

# Qualified ESPP Design and Compliance

A Practical Guidance® Practice Note by

Debra B. Hoffman and Stephanie B. Vasconcellos, Mayer Brown LLP



Debra B. Hoffman  
Mayer Brown LLP



Stephanie B. Vasconcellos  
Mayer Brown LLP

Employee stock purchase plans that satisfy the requirements of I.R.C. § 423 provide a tax-efficient way for a sponsoring corporation to grant to its employees—and the employees of its related corporations whose employees are (or may be) eligible to participate in the plan (participating corporations)—rights to purchase stock of the sponsoring corporation or its related corporations at a price that is less than the fair market value (FMV) of the underlying stock. This practice note describes in detail the process of designing and implementing an employee stock purchase plan that satisfies the requirements of I.R.C. § 423.

The practice note is organized in the following sections:

- Fundamentals of ESPPs
- ESPP Qualification Requirements
- Optional ESPP Terms and Design Considerations
- Tax Treatment of ESPP Awards
- ESPPs and Corporate Transactions
- ESPPs and Securities Laws

Related documents on this topic include [Board Resolutions: Qualified ESPP Adoption](#) and [Qualified ESPP Drafting Checklist](#).

## Fundamentals of ESPPs

An employee stock purchase plan that meets the requirements of I.R.C. § 423 allows a sponsoring corporation to grant rights to purchase its stock (or stock of its related parent corporation or a related subsidiary corporation) at a price that is less than FMV to its employees and the employees of participating corporations. The rights to purchase the stock are sometimes referred to as stock options or purchase rights, and the terms and conditions upon which the purchase rights will be granted are sometimes referred to as an offering. In this practice note, these tax-qualified employee stock purchase plans are referred to simply as ESPPs, but note that not all employee stock purchase plans are designed to qualify for preferential tax treatment under I.R.C. § 423.

Most ESPPs provide that, at the end of a specified period of time (offering period)—or under certain more complicated plan designs, upon exercise dates occurring during an offering period—an individual employee's purchase rights are automatically exercised in accordance with the terms of the plan. Payment of the exercise price, which is almost always discounted from FMV, is paid by using an employee's after-tax payroll deductions that have accumulated during the offering period. Because employees typically do not pay brokerage fees, commissions, or other costs on the purchase, there is an added incentive for employees to take advantage of participation under the plan.

In addition, one of the most significant benefits of an ESPP is that the employee is entitled to favorable tax treatment

on the purchase of the stock pursuant to the exercise of the purchase rights as compared to the tax treatment that applies on exercise of nonqualified stock options or options granted under employee stock purchase plans that are not ESPPs. In order to meet the requirements of an ESPP, however, an employee stock purchase plan and the offering of purchase rights thereunder must satisfy the qualification requirements of I.R.C. § 423, described in the following sections. If any of the qualification requirements are not met, the favorable tax treatment may be lost for all of the purchase rights granted under the specific offering or the entire plan (depending on the nature of the non-compliance and the design of the plan).

## ESPP Qualification Requirements

This section describes the requirements set forth in I.R.C. § 423 and its implementing regulations that must be met for an employee stock purchase plan to constitute an ESPP. Some of the requirements apply to the plan document while others may be satisfied by the plan terms or by the terms of the offering. In many cases, the plan document includes all of the terms applicable to the purchase rights. Some companies, however, use separate plans and offering documents. In the latter case, the plan documents may contain certain alternatives that are established for an offering in the offering documents. In either case, the plan document and/or the offering documents, separately or together, must satisfy the qualification requirements for the plan and purchase rights granted thereunder to qualify for the special tax treatment afforded to ESPPs. Treas. Reg. §§ 1.423-1, 1.423-2(a).

### Caution concerning I.R.C. § 409A

If a stock option is granted to an employee outside of an ESPP and the exercise price of the stock option is less than the FMV of the underlying stock on the date the option is granted, the stock option is subject to the nonqualified deferred compensation rules under I.R.C. § 409A and, accordingly, the stock option must satisfy (or otherwise be exempt from) those rules for the employee to avoid the imposition of significant excise taxes and possible penalty interest. Options or purchase rights granted under a compliant ESPP are exempt from I.R.C. § 409A. If your client is planning to grant discounted purchase rights under an employee stock purchase plan, it is important to ensure that the plan and the offering of the purchase rights satisfy all of the requirements of an ESPP in order to avoid adverse tax consequences to the plan participants. For more information on I.R.C. § 409A, see [Section 409A Fundamentals](#).

### Determination of Grant Date

Many of the qualification requirements that apply to ESPPs and offerings under ESPPs are tested as of the time the purchase rights under the plan or offering are granted. For example, the determinations of whether an employee has the requisite employment relationship to be granted purchase rights under an ESPP, the exercise price (or formula for the exercise price) applicable to the purchase rights, and the maximum exercise period are made as of the grant date. Generally, the grant date of a purchase right under an ESPP is the date that the granting corporation completes the corporate action constituting an offer for the stock offered under the ESPP. This is the same standard that is usually used under corporate law to determine when a stock option is granted for other purposes. Treas. Reg. § 1.421-1(c).

In addition, under the ESPP rules, the grant date will be treated as the first day of the offering period if the ESPP or an offering, by its terms:

- Designates a maximum number of shares that may be purchased by each employee during an offering –or–
- Includes an objective formula that may be used to establish, on the first day of the offering, the maximum number of shares that can be purchased by each employee during the offering

In other words, in order for the grant date to be treated as occurring on the first day of the offering period, the maximum number of shares that can be purchased during the offering period must be fixed or determinable as of the first day of the offering period. If that requirement is not met, the grant date will be considered to be the exercise date. Whether the grant date is or can be the first day of the offering period is a critically important concept in determining whether the qualification requirements for an ESPP will be met, as discussed below. Treas. Reg. § 1.423-2(h)(3).

Note that the imposition of a maximum number of shares as described above is a requirement that is separate and apart from the two limitations discussed below: the overall aggregate limit on shares that may be issued under the ESPP and the \$25,000 limitation. Neither of those limitations is sufficient to satisfy the requirement that a separate offering period share limit be included in order for the grant date to be treated as occurring on the first day of the offering period.

### Qualification Requirement: Purchase Rights Granted Only to Employees of Related Corporations

The plan must provide that purchase rights in the stock offered under the ESPP may only be granted to employees

of the sponsoring corporation or its related parent or subsidiary corporations (related corporations), as described below. I.R.C. § 423(b)(1). If the plan does not include a provision restricting awards to employees of the sponsoring corporation or related corporations, the plan will not satisfy the qualification requirements and will not constitute an ESPP. Treas. Reg. § 1.423-2(a)(2) and (b).

