

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 171

October 30, 1957

DEDUCTIONS: EMPLOYERS: EMPLOYEES STOCK OPTION PLAN BENEFITS

Syllabus:

An employer is entitled to a deduction of the difference between fair market value and the purchase price paid by an employer in exercising his right under a stock option plan when it is intended that the difference is to be additional compensation.

Taxpayer provided a stock option plan for key employees which has been exercised by a number of employees. Taxpayer now claims as a deduction the difference between the amount received from employees and the fair market value of the stock purchased by employees pursuant to the plan. Advice is requested whether the difference between the two values is an allowable deduction by the taxpayer as additional compensation to its employees.

The deduction is allowable to the employer and the same amount constitutes taxable income to the employees if the stock option plan was adopted in order to compensate the employees (Commercial Investment Trust Corp., 28 BTA 143, aff'd 74 F2d 1015; Chrysler Corporation, 42 BTA 795) but not if the purpose of the plan was to give the employees a proprietary interest in the business (Donald B. Bradner, T.C. Memo. Op, Dkt No. 31673, June 4, 1952, aff'd 209 F2d 956).

The option plan of the taxpayer allowed employees to purchase a specified number of shares each year, there were no restrictions on the right of the employees to resell the stock acquired, and continued employment was a condition to exercising the option. In view of these facts the exercise of the option by employees must be considered additional compensation. C. A. Van Dusen, 8 TC 388. Consequently, the difference is deductible by the taxpayer as additional compensation provided it does not result in compensation which exceeds the reasonable value of services actually rendered.