

(ii) If the sale to M is a disposition that meets the requirements of paragraph (b)(2)(i) of this section, instead of \$100 which otherwise would have been includible as compensation under §1.83-7, under paragraph (b)(2)(i) of this section, A must include only \$50 (the excess of the amount realized on such sale, \$150, over the adjusted basis of the share, \$100) in gross income as compensation attributable to the exercise of the incentive stock option. Because A's basis for the share is \$150 (the \$100 which A paid for the share, plus the \$50 increase in basis resulting from the inclusion of that amount in A's gross income as compensation attributable to the exercise of the option), A realizes no capital gain or loss as a result of the sale. If the requirements of section 83(h) and §1.83-6(a) are satisfied and the deduction is otherwise allowable under section 162, for its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of \$50 for the compensation attributable to A's exercise of the option and disqualifying disposition of the share.

(iii) Assume the same facts as in paragraph (i) of this *Example 3*, except that 10 days after the sale to M, A purchases substantially identical stock. Because under section 1091(a) a loss (if it were sustained on the sale) would not be recognized on the sale, under paragraph (b)(2)(ii) of this section, the special rule described in paragraph (b)(2)(i) of this section does not apply. A must include \$100 (the difference between the fair market value of the share on the date of transfer, \$200, and the amount paid for the share, \$100) in gross income as compensation attributable to the exercise of the option for the taxable year in which the disqualifying disposition occurred. A recognizes no capital gain or loss on the transaction. If the requirements of section 83(h) and §1.83-6(a) are satisfied and the deduction is otherwise allowable under section 162, for its taxable year in which the disqualifying disposition occurs X Corporation is allowed a \$100 deduction for compensation attributable to A's exercise of the option and disqualifying disposition of the share.

(iv) Assume the same facts as in paragraph (ii) of this *Example 3*, except that A sells the share for \$50. Under paragraph (b)(2)(i) of this section, A is not required to include any amount in gross income as compensation attributable to the exercise of the option. A is allowed a capital loss of \$50 (the difference between the amount realized on the sale, \$50, and the adjusted basis of the share, \$100). X Corporation is not allowed any deduction attributable to A's exercise of the option and disqualifying disposition of the share.

(c) *Failure to satisfy employment requirement.* Section 1.421-2(a) does not apply to the transfer of a share of stock pursuant to the exercise of an in-

centive stock option if the employment requirement, as determined under paragraph (a)(1)(i)(B) of this section, is not met at the time of the exercise of such option. Consequently, the effects of such a transfer are determined under the rules of §1.83-7. For rules relating to the employment relationship, see §1.421-1(h).

[T.D. 9144, 69 FR 46411, Aug. 3, 2004; 69 FR 61310, Oct. 18, 2004; 69 FR 70551, Dec. 7, 2004]

§ 1.422-2 Incentive stock options defined.

(a) *Incentive stock option defined*—(1) *In general.* The term *incentive stock option* means an option that meets the requirements of paragraph (a)(2) of this section on the date of grant. An incentive stock option is also subject to the \$100,000 limitation described in §1.422-4. An incentive stock option may contain a number of permissible provisions that do not affect the status of the option as an incentive stock option. See §1.422-5 for rules relating to permissible provisions of an incentive stock option.

(2) *Option requirements.* To qualify as an incentive stock option under this section, an option must be granted to an individual in connection with the individual's employment by the corporation granting such option (or by a related corporation as defined in §1.421-1(i)(2)), and granted only for stock of any of such corporations. In addition, the option must meet all of the following requirements—

(i) It must be granted pursuant to a plan that meets the requirements described in paragraph (b) of this section;

(ii) It must be granted within 10 years from the date of the adoption of the plan or the date such plan is approved by the stockholders, whichever is earlier (see paragraph (c) of this section);

(iii) It must not be exercisable after the expiration of 10 years from the date of grant (see paragraph (d) of this section);

(iv) It must provide that the option price per share is not less than the fair market value of the share on the date of grant (see paragraph (e) of this section);

(v) By its terms, it must not be transferrable by the individual to

whom the option is granted other than by will or the laws of descent and distribution, and must be exercisable, during such individual's lifetime, only by such individual (see §§1.421-1(b)(2) and 1.421-2(c)); and

(vi) Except as provided in paragraph (f) of this section, it must be granted to an individual who, 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 corporation employing such individual or of any related corporation of such corporation.

