

actment of this Act [Dec. 17, 1999] includes any portion of a benefit maintenance period for any qualified transfer on or before such date, the amendments made by subsection (b) [amending this section] shall not apply to such portion of the cost maintenance period (and such portion shall be treated as a benefit maintenance period)."

EFFECTIVE DATE OF 1994 AMENDMENT

Pub. L. 103-465, title VII, §731(d), Dec. 8, 1994, 108 Stat. 5004, provided that:

"(1) EXTENSION.—The amendments made by subsections (a) and (c)(3) [amending this section] shall apply to taxable years beginning after December 31, 1995.

"(2) BENEFITS.—The amendments made by subsections (b) and (c)(1) and (2) [amending this section] shall apply to qualified transfers occurring after the date of the enactment of this Act [Dec. 8, 1994]."

EFFECTIVE DATE

Pub. L. 101-508, title XII, §12011(c), Nov. 5, 1990, 104 Stat. 1388-571, provided that:

"(1) IN GENERAL.—The amendments made by this section [enacting this section and amending section 401 of this title] shall apply to transfers in taxable years beginning after December 31, 1990.

"(2) WAIVER OF ESTIMATED TAX PENALTIES.—No addition to tax shall be made under section 6654 or section 6655 of the Internal Revenue Code of 1986 for the taxable year preceding the taxpayer's 1st taxable year beginning after December 31, 1990, with respect to any underpayment to the extent such underpayment was created or increased by reason of [former] section 420(b)(4)(B) of such Code (as added by subsection (a))."

APPLICABILITY OF AMENDMENTS BY SUBTITLES A AND B OF TITLE I OF PUB. L. 109-280

For special rules on applicability of amendments by subtitles A (§§101-108) and B (§§111-116) of title I of Pub. L. 109-280 to certain eligible cooperative plans, PBGC settlement plans, and eligible government contractor plans, see sections 104, 105, and 106 of Pub. L. 109-280, set out as notes under section 401 of this title.

PART II—CERTAIN STOCK OPTIONS

Sec.	
421.	General rules.
422.	Incentive stock options.
[422A.	Renumbered.]
423.	Employee stock purchase plans.
424.	Definitions and special rules.
[425.	Renumbered.]

Editorial Notes

AMENDMENTS

1990—Pub. L. 101-508, title XI, §11801(b)(6), (c)(9)(A)(ii), Nov. 5, 1990, 104 Stat. 1388-522, 1388-524, struck out items 422 "Qualified stock options" and 424 "Restricted stock options" and redesignated items 422A and 425 as 422 and 424, respectively.

1981—Pub. L. 97-34, title II, §251(b)(6), Aug. 13, 1981, 95 Stat. 259, added item 422A.

1964—Pub. L. 88-272, title II, §221(a), Feb. 26, 1964, 78 Stat. 63, substituted "CERTAIN STOCK OPTIONS" for "MISCELLANEOUS PROVISIONS" in part II heading, and "General rules" for "Employee stock options" in item 421, and added items 422-425.

§ 421. General rules

(a) Effect of qualifying transfer

If a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a) or 423(a) are met—

(1) no income shall result at the time of the transfer of such share to the individual upon

his exercise of the option with respect to such share;

(2) no deduction under section 162 (relating to trade or business expenses) shall be allowable at any time to the employer corporation, a parent or subsidiary corporation of such corporation, or a corporation issuing or assuming a stock option in a transaction to which section 424(a) applies, with respect to the share so transferred; and

(3) no amount other than the price paid under the option shall be considered as received by any of such corporations for the share so transferred.

(b) Effect of disqualifying disposition

If the transfer of a share of stock to an individual pursuant to his exercise of an option would otherwise meet the requirements of section 422(a) or 423(a) except that there is a failure to meet any of the holding period requirements of section 422(a)(1) or 423(a)(1), then any increase in the income of such individual or deduction from the income of his employer corporation for the taxable year in which such exercise occurred attributable to such disposition, shall be treated as an increase in income or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred. No amount shall be required to be deducted and withheld under chapter 24 with respect to any increase in income attributable to a disposition described in the preceding sentence.

