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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

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CC:TEGE:EB:EC
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Date:
August 12, 2005

LEGEND

Taxpayer =
Plan =
Date 1 =
Date 2 =
a =
b =
c =
Plan 2 =

Dear _____ :

This letter is in response to your ruling request on behalf of Taxpayer, dated April 6, 2005. Taxpayer has requested rulings relating to its employee stock purchase plan ("the Plan") under § 423 of the Internal Revenue Code ("the Code").

Taxpayer adopted the Plan on date 1; Taxpayer intended to submit the plan to its shareholders for approval on date 2. The Plan is designed to encourage employees of Taxpayer and its subsidiaries to have a proprietary interest in Taxpayer by giving them the option to purchase shares of common stock of Taxpayer through payroll deductions. The Plan also provides that all employees of Taxpayer and such subsidiaries as Taxpayer's Compensation Committee designate will be eligible to participate in the offerings of options under the Plan.

Taxpayer proposes to amend the Plan to exclude from participation any individual who is treated as an independent contractor or employee of another company, as evidenced by the fact that taxpayer or its subsidiaries neither withholds federal income taxes from the compensation paid to the individual nor pays employer FICA taxes on behalf of the individual, even if the individual is subsequently determined

to be a common law employee of Taxpayer or a subsidiary of Taxpayer, provided that the individual (a) has worked for Taxpayer or a subsidiary of taxpayer for less than 2 years, (b) customarily works 20 hours a week or less, (c) customarily works for not more than 5 months in a calendar year or (d) is a highly compensated employee (within the meaning of section 414(q) of the Code).

The Plan provides that no employee will be granted an option if the employee, immediately after the option is granted, owns stock equal to five percent or more of the total combined voting power or value of all classes of stock of Taxpayer, computed in accordance with section 423(b)(3) of the code. No employee will be granted an option that permits the employee's rights to purchase common stock under all employee stock purchase plans of taxpayer to accrue at a rate which exceeds \$25,000 of fair market value of such common stock (determined at the date of grant) for each calendar year in which such option is outstanding at any time in accordance with the provisions of section 423(b)(8) of the Code.

No more than a shares of Taxpayer common stock, plus a maximum of b "net shares" will be available for options under the Plan, subject to the Plan's adjustment provision. For purposes of the Plan, the term "net shares" means any shares of Taxpayer common stock authorized for sale under Plan 2 that remain for sale on the effective date of the Plan, not including shares that are sold under any Plan 2 offering that is pending on such date.

Each year during the term of the Plan, unless the Compensation Committee determines otherwise Taxpayer will make one or more offerings in which options to purchase Company common stock will be granted under the Plan. The Compensation Committee will determine the option price per share for each offering under the Plan on or prior to the date of grant of the options, which shall not be less than (1) 85% of the fair market value of Taxpayer common stock on the date of grant of the options or (2) 85% of the fair market value of Taxpayer common stock on the date of exercise of the options, whichever is lower. The fair market value of Taxpayer common stock on the date of grant or exercise of options will be determined using such methods or procedures as are established by the Compensation Committee prior to or on the date of grant of the option. The expiration date of the options granted in each offering under the Plan will be determined by the Compensation Committee prior to or on the date of grant of the options, but shall not be more than c months after the date of grant of the options.

An option granted under the Plan will entitle the employee to purchase up to that number of shares of Taxpayer common stock that could be purchased at the option price as the Compensation Committee shall determine for each offering (but not to exceed the amount specified in section 423(b) of the Code). Alternatively, or in combination with setting a maximum number of shares, the Compensation Committee may choose to determine a maximum dollar amount that can be used to purchase shares for each offering (but not to exceed the amount specified in section 423(b) of the

Code). An employee will be permitted to participate for less than the maximum number of shares or dollar amount specified by the Compensation Committee. The Compensation Committee will determine, prior to or on the date of grant of an option, the consequences of an employee's election to participate for less than the maximum and whether the employee will be entitled to purchase fractional shares.

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.

Section 423(b) of the Code sets forth nine requirements that 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 plan 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.

Section 423(b)(4) of the Code requires that the terms of an employee stock purchase plan provide that options are to be granted to all employees of any corporation whose employees are granted an such options by reason of their employment by such corporation, except that there may be excluded (1) employees who have been employed less than two years; (2) employees whose customary employment is 20 hours or less per week; (3) employees whose customary employment is for not more than 5 months in any calendar year; and (4) highly compensated employees within the meaning of 414(q).

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 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) The proposed amendment to the Plan, excluding certain individuals from participation as described above, will not violate the requirements of Section 423(b)(4) of the Code and therefore will not affect the Plan's qualification under Section 423(b).
- (3) Section 421(a) will apply to the transfer of a share of Company common stock to an individual pursuant to his or her exercise of an option under the Plan if the requirements of section 423(a) of the Code are met.

No opinion is expressed concerning whether any individual is an employee of taxpayer or 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,

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