(3) *Amendment of option terms.* Except as otherwise provided in §1.424-1, the amendment of the terms of an incentive stock option may cause it to cease to be an option described in this section. If the terms of an option that has lost its status as an incentive stock option are subsequently changed with the intent to re-qualify the option as an incentive stock option, such change results in the grant of a new option on the date of the change. See §1.424-1(e).

(4) *Terms provide option not an incentive stock option.* If the terms of an option, when granted, provide that it will not be treated as an incentive stock option, such option is not treated as an incentive stock option.

(b) *Option plan*—(1) *In general.* An incentive stock option must be granted pursuant to a plan that meets the requirements of this paragraph (b). The authority to grant other stock options or other stock-based awards pursuant to the plan, where the exercise of such other options or awards does not affect the exercise of incentive stock options granted pursuant to the plan, does not disqualify such incentive stock options. The plan must be in writing or electronic form, provided that such writing or electronic form is adequate to establish the terms of the plan. See §1.422-5 for rules relating to permissible provisions of an incentive stock option.

(2) *Stockholder approval.* (i) The plan required by this paragraph (b) must be approved by the stockholders of the corporation granting the incentive stock option within 12 months before or after the date such plan is adopted. Ordinarily, a plan is adopted when it is approved by the granting corporation's

board of directors, and the date of the board's action is the reference point for determining whether stockholder approval occurs within the applicable 24-month period. However, if the board's action is subject to a condition (such as stockholder approval) or the happening of a particular event, the plan is adopted on the date the condition is met or the event occurs, unless the board's resolution fixes the date of approval as the date of the board's action.

(ii) For purposes of paragraph (b)(2)(i) of this section, the stockholder approval must comply with the rules described in §1.422-3.

(iii) The provisions relating to the maximum aggregate number of shares to be issued under the plan (described in paragraph (b)(3) of this section) and the employees (or class or classes of employees) eligible to receive options under the plan (described in paragraph (b)(4) of this section) are the only provisions of a stock option plan that, if changed, must be re-approved by stockholders for purposes of section 422(b)(1). Any increase in the maximum aggregate number of shares that may be issued under the plan (other than an increase merely reflecting a change in the number of outstanding shares, such as a stock dividend or stock split), or change in the designation of the employees (or class or classes of employees) eligible to receive options under the plan is considered the adoption of a new plan requiring stockholder approval within the prescribed 24-month period. In addition, a change in the granting corporation or the stock available for purchase or award under the plan is considered the adoption of a new plan requiring new stockholder approval within the prescribed 24-month period. Any other changes in the terms of an incentive stock option plan are not considered the adoption of a new plan and, thus, do not require stockholder approval.

(3) *Maximum aggregate number of shares.* (i) The plan required by this paragraph (b) must designate the maximum aggregate number of shares that may be issued under the plan through incentive stock options. If nonstatutory options or other stock-based awards may be granted, the plan may

separately designate terms for each type of option or other stock-based awards and designate the maximum number of shares that may be issued under such option or other stock-based awards. Unless otherwise specified, all terms of the plan apply to all options and other stock-based awards that may be granted under the plan.

(ii) A plan that merely provides that the number of shares that may be issued as incentive stock options under such plan may not exceed a stated percentage of the shares outstanding at the time of each offering or grant under such plan does not satisfy the requirement that the plan state the maximum aggregate number of shares that may be issued under the plan. However, the maximum aggregate number of shares that may be issued under the plan may be stated in terms of a percentage of the authorized, issued, or outstanding shares at the date of the adoption of the plan. The plan may specify that the maximum aggregate number of shares available for grants under the plan may increase annually by a specified percentage of the authorized, issued, or outstanding shares at the date of the adoption of the plan. A plan which provides that the maximum aggregate number of shares that may be issued as incentive stock options under the plan may change based on any other specified circumstances satisfies the requirements of this paragraph (b)(3) only if the stockholders approve an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event.

(iii) It is permissible for the plan to provide that, shares purchasable under the plan may be supplied to the plan through acquisitions of stock on the open market; shares purchased under the plan and forfeited back to the plan; shares surrendered in payment of the exercise price of an option; shares withheld for payment of applicable employment taxes and/or withholding obligations resulting from the exercise of an option.

