

# Options Granted Under an Employee Stock Purchase Plan (ESPP)

## Notice 2004-55

### I. PURPOSE

Since the issuance of proposed regulations concerning incentive stock options (ISO's) on June 9, 2003 (68 FR 34,344),<sup>1</sup> the Internal Revenue Service and Treasury Department have received questions concerning whether the final regulations concerning options granted under an employee stock purchase plan (ESPP) should be interpreted consistently with the proposed ISO regulations. The Service and the Treasury Department are considering whether to amend the final regulations under § 423 of the Internal Revenue Code. The Service and Treasury invite public comment concerning whether the final regulations under § 423 (the rules governing ESPP's) should be amended, and if so, what issues should be addressed or clarified.

### II. BACKGROUND

Section 423 of the Code was added to the Code by section 221(a) of the Revenue Act of 1964, Public Law No. 88-272. Changes to the applicable law concerning section 423 of the Code were made by section 11801 of the Omnibus Budget Reconciliation Act of 1989, Public Law 101-508; section 1114 of the Tax Reform Act of 1986, Public Law No. 99-514; section 1001 of the Deficit Reduction Act of 1984, Public Law No. 98-369; and section 1402 of the Tax Reform Act of 1976, Public Law No. 94-455.

Regulations under § 423 of the Code were published in the **Federal Register** on June 23, 1966 (T.D. 6887, 1966-2 C.B. 129). These regulations were amended on September 27, 1979 (T.D. 7645, 1979-2 C.B. 198), October 31, 1980 (T.D. 7728, 1980-2 C.B. 236), and December 1, 1988 (T.D. 8235, 1989-1 C.B. 117).

### III. COMMENTS REQUESTED

The Service and Treasury Department have received questions about whether the final regulations under § 423 should be interpreted consistently with the proposed regulations concerning ISO's. Additionally, the Service and Treasury have received specific questions including the following:

1. Whether any subcategory of employees may be excluded from participation in an ESPP under § 423(b)(4) of the Code, and if so, under what conditions these employees should be excluded;
2. Whether additional rules concerning the inadvertent exclusion of employees should be included in the regulations, and if so, whether and how the excluded employees should be allowed to participate in past offerings under the plan;
3. Whether the calculation of the amount of stock that may be purchased under an ESPP (the \$25,000 limit under § 423(b)(8)) should be determined in a manner consistent with the \$100,000 limitation for ISO's described in the §1.422-4;
4. Whether the participation rules in § 423(b)(4) and the equal rights and privileges rules in § 423(b)(5) should include additional rules for new employees or new participants (for example, if an employee is hired on the last day of the purchase period, whether the purchase period should be extended only for this individual);
5. Whether shareholder approval is required to add highly-compensated individuals to a plan under § 423(b)(2) and § 1.423-2(c)(3);
6. Whether individuals should be allowed to carryover amounts from an earlier plan or offering to a new plan or offering without violating the equal rights and privileges provision in § 423(b)(5);

7. Whether the regulations should include limitations on the increase or decrease of contribution amounts under an ESPP; and
8. Whether special rules concerning the exclusion and equal rights and privileges should be included in the regulations for foreign employees.

The Service and Treasury Department encourage comment on these issues and on any other issues that should be addressed or clarified in revising the final regulations under § 423.

Comments should be submitted by October 1, 2004, to CC:PA:LPD:PR (Notice 2004-55), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday to CC:PA:LPD:PR (Notice 2004-55), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, D.C. Alternatively, comments may be submitted via the Internet at [Notice.Comments@irscounsel.treas.gov](mailto:Notice.Comments@irscounsel.treas.gov). All comments will be available for public inspection.

### IV. DRAFTING INFORMATION

The principal author of this notice is Erinn Madden of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this notice, please contact Erinn Madden at (202) 622-6030 (not a toll-free call).