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).

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

Section 221(e) of Pub. L. 88–272, 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 AMENDMENTS

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.

Section 26(b) of Pub. L. 85–866 provided that: ''The amendments made by subsection (a) [amending this section] shall apply with respect to taxable years ending after September 30, 1958.''

Section 3 of Pub. L. 85–320 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.

(c) Special rules

(1) Good faith efforts to value of 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 such proceeding, shall constitute a disposition of such share for purposes of subsection (a)(1).

(4) Permissible provisions

An option which meets the requirements of subsection (b) shall be treated as an incentive stock option even if—

(A) the employee may pay for the stock with stock of the corporation granting the option,

(B) the employee has a right to receive property at the time of exercise of the option, or

(C) the option is subject to any condition not inconsistent with the provisions of subsection (b).

Subparagraph (B) shall apply to a transfer of property (other than cash) only if section 83 applies to the property so transferred.

(5) 10-percent shareholder rule

Subsection (b)(6) shall not apply if at the time such option is granted the option price is at least 110 percent of the fair market value of the stock subject to the option and such option by its terms is not exercisable after the expiration of 5 years from the date such option is granted.

(6) Special rule when disabled

For purposes of subsection (a)(2), in the case of an employee who is disabled (within the meaning of section 22(e)(3)), the 3-month period of subsection (a)(2) shall be 1 year.

(7) Fair market value

For purposes of this section, the fair market value of stock shall be determined without regard to any restriction other than a restriction which, by its terms, will never lapse.

(d) $100,000 per year limitation

(1) In general

To the extent that the aggregate fair market value of stock with respect to which incentive stock options (determined without regard to this subsection) are exercisable for the 1st time by any individual during any calendar year (under all plans of the individual's employer corporation and its parent and subsidiary corporations) exceeds $100,000, such options shall be treated as options which are not incentive stock options.

(2) Ordering rule

Paragraph (1) shall be applied by taking options into account in the order in which they were granted.

(3) Determination of fair market value

For purposes of paragraph (1), the fair market value of any stock shall be determined as of the time the option with respect to such stock is granted.

(Added Pub. L. 97–34, title II, §251(a), Aug. 13, 1981, 95 Stat. 256, §422A; amended Pub. L. 97–448,

title I, § 102(j)(1)–(4), Jan. 12, 1983, 96 Stat. 2373; Pub. L. 98–369, div. A, title V, § 555(a)(1), div. B, title VI, § 2662(f)(1), July 18, 1984, 98 Stat. 897, 1159; Pub. L. 99–514, title III, § 321(a), (b), title XVIII, § 1847(b)(5), Oct. 22, 1986, 100 Stat. 2220, 2856; Pub. L. 100–647, title I, § 1003(d)(1)(A), (2), Nov. 10, 1988, 102 Stat. 3384; renumbered § 422 and amended Pub. L. 101–508, title XI, § 11801(c)(9)(A)(i), (C), Nov. 5, 1990, 104 Stat. 1388–524, 1388–525.)

PRIOR PROVISIONS

A prior section 422, added Pub. L. 88–272, title II, § 221(a), Feb. 26, 1964, 78 Stat. 64; amended Pub. L. 94–455, title VI, § 603(a), (b), title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1574, 1834; Pub. L. 96–589, § 6(i)(3), Dec. 24, 1980, 94 Stat. 3410, related to qualified stock options, prior to repeal by Pub. L. 101–508, title XI, § 11801(a)(20), Nov. 5, 1990, 104 Stat. 1388–521. For savings provision, see section 11821(b) of Pub. L. 101–508, set out as a note under section 45K of this title.

AMENDMENTS

1990—Pub. L. 101–508, § 11801(c)(9)(A)(i), renumbered section 422A of this title as this section.

Subsec. (a)(2). Pub. L. 101–508, § 11801(c)(9)(C)(i), substituted ''424(a)'' for ''425(a)''.

Subsec. (c)(5) to (8). Pub. L. 101–508, § 11801(c)(9)(C)(ii), redesignated pars. (6) to (8) as (5) to (7), respectively, and struck out former par. (5) ''Coordination with sections 422 and 424'' which read as follows: ''Sections 422 and 424 shall not apply to an incentive stock option.''

1988—Subsec. (b). Pub. L. 100–647, § 1003(d)(1)(A), inserted at end ''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.''

Subsec. (b)(7). Pub. L. 100–647, § 1003(d)(2)(B), struck out par. (7) which read as follows: ''under the terms of the plan, the aggregate fair market value (determined at the time the option is granted) of the stock with respect to which incentive stock options are exercisable for the 1st time by such individual during any calendar year (under all such plans of the individual's employer corporation and its parent and subsidiary corporations) shall not exceed $100,000.''