### ***Related Corporations***

For purposes of applying this qualification requirement:

- A related parent corporation is any corporation (other than the sponsoring corporation) in an unbroken chain of corporations ending with the sponsoring corporation if each of the corporations in the unbroken chain, other than the sponsoring corporation, owns at least 50% of the total combined voting power of all classes of stock in one of the other corporations in the chain.
- A related subsidiary corporation is any corporation (other than the sponsoring corporation) in an unbroken chain of corporations beginning with the sponsoring corporation if each of the corporations in the unbroken chain, other than the last corporation in the chain, are connected through an ownership interest of at least 50% of the total combined voting power of all classes of stock in one of the other corporations in the chain.

Treas. Reg. §§ 1.423-2(a)(2)(i), 1.424-1(f).

The IRS, in private letter rulings and other guidance, has held that certain entities, such as limited liability companies that have elected to be taxed as corporations and disregarded entities with respect to a corporation, are treated as corporations (or as an entity that is not separate from its owner). Partnerships, limited liability companies that are taxed as partnerships, and similar entities are not eligible to establish an ESPP, and employees of such entities are not eligible to participate in an ESPP.

Note that the foregoing requirements apply to **unbroken** chains of corporations. If the chain is broken by an entity that is not a corporation, employees of the entity that is not a corporation and any entities, including corporations, that are not part of the unbroken chain of corporations that includes the sponsoring corporation are not eligible to participate in an ESPP. This nuance is frequently overlooked.

A common example of where this situation may arise is a structure where the parent is a corporation but all of the employees are employed by a subsidiary operating company that is a partnership. In this case, employees of the

partnership are not eligible to participate in an ESPP because there is no unbroken chain of corporations linking the parent corporation and the subsidiary partnership (and because the employees are not employed by a corporation). In addition, in the foregoing example, employees of corporations below the operating company level would not be eligible to participate in the ESPP, even though they are employed by a corporation, because they would not be employed by a corporation in an unbroken chain of corporations that includes the parent corporation—the chain is broken by the operating company partnership.

### ***Employment Relationship***

Whether an employee is employed by the sponsoring corporation or a related corporation is determined as of the date the purchase rights are granted, using the rules for determining employment under I.R.C. § 3401 (relating to the determination of wages paid by an employer to an employee). Treas. Reg. §§ 1.423-2(b), 1.421-1(h).

One of the first steps in determining whether and to what extent your client may establish an ESPP is to determine the groups of employees that the client wants to cover under the plan and which entity actually employs the employees. Although it is not always dispositive as to the employer, a key indicator of which entity employs the employee is whether the entity provides the employee with a Form W-2 reflecting the wages paid to the employee. Once you have the information about the desired coverage, you can better advise your client as to whether it will be able to offer the plan to all desired groups of employees based on whether the employing entities are related corporations and whether the groups of employees are actually employees of the sponsoring corporation or a related corporation. The employer of the employees is also relevant to other qualification requirements as described below. Due to the importance of this issue, it is critically important to consider the participation and employment issues before getting too far along in drafting or establishing an ESPP.

### **Qualification Requirement: Plan Adoption and Approval**

The plan must be approved by stockholders of the sponsoring corporation within 12 months before or after it is adopted by the sponsoring corporation. See I.R.C. § 423(b)(2).

### ***Adoption by Sponsoring Corporation***

An ESPP and the terms of the offering of purchase rights under the ESPP must be in writing (or in electronic form) with sufficient detail to establish the terms of the plan and/

or offering. Treas. Reg. § 1.423-2(a)(1). The required terms of the ESPP and offerings under the ESPP are usually included in the ESPP document rather than a separate offering document, and ESPP documents are almost always in written form (as opposed to electronic form).

Generally, an ESPP is considered adopted when it is adopted by the board of directors of the sponsoring corporation, and the date of the board action will be the reference point for purposes of determining whether the plan is properly approved by the sponsoring corporation's stockholders within applicable time limits (as discussed below). Treas. Reg. § 1.423-2(c)(2). If, however, the approval is done by unanimous consent or is otherwise subject to a subsequent condition (such as stockholder approval), the plan will be considered adopted at the time all conditions are satisfied, unless the board action specifically provides otherwise.

Sometimes, a corporation that is a subsidiary (and related corporation) of the corporation whose stock will be issued under an ESPP (the issuer) may want to sponsor an ESPP with respect to the issuer's stock. This may happen, for example, where the issuer has publicly traded stock but does not want to sponsor an ESPP, and the subsidiary does not have publicly traded stock but does want to sponsor an ESPP. In this case, the board of directors of the sponsoring corporation (the subsidiary) will need to adopt the ESPP, and the stockholder(s) of the subsidiary (the parent corporation) must approve the ESPP in accordance with the stockholder approval rules (discussed in greater detail below).

At a minimum, an ESPP, as adopted, must state the maximum number of shares issuable thereunder and the related corporations or classes of related corporations that may be participating corporations under the ESPP. Treas. Reg. § 1.423-2(c)(3). More information on these material terms is provided below.

Because an ESPP involves the issuance of stock, the board resolutions adopting the ESPP will typically cover not only adoption of the ESPP document (which includes the related corporations or classes of related corporations that may be participating corporations under the ESPP), but also:

- Authorizations relating to the issuances of stock and a reservation of the number of shares available for issuance under the ESPP
- Designation of a transfer agent
- Authorizations for filing of materials with governmental agencies –and–

- Other authorizations and appointments that are typically included in the corporation's resolutions authorizing the issuance of stock

If the stock of the issuing corporation is publicly traded, you should make sure that the resolutions and other matters relating to the adoption conform to the rules of the applicable securities exchange on which the shares are traded. In any event, the issuance of stock should be done in accordance with the corporate laws of the jurisdiction in which the sponsoring corporation is incorporated and in accordance with its corporate documents, such as its charter and bylaws. See [Board Resolutions: Qualified ESPP Adoption](#) for sample language.

It is important to document when the ESPP is adopted because the satisfaction of the stockholder approval requirement (discussed below) is based on when the ESPP is adopted.

### ***Stockholder Approval Requirement***

An ESPP must be approved by the stockholders of the sponsoring corporation within the period commencing 12 months before and ending 12 months after the ESPP is adopted by the sponsoring corporation's board of directors. The approval must comply with all applicable requirements of the corporation's charter and bylaws and applicable state law requirements for approval of the issuance of stock or purchase rights. The approval must also satisfy any securities exchange rules, if applicable. Treas. Reg. § 1.423-2(c).

