

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EB:EC-PLR-118019-02

Date:

October 29, 2002

Legend

Company =

Plan =

Date 1 =

Date 2 =

X =

Dear :

This is in reply to your letters dated February 28, and September 23, 2002 in which rulings were requested that the Plan, as amended, qualifies as an "employee stock purchase plan," as defined in section 423(b) of the Internal Revenue Code.

The facts submitted are as follows. On Date 1, Company's Board of Directors adopted and its shareholder approved an employee stock purchase plan (the "Plan") intended to qualify as an employee stock purchase plan within the meaning of section 423 of the Code. The purpose of the Plan is to provide employees of Company a continued opportunity to purchase stock in order to acquire a greater stake in Company through increased stockholdings. The total number of shares that may be issued under the Plan is X.

The Plan is administered by the Compensation and Benefits Committee of the Company Board of Directors (the "Committee"). The Committee has approved certain amendments to the Plan, which will become effective for the Plan year beginning on Date 2. These amendments will not increase the aggregate number of shares which may be issued under the Plan. The Plan, as amended, is described below.

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The Plan provides that no right to purchase shares shall be granted to a person who is not an employee of Company or a subsidiary corporation. As used in the Plan, the terms “parent corporation” and “subsidiary corporation” have the meanings respectively given to such terms in sections 424(e) and 424(f) of the Code.

Each offering is made to all employees of Company and to all employees of any subsidiary corporations who are designated by the Committee as participants in the Plan, excluding (i) employees whose customary employment is 20 hours or less per week or not more than five months in any calendar year; (ii) in the discretion of the Committee, as specified in the terms of any offering, highly compensated employees within the meaning of section 414(q) of the Code; and (iii) any employee who, immediately after the grant of a right to purchase stock pursuant to an offering, owns stock possessing 5% or more of the total combined voting power or value of all classes of stock of the employee’s employer or of any subsidiary or parent corporation of the employee’s employer. In determining stock ownership, the rules of section 424(d) are applied. Stock that the employee may purchase under rights of purchase and options are treated as stock owned by such employee.

Eligible employees can enroll at any time during a grant period. An employee may contribute to the Plan between one percent and ten percent of the employee’s gross pay, deducted after taxes, from each pay period. The Plan administrator maintains a payroll deduction account for each participating employee. It has been represented that the Plan will be amended to provide that in cases where applicable law prohibits payroll deductions, an employee shall make cash payments or deposits for the purchase of Company stock.

A participating employee may at any time and for any reason withdraw the entire cash balance then accumulated in such employee’s payroll deduction account and thereby withdraw from participating in an offering. Partial withdrawals are not permitted.

The Committee makes grants to all eligible employees of Company and any subsidiary. The terms and conditions of each offering state its effective date, define the duration of such offering and the purchase period thereunder, specify the number of shares that may be purchased, specify the purchase price for such shares and specify which employees, if any, are excluded pursuant to the Plan. During the purchase period specified in the terms of an offering, payroll deductions are made from such employee’s compensation (unless otherwise prohibited by local law). Any stated purchase period shall end no later than 27 months from the effective date of any offering.

The right to purchase shares under the Plan are subject to the limit of section 423(b)(8) of the Code which generally limits accrual of the right of any employee to purchase shares under all employee stock purchase plans of Company and any

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subsidiary or parent corporation, qualified under Section 423 of the Code to an annual rate of \$25,000 in fair market value.

The Plan provides for four quarterly offerings of Company stock. Each offering shall allow for stock purchases to occur on a quarterly basis. Purchases will occur on the last trading day of each calendar quarter. The participant's payroll deduction account is charged for the amount of the purchase and a stock certificate is issued for the benefit of the participant as soon thereafter as practicable. A participant has no rights as a shareholder with respect to any shares covered by a right of purchase until a stock certificate for such shares is issued to the benefit of such participant.

The purchase price for each share of Company stock under each right of purchase granted pursuant to a quarterly offering will be the lower of (i) an amount equal to 85% of the fair market value (as defined in the Plan) of such share determined on the first day of the applicable offering period, or (ii) an amount equal to 85% of the fair market value (as defined in the Plan) of such share determined on the last day of the applicable offering period.

Rights to purchase shares under the Plan are not transferrable by a participating employee and may be exercised only by such employee during the employee's lifetime.

The Plan restricts the sale or transfer of shares of Company stock purchased under the Plan until after the first anniversary of the date of purchase of such shares.

The Plan will clearly state the authority of the Committee to delegate its duties under the Plan to any person or committee.

Section 421(a) of the Code provides, in part, that if a share of stock is transferred to an individual in a transfer in which the requirements of section 423(a) are met, no income shall result to the individual at the time of the transfer, no deduction shall be allowable to the employer corporation at any time with respect to the share transferred, and no amount other than the price paid under the option shall be considered as received by the issuing corporation for the share transferred.

Section 423(a) of the Code, dealing with employee stock purchase plans, provides that section 421 will apply to the transfer of a share of stock to an individual pursuant to the exercise of an option if no disposition of the stock is made by the employee within 2 years after the date the option is granted nor within 1 year after the exercise of such option, and at all times during the period beginning with the date of the granting of the option and ending 3 months before the date of exercising the option, the individual to whom the option was granted remains an employee of the granting corporation, a parent or subsidiary corporation of such corporation, or a corporation (or a parent or subsidiary corporation of such corporation) issuing or assuming a stock option to which section 424(a) applies.

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For purposes of these determinations, section 424(f) of the Code defines “subsidiary corporation” as any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the options, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in such chain.