(iv) If there is more than one plan under which incentive stock options may be granted and stockholders of the granting corporation merely approve a maximum aggregate number of shares

that are available for issuance under such plans, the stockholder approval requirements described in paragraph (b)(2) of this section are not satisfied. A separate maximum aggregate number of shares available for issuance pursuant to incentive stock options must be approved for each plan.

(4) *Designation of employees.* The plan described in this paragraph (b), as adopted and approved, must indicate the employees (or class or classes of employees) eligible to receive the options or other stock-based awards to be granted under the plan. This requirement is satisfied by a general designation of the employees (or the class or classes of employees) eligible to receive options or other stock-based awards under the plan. Designations such as “key employees of the grantor corporation”; “all salaried employees of the grantor corporation and its subsidiaries, including subsidiaries which become such after adoption of the plan;” or “all employees of the corporation” meet this requirement. This requirement is considered satisfied even though the board of directors, another group, or an individual is given the authority to select the particular employees who are to receive options or other stock-based awards from a described class and to determine the number of shares to be optioned or granted to each such employee. If individuals other than employees may be granted options or other stock-based awards under the plan, the plan must separately designate the employees or classes of employees eligible to receive incentive stock options.

(5) *Conflicting option terms.* An option on stock available for purchase or grant under the plan is treated as having been granted pursuant to a plan even if the terms of the option conflict with the terms of the plan, unless such option is granted to an employee who is ineligible to receive options under the plan, options have been granted on stock in excess of the aggregate number of shares which may be issued under the plan, or the option provides otherwise.

(6) The following examples illustrate the principles of this paragraph (b):

Example 1. Stockholder approval. (i) S Corporation is a subsidiary of P Corporation, a

publicly traded corporation. On January 1, 2006, S adopts a plan under which incentive stock options for S stock are granted to S employees.

(ii) To meet the requirements of paragraph (b)(2) of this section, the plan must be approved by the stockholders of S (in this case, P) within 12 months before or after January 1, 2006.

(iii) Assume the same facts as in paragraph (i) of this *Example 1*, except that the plan was adopted on January 1, 2010. Assume further that the plan was approved by the stockholders of S (in this case, P) on March 1, 2010. On January 1, 2012, S changes the plan to provide that incentive stock options for P stock will be granted to S employees under the plan. Because there is a change in the stock available for grant under the plan, the change is considered the adoption of a new plan that must be approved by the stockholder of S (in this case, P) within 12 months before or after January 1, 2012.

Example 2. Stockholder approval. (i) Assume the same facts as in paragraph (i) of *Example 1*, except that on March 15, 2007, P completely disposes of its interest in S. Thereafter, S continues to grant options for S stock to S employees under the plan.

(ii) The new S options are granted under a plan that meets the stockholder approval requirements of paragraph (b)(2) of this section without regard to whether S seeks approval of the plan from the stockholders of S after P disposes of its interest in S.

(iii) Assume the same facts as in paragraph (i) of this *Example 2*, except that under the plan as adopted on January 1, 2006, only options for P stock are granted to S employees. Assume further that after P disposes of its interest in S, S changes the plan to provide for the grant of options for S stock to S employees. Because there is a change in the stock available for purchase or grant under the plan, under paragraph (b)(2)(iii) of this section, the stockholders of S must approve the plan within 12 months before or after the change to the plan to meet the stockholder approval requirements of paragraph (b) of this section.

Example 3. Stockholder approval. (i) Corporation X maintains a plan under which incentive stock options may be granted to all eligible employees. Corporation Y does not maintain an incentive stock option plan. On May 15, 2006, Corporation X and Corporation Y consolidate under state law to form one corporation. The new corporation will be named Corporation Y. The consolidation agreement describes the Corporation X plan, including the maximum aggregate number of shares available for issuance pursuant to incentive stock options after the consolidation and the employees eligible to receive options under the plan. Additionally, the consolidation agreement states that the plan will be continued by Corporation Y after the con-

solidation and incentive stock options will be issued by Corporation Y. The consolidation agreement is unanimously approved by the shareholders of Corporations X and Y on May 1, 2006. Corporation Y assumes the plan formerly maintained by Corporation X and continues to grant options under the plan to all eligible employees.