If applicable state law does not prescribe rules for a method and degree of required stockholder approval, then an ESPP must be approved:

- By a majority of the votes cast at a duly held stockholders meeting at which a quorum representing a majority of all outstanding voting stock is present (whether in person or by proxy) and voting on the ESPP –or–
- By a method (including any majority threshold or similar requirements) that would be treated as adequate under applicable state law in the case of an action requiring stockholder approval

The foregoing rules also apply in the case of an ESPP that is sponsored by a subsidiary of another corporation. In that case, the stockholders of the subsidiary (i.e., the sponsoring subsidiary's parent corporation(s)) must approve the ESPP to satisfy the stockholder approval rules. The stockholders of the parent corporation, however, do not need to approve the ESPP (even if the parent corporation is a public company).

Treas. Reg. §1.423-2(c)(5) provides examples of the application of the stockholder approval rules in the situation where a subsidiary is the sponsoring corporation of an ESPP that provides for options on the stock of the sponsoring corporation's parent corporation.

Even though there is a long window within which to obtain stockholder approval, no purchase rights should be granted, and no stock may be issued, under the ESPP until the approval vote is successfully completed. Timing should be taken into account in planning and coordinating the adoption and approval, particularly in public companies where obtaining stockholder approval can be burdensome.

### **Material Terms**

An ESPP document as adopted by the sponsoring corporation and approved by the sponsoring corporation's stockholders must state the maximum aggregate number of shares reserved for issuance under the ESPP. This requirement may be satisfied through use of a specified number or an objective formula that results in a specified number determined as of the date of adoption or the date of approval. For example, the ESPP could provide that the number of shares available for issuance under the ESPP is a percentage of the outstanding shares of the sponsoring corporation on the date of adoption, because that formula would result in a specific number. An indeterminate or subjective formula may not be used, such as percentage of the number of shares outstanding as of the first day of each offering period, as that formula does not result in an objectively determinable number of shares as of the date of adoption or approval. Treas. Reg. § 1.423-2(c)(3).

An ESPP may provide that the number of shares available for issuance is to be adjusted each year based on an objective formula whose results are determinable at the time of adoption or the date of approval. For example, an ESPP could provide that the number of shares available increases each January 1 by a specified percentage of the outstanding shares at the time of adoption or approval of the ESPP.

The ESPP, as adopted by the sponsoring corporation and approved by its stockholders, must also designate the related corporations or classes of related corporations that may be participating corporations under the ESPP. For example, the ESPP could designate all U.S. subsidiaries or, alternatively, identify specific subsidiaries. It is generally advisable to make the designation as broad as possible and to specifically include any newly acquired related corporations, since any change to the corporations or classes of corporations is subject to additional stockholder approval. See also the discussion under ESPPs and Corporate Transactions below.

It is not typically difficult to obtain stockholder approval of ESPPs, given that they are broad-based plans and result in the issuance of a relatively small amount of stock. The process of obtaining such approval, however, may be burdensome, particularly in public companies. Therefore, you may want to advise your client to make the ESPP as broad and flexible as possible from the beginning so as to minimize the necessity of frequently obtaining subsequent stockholder approval upon material changes to the plan.

### **Subsequent Stockholder Approval**

Once approved by the stockholders, an ESPP does not need to be approved by the stockholders again unless there is an amendment to the ESPP that would be considered the "adoption of a new plan." As a practical matter, this means a change in the number of shares reserved for issuance or a change in the related corporations or classes of related corporations that may be participating corporations under the ESPP (or another change in the group of eligible employees), in either case, in a manner that would be considered to be an adoption of a new ESPP. Changes in those two features would likely only be considered the adoption of a new plan if there is or could be an increase in the number of shares available or a broadening of the related corporations or classes of related corporations that may be participating corporations under the ESPP (such that the group of eligible employees is expanded). Treas. Reg. § 1.423-2(c)(4).

### **Qualification Requirement: 5% Stockholder Exclusion**

Purchase rights may not be granted to an employee who, immediately after the grant of the purchase rights, owns stock possessing 5% or more of the total combined voting power or value of all classes of stock of the sponsoring corporation or any related corporation. I.R.C. § 423(b)(3).

As a practical matter, compliance with the 5% stockholder exclusion requirement will be an issue only in private companies or smaller or closely held public companies. Nonetheless, an ESPP or offering must, by its terms, prohibit grants to employees who would not be eligible for a grant under the 5% stockholder exclusion.

Note that, in applying the 5% stockholder exclusion, stock representing combined voting power or value is taken into account. This is different from the rule for determining which entities qualify as related corporations, where only voting power is considered.

### ***Attribution Rules***

When determining an employee's stock ownership for purposes of the 5% stockholder exclusion requirement, the employee is attributed with certain ownership interests even though the employee may not actually own the shares. Specifically, an employee is considered to own stock that is owned, directly or indirectly, by or for his or her brothers, sisters, spouse, ancestors, and lineal descendants. In addition, stock owned by or for a corporation, partnership, estate, or trust is treated as owned proportionately by or for its stockholders, partners, or beneficiaries, as applicable. Treas. Reg. § 1.423-2(d)(1); I.R.C. § 424(d); Treas. Reg. § 1.424-1(d).

Although the attribution rules do not arise very frequently, application of the rules can sometimes be complex and can require a detailed examination of familial relationships and other stock holdings. Sometimes employees are reluctant to share this information. In that case and other situations where application of the 5% stockholder exclusion requirement is likely to be an issue, you should consider whether you can exclude from participation in the ESPP one or more categories of employees who are likely to be subject to the attribution rules. Groups that may be excluded from ESPP participation are discussed under "Permitted Groups of Excluded Employees" in the section below on the uniformity requirement.

### ***Attribution from Stock Options***

In addition, for purposes of determining an employee's stock ownership in connection with the 5% stockholder exclusion requirement, an employee is treated as owning stock that the employee may purchase under outstanding stock options (whether or not they are purchase rights under an ESPP). A stock option is treated as outstanding in this case even though it is not vested. I.R.C. § 423(b)(3).

### ***Consequences of Failure to Satisfy 5% Stockholder Requirement***

If purchase rights are granted to an employee in violation of the 5% stockholder requirement, no portion of the purchase rights granted to such employee will be treated as granted under an ESPP. Such a grant, however, will not taint purchase rights granted to other employees under the ESPP or offering. Treas. Reg. § 1.423-2(d)(1).

### ***Qualification Requirement: Uniformity***

Purchase rights must be granted to all employees of any participating corporation whose employees are granted any

purchase rights under the ESPP, with limited exceptions discussed below. I.R.C. § 423(b)(4).

### ***General Rule***

An ESPP, or any offering under an ESPP, must, by its terms, provide that purchase rights are to be granted to all employees of any participating corporation whose employees are granted any purchase right under the ESPP or the offering. I.R.C. § 423(b)(4). In other words, if one employee of a participating corporation is granted a purchase right under an offering, all employees of that participating corporation must be granted a purchase right under the offering. Therefore, in order to determine whether the uniformity requirement is met, it is very important to know which participating corporations employ which employees. In smaller companies, this may not be an issue, but in larger companies, it is important to determine where the employees are employed within the family of companies in order to be able to properly design an ESPP, or an offering thereunder, that satisfies the uniformity requirement. Treas. Reg. § 1.423-2(e).

