Rev. Proc. 2002–50

26 CFR 1.6045–1: Returns of Information of brokers and barter exchanges.
(Also Part III, §§ 83, 421, 422, 423, 1001, 1011, 3121, 3306, 3401, 3402, 6041, 6051.)

SECTION 1. PURPOSE

This revenue procedure provides an exception from reporting on Form 1099–B, "*Proceeds From Broker and Barter Exchange Transactions*", for transactions involving an employee, former employee, or other service provider (a "service provider") who has obtained a stock option in connection with the performance of services. Where the service provider purchases stock through the exercise of the stock option and sells that stock on the same day through a broker, the broker executing such a sale is not required to report the sale on Form 1099–B, provided certain conditions are met.

SECTION 2. BACKGROUND

.01 *Tax treatment of stock options*. Section 83 of the Internal Revenue Code governs the tax treatment of nonstatutory stock options granted in connection with the performance of services. Sections 421 through 424 govern the tax treatment of statutory stock options, *i.e.*, incentive stock options described in § 422(b) and options granted under an employee stock purchase plan described in § 423(b). A stock option is not taxable when granted, provided the option either lacks "a readily ascertainable fair market value" as defined in § 1.83–7(b) of the Income Tax Regulations or meets the requirements of § 422 or § 423.

For nonstatutory stock options that lack a readily ascertainable fair market value, the service provider generally recognizes income at the time of the exercise of the options, in an amount generally equal to the fair market value of the stock received (disregarding lapse restrictions) minus the amount paid for that stock. See § 83(a) and § 1.83–7. The time for recognizing this income and for determining the fair market value of the stock is the first day that the transferee's rights in the stock are "substantially vested", *i.e.*, transferable or not subject to a substantial risk of forfeiture. Where the individual exercising such options is an employee, the taxable compensation income generated by § 83(a) constitutes wages for purposes of §§ 3121, 3306, and 3401.

For statutory stock options, if the individual receiving the statutory stock option satisfies the employment requirements of § 422(a) or § 423(a), the exercise of the stock option produces taxable income only when the stock acquired pursuant to the exercise of the option is sold or disposed of. If that stock is sold in a disqualifying disposition (*i.e.*, prior to the later of the date that is one year after the exercise of the option and two years after the grant of the option), certain amounts will be taxable compensation income under § 83(a). In addition, pursuant to § 423(c), where the holding periods are satisfied, and where the stock options under an employee stock purchase plan are offered at an exercise price below the fair market value of the stock at the date of grant, certain amounts may be included as compensation income at the time of disposition of the stock acquired at exercise of the option.

Notice 2002–47, 2002–28 I.R.B. 97, provides, in part, that until the Treasury Department and the Internal Revenue Service issue further guidance, in the case of a statutory stock option, the Service will not assess the Federal Insurance Contributions Act (FICA) tax or Federal Unemployment Tax Act (FUTA) tax, or apply federal income tax withholding obligations, upon either the exercise of the option or the disposition of the stock acquired by an employee pursuant to the exercise of the option.

Section 1001 dictates the tax consequences when substantially vested stock obtained through the exercise of an option is sold. Pursuant to § 1001(a), the gain from sale of the stock is the amount realized minus the adjusted basis provided in § 1011, and the loss is the adjusted basis provided in § 1011 minus the amount realized. For this purpose, the adjusted basis of the stock includes the amount included in gross income under § 83(a) upon exercise of an option that did not have a readily ascertainable fair market value at grant.

.02 *Information reporting — Form W–2 and Form 1099*. Section 6051 provides generally that an employer must annually report to each of its employees the total wages paid to the employee. Compensation income constitutes "wages" for purposes of this reporting obligation. Form W–2 is used to report the information required by § 6051.

Section 6041 provides that where a person engaged in a trade or business makes payments in the course of the trade or business to another person of compensation of $600 or more in a taxable year, the person must render a return, in accordance with such regulations as the Secretary may prescribe, that sets forth the amount of the income, and the name and address of the recipient of the payment. Forms in the 1099 series are generally used to report the information required by § 6041 where the compensation income does not constitute wages, such as where the service provider does not provide the services as an employee of the service recipient.

.03 *Information reporting — Form 1099–B*. Section 6045(a) provides that brokers, when required to do so by the Secretary, must make a return in accordance with such regulations as the Secretary may prescribe regarding transactions they carry out for customers.

Section 1.6045–1(c)(2) of the regulations states, in general, that each broker must make a return of information with respect to each sale by a customer effected by the broker.

Section 1.6045–1(d)(2) provides, in part, that a broker must report the gross proceeds of a stock sale.

Section 1.6045–1(d)(5) provides that the broker may, but is not required to, take commissions and option premiums into account in determining gross proceeds provided the treatment chosen is consistent with the books of the broker. Form 1099–B is used to report the information required by § 6045 and the regulations thereunder.

