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Internal Revenue Service
Office of Associate Chief Counsel (Procedure & Administration)
CC:PA:LPD:PR (Notice 2009-17), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

**RE: Information Reporting of Customer's Basis in Securities Transactions
(Notice 2009-17)**

Dear Mr. Schaeffer:

On behalf of our clients, and in response to Notice 2009-17, we would like to request special consideration of the impact of sections 6045(g), (h), 6045A, and 6045B of the Internal Revenue Code of 1986, as amended (the "Code"), enacted as part of the Energy Improvement and Extension Act of 2008 (Act), to employers providing equity based compensation to their employees so that the new rules in this area will not be superimposed on such programs.

For 35 years, Groom Law Group, Chartered, a Washington law firm, has specialized in employee benefits law. Groom's national client base includes a diverse group of Fortune 500 corporations and financial institutions who offer employees a wide array of equity based compensation programs and handle plan administration and tax compliance functions.

As more fully described below, equity based compensation comes in a variety of forms, each with its own intricate taxation and reporting requirements. Specifically, employer stock acquired through compensation arrangements is subject to a variety of: (1) detailed basis recovery rules, (2) comprehensive reporting requirements under Form W-2, 1099-R, etc., and (3) disclosure materials that educate employees about the appropriate tax treatment. Importantly, those arrangements are not subject to the generic basis recovery and capital gain rules under Code sections 1012 and 1222, which are the focus of Code section 6045(g) and the new Form 1099-B reporting. Moreover, any extension of the term "applicable person" under Code section 6045A to include employers (or their agents) would result in duplicative and likely counter-productive reporting by brokers, and a costly system redesign for all parties that – in light of the economic downturn facing the Nation – is particularly ill-timed. Therefore, we strongly recommend that equity based compensation arrangements be exempt from the term "specified

security" or that future guidance otherwise exclude employers (and their agents) from the reporting requirements of Code section 6045A and 6045B with respect to such stock.

We appreciate your consideration of these comments especially in view of submission after the official comment period.

I. Equity Based Compensation

A. Types of Equity Based Compensation

Equity based compensation comes in a variety of different forms. Each form has various levels of tax reporting and guidance. The key types of equity-based compensation are described below:

- Employer Stock Distributed From a Qualified Plan. Most types of tax-favored retirement plans can hold and distribute employer stock, including 401(k) plans, employee stock ownership plans (ESOPs), stock bonus plans, and profit sharing plans.
- Statutory Stock Options. Statutory stock options include incentive stock options under Code section 422 (ISO), and employee stock purchase plans under Code section 423 (ESPP). With an ISO, an employer grants an employee an option to buy employer stock with an exercise price no less than the fair market value ("FMV") at the grant date and a term of 10 years or less. To receive favorable tax treatment, the shares must be held for one year after the exercise date and two years after the grant date. With an ESPP, employees defer after-tax pay into an account that accumulates over a period of time, typically three months to two years, at the end of which employees may use the money to purchase employer stock. Usually, the stock is offered at a discount from either the price at the end of the period or at the beginning of the period, or both. The discount typically is up to 15%.
- Nonqualified Stock Options (NQSO). Employer grants employee an option to buy employer stock, with no tax code restrictions on the option as long as it is based on the fair market value of the stock.
- Stock Appreciation Rights (SARs). Employer grants employee a right to receive, without payment, the excess of the FMV of the employer stock on the exercise date over the base price. This award may be paid in employer stock, cash, or a combination of cash and employer stock.
- Restricted Stock. Employer issues company stock to the employee (or in his or her name), subject to forfeiture if vesting conditions are not satisfied. These shares are

nontransferable prior to the vesting date. For example, an employee must work for 3 years from the grant date of the award.

- Restricted Stock Units (RSUs). Employer grants employee a right to receive employer shares (or their value in cash) in the future if vesting conditions are met.

B. Comprehensive Basis and Reporting Rules

Each type of equity based compensation is subject to its own taxation provisions, which include the treatment on sale of such employer stock and associated reporting rules. The basis recovery rules are briefly outlined in the attached Appendix A. The comprehensive reporting rules, which include Forms 1099-R, W-2, 1099-MISC for non-employees, and proposed Forms 3921 and 3922, are briefly summarized below. These reports are made pursuant to Code sections 6039, 6041 and 6047(d).