Normally, the uniformity requirement is satisfied by the eligibility provisions set forth in the ESPP that apply to all offerings. It is, however, possible for the uniformity requirement to be satisfied on an offering-by-offering basis. ESPPs with multiple or overlapping offering periods are significantly more complex than single-offering-period plans. The requirements of offering periods are discussed below in greater detail.

### ***Permitted Groups of Excluded Employees***

The ESPP rules provide that one or more of the following classes of employees may be excluded when determining whether the uniformity requirement is satisfied with respect to the ESPP and/or an offering:

- Employees who have been employed for less than two years
- Employees whose customary employment is 20 hours or less per week
- Employees whose customary employment is for not more than five months in any calendar year
- Highly compensated employees (using the definition under I.R.C. § 414(q) for determinations under qualified retirement plans (2020 threshold \$130,000, 2021 threshold \$130,000))

I.R.C. § 423(b)(4)(A)-(D); Treas. Reg. § 1.423-2(e).

If one employee in a class is excluded, all employees in that class must be excluded.

Special rules:

- **New hire rule.** An ESPP or offering may provide for participation by employees who have completed shorter periods of service or whose customary employment is for fewer hours or months in the applicable period without violating the uniformity requirement, provided that the lower standards are applied in an identical manner to all employees of **every** participating corporation. Treas. Reg. § 1.423-2(e)(2)(i).
- **Highly compensated employee rule.** An ESPP or offering may exclude highly compensated employees with compensation above a certain level or who are officers or subject to Section 16 of the Securities Exchange Act of 1934 (Exchange Act) without violating the uniformity requirement provided that the exclusions are applied in identical manner to all highly compensated employees of **all** participating corporations. Treas. Reg. § 1.423-2(e)(2)(ii).
- **Non-U.S. employee rule.** An ESPP or offering may exclude employees who are citizens or residents of non-U.S. jurisdictions (even if they are also citizens or resident aliens of the U.S.) but only if either:
  - The grant of a purchase right under the ESPP or offering to a citizen or resident of the foreign jurisdiction is prohibited under foreign law –or–
  - Compliance with foreign law would cause the plan or offering to fail to satisfy the requirements of an ESPP

Treas. Reg. § 1.423-2(e)(3).

Coverage of non-U.S. employees under an ESPP is often a very difficult concept to address and for clients to understand. Frequently, the laws of a foreign jurisdiction do not prohibit the grant of purchase rights or would not cause the plan or offering to fail to satisfy I.R.C. § 423, so the special exclusion rule would not apply. The easiest way to solve the issue is if the non-U.S. employees are employed by an entity that can be excluded as a participating corporation (e.g., where the employees employed by the corporation are solely non-U.S. employees). If, however, the employees are employed by a participating corporation along with other non-excludible employees who are participating in an offering, the analysis will require further discussions and an understanding of the laws of the relevant jurisdiction.

## ***Consequences of Failure to Satisfy Uniformity Requirement***

If the uniformity requirement is not satisfied because even one employee is impermissibly excluded, none of the purchase rights granted under the offering will be treated as granted under an ESPP. Thus, violation of the uniformity requirement due to the impermissible exclusion of employees taints **all** purchase rights granted under the offering. An otherwise eligible employee's election not to participate in an ESPP or offering will not be considered a violation of the uniformity requirement. Treas. Reg. § 1.423-2(e)(4).

Employees who must be excluded in order to satisfy the 5% stockholder exclusion requirement, the \$25,000 purchase limit requirement, and the equal terms and conditions requirement (because they have purchased the maximum amount of stock permitted under the plan or offering) are not considered to be impermissibly excluded for purposes of the uniformity requirement.

## ***Qualification Requirement: Equal Rights and Privileges***

All employees granted purchase rights under the ESPP or offering must have the same rights and privileges. I.R.C. § 423(b)(5).

### ***General Rules***

An ESPP and each offering must, by their terms, provide that all employees who are granted purchase rights under the ESPP or offering, as applicable, have the same rights and privileges. This requirement is strictly and narrowly applied and generally applies to each term of each purchase right. For example, differences in the method of payment for the stock subject to purchase rights, the number of shares of stock that may be purchased by an employee, the determination of the exercise price for the stock, and all other terms of all purchase rights must be the same for all employees participating in the plan or offering, as applicable, except for the differences noted below. Treas. Reg. § 1.423-2(f).

### ***Permitted Differences***

The following types of provisions or terms will not violate the equal rights and privileges requirement:

- **Compensation-based limitation.** Different limitations on the amount of stock that may be purchased by an employee are permitted if the limitations have a uniform relationship to the total compensation or regular or basic rate of compensation of all employees. Treas. Reg. § 1.423-2(f)(2).

This exception is limited to limitations relating to total compensation or the basic rate of compensation. Variations based on other compensation definitions are not permitted. For example, an offering may cap the amount of stock an eligible employee may purchase at one share for each \$100 of the employee's annual salary, but it would be impermissible to use a formula cap such as one share for each \$100 of the employee's annual salary up to \$10,000 and two shares for each \$100 of annual salary in excess of \$10,000, because the latter formula is not based on a uniform relationship to the salary. It would also generally be impermissible to apply one cap to one group of employees and a different cap to another group.

- **Additional fixed purchase limitations.** Fixed limitations on the maximum amount of stock that may be purchased by employees participating in the plan or offering are also permitted (either on their own or in conjunction with a compensation-based limit). Treas. Reg. § 1.423-2(f)(3).

Sometimes ESPPs include limitations, over and above any required limitations, on the amount of stock that can be purchased by any employee during an offering period. For example, the ESPP may provide that no employee may purchase more than a specified dollar limit or a specified number of shares. These limitations are more common in smaller companies where the sponsoring employer wants to limit stock ownership of employees while still providing an attractive benefit.

- **Non-U.S. law-based terms.** Terms and conditions of purchase rights granted to citizens or residents of a foreign jurisdiction that are less favorable than the terms and conditions of purchase rights granted to employees who are residents of the U.S. (without regard to whether they are also citizens or nonresident aliens of the U.S.), provided that such less favorable terms are necessary to comply with foreign law. Treas. Reg. § 1.423-2(f)(4).

This exception is limited to terms that are not only less favorable than those applicable to other eligible employees but also necessary to comply with foreign law. Terms and conditions that are less favorable due to employer convenience or any reason not required to comply with foreign law do not fit within this exception.