Section 1.6045–1(c)(3)(ii) states that no return of information is required with respect to a sale effected by a broker for a customer if the sale is an excepted sale. This regulation defines an "excepted sale" as one so designated by the Internal Revenue Service in a revenue ruling or revenue procedure published in the Internal Revenue Bulletin.

SECTION 3. SCOPE

.01 *Applicability*. The exception provided by this revenue procedure applies to a sale of stock acquired by a service provider through the exercise of an option if:

(1) the sale is executed for the service provider on the same day that the stock being sold is acquired through the exercise of an option;

(2) the option was granted in connection with the performance of services, such that the federal tax consequences of the transactions are governed by section 83 of the Code (*e.g.*, an exercise of a nonstatutory stock option granted in exchange for services or an exercise of a statutory stock option followed by a disqualifying disposition of the stock acquired pursuant to the exercise);

(3) the service recipient certifies in writing to the broker that the service recipient will report any compensation income generated by the exercise of the option, or disposition of the stock acquired pursuant to the exercise of the option, in accordance with section 6041 (Form 1099) or section 6051 (Form W–2), as applicable; and

(4) the broker either:

(a) does not charge a commission or other fee on the transaction; or

(b) does charge a commission or other fee on the transaction and furnishes to the service provider the written statement described in section 4.03 of this revenue procedure.

.02 *Inapplicability*. The exception provided by this revenue procedure does not apply if the service recipient uses an amount other than the sale price of the shares to calculate the compensation income generated to the service provider by the option exercise. This revenue procedure also does not apply to the exercise of a stock option if, at the date of grant, the stock option had a readily ascertainable fair market value as defined in § 1.83–7(b).

SECTION 4. PROCEDURE

.01 *General*. A broker may treat a sale as an "excepted sale" for purposes of § 1.6045–1(c)(3)(ii) if an employee, former employee or other service provider obtains substantially vested shares of stock from the exercise of an option and on the same day sells the shares through a broker.

.02 *Statement to broker*. To determine whether the service provider exercised the option and sold the underlying shares on the same day, the broker may rely on a receipt or written statement provided by the service recipient or the service provider showing the date of exercise. To determine whether the service recipient uses the sale price of the shares to calculate the compensation income generated to service providers by the option exercise, the broker may rely upon a written statement from the service recipient certifying that it follows that practice.

.03 *Statement to customer*. Under the circumstances described in section 3.01(4)(b) of this revenue procedure, the broker must furnish the service provider with a statement containing the following information:

(1) the gross sales price with respect to the shares sold through the broker;

(2) the commissions or other fees charged by the broker on the sale; and

(3) a description of how gain or loss with respect to shares obtained through the option exercise is calculated and the manner in which such gain or loss should be reported on a federal income tax return. The description need not be an

independent document, but may be incorporated in a document such as a settlement sheet provided to the broker's customer in connection with the sale.

SECTION 5. EXAMPLES

.01 *Example 1*. An employee holds an option for 100 shares of Company A stock at an exercise price of $20 per share. When granted, the option had no readily ascertainable fair market value. The employee exercises the option on January 15, 2003, receives substantially vested shares and immediately sells the shares for the fair market value of $30 per share. The sale is executed by a broker rendering its services to Company A employees through a contractual arrangement with Company A. The broker charges no commissions or other fees to the employee in connection with the sale of the shares. Company A uses the sale price of the shares to calculate the compensation income of the employee reported as wages on Form W–2.

Under these facts, the employee has compensation income of $10 per share under § 83(a) ($30 fair market value minus $20 exercise price). Company A certifies in writing to the broker that it will report $1,000 as wages of the employee, and includes that amount on the employee's Form W–2. The employee's basis is $30 per share ($20 cost of exercising the option plus $10 taxable income recognized). Because the employee's amount realized on the sale of the stock ($30 per share) equals his basis, the employee has no capital gain or loss on the sale. The broker is not required to report the proceeds of the sale on Form 1099–B.

.02 *Example 2*. Assume the same facts as *Example 1*, except that the employee pays a commission of $.05 per share to the broker. The employee's compensation income is $10 per share ($30 fair market value of stock received minus $20 exercise price). Company A reports $1,000 as wages on the employee's Form W–2 (as in *Example 1*), since commission expense does not reduce the income generated by the exercise. The employee has a loss of $5.00 ($.05 per share times 100 shares). Because the employee realizes a loss, "excepted sale" treatment will apply only if the broker provides the statement required by section 4.03 to the employee.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for sales of stock occurring after December 31, 2001.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Nathan Rosen of the Office of the Associate Chief Counsel (Procedure & Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue procedure, contact Mr. Rosen at (202) 622–4910 (not a toll free call).