(ii) Because there is a change in the granting corporation (from Corporation X to Corporation Y), under paragraph (b)(2)(iii) of this section, Corporation Y is considered to have adopted a new plan. Because the plan is fully described in the consolidation agreement, including the maximum aggregate number of shares available for issuance pursuant to incentive stock options and employees eligible to receive options under the plan, the approval of the consolidation agreement by the shareholders constitutes approval of the plan. Thus, the shareholder approval of the consolidation agreement satisfies the shareholder approval requirements of paragraph (b)(2) of this section, and the plan is considered to be adopted by Corporation Y and approved by its shareholders on May 1, 2006.

Example 4. Maximum aggregate number of shares. X Corporation maintains a plan under which statutory options and nonstatutory options may be granted. The plan designates the number of shares that may be used for incentive stock options. Because the maximum aggregate number of shares that will be used for incentive stock options is designated in the plan, the requirements of paragraph (b)(3) of this section are satisfied.

Example 5. Maximum aggregate number of shares. Y Corporation adopts an incentive stock option plan on November 1, 2006. On that date, there are two million outstanding shares of Y Corporation stock. The plan provides that the maximum aggregate number of shares that may be issued under the plan may not exceed 15% of the outstanding number of shares of Y Corporation on November 1, 2006. Because the maximum aggregate number of shares that may be issued under the plan is designated in the plan, the requirements of paragraph (b)(3) of this section are met.

Example 6. Maximum aggregate number of shares. (i) B Corporation adopts an incentive stock option plan on March 15, 2005. The plan provides that the maximum aggregate number of shares available for issuance under the plan is 50,000, increased on each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares.

(ii) Because the maximum aggregate number of shares is not designated under the plan, the requirements of paragraph (b)(3) of this section are not met.

(iii) Assume the same facts as in paragraph (i) of this *Example 6*, except that the plan provides that the maximum aggregate number of shares available under the plan is the

lesser of (a) 50,000 shares, increased each anniversary date of the adoption of the plan by 5 percent of the then-outstanding shares, or (b) 200,000 shares. Because the maximum aggregate number of shares that may be issued under the plan is designated as the lesser of one of two numbers, one of which provides an immediately determinable maximum aggregate number of shares that may be issued under the plan in any event, the requirements of paragraph (b)(3) of this section are met.

(c) *Duration of option grants under the plan.* An incentive stock option must be granted within 10 years from the date that the plan under which it is granted is adopted or the date such plan is approved by the stockholders, whichever is earlier. To grant incentive stock options after the expiration of the 10-year period, a new plan must be adopted and approved.

(d) *Period for exercising options.* An incentive stock option, by its terms, must not be exercisable after the expiration of 10 years from the date such option is granted, or 5 years from the date such option is granted to an employee described in paragraph (f) of this section. An option that does not contain such a provision when granted is not an incentive stock option.

(e) *Option price.* (1) Except as provided by paragraph (e)(2) of this section, the option price of an incentive stock option must not be less than the fair market value of the stock subject to the option at the time the option is granted. The option price may be determined in any reasonable manner, including the valuation methods permitted under §20.2031-2 of this chapter, so long as the minimum price possible under the terms of the option is not less than the fair market value of the stock on the date of grant. For general rules relating to the option price, see §1.421-1(e). For rules relating to the determination of when an option is granted, see §1.421-1(c).

(2)(i) If a share of stock is transferred to an individual pursuant to the exercise of an option which fails to qualify as an incentive stock option merely because there was a failure of an attempt, made in good faith, to meet the option price requirements of paragraph (e)(1) of this section, the requirements of such paragraph are considered to have been met. Whether there was a

good-faith attempt to set the option price at not less than the fair market value of the stock subject to the option at the time the option was granted depends on the relevant facts and circumstances.

(ii) For publicly held stock that is actively traded on an established market at the time the option is granted, determining the fair market value of such stock by the appropriate method described in §20.2031-2 of this chapter establishes that a good-faith attempt to meet the option price requirements of this paragraph (e) was made.

(iii) For non-publicly traded stock, if it is demonstrated, for example, that the fair market value of the stock at the date of grant was based upon an average of the fair market values as of such date set forth in the opinions of completely independent and well-qualified experts, such a demonstration generally establishes that there was a good-faith attempt to meet the option price requirements of this paragraph (e). The optionee's status as a majority or minority stockholder may be taken into consideration.