(c) Exercise by estate

(1) In general

If an option to which this part applies is exercised after the death of the employee by the estate of the decedent, or by a person who acquired the right to exercise such option by bequest or inheritance or by reason of the death of the decedent, the provisions of subsection (a) shall apply to the same extent as if the option had been exercised by the decedent, except that—

(A) the holding period and employment requirements of sections 422(a) and 423(a) shall not apply, and

(B) any transfer by the estate of stock acquired shall be considered a disposition of such stock for purposes of section 423(c).

(2) Deduction for estate tax

If an amount is required to be included under section 423(c) in gross income of the estate of the deceased employee or of a person described in paragraph (1), there shall be allowed to the estate or such person a deduction with respect to the estate tax attributable to the inclusion in the taxable estate of the deceased employee of the net value for estate tax purposes of the option. For this purpose, the deduction shall be determined under section 691(c) as if the option acquired from the deceased employee were an item of gross income in respect of the decedent under section 691 and as if the amount includible in gross income under section 423(c) were an amount included in gross income under section 691 in respect of such item of gross income.

(3) Basis of shares acquired

In the case of a share of stock acquired by the exercise of an option to which paragraph (1) applies—

(A) the basis of such share shall include so much of the basis of the option as is attributable to such share; except that the basis of such share shall be reduced by the excess (if any) of (i) the amount which would have been includible in gross income under section 423(c) if the employee had exercised the option on the date of his death and had held the share acquired pursuant to such exercise at the time of his death, over (ii) the amount which is includible in gross income under such section; and

(B) the last sentence of section 423(c) shall apply only to the extent that the amount includible in gross income under such section exceeds so much of the basis of the option as is attributable to such share.

(d) Certain sales to comply with conflict-of-interest requirements

If—

(1) a share of stock is transferred to an eligible person (as defined in section 1043(b)(1)) pursuant to such person's exercise of an option to which this part applies, and

(2) such share is disposed of by such person pursuant to a certificate of divestiture (as defined in section 1043(b)(2)),

such disposition shall be treated as meeting the requirements of section 422(a)(1) or 423(a)(1), whichever is applicable.

(Aug. 16, 1954, ch. 736, 68A Stat. 142; Pub. L. 85-320, §1, Feb. 11, 1958, 72 Stat. 4; Pub. L. 85-866, title I, §§25, 26(a), Sept. 2, 1958, 72 Stat. 1623, 1624; Pub. L. 88-272, title II, §221(a), Feb. 26, 1964, 78 Stat. 63; Pub. L. 97-34, title II, §251(b)(1), Aug. 13, 1981, 95 Stat. 259; Pub. L. 101-508, title XI, §11801(c)(9)(B), Nov. 5, 1990, 104 Stat. 1388-524; Pub. L. 108-357, title II, §251(b), title VIII, §905(a), Oct. 22, 2004, 118 Stat. 1458, 1653.)

Editorial Notes**AMENDMENTS**

2004—Subsec. (b). Pub. L. 108-357, §251(b), inserted at end “No amount shall be required to be deducted and withheld under chapter 24 with respect to any increase in income attributable to a disposition described in the preceding sentence.”

Subsec. (d). Pub. L. 108-357, §905(a), added subsec. (d). 1990—Subsec. (a). Pub. L. 101-508, §11801(c)(9)(B)(i)(I), substituted “422(a) or 423(a)” for “422(a), 422A(a), 423(a), or 424(a)” in introductory provisions.

Subsec. (a)(1). Pub. L. 101-508, §11801(c)(9)(B)(i)(II), struck out “except as provided in section 422(c)(1),” before “no income”.

Subsec. (a)(2). Pub. L. 101-508, §11801(c)(9)(B)(i)(III), substituted “424(a)” for “425(a)”.

Subsec. (b). Pub. L. 101-508, §11801(c)(9)(B)(ii), substituted “422(a) or 423(a)” for “422(a), 422A(a), 423(a), or 424(a)” and “422(a)(1) or 423(a)(1),” for “422(a)(1), 422A(a)(1), 423(a)(1), or 424(a)(1),”.

