Section 2511.—Transfers in General

26 CFR 25.2511–1: Transfers in general. (Also Section 2512; 25.2512–1.)

Transfer of nonstatutory stock option. This ruling provides guidance on the time that a completed gift occurs when a nonstatutory stock option is transferred without consideration by the optionee to a family member.

Rev. Rul. 98–21

ISSUE

When is the transfer of a nonstatutory stock option (*i.e.*, a compensatory stock option that is not subject to the provisions of § 421 of the Internal Revenue Code) by the optionee to a family member, for no consideration, a completed gift under § 2511?

FACTS

A is employed by Company. Company has one class of stock. Company has a stock option plan under which employees can be awarded nonstatutory stock options to purchase shares of Company's stock. These stock options are not traded on an established market. The shares acquired on the exercise of an option are freely transferable, subject only to generally applicable securities laws, and subject to no other restrictions or limitations.

Company grants to *A*, in consideration for services to be performed by *A*, a nonstatutory stock option to purchase shares of Company common stock. Company's stock option plan provides that the stock option is exercisable by *A* only after *A* performs additional services.

All options granted under Company's stock option plan expire 10 years from the grant date. The exercise price per share of *A*'s option is the fair market value of one share of Company's common stock on the grant date. Company's stock option plan permits the transfer of nonstatutory stock options to a member of an optionee's immediate family or to a trust for the benefit of those individuals. The effect of such a transfer is that the transferee (after the required service is completed and before the option's expiration date) will determine whether and when to exercise the stock option and will also be obligated to pay the exercise price.

Before *A* performs the additional services necessary to allow *A*'s option to be exercised, *A* transfers *A*'s option to *B*, one of *A*'s children, for no consideration.

LAW AND ANALYSIS

Section 2501 imposes a tax on the transfer of property by gift by any individual. The gift tax is not imposed upon the receipt of the property by the donee, is not necessarily determined by the measure of enrichment resulting to the donee from the transfer, and is not conditioned upon the ability to identify the donee at the time of the transfer. The tax is a primary and personal liability of the donor, is an excise upon the donor's act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable. Section 25.2511–2(a) of the Gift Tax Regulations.

The gift tax applies to a transfer of property by way of gift, whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Section 25.2511–1(a). For this purpose, the term property is used in its broadest and most comprehensive sense and reaches "every species of right or interest protected by law and having an exchangeable value." H.R. Rep. No. 708, 72d Cong., 1st Sess. 27 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 39, (1932); both reprinted in 1939–1 (Part 2) C.B. 476, 524. Some rights, however, are not property. *See e.g., Estate of Howell v. Commissioner*, 15 T.C. 224 (1950) (nonvested pension rights were not property rights includible in gross estate under § 811(c) of the 1939 Code); *Estate of Barr v. Commissioner*, 40 T.C. 227 (1963) *acq.*, 1964–1 C.B. 4 (death benefits

payable at discretion of board of directors who usually but not always, agreed to payment, were in the nature of hope or expectancy and not property rights includible in gross estate for estate tax purposes).

Generally, a gift is complete when the donor has so parted with dominion and control over the property as to leave the donor no power to change its disposition, whether for the donor's own benefit or for the benefit of another. Section 25.2511–2(b).

In *Estate of Copley v. Commissioner,* 15 T.C. 17 (1950), *aff'd,* 194 F.2d 364 (7th Cir. 1952), *acq.,* 1965–2 C.B. 4, the petitioner entered into an antenuptial agreement in which the petitioner promised to give the future spouse a sum of money in consideration of the marriage and in lieu of all the spouse's marital rights in the petitioner's property. The agreement became legally enforceable under state law on the date of the marriage in 1931. The petitioner transferred part of the sum of money in 1936 and the rest in 1944. The court concluded that a gift tax would have been due in 1931 if there had been a gift tax law in effect at that time.

In Rev. Rul. 79–384, 1979–2 C.B. 344, a parent promised to pay a child $10,000 if the child graduated from college. Rev. Rul. 79–384 holds that the parent made a gift on the day the child graduated from college, the date when the parent's promise became enforceable and determinable in value.

In Rev. Rul. 80–186, 1980–2 C.B. 280, a parent transferred to a child, for nominal consideration, an option to purchase real property for a specified period of time at a price below fair value. Rev. Rul. 80–186 holds that the transfer is a completed gift at the time the option is transferred provided the option is binding and enforceable under state law on the date of the transfer.

In the present case, Company grants to *A* a nonstatutory stock option conditioned on the performance of additional services by *A*. If *A* fails to perform the services, the option cannot be exercised. Therefore, before *A* performs the services, the rights that *A* possesses in the stock option have not acquired the character of enforceable property rights susceptible of transfer for federal gift tax purposes. *A* can make a gift of the stock option to *B* for federal gift tax purposes only after *A* has completed the additional required services because only upon completion of the services does the right to exercise the option become binding and enforceable. In the event the option were to become exercisable in stages, each portion of the option that becomes exercisable at a different time is treated as a separate option for the purpose of applying this analysis. In the event that *B* is a skip person (within the meaning of § 2613(a)), the generation-skipping transfer tax would apply at the same time as the gift tax. *See* Rev. Proc. 98–34, 1998–18, which sets forth a methodology to value certain compensatory stock options for gift, estate, and generation-skipping transfer tax purposes.

HOLDING

On the facts stated above, the transfer to a family member, for no consideration, of a nonstatutory stock option, is a completed gift under § 2511 on the later of (i) the transfer or (ii) the time when the donee's right to exercise the option is no longer conditioned on the performance of services by the transferor.

DRAFTING INFORMATION

The principal author of this revenue ruling is Robert B. Hanson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Melissa C. Liquerman on (202) 622-3120 (not a toll-free call).

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1998. See Rev. Rul. 98–23, page 5.

Section 7872.—Treatment of Loans with Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1998. See Rev. Rul. 98–23, page 5.