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October 29, 2003

The Honorable Pamela F. Olson
Assistant Secretary (Tax Policy)
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Washington, D.C. 20220

Mark W. Everson
Commissioner
Internal Revenue Service
Room 3000 IR
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Washington, D.C. 20224

Dear Assistant Secretary Olson and Commissioner Everson:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1044, providing recommendations concerning Proposed Regulations under Sections 421, 422 and 424 of the Internal Revenue Code, relating to incentive stock options ("ISOs"). The Proposed Regulations provide welcome consolidation and clarification to previously issued guidance.

It is our observation that because corporations are not entitled to compensation deductions with respect to ISOs, and given corporations' desire to preserve the tax benefits of ISO treatment for its employees, corporations do not typically seek to stretch the boundaries of the ISO rules. Therefore, our overarching theme in the report is that regulations in this area should, to the extent possible, make the requirements of the Code as clear and straightforward as possible. This will facilitate compliance and enhance

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certainty to ISO holders, individual taxpayers who often do not have their own tax counsel.

Our principal recommendations made in the report are as follows:

- The assumption or substitution of an option in connection with a corporate transaction should not be analyzed as a “new grant” in order to determine whether it has resulted in a modification under Section 424. In particular, we recommend that no new shareholder approval or employment requirements be imposed at the time of the transaction.
- The regulations regarding assumption or substitution of options in a corporate transaction should be modified so that it is possible, in connection with a spinoff, to preserve ISO status for all options held by current and former employees of both the distributing company and the spun-off company, regardless of which company’s stock is subject to the options after the spinoff.
- Section 1.425-1(e)(5)(ii)(a) of the current final regulations should be preserved so that holders of ISOs are assured of the same anti-dilution protection as shareholders in connection with stock splits, stock dividends and similar events.
- The shareholder approval requirement of Section 422(b)(1) should be considered to be satisfied by a plan provision specifying the maximum number of shares available for awards pursuant to ISOs, with no requirement to specify the maximum number available for nonqualified options or other stock awards under the plan.
- Generally, a change to an option which provides that the optionee may receive an additional benefit at the future

discretion of the grantor should not be considered a modification unless and until the discretion is actually exercised to provide the additional benefit.

We appreciate the opportunity to comment on the Proposed Regulations. If you would like to discuss any of our recommendations or any other aspect of the Proposed Regulations, the principal authors of the report, Karen G. Kreuger (212-403-1242) and Max J. Schwartz (212-558-3936) would be happy to talk to you.

Respectfully submitted,

A handwritten signature in black ink that reads "Andrew N. Berg". The signature is written in a cursive style with a large, prominent initial "A".

Andrew N. Berg
Chair

cc: Eric Solomon, Deputy Assistant Secretary, Regulatory Affairs,
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