

Newly designated section	Remove	Add
1.421–1(h)(4), <i>Example 6</i> , last sentence.	can apply	applies.
1.421–1(h)(4), <i>Example 7</i> , first and last sentences.	a qualified stock	an incentive.
1.421–1(h)(4), <i>Example 7</i> , first sentence.	parent or subsidiary	related corporation.
1.421–1(h)(4), <i>Example 7</i> , last sentence.	its parent and subsidiary corporation	related corporations.
1.421–1(h)(4), <i>Example 7</i> , last sentence.	terminated	deemed terminated.

25. Revising paragraph (i).

26. Adding paragraph (j).

The additions and revisions read as follows:

§ 1.421–1 Meaning and use of certain terms.

(a) * * * (1) * * * While no particular form of words is necessary, the option must express, among other things, an offer to sell at the option price, the maximum number of shares purchasable under the option, and the period of time during which the offer remains open. The term option includes a warrant that meets the requirements of this paragraph (a)(1).

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(3) An option must be in writing (in paper or electronic form), provided that such writing is adequate to establish an option right or privilege that is enforceable under applicable law.

(b) *Statutory options.* (1) The term *statutory option*, for purposes of this section and §§ 1.421–2 through 1.424–1, means an *incentive stock option*, as defined in § 1.422–2(a), or an option granted under an *employee stock purchase plan*, as defined in § 1.423–2.

(2) An option qualifies as a statutory option only if the option is not transferable (other than by will or by the laws of descent and distribution) by the individual to whom the option was granted, and is exercisable, during the lifetime of such individual, only by such individual. See §§ 1.422–2(a)(2)(v) and 1.423–2(j). Accordingly, an option which is transferable or transferred by the individual to whom the option is granted during such individual's lifetime, or is exercisable during such individual's lifetime by another person, is not a statutory option. However, if the option or the plan under which the option was granted contains a provision permitting the individual to designate the person who may exercise the option after such individual's death, neither such provision, nor a designation pursuant to such provision, disqualifies the option as a statutory option. A pledge of the stock purchasable under an option as security for a loan that is

used to pay the option price does not cause the option to violate the nontransferability requirements of this paragraph (b). Also, the transfer of an option to a trust does not disqualify the option as a statutory option if, under section 671 and applicable State law, the individual is considered the sole beneficial owner of the option while it is held in the trust. If an option is transferred incident to divorce (within the meaning of section 1041) or pursuant to a qualified domestic relations order (within the meaning of section 414(p)), the option does not qualify as a statutory option as of the day of such transfer. For the treatment of nonstatutory options, *see* § 1.83–7.

(3)(ii) * * * * *

Example 1. * * * Because X was a subsidiary of P on the date of the grant of the statutory option, the option does not fail to be a statutory option even though X ceases to be a subsidiary of P.

Example 2. * * * Because X was not a subsidiary of P on the date of the grant of the option, the option is not a statutory option even though S later becomes a subsidiary of P. See §§ 1.422–2(a)(2) and 1.423–2(b).

(c) *Time and date of granting option.*

(1) For purposes of this section and §§ 1.421–2 through 1.424–1, the language “the date of the granting of the option” and “the time such option is granted,” and similar phrases refer to the date or time when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. A corporate action constituting an offer of stock for sale is not considered complete until the date on which the maximum number of shares that can be purchased under the option and the minimum option price are fixed or determinable.

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(d) *Stock and voting stock.* (1) For purposes of this section and §§ 1.421–2 through 1.424–1, the term *stock* means capital stock of any class, including voting or nonvoting common or preferred stock. Except as otherwise provided, the term includes both

treasury stock and stock of original issue. Special classes of stock authorized to be issued to and held by employees are within the scope of the term *stock* as used in such sections, provided such stock otherwise possesses the rights and characteristics of capital stock.

(2) For purposes of determining what constitutes voting stock in ascertaining whether a plan has been approved by stockholders under § 1.422–2(b) or 1.423–2(c) or whether the limitations pertaining to voting power contained in sections §§ 1.422–2(f) and 1.423–2(d) have been met, stock which does not have voting rights until the happening of an event, such as the default in the payment of dividends on preferred stock, is not voting stock until the happening of the specified event. Generally, stock which does not possess a general voting power, and may vote only on particular questions, is not voting stock. However, if such stock is entitled to vote on whether a stock option plan may be adopted, it is voting stock.

(3) In general, for purposes of this section and §§ 1.421–2 through 1.424–1, ownership interests other than capital stock are considered stock.

(e) *Option price.* (1) For purposes of this section and §§ 1.421–2 through 1.424–1, the term *option price*, *price paid under the option*, or *exercise price* means the consideration in cash or property which, pursuant to the terms of the option, is the price at which the stock subject to the option is purchased. The term *option price* does not include any amounts paid as interest under a deferred payment arrangement or treated as interest.

(2) Any reasonable valuation method may be used to determine whether, at the time the option is granted, the option price satisfies the pricing requirements of sections 422(b)(4), 422(c)(5), 422(c)(7), and 423(b)(6) with respect to the stock subject to the option. Such methods include, for example, the valuation method described in § 20.2031–2 of this chapter (Estate Tax Regulations).