- Qualified Plans (Form 1099-R): A distribution of employer stock is reported on Form 1099-R. Box 1 reports the gross distribution, box 2a reports the taxable portion of the distribution (which does not include the NUA, as described in Appendix A), and box 6 reports the NUA. Additional rules apply if the employer stock is rolled over to an IRA or another eligible employer plan.
- ESPPs and ISOs (Pending Forms 3921 and 3922). Recently proposed IRS regulations mandate IRS reporting on Forms 3921 and 3922 of information intended to enable an employee to calculate their tax obligation in the event of a sale of the ESPP/ISO stock. Treas. Reg. § 1.6039-1. As noted above, the tax treatment and reporting of the sale depends on a number of factors, including if the special holding period was met and whether the ESPP was discounted, which cannot be determined at the time of transfer to a broker. A portion of the gain may be treated as capital gain that is reported on Schedule D (Form 1040) while another portion may be treated as ordinary income that is reported as wages on Form W-2 or Form 1040, line 7. For example, an employer is required to report in box 1 of Form W-2 (a) the discount portion of stock acquired by the exercise of an ESPP option upon disposition of the stock, and (b) the spread (between the exercise price and the FMV of the stock at the time of exercise) upon a disqualifying disposition of stock acquired by the exercise of an ISO or an ESPP option. IRS Pub. 15-B, p. 11. Moreover, cashless exercises of ISOs/ESPPs are currently exempt from 1099-B reporting where such amounts are reported on Form W-2 by the employer and otherwise meet the requirements of Revenue Procedure 2002-50.
- NQSO. On exercise of a NQSO, the excess of the FMV of the shares over the exercise price is reported in boxes 1, 3 and 5 of Form W-2. This amount is also reported separately in box 12, code "V." IRS Pub. 15-B, p. 11. This amount, along with the exercise price, makes up the employee's basis for a later sale of the stock,

which will generate either long term or short term capital gain/loss treatment (based on the holding period of the stock).

- SAR. Upon exercise, the employer reports in boxes 1, 3 and 5 the FMV of the award. This amount becomes the employee's basis in the stock (if the award is paid entirely in stock) for a later sale of the stock, which will generate either long term or short term capital gain/loss treatment (based on the holding period of the stock).
- Restricted Stock¹. Upon vesting, the employer reports in boxes 1, 3 and 5 the FMV of the stock less any amount paid by the employee for such stock. This income, along with any amount paid for the stock, makes up the employee's basis for a later sale of the stock, which will generate either long term or short term capital gain/loss treatment (based on the holding period of the stock).
- Restricted Stock Units (RSUs). If the RSUs are settled in employer stock, upon vesting, the employer reports in boxes 1, 3 and 5 the FMV of the stock less any amount paid by the employee for such stock. This income, along with any amount paid for the stock makes up the employee's basis on a later sale of the stock, which will generate either long term or short term capital gain/loss treatment.

In addition, box 11 of Form W-2 is used to report distributions to an employee from a nonqualified plan. Moreover, the employer can use box 14 of Form W-2 to report other information that it would like to provide to an employee, which can include the tax basis for equity based compensation.

C. Ample Education Materials

An employee who receives equity based compensation has numerous sources of information to provide assistance with basis calculations. For example,

- (1) Plan Document/Award Letter. Plan documents, award letters, participant statements, FAQs/terms and conditions, and other types of summary materials provide various materials to the employee that describe the award, its restrictions and the related tax treatment.

¹ Different rules apply if the employee elects to take the value of restricted property at the time of transfer (minus any amount the employee paid for the award) into income for the year of the transfer by making a Code section 83(b) election. In that case, the general rules above do not apply, and any later appreciation is not W-2 wages. Moreover, the basis in the property is the amount paid for the award plus the amount included in income under the election.

- (2) Prospectus. The prospectus for the stock award includes a description of the tax treatment of the award, which includes a discussion of the tax basis and how to calculate the taxable income in the event of a disposition of the stock. (The Form 10-k may also contain helpful stock award information for certain employees.)
- (3) IRS Publications. The IRS has numerous publications to assist employees in calculating their taxable income in the event of disposition of an employee stock award. For example, IRS Publication 15-B provides a summary of the tax rules applicable to employee stock options, which covers ISOs, ESPPs, and NQSOs. Pub. 15-B, p. 10-11. Moreover, IRS Publication 525 provides a detailed summary of the taxation rules for stock options and restricted property, which generally covers the key equity based compensation programs. And Publication 575 provides information on qualified plan distributions including NUA treatment.

II. New Broker Reporting Requirements

New Code section 6045(g) requires a broker to report on Form 1099-B a customer's adjusted cost basis in a covered security that is disposed of, and whether any gain or loss with respect to such security is long term or short term within the meaning of Code section 1222. The adjusted basis is generally determined under a first-in first-out method or average basis method under Code section 1012, unless the customer notifies the broker otherwise. For options, the amount received with the grant or on exercise is treated as an adjustment to proceeds or adjustment to basis. Code § 6045(h). These new rules were intended to fill in gaps in prior tax reporting requirements and improve taxpayer compliance. As explained above, however, these generic cost basis and capital gain rules generally do not apply to equity based compensation. Rather, each employer-based arrangement is governed by various sets of tax rules that combine compensation and capital gain reporting. Therefore, applying these rules to equity based compensation undoubtedly will result in confusing and incorrect basis reporting to employees and is unnecessary.

Code section 6045A requires that every "applicable person" who transfers a covered security to a broker furnish a written statement of the information necessary to meet the requirements of Code section 6045(g) within 15 days of the transfer. As explained above, equity based compensation is subject to entirely different basis and reporting rules, and the appropriate cost basis often cannot be determined at the time the stock is transferred. Therefore, to extend the term "applicable person" to include employers or their agents is likely to result in duplicative and possibly counter-productive reporting by brokers, and, in all events, would be a costly and unwieldy endeavor.

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We appreciate the opportunity to submit comments on Notice 2009-17, and if you have any questions or would like additional information, please contact us at 202-857-0620.

Respectfully Submitted,

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Elizabeth T. Dold

Enclosure