

# Supplemental Information for Notice 2003-47 and Announcement 2005-19, Executive Stock Option Transaction and Settlement Initiative

## Announcement 2005-39

This document sets forth additional guidance relating to Notice 2003-47, 2003-2 C.B. 132, and Announcement 2005-19, 2005-11 I.R.B. 744. Notice 2003-47 identifies as a listed transaction for purposes of sections 6111 and 6112 of the Internal Revenue Code and section 1.6011-4 of the Income Tax Regulations a transaction (Transaction) in which an officer, director, or employee (Executive) to whom a compensatory nonstatutory stock option or restricted stock is granted in connection with the performance of services transfers the option or restricted stock to a related person in exchange for a deferred payment obligation. Announcement 2005-19 describes the terms under which the Internal Revenue Service will resolve listed transactions that are the same as, or substantially similar to, the transaction described in Notice 2003-47. Taxpayers have until May 23, 2005, to notify the Service of their intent to participate in the settlement described in the announcement.

### A. Penalty for Executives with Unexercised Options or Unvested Stock

Under Section 3(c)(1) of Announcement 2005-19, if the option has not been exercised or the restricted stock has not vested, then the Executive recognizes compensation income in the year in which the option is exercised or the stock vests, and the Executive must pay an accuracy-related penalty under section 6662 equal to ten percent of the amount of the underpayment attributable to the Transaction. Specifically, Section 3(c)(1)(iv) of Announcement 2005-19 states that “the amount of the underpayment attributable

to the Transaction is equal to the increased tax resulting from the income recognized under Sections 3(a)(1) and (2).” Section 3(a)(1) determines the amount of compensation income the Executive must recognize, and Section 3(a)(2) determines the amount of gain the Executive must recognize.

To determine the amount of the penalty imposed under Section 3(c)(1)(iv), the underpayment attributable to the Transaction does not include the increased tax resulting from compensation income recognized in the year of exercise or vesting in excess of the amount of the deferred payment obligation received in exchange for the option or restricted stock.<sup>1</sup>

### B. Application of Section 6654 for a Settlement of Taxable Year 2004

Under Section 3(a) of Announcement 2005-19, an Executive generally must recognize the compensation income from the Transaction in the taxable year that the stock was disposed of or, if not yet disposed of, in the taxable year that includes December 31, 2004, except in the case of an unexercised option or unvested stock.

Section 6654(a) imposes an addition to the tax in the case of any underpayment of estimated tax by an individual, computed at the underpayment rate established under section 6621 on the amount of the underpayment for the period of the underpayment. Section 6654(b)(1) provides that the amount of the underpayment is the excess of the required installment over the amount (if any) of the installment paid on or before the due date of the installment. Section 6654(d)(1) generally provides that the required installment is 25 percent of the required annual payment, which is the lesser of (i) 90 percent of the tax shown on the return for the taxable year (or, if no return is filed, 90 percent of the tax for the year), or (ii) 100 percent (or 110 percent for adjusted gross income in excess of \$150,000) of the tax shown on the return for the individual for the preceding taxable year. Section 6654(e)(3) provides that no addition to tax shall be imposed under

section 6654(a) with respect to any underpayment to the extent the Secretary determines that by reason of casualty, disaster, or other unusual circumstances the imposition of an addition to tax would be against equity and good conscience.

In determining the amount of any addition to tax under section 6654, tax attributable to income that was recognized in the taxable year that includes December 31, 2004, as a result of settling the Transaction pursuant to Announcement 2005-19 and that otherwise would not have been included in income in 2004 will not be treated as “tax shown on the return for the taxable year.”

### C. Effect of Settling on Filing Future Disclosure Statements Under Treas. Reg. § 1.6011-4

Under Treas. Reg. § 1.6011-4(e)(1), the disclosure statement for a reportable transaction, which includes a listed transaction, must be attached to the taxpayer’s tax return for each taxable year in which a taxpayer participates in a reportable transaction. Under section 6707A(a), any person who fails to include on any return or statement any information with respect to a reportable transaction that is required under section 6011 to be included with a return or statement shall pay a penalty in the amount determined under section 6707A(b).

A taxpayer who settles a Transaction pursuant to Announcement 2005-19 does not have to disclose that Transaction under Treas. Reg. § 1.6011-4 for the taxable year that includes December 31, 2004, or for any subsequent taxable year.

### D. Contact Information

The principal author of this announcement is Nancy M. Galib of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this announcement, contact Nancy M. Galib at (202) 622-4940 (not a toll-free call).

<sup>1</sup> For a discussion of the determination of the amount of the deferred payment obligation, see Announcement 2005-19 at n. 4.