- **Service-based waiting period.** The delay of a grant of a purchase right to an employee until the employee satisfies the minimum service requirements applicable under the ESPP or offering (assuming that the minimum service requirements conform to the uniformity requirement). Treas. Reg. § 1.423-2(f)(6).

### **Carryovers**

Generally, the equal rights and privileges requirement would prohibit an employee from carrying over amounts that

were withheld for one plan or offering to a subsequent plan or offering because such a carryover could result in one employee being able to purchase more stock in a subsequent period than another employee who did not carry over amounts.

A carryover provision could be structured so as not to violate the equal rights and privileges requirement if all other employees participating in the first plan or offering are permitted to make direct payments under the subsequent plan or offering period in an amount equal to the greatest amount allowed to be carried over by any employee. Treas. Reg. § 1.423-2(f)(5)(i).

In addition, ESPPs can allow employees to carry over amounts representing the value of fractional shares that are not used to purchase stock in a prior plan or offering. Treas. Reg. § 1.423-2(f)(5)(ii).

It is extremely common to include provisions relating to carryovers of the value of fractional shares. Allowing carryovers of more than the value of fractional shares is very uncommon, as is permitting employees to make direct payments other than pursuant to normal payroll deductions.

### **Consequences of Failure to Satisfy Equal Rights and Privileges Requirement**

If the equal rights and privileges requirement is not satisfied (taking into account any permitted differences)—even with respect to one employee or one term of a purchase right—none of the purchase rights granted under the offering will be treated as granted under an ESPP. Thus, violation of the equal rights and privileges requirement taints **all** purchase rights granted under the offering. Treas. Reg. § 1.423-2(f)(1).

### **Offering-Specific Terms**

It is possible to provide different terms and conditions to different groups of employees by using separate offerings under the plan. The plan would need to be clearly written to provide for multiple offerings and care would, of course, need to be taken to ensure that the terms of each offering itself satisfied not only the equal rights and privileges requirement but also all of the other requirements applicable to ESPPs, such as the uniformity requirement. It is very unusual to have separate offerings under an ESPP.

### **Qualification Requirement: Minimum Pricing**

The exercise price of purchase rights granted under the ESPP may not, under the terms of the plan, be less than the lesser of either:

- 85% of the FMV of the stock on the grant date of the purchase right –or–



- 85% of the FMV of the stock on the exercise date

I.R.C. § 423(b)(6); Treas. Reg. § 1.423-2(g)(3).

For example, the determination of the exercise price could be calculated using any of the following formulas:

- 85% of grant date FMV
- 85% of exercise date FMV
- 85% of grant date FMV or 85% of exercise date FMV, whichever is less
- 85% of exercise date FMV, but no less than \$X per share
- A fixed dollar amount that is no less than 85% of grant date FMV (as discussed in the following paragraph)

The exercise price can be stated either as a percentage of FMV or a specific dollar amount, although it is by far most common to state the price as a percentage. If a specific dollar amount is used, the ESPP or offering must be designed so that the exercise price is set at an amount that is not less than 85% of the FMV on the grant date (rather than the lesser-of formula described above). Under this approach, the exercise price is tested only on the grant date. The minimum pricing requirement will not be met if the pricing requirements are not met on the grant date, even if the FMV of the stock declines during the offering period such that the minimum pricing requirement would be met if the stock price was tested at a later point in the offering period (e.g., on the exercise date). Treas. Reg. § 1.423-2(g)(3).

Although the exercise price is typically based on the lesser of the FMV on the grant date or the exercise date, some plans do provide for a price that is based just on the grant date or just on the exercise date. In addition, some plans use an exercise price that is greater than 85% but less than 100% of the FMV of either the grant date price or the exercise date price. It is very uncommon to use a specified dollar amount for the exercise price.

### ***Determination of FMV***

For purposes of ESPPs, the FMV of the stock may be determined in any reasonable manner, including valuation methods permitted under Treas. Reg. § 20.2031-2 (relating to methods for valuing stocks and bonds). In public companies, the value is almost always determined by reference to a market price, such as the closing price on the grant or exercise date. Treas. Reg. § 1.423-2(g)(2).

### ***Consequences of Failure to Satisfy Minimum***

#### ***Pricing Requirement***

If the minimum pricing requirement is not satisfied, none of the purchase rights granted under the offering will be treated as granted under an ESPP. Thus, violation of the minimum pricing requirement taints **all** purchase rights granted under the offering. Treas. Reg. § 1.423-2(g)(2).

#### **Qualification Requirement: Exercise Period Limitation**

Purchase rights granted under an ESPP cannot be exercised more than five years after the grant date or 27 months after the grant date, depending on how the exercise price is determined. I.R.C. § 423(b)(7).

To satisfy the exercise period requirement, an ESPP or offering must provide, by its terms, that purchase rights granted under the ESPP cannot be exercised after the expiration of 27 months from the grant date unless, under the terms of the purchase right, the exercise price cannot be less than 85% of the FMV of a share of stock at the time of exercise. If the exercise price formula is determined solely with reference to the 85% of exercise-date FMV limitation, the purchase rights granted under the ESPP can be made exercisable for up to five years from the grant date.

For example, if the exercise price of a purchase right is based on the lesser of the FMV at the time of grant or the time of exercise, the ESPP or offering must provide that the exercise date of the purchase right is no later than 27 months after the grant date. The exercise date is also limited to 27 months from the grant date if the price is fixed at the grant date and the price cannot exceed another price that otherwise complies with the minimum pricing rules. Treas. Reg. § 1.423-2(h).

In most cases where there is no lookback to the FMV on the grant date, the ESPP or offering may provide for an exercise date of up to five years after the grant date, regardless of whether the FMV of the stock at the exercise date is more or less than the FMV at the grant date. However, if the terms provide for an exercise price of 85% of the exercise-date FMV, but not more than some fixed dollar amount, then the exercise date is subject to the 27-month limit.

These rules only establish an outside limit on exercise. Exercise dates for offering periods are almost always

significantly shorter, regardless of the method used to determine the exercise price. A six-month offering period, with exercise on the last day of the offering period (i.e., an exercise date of six months following the grant date) is one of the most common ESPP designs. It is important to understand that other periods are available in the event that you have a client with special circumstances where a longer (or shorter) exercise period may be appropriate.

### ***Consequences of Failure to Satisfy Exercise Period Requirement***

If the plan or offering does not satisfy the exercise period requirement, none of the purchase rights granted under the plan or offering will be treated as granted under an ESPP, regardless of whether the purchase rights are actually exercised or exercisable within a permitted exercise period. Thus, violation of the exercise period limitation taints **all** purchase rights granted under the plan or offering. Treas. Reg. § 1.423-2(h)(1).