Subsec. (c)(1)(A). Pub. L. 101-508, §11801(c)(9)(B)(iii)(I), substituted “422(a) and 423(a)” for “422(a), 422A(a), 423(a), and 424(a)”.

Subsec. (c)(1)(B). Pub. L. 101-508, §11801(c)(9)(B)(iii)(II), substituted “section 423(c)” for “sections 423(c) and 424(c)(1)”.

Subsec. (c)(2). (3)(A). Pub. L. 101-508, §11801(c)(9)(B)(iii)(III), substituted “423(c)” for “422(c)(1), 423(c), or 424(c)(1)” wherever appearing.

Subsec. (c)(3)(B). Pub. L. 101-508, §11801(c)(9)(B)(iii)(IV), (V), substituted “section 423(c)” for “sections 422(c)(1), 423(c), and 424(c)(1)” and “such section” for “such sections”.

1981—Subsecs. (a), (b), (c)(1)(A). Pub. L. 97-34 inserted references to section 422A(a) in subsecs. (a), (b), and (c)(1)(A) and to section 422A(a)(1) in subsec. (b).

1964—Pub. L. 88-272 amended section generally, and among other changes, inserted provisions relating to the effect of a qualifying transfer, and to the basis of shares acquired when an option is exercised by an estate, and omitted provisions relating to treatment of restricted stock options, a special rule where option price was between 85 percent and 95 percent of value of stock, acquisition of new stock, definitions, modification, extension, or renewal of option, and corporate reorganizations, liquidations, etc. See sections 421 to 425 of this title.

1958—Subsec. (a). Pub. L. 85-866, §25, inserted sentence authorizing substitution of “grantor corporation” or “corporation issuing or assuming a stock option in a transaction to which subsection (g) is applicable” for “employer corporation”.

Subsec. (d)(6)(C). Pub. L. 85-320 added subpar. (C).

Subsec. (d)(1)(A)(ii). Pub. L. 85-866, §26(a)(1), substituted “in the case of a variable price option” for “in case the purchase price of the stock under the option is fixed or determinable under a formula in which the only variable is the value of the stock at any time during a period of 6 months which includes the time the option is exercised” and inserted “fair” before “market value”.

Subsec. (d)(7). Pub. L. 85-866, §26(a)(2), added par. (7).

Statutory Notes and Related Subsidiaries**EFFECTIVE DATE OF 2004 AMENDMENT**

Pub. L. 108-357, title II, §251(d), Oct. 22, 2004, 118 Stat. 1459, provided that: “The amendments made by this section [amending this section, sections 423, 3121, 3231, and 3306 of this title, and section 409 of Title 42, The Public Health and Welfare] shall apply to stock acquired pursuant to options exercised after the date of the enactment of this Act [Oct. 22, 2004].”

Pub. L. 108-357, title VIII, §905(b), Oct. 22, 2004, 118 Stat. 1653, provided that: “The amendment made by this section [amending this section] shall apply to sales after the date of the enactment of this Act [Oct. 22, 2004].”

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by Pub. L. 97-34 applicable with respect to options granted on or after Jan. 1, 1976, and exercised on or after Jan. 1, 1981, or outstanding on Jan. 1, 1981, or granted on or after Jan. 1, 1976, and outstanding Aug. 13, 1981, see section 251(c) of Pub. L. 97-34, set out as an Effective Date note under section 422 of this title.

EFFECTIVE DATE OF 1964 AMENDMENT

Pub. L. 88-272, title II, §221(e), Feb. 26, 1964, 78 Stat. 75, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(1) Except as provided in paragraphs (2) and (3), the amendments made by this section [enacting sections 422 to 425 and 6039, amending this section, sections 402, 691, 6652, 6678, and the analysis preceding sections 401 and 6031, and renumbering section 3039 as 3040 of this title] shall apply to taxable years ending after December 31, 1963.

