IRS Wants Tech Firms to Report Option Values in Affiliate Deals

By GLENN R. SIMPSON

WASHINGTON—In a renewed attack on technology companies' use of stock options, the Internal Revenue Service is seeking to force firms to report the options' value in deals with foreign affiliates.

If the IRS prevails, many technology companies that use foreign subsidiaries to make their products could be forced to pay hefty taxes on stock awards to both domestic and foreign employees. The changes might also force companies to re-evaluate how to structure relationships between parents and subsidiaries when developing intellectual property.

Alarmed by recent IRS cases, two trade groups filed briefs in recent weeks urging the U.S. Tax Court here to block the agency. The briefs come in a case the IRS is pursing against Xilinx Inc., a midsize Silicon Valley software company with over $1 billion in revenue, which is headed for a Tax Court ruling that could set a precedent on the issue.

The Software Finance and Tax Executives Council filed a brief with exhibits running to 756 pages, rebutting the IRS's contention that options are a "cost" in product development that must be included in any cost-sharing agreement between a U.S. firm and its foreign units.

If the IRS prevails, some high-tech companies will find the new standard "so onerous that they would discontinue offering options to all but the most senior executives," warned a brief by AeA, the industry group formerly known as the American Electronics Association. The group said such a development would be unfair to high-tech employees, who more than workers in any other industry are accustomed to their compensation being bolstered by stock options.

The IRS has sought for years to reduce or eliminate the tax incentives for issuing stock options, derided by some economists as a subsidy. Under existing Treasury Department rules, gains that employees make on the difference between an option's issue price and its market value when exercised—known as the spread—are tax deductible to the company.

The IRS crackdown was outlined in a Jan. 25 memo to IRS field employees from Thomas W. Wilson, the IRS industry director for communications, technology and the media. He instructed employees to drop cases dating before 1995, but or-

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