### **Qualification Requirement: \$25,000 Limitation**

An employee's right to purchase shares of stock under an ESPP (and all other ESPPs maintained by his employer and its related corporations) cannot accrue at a rate that exceeds \$25,000 of FMV of stock (determined as of the grant date) for each calendar year in which the purchase right is outstanding. I.R.C. § 423(b)(8).

An ESPP or offering must, by its terms, include the \$25,000 limitation. For purposes of determining whether the \$25,000 limitation is satisfied, the right to purchase stock under a purchase right accrues when the purchase right (or any portion thereof) first becomes exercisable during a calendar year. This limitation applies only to purchase rights granted under ESPPs and does not limit an employee's right to purchase stock under other types of stock options, including incentive stock options. Treas. Reg. § 1.423-2(i).

### ***Application of the \$25,000 Limitation***

The \$25,000 limitation applies to the accrual rate (as opposed to setting an annual cap). As a result, an ESPP can comply with this requirement by limiting the amount of stock an employee may purchase under the plan to \$25,000 (based on the FMV of the underlying stock on the grant date):

- On a per-year basis each calendar year –or–
- On an accumulated basis (accumulation method) during a multi-year period (e.g., an employee with an outstanding, unexercised option could potentially accrue the right to purchase stock with an FMV of up to \$50,000 through the ESPP in a second year, \$75,000 in a third year, and so on)

Treas. Reg. § 1.423-2(i)(4).

The first alternative is the more common approach and is easier to administer. The latter approach gives employees greater flexibility.

Under the accumulation method, accruals are based only on the current and past years in which the option was outstanding, and employees may not purchase stock under the ESPP based on an expectation that an option will be outstanding in a future year. That is, an employee is not permitted to exceed the \$25,000 limitation in year 1 in anticipation that an option will remain outstanding or a new option will be granted in year 2 (or any later year). Other rules for the accumulation method are:

- The limitation cannot be increased based on the failure to grant an option under the ESPP in an earlier year, or because an earlier option granted under the ESPP has expired without exercise.

Example: In year 1, Participant A receives an option under an ESPP to purchase stock on an exercise date of December 31 of year 1, but does not elect to exercise the option (or any other option under the ESPP in that year). Even though Participant A did not exercise the year 1 option, the \$25,000 limit applies for any option granted under the ESPP to Participant A that is exercisable in year 2. If, instead, the year 1 option was exercisable at any time before December 31 of year 2, then a plan employing the accumulation method could allow A to exercise options with respect to up to \$50,000 of stock (based on grant date FMV) in year 2 (again, assuming Participant A did not elect to exercise the option in year 1).

- If an option granted under an ESPP is outstanding in more than one calendar year, then the stock purchased under the option is applied first to the \$25,000 limitation for the earliest year in which the option was outstanding, and then to each succeeding year it was outstanding, in order.

Note that the \$25,000 limitation is applied on an organization-wide basis, prohibiting the grant of any purchase rights that exceed the cap under not only another offering within the same ESPP, but also under any other ESPP of the employer or a related corporation. Treas. Reg. § 1.423-2(a)(3)(vi).

### ***Consequences of Failure to Satisfy \$25,000 Limitation***

If a purchase right is granted under an ESPP or offering that fails to satisfy the \$25,000 limitation, no portion of the purchase right is treated as a purchase right under an ESPP. In addition, if purchase rights are granted to an employee

entitled to a grant under the ESPP or offering and the purchase rights do not satisfy the \$25,000 limitation, none of the purchase rights granted under the plan or offering will satisfy the \$25,000 limitation. Thus, failure to satisfy the \$25,000 limitation taints **all** purchase rights granted under the offering. Treas. Reg. § 1.423-2(i)(2).

### Qualification Requirement: Non-transferability Restriction

Purchase rights granted to an employee under an ESPP cannot be transferable other than by will or the laws of descent and distribution. Purchase rights granted to an employee under an ESPP must be exercisable by an employee during his or her lifetime only by him or her. I.R.C. § 423(b)(9); Treas. Reg. §§ 1.423-2(b), (j).

## Optional ESPP Terms and Design Considerations

An ESPP (or an offering) may include provisions other than the required terms described in the previous section so long as those provisions do not cause the plan or offering to fail to satisfy the qualification requirements. Common optional provisions include the following:

- **Voluntary withdrawal.** Provisions permitting an employee to withdraw participation during an offering prior to the exercise date. Usually ESPPs that include such provisions provide that no purchases will be made for the period in which the employee withdraws and that the employee is entitled to receive a refund (without interest) of all of his or her accumulated after-tax contributions.
- **Termination of employment.** Provisions outlining the treatment of purchase rights if an employee terminates employment during an offering. ESPPs almost always provide that, upon a termination of employment, participation ceases, no purchases will be made for the period in which the employee's employment terminates, and all accumulated after-tax contributions will be refunded (without interest). As discussed above, in order to satisfy the qualification requirements, employees receiving purchase rights under an ESPP or offering must be employed by the sponsoring corporation or a related corporation on the grant date. If, under the plan or offering, the grant date is determined to be the exercise date (whether by design or otherwise) and an individual who is not an employee as of that date is permitted to purchase stock on the exercise date, there can be violation of the requirements. In addition, providing for cessation of participation upon termination eliminates certain tax issues that may arise in the event of exercise

more than three months after termination, as discussed under Tax Treatment of ESPP Awards below.

- **Payment mechanics.** Provisions relating to the manner of payment of the exercise price. The payment method is almost always after-tax payroll deductions, but an ESPP could provide for lump sum payments or other payment methods.
- **Share holding requirements.** Provisions requiring holding of the shares purchased on exercise for a minimum period. The tax treatment relating to shares acquired upon exercise of purchase rights depends on whether the shares are disposed of in a qualifying or disqualifying disposition, as discussed under Tax Treatment of ESPP Awards below. Some companies do not want their employees to “flip” the shares (i.e., purchase the shares under the ESPP and immediately sell them) and include holding period requirements for the acquired shares.

## Tax Treatment of ESPP Awards

The tax treatment of purchase rights granted under an ESPP is governed by I.R.C. §§ 423 and 421. The following is a summary of the income tax treatment under U.S. law as currently in effect.

No income will be taxable to an employee upon the grant of a purchase right under an ESPP or at the time shares of stock are purchased under the ESPP, provided that the employee was employed by the sponsoring corporation or a related corporation for the period running from the grant date through the date that is three months prior to the exercise date. The employer will not be entitled to a deduction with respect to any shares transferred to the employee. I.R.C. § 421(a); Treas. Reg. § 1.421-2(a); I.R.C. § 423(a). Upon the sale or disposition of the shares acquired under the ESPP, the employee will have taxable income (or a deductible loss) in an amount equal to the difference between the amount the employee paid for the shares and the amount the employee receives on the sale or disposition. Normally, the difference will be treated as capital gain income (or loss), but in certain circumstances the employee may also have ordinary income. The type and amount of income (or loss) depends on whether the shares were sold or disposed of in a qualifying disposition or a disqualifying disposition.