Section 423(b) of the Code sets forth nine requirements which a plan must meet in order to qualify as an employee stock purchase plan. Section 423(b)(1) provides that only employees of the employer corporation or a participating subsidiary are eligible to participate in the plan. Section 423(b)(2) requires the stockholders of the plan sponsor to approve the plan within 12 months before or after the date the plan is adopted. Section 423(b)(3) and 423(b)(4) restrict the employees who may be granted options under an employee stock purchase plan. Section 423(b)(5) requires that all employees granted options under the plan shall have the same rights and privileges. Section 423(b)(6) restricts the price of each option. Section 423(b)(7) limits the period within which an option may be exercised. Section 423(b)(8) limits an employee’s rate of accrual under all employee stock purchase plans maintained by his employer and its related corporations to \$25,000 of fair market value of the stock for each calendar year in which such option is outstanding at any time. Section 423(b)(9) precludes an employee from transferring an option except by the laws of descent and distribution.

Section 421(b) of the Code provides that if the transfer of a share of stock to an individual pursuant to the exercise of an option would otherwise meet the requirements of section 423(a) except there is a failure to meet the holding period requirements of section 423(a)(1), then any increase in the income of such individual or deduction from the income of the employer corporation for the taxable year in which such exercise occurred attributable to such disposition is treated as an increase in income or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred.

Section 423(b)(2) of the Code requires shareholder approval of an employee stock purchase plan within 12 months before or after the date such plan is adopted by the Board of Directors. Section 1.423-2(c)(4) of the Income Tax Regulations provides, in pertinent part, that increases in the aggregate number of shares that may be issued under the plan (other than an increase merely reflecting a change in capitalization such as a stock dividend or stock split-up) will be treated as the adoption of a new plan requiring shareholder approval. Similarly a change in the designation of corporations whose employees may be offered options under the plan will be treated as the adoption of a new plan requiring stockholder approval. Any other changes in the terms of an employee stock purchase plan may be made without such changes being considered the adoption of a new plan. See Rev. Rul. 78-326, 1978-2 C.B. 162.

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Section 423(c) of the Code applies a special rule if the option price of stock acquired through a section 423 transfer was less than 100% of its fair market value when the option was granted. If an individual disposes of such stock after the holding periods specified in section 423(a) have elapsed or dies while owning such stock, compensation is included in his or her gross income for the taxable year in which the disposition occurs or for the taxable year closing with his or her death, whichever applies. The amount of compensation income included is equal to the lesser of (1) the excess of the fair market value of the stock on the date of its disposition or on the date of death over the amount paid under the option for the stock, or (2) the excess of the fair market value of the stock at the time the option was granted over the option price. If the option price is not fixed or determinable at the time the option is granted, then, for purposes of this rule, the option price is determined as if the option were exercised at such time. If such a share is disposed of by the individual, the basis of the share in his or her hands at the time of such disposition is increased by an amount equal to the amount so includible in his or her gross income.

Section 1.421-7(c)(1) of the regulations provides, in part, that, for purposes of sections 421 and 423 of the Code, the words “the date of the granting of the option” and “the time such option is granted” (and similar phrases) refer to the date or time when the corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option.

For purposes of determining when an option is granted, a corporation “completes corporate action,” within the meaning of section 1.421-7(c)(1) of the regulations when, pursuant to the terms of the offer, the number of shares of stock that may be purchased is fixed and determinable. If an offer to sell stock does not designate a fixed a determinable number of shares that may be purchased, then corporate action has not been completed. See Rev. Rul. 68-317, 1968-1 C.B. 186, and Rev. Rul. 70-358, 1970-2 C.B. 96, both of which are clarified by Rev. Rul. 73-223, 1973-1 C.B. 206.

Section 1.421-7(f) of the regulations provides, in part, that, for purposes of section 421 and 423 of the Code, the term “exercise,” when used in reference to an option, means the act of acceptance by the optionee of the offer to sell contained in the option. Generally, the time of exercise is the time when there is a sale or contract to sell between the corporation and the employee. A mere promise to pay the option price does not constitute an exercise, unless the optionee is subject to personal liability on the promise. An agreement or undertaking by the employee to make payments under an employee stock purchase plan does not constitute the exercise of an option so long as the payments remain subject to withdrawal by the employee.

The disposition of a share of stock acquired by the exercise of a statutory option before the expiration of the holding period described in section 423(a)(1) makes section 421(a) inapplicable to the transfer of such share. Section 1.421-8(b)(1) of the

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regulations. Income attributable to such transfer shall be treated by the individual as income received in the taxable year in which the disposition occurs.

Section 83 of the Code governs the tax consequences resulting from dispositions of Plan stock held by employees if section 421 does not apply to such disposition.

Section 83(a) of the Code provides the general rule that the excess of the fair market value of property transferred to an employee in connection with the performance of services over the amount paid for such property shall be included in the gross income of the employee in the first taxable year in which the rights of such person are transferable or are not subject to a substantial risk of forfeiture.

Based on the information submitted, we rule as follows:

(1) The Plan, including the proposed amendments, qualifies as an “employee stock purchase plan” within the meaning of section 423(b) of the Code.

(2) Section 421(a) will apply to the transfer of a full and/or fractional share of stock to an individual pursuant to his or her exercise of an option under the Plan if the requirements of section 423(a) are met.

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provisions of the Code. Moreover, if the Plan is subsequently amended, this ruling may not remain in effect.

A copy of this letter should be attached to Company’s federal income tax return for the year in which the amended Plan is implemented. This ruling is directed only to the taxpayer who requested it. section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

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

Enclosure:
Copy for 6110 purposes.