“(2) The amendments made by paragraphs (1) and (3) of subsection (b) [enacting section 3039, renumbering former section 3039 as 3040, and amending section 6678 of this title] and paragraph (2) of section 6652(a) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as amended by paragraph (2) of subsection (b)), shall apply to stock transferred pursuant to options exercised on or after January 1, 1964.

“(3) In the case of an option granted after December 31, 1963, and before January 1, 1965—

“(A) paragraphs (1) and (2) of section 422(b) of the Internal Revenue Code of 1986 (as added by subsection (a)), shall not apply, and

“(B) paragraph (1) of section 425(h) of such Code (as added by subsection (a)), shall not apply to any change in the terms of such option made before January 1, 1965, to permit such option to qualify under paragraphs (3), (4), and (5) of such section 422(b).”

EFFECTIVE DATE OF 1958 AMENDMENT

Amendment by section 25 of Pub. L. 85-866 applicable to taxable years beginning after Dec. 31, 1953, and ending after Aug. 16, 1954, see section 1(c)(1) of Pub. L. 85-866, set out as a note under section 165 of this title.

Pub. L. 85-866, title I, §26(b), Sept. 2, 1958, 72 Stat. 1624, provided that: “The amendments made by subsection (a) [amending this section] shall apply with respect to taxable years ending after September 30, 1958.”

Pub. L. 85-320, §3, Feb. 11, 1958, 72 Stat. 5, provided that: “The amendments made by this Act [amending this section and section 1014 of this title] shall apply with respect to taxable years ending after December 31, 1956, but only in the case of employees dying after such date.”

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

§ 422. Incentive stock options

(a) In general

Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an incentive stock option if—

(1) no disposition of such share is made by him within 2 years from the date of the granting of the option nor within 1 year after the transfer of such share to him, and

(2) at all times during the period beginning on the date of the granting of the option and ending on the day 3 months before the date of such exercise, such individual was an employee of either the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming a stock option in a transaction to which section 424(a) applies.

(b) Incentive stock option

For purposes of this part, the term “incentive stock option” means an option granted to an individual for any reason connected with his employment by a corporation, if granted by the employer corporation or its parent or subsidiary corporation, to purchase stock of any of such corporations, but only if—

(1) the option is granted pursuant to a plan which includes the aggregate number of shares which may be issued under options and the employees (or class of employees) eligible to receive options, and which is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

(2) such option is granted within 10 years from the date such plan is adopted, or the date

such plan is approved by the stockholders, whichever is earlier;

(3) such option by its terms is not exercisable after the expiration of 10 years from the date such option is granted;

(4) the option price is not less than the fair market value of the stock at the time such option is granted;

(5) such option by its terms is not transferable by such individual otherwise than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by him; and

(6) such individual, at the time the option is granted, does not own stock possessing more than 10 percent of the total combined voting power of all classes of stock of the employer corporation or of its parent or subsidiary corporation.

Such term shall not include any option if (as of the time the option is granted) the terms of such option provide that it will not be treated as an incentive stock option. Such term shall not include any option if an election is made under section 83(i) with respect to the stock received in connection with the exercise of such option.

(c) Special rules

(1) Good faith efforts to value stock

If a share of stock is transferred pursuant to the exercise by an individual of an option which would fail to qualify as an incentive stock option under subsection (b) because there was a failure in an attempt, made in good faith, to meet the requirement of subsection (b)(4), the requirement of subsection (b)(4) shall be considered to have been met. To the extent provided in regulations by the Secretary, a similar rule shall apply for purposes of subsection (d).

(2) Certain disqualifying dispositions where amount realized is less than value at exercise

If—

(A) an individual who has acquired a share of stock by the exercise of an incentive stock option makes a disposition of such share within either of the periods described in subsection (a)(1), and

(B) such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to such individual,

then the amount which is includible in the gross income of such individual, and the amount which is deductible from the income of his employer corporation, as compensation attributable to the exercise of such option shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of such share.

(3) Certain transfers by insolvent individuals

If an insolvent individual holds a share of stock acquired pursuant to his exercise of an incentive stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary in any proceeding under title 11 or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of his creditors in