### Qualifying Disposition

If the employee sells or disposes of (including by way of gift) shares of stock acquired pursuant to the exercise of purchase rights under an ESPP on or after the date that is at least two years after the date the purchase right was granted

**and** at least one year after the exercise date (a qualifying disposition), the employee will be taxed as follows:

- If the FMV of the shares at the time the purchase rights were granted is below the exercise price at the date of grant, the employee recognizes, as ordinary income, the lesser of:
  - The excess of the FMV of the shares as of the grant date over the exercise price (see note below) (i.e., the amount of any discount off the share price) –or–
  - The excess of the FMV of the shares at the time of sale or disposition over the amount paid for the shares (I.R.C. § 423(c))
- Any further gain on disposition will be treated as capital gain, and any loss will be treated as a capital loss.

For purposes of determining the exercise price in the event of a qualifying disposition, the exercise price is determined as if the exercise occurred on the grant date if the exercise price is not fixed or determinable at that time (e.g., the plan uses a lesser-of formula for determining exercise price, as discussed above).

In addition, for a qualifying disposition, the employer will not be entitled to a deduction with respect to shares transferred to the employee. Treas. Reg. § 1.421-2(a).

The holding period requirement for a qualifying disposition may be waived if an employee is obligated to dispose of shares of stock acquired pursuant to the exercise of purchase rights under an ESPP to satisfy certain conflict-of-interest requirements. I.R.C. § 421(d).

### **Disqualifying Disposition**

If the employee disposes of the shares of stock acquired pursuant to the exercise of purchase rights under an ESPP before the expiration of either of the holding periods described above (a disqualifying disposition), the excess of the FMV of the shares on the exercise date over the exercise price will be treated as ordinary income to the employee in the year of the disposition. This excess will constitute ordinary income in the year of sale or other disposition, even if no gain (or a loss) is realized on the sale (or a gratuitous transfer of the shares is made). The balance of any gain will be treated as capital gain. Even if the shares are sold for less than their FMV on the exercise date, the same amount of ordinary income is attributed to an employee, and a capital loss is recognized equal to the difference between the sale price and the FMV of the shares on the exercise date.

The employer will be entitled to a deduction for the taxable year in which a disqualifying disposition occurs equal to the

amount includible as compensation in the employee's gross income. Treas. Reg. § 1.421-2(b).

### **Effect of Section 83(i) Election**

Under tax reform legislation enacted in 2017, certain private company service providers may have a right to make an election under new I.R.C. § 83(i) to defer income inclusion that may otherwise occur upon the issuance of so-called qualified stock at the exercise of a stock option or settlement of a restricted stock unit. See Pub. L. No. 115-97, § 13603. If a Section 83(i) election is made regarding stock issued pursuant to an option offered under a qualified ESPP, the option can no longer qualify for tax-advantaged ESPP treatment. Instead, the rules for nonqualified stock options apply subject to the special timing rules under I.R.C. § 83(i), I.R.C. §§ 423(b)(5), (d).

### **Tax Consequences for ESPP Awards in the Event of the Employee's Death**

A plan or an offering may, but is not required to, permit an estate or a beneficiary to exercise an unexercised purchase right under an ESPP. The estate or beneficiary will be subject to the same tax treatment as that which would have applied to the employee in connection with such exercise. I.R.C. § 421(c)(1).

If an employee has exercised a purchase right under an ESPP, upon the employee's death, the amount included in the employee's gross income will be as described in the section entitled "Qualifying Disposition" above, even if the requisite holding periods have not been satisfied. Treas. Reg. § 1.421-2(k)(1)(i). Any transfer by the estate of the stock will be considered a disposition. I.R.C. § 421(c)(2).

### **No Withholding Obligation**

The employer is not required to withhold taxes on any income recognized by the employee in connection with the exercise of the purchase right or issuance of the ESPP shares, even for amounts that are includible in the employee's gross income (and regardless of whether a disqualifying disposition occurs). I.R.C. § 421(b).

### **Reporting Requirements for ESPPs**

An employer must report on IRS Form 3922 the first transfer of legal title of a share of stock acquired by an employee (or other person who acquired shares) pursuant to the exercise of a purchase right under an ESPP or offering, including a transfer to a recognized broker or financial institution. A copy of the form must be provided to the IRS and to the employee. An exception to the Form 3922 requirement applies if the employee is a nonresident alien for whom the corporation

is not required to provide a Form W-2 for any calendar year with the period beginning with the first day of the calendar year in which the option was granted to the employee and ending on the last day of the calendar year in which the employee exercised the purchase right. I.R.C. § 6039(a)(2), (b); Treas. Reg. §§ 1.6039-1(b), 1.6039-2(b).

In addition, note that income from dispositions of stock acquired under an ESPP is generally reported as “other compensation” using Code V on IRS Form W-2. For more information, see [IRS, Employer’s Tax Guide to Fringe Benefits](#).

## ESPPs and Corporate Transactions

The treatment of an ESPP in the context of a corporate transaction (merger, consolidation, acquisition, separation, reorganization, etc.) will depend on the terms of the ESPP and, in large part, the parties’ negotiation. Depending on the facts, it may be possible to continue the ESPP after the transaction, either with respect to the same stock that was subject to the ESPP prior to the transaction or with the stock of a new sponsoring corporation (or a related corporation). In addition, it may be possible to make adjustments to outstanding purchase rights under the ESPP to take into account the effect of the transaction with respect to the number of shares subject to the purchase right and the exercise price, as long as the ESPP qualification requirements continue to be met. Treas. Reg. § 1.424-1(a)(1)(ii).

As a practical matter, however, in most cases, an ESPP that is maintained by an entity being acquired will be terminated prior to the closing of the transaction either by having a special exercise date or by refunding all of the accumulated contributions, with any new ESPP participation to be determined post-closing.

### Assumption and Substitution of Awards

For purposes of the ESPP rules, a modification, extension or renewal of a purchase right is treated as the grant of a new purchase right and, accordingly, would need to satisfy all of the ESPP requirements, including all of the qualification requirements, on the date of the modification, extension, or renewal (which would thereafter be treated as the grant date). Treas. Reg. § 1.424-1(e).

However, the assumption of purchase rights under an ESPP or the issuance of a new purchase right in substitution of an existing purchase right in the context of a corporate transaction does not constitute a modification, renewal, or extension of the purchase right (and, accordingly, is not

treated as a new grant of a purchase right) as long as it meets certain requirements, including that:

- Immediately after the substitution or assumption, the employee does not have any additional benefits that he or she did not have prior to the substitution or assumption –and–
- The excess of the FMV of the shares subject to the purchase right over the exercise price immediately after the substitution or assumption does not exceed such spread immediately before the substitution or assumption

I.R.C. § 424(a), (h); Treas. Reg. § 1.424-1(a).

