

Publications

Groom Law Group Plays Key Role in ESPP/ISO Employment Tax Moratorium

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SERVICES

Over the last several years, a team of attorneys from Groom Law Group — including Lou Mazawey, Mike Thrasher, Brigen Winters and Liz Dold — has played a key supporting role in efforts by business groups and high-tech companies to prevent employment taxes from being imposed on qualified employee stock purchase plan (ESPP) and incentive stock option (ISO) (collectively, statutory stock options) transactions. In an important victory, the IRS on June 25 issued Notice 2002-47 which indefinitely extends the current moratorium on the assessment of FICA and FUTA taxes on the exercise of statutory stock options or the disposition of stock acquired through such plans. The Notice also announces that any final guidance imposing these taxes on statutory stock options will not apply to any exercise of an option that occurs before January 1 of the year that follows the second anniversary of the publication of the final guidance.

For over 30 years, the published IRS position was that the grant, exercise, and disposition of statutory stock options does not trigger income tax withholding or FICA/FUTA taxes. In the late 1990s, however, some IRS agents assessed employment taxes in random audits. In response to industry efforts, the IRS announced in Notice 2001-14 that it would no longer pursue the audits and granted a 2-year moratorium (until 2003) on the imposition of these taxes. In November 2001, the IRS issued proposed regulations under which FICA and FUTA taxes would apply to the exercise of statutory stock options beginning in 2003.

A coalition of companies and Washington trade associations has been lobbying Congress, the White House, IRS, and Treasury on this issue since mid-1998, and the team of lawyers at Groom have played an integral role in providing legal and legislative assistance in support of these efforts throughout this period. As a result of these efforts, the Enron-related pension bill (H.R. 3762, the Pension Security Act of 2002) that passed the House in April includes a provision that would provide an exclusion from FICA and FUTA for amounts realized on transfers of stock pursuant to the exercise of statutory stock options or any disposition of such stock. The Senate has

not yet acted on legislation in this area, partly because of concerns about Joint Committee on Taxation estimates of the effect of the provision on government revenues. It is; however, possible that the recent IRS Notice could help spur legislative action in the Senate.

*“American Benefits Council
BENEFITS BYTE
June 25, 2002
BB-02/64”*

*“Treasury Extends Stock Option Tax Withholding Moratorium
On June 25, the Treasury Department and IRS announced the release of Notice 2002-47, which extends the current moratorium on the assessment of Federal Insurance Contributions Act (FICA) taxes and Federal Unemployment Tax Act (FUTA) taxes, and on federal income tax withholding, upon the exercise of an incentive stock option (ISO) or employee stock purchase plan (ESPP) or the disposition of stock acquired through such plans. Moreover, under Notice 2002-47, any final guidance that would apply employment taxes to ESPPs or ISOs will not go into effect before the January 1 of the year that follows the second anniversary of the publication of the final guidance. Comments by Treasury officials indicate that the moratorium is extended indefinitely as the Treasury and IRS will be reconsidering the whole issue of employment tax withholding on ESPPs and ISOs. The proposed tax withholding rules were originally scheduled to go into effect on January 1, 2003.”*

Exempting ESPPs and ISOs from employment tax withholding has been a top priority of the Council over the past three years. The Council recently submitted a comment letter to the Treasury and IRS and testified at a recent IRS hearing on the imposition of employment tax withholding on stock option plans. Council staff has been active in lobbying Congressional offices, the White House and agency staff as well as playing an important role in a coalition of companies and organizations that has been working on this issue. Many Council member companies have been active on this issue, and we want to thank the membership for helping to make today's success possible. The Council will continue to advocate for the outright withdrawal of the proposed rules regarding employment tax withholding and for legislative clarification that ESPPs and ISOs are exempt from employment tax withholding.

*“Senate Finance Committee Targets Week of July 8 for Pension Mark-Up
Senate Finance Committee staff have been instructed to be ready to mark up pension legislation stemming from the Enron bankruptcy during the week of July 8. This legislation will likely be a product of the ongoing discussions between Finance Committee Chairman Max Baucus (D-MT) and Finance Committee Ranking Republican Charles Grassley (R-IA). The Senators' offices have not yet issued a blueprint for the bill and do not appear to have come to closure on what elements it will contain. They are expected to begin with Senator Grassley's Enron-motivated legislation (S. 1971) and the House-passed Pension Security Act (H.R. 3762) and then make various modifications and additions.”*