Subsec. (c)(1). Pub. L. 100–647, § 1003(d)(2)(C), substituted ''subsection (d)'' for ''paragraph (7) of subsection (b)''.

Subsec. (d). Pub. L. 100–647, § 1003(d)(2)(A), added subsec. (d).

1986—Subsec. (b)(7). Pub. L. 99–514, § 321(a), added par. (7) and struck out former par. (7) which read as follows: ''such option by its terms is not exercisable while there is outstanding (within the meaning of subsection (c)(7)) any incentive stock option which was granted, before the granting of such option, to such individual to purchase stock in his employer corporation or in a corporation which (at the time of the granting of such option) is a parent or subsidiary corporation of the employer corporation, or in a predecessor corporation of any of such corporations; and''.

Subsec. (b)(8). Pub. L. 99–514, § 321(a), struck out par. (8) which read as follows: ''in the case of an option granted after December 31, 1980, under the terms of the plan the aggregate fair market value (determined as of the time the option is granted) of the stock for which any employee may be granted incentive stock options in any calendar year (under all such plans of his employer corporation and its parent and subsidiary corporation) shall not exceed $100,000 plus any unused limit carryover to such year.''

Subsec. (c)(1). Pub. L. 99–514, § 321(b)(2), substituted ''paragraph (7) of subsection (b)'' for ''paragraph (8) of subsection (b) and paragraph (4) of this subsection''.

Subsec. (c)(4). Pub. L. 99–514, § 321(b)(1), redesignated par. (5) as (4) and struck out former par. (4) relating to carryover of unused limit.

Subsec. (c)(5), (6). Pub. L. 99–514, § 321(b)(1)(B), redesignated pars. (6) and (8) as (5) and (6), respectively. Former par. (5) redesignated (4).

Subsec. (c)(7). Pub. L. 99–514, § 321(b)(1), redesignated par. (9) as (7) and struck out former par. (7) which provided that for purposes of subsec. (b)(7) any incentive stock option be treated as outstanding until such option was exercised in full or expired by reason of lapse of time.

Subsec. (c)(8). Pub. L. 99–514, § 321(b)(1)(B), redesignated par. (10) as (8). Former par. (8) redesignated (6).

Subsec. (c)(9). Pub. L. 99–514, § 321(b)(1)(B), redesignated par. (9) as (7).

Pub. L. 99–514, § 1847(b)(5), substituted ''section 22(e)(3)'' for ''section 37(e)(3)''.

Subsec. (c)(10). Pub. L. 99–514, § 321(b)(1)(B), redesignated par. (10) as (8).

1984—Subsec. (c)(9). Pub. L. 98–369, § 2662(f)(1), substituted ''section 37(e)(3)'' for ''section 105(d)(4)''.

Subsec. (c)(10). Pub. L. 98–369, § 555(a)(1), added par. (10).

1983—Subsec. (b)(8). Pub. L. 97–448, § 102(j)(1), substituted ''granted incentive stock options'' for ''granted options''.

Subsec. (c)(1). Pub. L. 97–448, § 102(j)(2), substituted ''Good faith efforts to value stock'' for ''Exercise of option when price is less than value of stock'' as par. (1) heading and inserted sentence providing that, to the extent provided in regulations by the Secretary, a rule similar to that already enunciated in the paragraph applies for purposes of par. (8) of subsec. (b) and par. (4) of subsec. (c).

Subsec. (c)(2)(A). Pub. L. 97–448, § 102(j)(3), substituted ''either of the periods'' for ''the 2-year period''.

Subsec. (c)(4)(A)(ii). Pub. L. 97–448, § 102(j)(4), substituted ''granted incentive stock options'' for ''granted options''.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100–647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99–514, to which such amendment relates, see section 1019(a) of Pub. L. 100–647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Section 321(c) of Pub. L. 99–514 provided that: ''The amendments made by this section [amending this section] shall apply to options granted after December 31, 1986.''

Amendment by section 1847(b)(5) of Pub. L. 99–514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98–369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99–514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 555(c)(1) of Pub. L. 98–369, as amended by Pub. L. 99–514, title XVIII, § 1855(a)(1), Oct. 22, 1986, 100 Stat. 2882, provided that: ''The amendment made by subsection (a)(1) [amending this section] shall apply to options granted after March 20, 1984, except that such subsection shall not apply to any incentive stock option granted before September 20, 1984, pursuant to a plan adopted or corporate action taken by the board of directors of the grantor corporation before May 15, 1984.''

