

Newly designated section	Remove	Add
1.424–1(e)(7) <i>Example 1</i> , third, fourth, fifth, sixth and last sentences.	1965	2005.
1.424–1(e)(7) <i>Example 1</i> , fifth sentence.	425(h)	424(h).
1.424–1(e)(7) <i>Example 1</i> , last sentence.	The exercise of such	Because the requirements of § 1.424–1(e)(3) and § 1.423–2(g) have not been met, the exercise of such.
1.424–1(e)(7) <i>Example 2</i> , first, second, and fifth sentences.	1964	2004.
1.424–1(e)(7) <i>Example 2</i> , first, third, fourth, and fifth sentences, wherever it appears.	1965	2005.
1.424–1(e)(7) <i>Example 2</i> , first and third sentences.	1966	2006.
1.424–1(e)(7) <i>Example 2</i> , fifth sentence.	425(h)	424(h).
1.424–1(e)(7) <i>Example 2</i> , last sentence.	The exercise of such	Because the requirements of § 1.424–1(e)(3) and § 1.423–2(g) have not been met, the exercise of such.
1.424–1(e)(7) <i>Example 3</i> , first, second, and last sentences.	1965	2005.

24. In paragraph (e)(7), remove *Example 4*.

25. Adding paragraphs (f) and (g).

The additions and revisions are as follows:

§ 1.424–1 Definitions and special rules applicable to statutory options.

(a) *Substitutions and assumptions of options*—(1) *In general*. (i) This paragraph (a) provides rules under which an *eligible corporation* (as defined in paragraph (a)(2) of this section) may, by reason of a *corporate transaction* (as defined in paragraph (a)(3) of this section), substitute a new statutory option (new option) for an outstanding statutory option (old option) or assume an old option without such substitution or assumption being considered a modification of the old option. For the definition of *modification*, see paragraph (e) of this section.

(ii) For purposes of §§ 1.421–1 through 1.424–1, the phrase “substituting or assuming a stock option in a transaction to which section 424 applies,” “substituting or assuming a stock option in a transaction to which § 1.424–1(a) applies,” and similar phrases means a substitution of a new option for an old option or an assumption of an old option that meets the requirements of this paragraph (a). For a substitution or assumption to qualify under this paragraph (a), the substitution or assumption must meet all of the requirements described in paragraphs (a)(4) and (a)(5) of this section.

(2) *Eligible corporation*. For purposes of this paragraph (a), the term *eligible corporation* means a corporation that is the employer of the optionee or a related corporation of such corporation. For

purposes of this paragraph (a), the determination of whether a corporation is the employer of the optionee or a related corporation of such corporation is based upon all of the relevant facts and circumstances existing immediately after the corporate transaction.

(3) *Corporate transaction*. For purposes of this paragraph (a), the term *corporate transaction* includes—

(i) A corporate merger, consolidation, acquisition of property or stock, separation, reorganization, or liquidation;

(ii) A distribution (excluding ordinary dividends) or change in the terms or number of outstanding shares of such corporation (e.g., a stock split or stock dividend);

(iii) A change in the name of the corporation whose stock is purchasable under the old option; and

(iv) Such other corporate events prescribed by the Commissioner in published guidance.

(4) *By reason of*. (i) For a change in an option or issuance of a new option to qualify as a substitution or assumption under this paragraph (a), the change must be made by an *eligible corporation* (as defined in paragraph (a)(2) of this section) and occur by reason of a *corporate transaction* (as defined in paragraph (a)(3) of this section).

(ii) Generally, a change in an option or issuance of a new option is considered to be by reason of a corporate transaction, unless the relevant facts and circumstances demonstrate that such change or issuance is made for reasons unrelated to such corporate transaction. For example, a change in an option or issuance of a new option will be

considered to be made for reasons unrelated to a corporate transaction if there is an unreasonable delay between the corporate transaction and such change in the option or issuance of a new option, or if the corporate transaction serves no substantial corporate business purpose independent of the change in options. Similarly, a change in the number or price of shares purchasable under an option merely to reflect market fluctuations in the price of the stock purchasable under an option is not by reason of a corporate transaction.

(iii) A change in an option or issuance of a new option is by reason of a distribution or change in the terms or number of the outstanding shares of a corporation (as described in paragraph (a)(3)(ii) of this section) only if the option as changed or the new option issued is an option on the same stock as under the old option (or if such class of stock is eliminated in the change in capital structure, on other stock of the same corporation).

(iv) A change in an option or issuance of a new option is by reason of a change in the name of a corporation (as defined in paragraph (a)(3)(iii) of this section) only if the option as changed or the new option issued is an option on stock of the successor corporation.

(5) *Other requirements*. For a change in an option or issuance of a new option to qualify as a substitution or assumption under this paragraph (a), all of the requirements described in this paragraph (a)(5) must be met.

(i) In the case of an issuance of a new option (or a portion thereof) in exchange for an old option (or portion thereof), the optionee's rights under the old option (or portion thereof) must be