

(f) *Exercise.* * * * An agreement or undertaking by the employee to make payments under a stock purchase plan does not constitute the exercise of an option to the extent the payments made remain subject to withdrawal by or refund to the employee.

(g) *Transfer.* * * * A transfer does not fail to occur merely because, under the terms of the arrangement, the individual may not dispose of the share for a specified period of time or the share is subject to a right of first refusal at the share's fair market value at the time of sale.

(h) *Employment relationship.* (1) An option is a statutory option only if, at the time the option is granted, the optionee is an employee of the corporation granting the option, or a related corporation of such corporation. If the option has been assumed or a new option has been substituted in its place under § 1.424-1(a), the optionee must, at the time of such substitution or assumption, be an employee of the corporation so substituting or assuming the option, or a related corporation of such corporation. The determination of whether the optionee is an employee at the time the option is granted (or at the time of the substitution or assumption under § 1.424-1(a)) is made in accordance with section 3401(c) and the regulations thereunder. * * *

(2) In addition, § 1.421-2(a) is applicable to the transfer of a share pursuant to the exercise of the statutory option only if the optionee is, at all times during the period beginning with the date of the granting of such option and ending on the day 3 months before the date of such exercise, an employee of either the corporation granting such option, a related corporation of such corporation, or a corporation (or a related corporation of such corporation) substituting or assuming a stock option in a transaction to which § 1.424-1(a) applies. For purposes of the preceding sentence, the employment relationship is treated as continuing intact while the individual is on military leave, sick leave, or other bona fide leave of

absence (such as temporary employment by the Government) if the period of such leave does not exceed 90 days, or if longer, so long as the individual's right to reemployment with the corporation granting the option (or a related corporation of such corporation) or a corporation (or a related corporation of such corporation) substituting or assuming a stock option in a transaction to which § 1.424-1(a) applies, is guaranteed either by statute or by contract. If the period of leave exceeds 90 days and the individual's right to reemployment is not guaranteed either by statute or by contract, the employment relationship is deemed to terminate on the 91st day of such leave. Thus, if the option is not exercised before such deemed termination of employment, § 1.421-2(a) applies to the transfer of a share pursuant to an exercise of the option only if the exercise occurs within 3 months from the date the employment relationship is deemed terminated.

* * * * *

(i) *Additional definitions.* (1) *Corporation.* For purposes of this section and §§ 1.421-2 through 1.424-1, the term *corporation* has the meaning prescribed by section 7701(a)(3) and § 301.7701-2(b) of this chapter. For example, a *corporation* for purposes of the preceding sentence includes an S corporation (as defined in section 1361), a foreign corporation (as defined in section 7701(a)(5)), and a limited liability company that is treated as a corporation for all Federal tax purposes.

(2) *Parent corporation and subsidiary corporation.* For the definition of the terms *parent corporation* (and *parent*) and *subsidiary corporation* (and *subsidiary*), for purposes of this section and §§ 1.421-2 through 1.424-1, see § 1.424-1(f)(i) and (ii), respectively. *Related corporation* as used in this section and in §§ 1.421-2 through 1.424-1 means either a parent corporation or subsidiary corporation.

(j) *Effective date.* This section applies to any statutory option granted on or

after the date that is 180 days after publication of final regulations in the **Federal Register**. Taxpayers can rely on these regulations for the treatment of any statutory option granted on or after June 9, 2003.

Par. 4. Section 1.421-8 is redesignated as 1.421-2 and is amended by:

1. Revising paragraphs (a)(1), (b), and (c)(1).

2. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Newly designated section	Remove	Add
1.421-2(c)(2), second sentence.	or 424(c)(1)
Add 1.421-2(c)(2), third sentence.	or 424(c)(1)
1.421-2(c)(3)(i), first, second, and third sentences.	422(c)(1), 423(c), or 424(c)(1).	423(c)
1.421-2(c)(3)(ii), <i>Example</i> , first sentence.	1964	2004
1.421-2(c)(3)(ii), <i>Example</i> , third, fifth, and sixth sentences.	1966	2006

3. In paragraph (c)(2), first sentence, add the phrase "for purposes of section 423(c)" at the end of the first sentence.

4. Removing paragraph (c)(4)(i) and redesignating paragraphs (c)(4)(ii) through (c)(4)(iv) as paragraphs (c)(4)(i) through (c)(4)(iii), respectively.

5. In newly designated paragraph (c)(4)(i)(a), first sentence, removing the phrase "In the case of an employee dying after December 31, 1956" and adding "In the case of the death of an optionee" in its place.

6. Removing *Example (1)* in newly designated paragraph (c)(4)(iii) and redesignating *Examples (2)* through (5) as *Examples (1)* through (4), respectively.

7. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Newly designated section	Remove	Add
1.421-2(c)(4)(i)(a), last sentence	422(c)(1), 423(c), or 424(c)(1)	423(c).
1.421-2(c)(4)(i)(b), first, second, and last sentences.	422(c)(1), 423(c), or 424(c)(1)	423(c).
1.421-2(c)(4)(i)(c), first sentence	422(c)(1), 423(c), or 424(c)(1)	423(c).
1.421-2(c)(4)(iii), <i>Example 1</i> , first sentence.	1964	2005.
1.421-2(c)(4)(iii), <i>Example 1</i> , eighth sentence.	subdivision (ii)(b) of this subparagraph	paragraph (c)(4)(i)(b) of this section.
1.421-2(c)(4)(iii), <i>Example 1</i> , third and fifth sentences.	1966	2006.
1.421-2(c)(4)(iii), <i>Example 1</i> , ninth sentence.	subdivision (ii)(c) of this subparagraph	paragraph (c)(4)(i)(c) of this section.