B. Wethly](#).

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## *Authors*



**R. Scott Kilgore**  
PARTNER

✉ [scott.kilgore@wilmerhale.com](mailto:scott.kilgore@wilmerhale.com)

☎ +1 202 663 6116



**Kimberly B. Wethly**  
PARTNER  
Chair, Tax Practice

✉ [kim.wethly@wilmerhale.com](mailto:kim.wethly@wilmerhale.com)

☎ +1 617 526 6481



## **Ciara R. M. Baker**

**PARTNER**



[ciara.baker@wilmerhale.com](mailto:ciara.baker@wilmerhale.com)



+1 202 663 6747