Amendment by section 2662 of Pub. L. 98–369 effective as though included in the enactment of the Social Security Amendments of 1983, Pub. L. 98–21, see section 2664(a) of Pub. L. 98–369, set out as a note under section 401 of Title 42, The Public Health and Welfare.

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97–448 effective, except as otherwise provided, as if it had been included in the provision of the Economic Recovery Tax Act of 1981, Pub. L. 97–34, to which such amendment relates, see section 109 of Pub. L. 97–448, set out as a note under section 1 of this title.

EFFECTIVE DATE

Section 251(c) of Pub. L. 97–34, as amended by Pub. L. 99–514, § 2, Oct. 22, 1986, 100 Stat. 2095, provided that:

''(1) OPTIONS TO WHICH SECTION APPLIES.—

''(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by this section [enacting this section and amending sections 421, 425 [now 424], and 6039 of this title] shall apply with respect to options granted on or after January 1, 1976, and exercised on or after January 1, 1981, or outstanding on such date.

''(B) ELECTION AND DESIGNATION OF OPTIONS.—In the case of an option granted before January 1, 1981, the amendments made by this section shall apply only if the corporation granting such option elects (in the manner and at the time prescribed by the Secretary of the Treasury or his delegate) to have the amendments made by this section apply to such option. The aggregate fair market value (determined at the time the option is granted) of the stock for which any employee was granted options (under all plans of his employer corporation and its parent and subsidiary corporations) to which the amendments made by this section apply by reason of this subparagraph shall not exceed $50,000 per calendar year ans shall not exceed $200,000 in the aggregate.

''(2) CHANGES IN TERMS OF OPTIONS.—In the case of an option granted on or after January 1, 1976, and outstanding on the date of the enactment of this Act [Aug. 13, 1981], paragraph (1) of section 425(h) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] shall not apply to any change in the terms of such option (or the terms of the plan under which granted, including shareholder approval) made within 1 year after such date of enactment to permit such option to qualify as a incentive stock option.''

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.

TREATMENT OF OPTIONS AS INCENTIVE STOCK OPTIONS

Section 1003(d)(1)(B) of Pub. L. 100–647 provided that: ''In the case of an option granted after December 31, 1986, and on or before the date of the enactment of this Act [Nov. 10, 1988], such option shall not be treated as an incentive stock option if the terms of such option are amended before the date 90 days after such date of enactment to provide that such option will not be treated as an incentive stock option.''

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101–1147 and 1171–1177] or title XVIII [§§ 1800–1899A] of Pub. L. 99–514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99–514, as amended, set out as a note under section 401 of this title.

[§ 422A. Renumbered § 422]

§ 423. Employee stock purchase plans

(a) General rule

Section 421(a) shall apply with respect to the transfer of a share of stock to an individual pursuant to his exercise of an option granted after December 31, 1963, under an employee stock purchase plan (as defined in subsection (b)) if—

(1) no disposition of such share is made by him within 2 years after 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 with the date of the granting of the option and ending on the day 3 months before the date of such exercise, he is an employee of 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) Employee stock purchase plan

For purposes of this part, the term ''employee stock purchase plan'' means a plan which meets the following requirements:

(1) the plan provides that options are to be granted only to employees of the employer corporation or of its parent or subsidiary corporation to purchase stock in any such corporation;

(2) such plan is approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted;

(3) under the terms of the plan, no employee can be granted an option if such employee, immediately after the option is granted, owns stock possessing 5 percent or more of the total combined voting power or value of all classes of stock of the employer corporation or of its parent or subsidiary corporation. For purposes of this paragraph, the rules of section 424(d) shall apply in determining the stock ownership of an individual, and stock which the employee may purchase under outstanding options shall be treated as stock owned by the employee;

(4) under the terms of the plan, options are to be granted to all employees of any corporation whose employees are granted any of such options by reason of their employment by such corporation, except that there may be excluded—

(A) employees who have been employed less than 2 years,

(B) employees whose customary employment is 20 hours or less per week,

(C) employees whose customary employment is for not more than 5 months in any calendar year, and

(D) highly compensated employees (within the meaning of section 414(q));

(5) under the terms of the plan, all employees granted such options shall have the same rights and privileges, except that the amount of stock which may be purchased by any employee under such option may bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of employees, and the plan may provide that no employee may purchase more than a maximum amount of stock fixed under the plan;

(6) under the terms of the plan, the option price is not less than the lesser of—

(A) an amount equal to 85 percent of the fair market value of the stock at the time such option is granted, or

(B) an amount which under the terms of the option may not be less than 85 percent of