An ESPP document may provide for substitutions or assumptions in the event of a corporate transaction, but is not required to include such a provision. Depending on the amending authority reserved under the ESPP, this type of provision could be added to the ESPP at the time of a relevant transaction.

Most ESPPs contain relatively standard language permitting adjustment of the number and type of shares subject to the ESPP and the exercise price of outstanding awards in the event of a corporate transaction. The language will typically give to the administrator of the ESPP the authority to make adjustments it determines appropriate, subject to the ESPP requirements.

### Participation by Employees of Newly Acquired Related Corporation

Whether employees of a newly acquired related corporation (such as a newly acquired corporate subsidiary) can participate in an ESPP maintained by an acquirer will depend on the terms of the applicable ESPP. As discussed above, an ESPP must designate the participating corporations (which, in turn, determines the scope of eligible employees), and that is one of the terms that must be approved by the sponsoring corporation’s stockholders. If the ESPP is drafted broadly, employees of newly acquired related corporations may be eligible to participate in the ESPP. Any such participation, however, must always comply with the terms of the ESPP and all of the qualification requirements of the ESPP.

## ESPPs and Securities Laws

The securities laws that apply to ESPPs vary depending on a variety of factors, the most significant of which is whether the stock issued under the ESPP is that of a company whose securities are publicly traded on a securities exchange. The following is a brief overview of the most common requirements that must be met.

- In the case of stock of an issuer that is publicly traded, the Securities Act of 1933 generally requires registration of stock that is issued pursuant to an ESPP. Registration is usually made on a Form S-8. Registration is required before any purchase rights are granted under the ESPP. A prospectus describing the material plan terms must be prepared and distributed to employees who are eligible to participate in the ESPP prior to the date on which they are eligible to elect to participate in the ESPP.
- In the case of stock of an issuer that is not publicly traded, Rule 701 (17 C.F.R. § 230.701) under the Securities Act generally provides an exemption from registration for a written, compensatory benefit plan that grants stock options to employees. Rule 701 imposes limitations on the value of stock that can be sold by a corporation in a specified period pursuant to the Rule 701 exemption, but such limitations generally do not adversely impact or restrict ESPPs. Rule 701 requires a written plan document and contains participant disclosure requirements, which are enhanced if the value of stock issued under the ESPP and any other company plan relying on Rule 701 during a specified period exceeds the applicable threshold. Finally, even if the stock is exempt from registration under the federal rules, registration may be required under state blue sky laws. For details, see [Employee Incentive Compensation and Rule 701](#).
- Grants to officers and directors under a qualifying ESPP are exempt from the reporting requirements that otherwise apply to officers, directors, and 10% stockholders under Section 16 of the Exchange Act. These insiders are generally required to report their transactions in the equity securities of the issuer, including derivative securities, such as purchase rights, that derive their value from such equity securities. The grant of purchase rights acquired under an ESPP would constitute such a derivative security and, absent the exemption, would be reportable on Form 4 within two business days of the grant.
- In the case of publicly traded stock, the issuing corporation will also need to ensure compliance with any requirements of the securities exchange on which the stock is listed. Generally, any equity compensation plan, as well as any material revisions to such plan, must be approved by the issuing corporation's stockholders. However, ESPPs that are intended to meet the requirements of I.R.C. § 423 are exempt from such stockholder approval requirements.
- Section 16(b) of the Exchange Act prohibits insiders from retaining the profits realized from the purchase or sale of securities within six months of an opposite-way transaction. Exempt sales and purchases are disregarded for this purpose. The acquisition of purchase rights under an ESPP is an exempt transaction (and therefore are disregarded for purposes of matching with prior or subsequent non-exempt sales) if certain requirements are met. These requirements are usually met in the case of ESPPs that meet the coverage and participation requirements of the I.R.C., but would not be met, for example, if an ESPP failed to satisfy the requirements of I.R.C. § 410(b).

When establishing an ESPP, it is necessary to obtain the advice of a competent securities lawyer. The rules are extremely technical. Strict timing requirements may apply to various filing and disclosure requirements and issues with the Securities and Exchange Commission, state securities commissions, or the securities exchange on which the stock is traded, if applicable, can be easily avoided when advice is obtained from a lawyer who regularly practices in that area.

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**Debra B. Hoffman, Partner, Mayer Brown LLP**

Debra Hoffman is a partner in the Firm of Mayer Brown LLP. She has practiced in the employee benefit and executive compensation area for over 30 years and had significant depth and breadth in all relevant areas, both in the domestic and international context. Her practice focuses exclusively in the areas of employee benefit plans and executive compensation and she advises both public and private clients daily with respect to on-going benefits and executive compensation matters, such as issues relating to employment agreements, equity and equity-based arrangements (including for LLCs and non-corporate entities), deferred compensation arrangements (including application of Code Section 409A), bonus and incentive arrangements (including application of Code Section 162(m)), severance agreements, change in control/golden parachute issues, governmental audits, pension de-risking, and compliance issues (including the IRS and DOL voluntary compliance submissions). Debra also advises creditors and debtors in connection with various types of financing structures, bankruptcy and reorganizations. In addition, Debra has extensive expertise with respect to issues arise in the context of corporate transactions, including divestitures, acquisitions, mergers, spin-offs, and initial public offerings.

Debra has served as the practice leader of Mayer Brown's US Employment and Benefits group for several terms. She has been recognized by *Chambers* (2013-2016) as being "very levelheaded," "is very responsive", and "gives plain English, business-minded advice. In addition to *Chambers*, Debra has been recognized as a Best Lawyer in America, a Best Lawyer in Illinois, and a Super Lawyer for several consecutive years.

**Stephanie B. Vasconcellos, Partner, Mayer Brown LLP**

Stephanie Vasconcellos is a partner in the Employment & Benefits practice in Chicago, where she counsels clients regarding employee benefits and executive compensation issues that arise in corporate transactions involving public and private companies. She advises public and private companies on day-to-day executive compensation matters, including assisting clients with implementing, amending and terminating equity compensation plans and agreements, employment and severance agreements, and nonqualified deferred compensation plans, and advising on the application of Code Sections 409A, 162(m), and 280G. Stephanie also counsels clients on a variety of regulatory matters with a particular focus on health and welfare plans, including compliance with the Affordable Care Act, COBRA and HIPAA.

Stephanie has been recognized by *Legal 500 US* as a Next Generation Partner (2020) in Employee Benefits, Executive Compensation and Retirements: Transactional, and as a Rising Star in Employee Benefits by Super Lawyer (2014-2021).

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