(iv) Regardless of whether the stock offered under an option is publicly traded, a good-faith attempt to meet the option price requirements of this paragraph (e) is not demonstrated unless the fair market value of the stock on the date of grant is determined with regard to *nonlapse restrictions* (as defined in §1.83-3(h)) and without regard to *lapse restrictions* (as defined in §1.83-3(i)).

(v) Amounts treated as interest and amounts paid as interest under a deferred payment arrangement are not includible as part of the option price. See §1.421-1(e)(1). An attempt to set the option price at not less than fair market value is not regarded as made in good faith where an adjustment of the option price to reflect amounts treated as interest results in the option price being lower than the fair market value on which the option price was based.

(3) Notwithstanding that the option price requirements of paragraphs (e)(1) and (2) of this section are satisfied by an option granted to an employee whose stock ownership exceeds the limitation provided by paragraph (f) of

this section, such option is not an incentive stock option when granted unless it also complies with paragraph (f) of this section. If the option, when granted, does not comply with the requirements described in paragraph (f) of this section, such option can never become an incentive stock option, even if the employee's stock ownership does not exceed the limitation of paragraph (f) of this section when such option is exercised.

(f) *Options granted to certain stockholders.* (1) If, immediately before an option is granted, an individual owns (or is treated as owning) stock possessing more than 10 percent of the total combined voting power of all classes of stock of the corporation employing the optionee or of any related corporation of such corporation, then an option granted to such individual cannot qualify as an incentive stock option unless the option price is at least 110 percent of the stock's fair market value on the date of grant and such option by its terms is not exercisable after the expiration of 5 years from the date of grant. For purposes of determining the minimum option price for purposes of this paragraph (f), the rules described in paragraph (e)(2) of this section, relating to the good-faith determination of the option price, do not apply.

(2) For purposes of determining the stock ownership of the optionee, the stock attribution rules of § 1.424-1(d) apply. Stock that the optionee may purchase under outstanding options is not treated as stock owned by the individual. The determination of the percentage of the total combined voting power of all classes of stock of the employer corporation (or of its related corporations) that is owned by the optionee is made with respect to each such corporation in the related group by comparing the voting power of the shares owned (or treated as owned) by the optionee to the aggregate voting power of all shares of each such corporation actually issued and outstanding immediately before the grant of the option to the optionee. The aggregate voting power of all shares actually issued and outstanding immediately before the grant of the option does not include the voting power of

treasury shares or shares authorized for issue under outstanding options held by the individual or any other person.

(3) *Examples.* The rules of this paragraph (f) are illustrated by the following examples:

Example 1. (i) E, an employee of M Corporation, owns 15,000 shares of M Corporation common stock, which is the only class of stock outstanding. M has 100,000 shares of its common stock outstanding. On January 1, 2005, when the fair market value of M stock is \$100, E is granted an option with an option price of \$100 and an exercise period of 10 years from the date of grant.

(ii) Because E owns stock possessing more than 10 percent of the total combined voting power of all classes of M Corporation stock, M cannot grant an incentive stock option to E unless the option is granted at an option price of at least 110 percent of the fair market value of the stock subject to the option and the option, by its terms, expires no later than 5 years from its date of grant. The option granted to E fails to meet the option-price and term requirements described in paragraph (f)(1) of this section and, thus, the option is not an incentive stock option.

(iii) Assume the same facts as in paragraph (i) of this *Example 1*, except that E's father and brother each owns 7,500 shares of M Corporation stock, and E owns no M stock in E's own name. Because under the attribution rules of § 1.424-1(d), E is treated as owning stock held by E's parents and siblings, M cannot grant an incentive stock option to E unless the option price is at least 110 percent of the fair market value of the stock subject to the option, and the option, by its terms, expires no later than 5 years from the date of grant.

Example 2. Assume the same facts as in paragraph (i) of this *Example 1*. Assume further that M is a subsidiary of P Corporation. Regardless of whether E owns any P stock and the number of P shares outstanding, if P Corporation grants an option to E which purports to be an incentive stock option, but which fails to meet the 110-percent-option-price and 5-year-term requirements, the option is not an incentive stock option because E owns more than 10 percent of the total combined voting power of all classes of stock of a related corporation of P Corporation (*i.e.*, M Corporation). An individual who owns (or is treated as owning) stock in excess of the ownership specified in paragraph (f)(1) of this section, in any corporation in a group of corporations consisting of the employer corporation and its related corporations, cannot be granted an incentive stock option by any corporation in the group unless such option meets the 110-percent-option-price and 5-

year-term requirements of paragraph (f)(1) of this section.

