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New Reporting Requirements for Incentive Stock Options and Employee Stock Purchase Plans

What's New

The Internal Revenue Service (IRS) has issued new information reporting forms, beginning with the 2010 tax year, that employers – both public and private – must provide by **January 31, 2011** to employees who during 2010:

- Exercised incentive stock options (ISOs) (Form 3921) and/or
- First transferred legal title, including transfers to brokers or financial institutions, to stock that was acquired upon exercise of options under employee stock purchase plans qualified under tax code Section 423 (ESPPs), where the exercise price was less than 100 percent of fair market value on the date of grant (Form 3922).

A Form 3922 is **not** required in connection with:

- An employer's issuance of stock certificates directly to an employee who purchases stock under an ESPP, or
- The registration of ESPP shares in the employee's name on the employer's record books, where the employer or its transfer agent holds the shares for the employee in book-entry form.

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Contacts:

[Michael G. Meissner](#)
+1.216.479.8593

[Helen B. Jensen](#)
+1.216.479.8272

[Arman Pahlavan](#)
+1.650.843.3292
+1.212.872.9810

[Robert B. Webb III](#)
+1.703.720.7855

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In addition, 2010 is the first tax year that the information provided to employees must also be filed with the IRS.

The deadline for filing the new forms with the IRS is **February 28, 2011**, for paper filers, and **March 31, 2011**, for electronic filers. An automatic 30-day extension of time to file with the IRS can be requested on Form 8809 (Application for Automatic Extension of Time To File Information Returns).

Be Sure to Order Official Forms Early

Although Forms 3921 and 3922 are available for informational purposes on the IRS website, downloaded copies cannot be scanned, as required of all tax returns. Thus, employers must order official IRS forms by calling 1-800-829-3676 (1-800-TAX-FORM) or by ordering them online.

Employers with more than 250 Forms 3921 (ISOs) or 250 Forms 3922 (ESPPs) must file electronically using the IRS Filing Information Returns Electronically (FIRE) system. It is easy to amass a large number of forms, since *each* ISO exercise and *each* ESPP transaction in which transfer of legal title first occurs must be listed on a separate form. If an employer is not already enrolled in the FIRE system, a Form 4419 (Application for Filing Information Returns Electronically) must be filed at least 30 days prior to submitting a return. Thus, **March 1, 2011**, is the last date for FIRE enrollment, unless a 30-day filing extension has been requested.

Information Required on Form 3921 (ISOs)

The information required on Form 3921 includes the following for each ISO exercise:

- The name, address and employer identification number of the corporation transferring the shares and (if different) name, address and employer identification number of the corporation whose stock is being transferred
- The employee's name, address and social security number
- If applicable, a unique "account number" that the employer assigns, for purposes of the Form 3921, to each ISO exercise for those employees who had more than one ISO exercise during 2010
- The date the option was granted
- The date the option was exercised

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- The exercise price per share
- The fair market value per share on the exercise date
- The number of shares transferred

As noted above, the IRS requires that the employer file a separate Form 3921 for each ISO exercise by an employee.

Information Required on Form 3922 (ESPPs)

The information required on Form 3922 includes the following for the first transfer of legal title of shares after an ESPP exercise:

- The name, address and employer identification number of the corporation issuing the stock
- The employee's name, address and social security number
- If applicable, a unique "account number" that the employer assigns, for purposes of the Form 3922, to each first transfer of legal title of ESPP shares for those employees who had more than one first transfer of legal title during 2010
- The date the option was granted
- The date the option was exercised
- The fair market value per share on the grant date
- The fair market value per share on the exercise date
- The exercise price paid per share
- The number of shares transferred
- The date legal title was transferred by the employee
- If the exercise price was not fixed or determinable on the date of grant, the exercise price per share determined as if the option were exercised on the date it was granted to the employee

As noted above, the IRS requires that the employer file a separate Form 3922 for each first transfer of legal title of ESPP shares including for those employees who had

more than one first transfer during 2010.

Although the employer usually may provide employees with substitute information statements if IRS requirements are met, Publication 1179, as of this writing, has not yet been updated to include Forms 3921 and 3922. Thus, we recommend that employers furnish employees Copy B of the official Forms 3921 and 3922.

Penalties

Failure to furnish employees with timely information statements or failure to provide correct or complete statements, subjects an employer to penalties of \$50 per statement, up to a \$100,000 maximum penalty per year. Failure to furnish the IRS with timely information returns, or failure to provide correct or complete returns, subjects an employer to a sliding scale of penalties ranging from \$15 to \$50 per return, up to maximums ranging from \$75,000 to \$250,000 per year. Intentional disregard of filing requirements is subject to penalties of \$100 per return, with no maximum limit on penalties.

For more information about the IRS' new information forms please contact your principal Squire Sanders lawyer or one of the professionals listed in this Alert.

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations. Counsel should be consulted for legal planning and advice.

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