Example 3. (i) F is an employee of R Corporation. R has only one class of stock, of which 100,000 shares are issued and outstanding. F owns no stock in R Corporation or any related corporation of R Corporation. On January 1, 2005, R grants a 10-year incentive stock option to F to purchase 50,000 shares of R stock at \$3 per share, the fair market value of R stock on the date of grant of the option. On April 1, 2005, F exercises half of the January option and receives 25,000 shares of R stock that previously were not outstanding. On July 1, 2005, R grants a second 50,000 share option to F which purports to be an incentive stock option. The terms of the July option are identical to the terms of the January option, except that the option price is \$3.25 per share, which is the fair market value of R stock on the date of grant of the July option.

(ii) Because F does not own more than 10% of the total combined voting power of all classes of stock of R Corporation or any related corporation on the date of the grant of the January option and the pricing requirements of paragraph (e) of this section are satisfied on the date of grant of such option, the unexercised portion of the January option remains an incentive stock option regardless of the changes in F's percentage of stock ownership in R after the date of grant. However, the July option is not an incentive stock option because, on the date that it is granted, F owns 20 percent (25,000 shares owned by F divided by 125,000 shares of R stock issued and outstanding) of the total combined voting power of all classes of R Corporation stock and, thus the pricing requirements of paragraph (f)(1) of this section are not met.

(iii) Assume the same facts as in paragraph (i) of this *Example 3* except that the partial exercise of the January incentive stock option on April 1, 2003, is for only 10,000 shares. Under these circumstances, the July option is an incentive stock option, because, on the date of grant of the July option, F does not own more than 10 percent of the total combined voting power (10,000 shares owned by F divided by 110,000 shares of R issued and outstanding) of all classes of R Corporation stock.

[T.D. 9144, 69 FR 46412, Aug. 3, 2004; T.D. 9471, 74 FR 59077, Nov. 17, 2009]

§ 1.422-3 Stockholder approval of incentive stock option plans.

This section addresses the stockholder approval of incentive stock option plans required by section 422(b)(1) of the Internal Revenue Code. (Section 422 was added to the Code as section 422A by section 251 of the Economic Re-

covery Tax Act of 1981, and was redesignated as section 422 by section 11801 of the Omnibus Budget Reconciliation Act of 1990.) The approval of stockholders must comply with all applicable provisions of the corporate charter, bylaws, and applicable State law prescribing the method and degree of stockholder approval required for the issuance of corporate stock or options. If the applicable State law does not prescribe a method and degree of stockholder approval in such cases an incentive stock option plan must be approved:

(a) By a majority of the votes cast at a duly held stockholders' meeting at which a quorum representing a majority of all outstanding voting stock is, either in person or by proxy, present and voting on the plan; or

(b) By a method and in a degree that would be treated as adequate under applicable State law in the case of an action requiring stockholder approval (i.e., an action on which stockholders would be entitled to vote if the action were taken at a duly held stockholders' meeting).

[T.D. 8374, 56 FR 61160, Dec. 2, 1991. Redesignated by T.D. 9144, 69 FR 46415, Aug. 3, 2004]

§ 1.422-4 \$100,000 limitation for incentive stock options.

(a) *\$100,000 per year limitation—(1) General rule.* An option that otherwise qualifies as an incentive stock option nevertheless fails to be an incentive stock option to the extent that the \$100,000 limitation described in paragraph (a)(2) of this section is exceeded.

(2) *\$100,000 per year limitation.* To the extent that the aggregate fair market value of stock with respect to which an incentive stock option (determined without regard to this section) is exercisable for the first time by any individual during any calendar year (under all plans of the employer corporation and related corporations) exceeds \$100,000, such option is treated as a nonstatutory option. See § 1.83-7 for rules applicable to nonstatutory options.

(b) *Application.* To determine whether the limitation described in paragraph (a)(2) of this section has been exceeded, the following rules apply: