Five Most Common ESPP Compliance Errors

In our consulting practice here at SOS, we often encounter the same sorts of compliance issues at many different issuing firms. As we began to compile our list of "favorites" we realized that we had too many to include for just one article, we'll start our series of articles by focusing on ESPP.

1. Tracking and report qualifying dispositions of ESPP shares

Many companies seem to be unaware of the requirement to report not just disqualifying dispositions, but also qualifying dispositions and stop tracking the shares as soon as the holding period has lapsed. In fact the shares should be tracked indefinitely which is, of course, challenging, but can be managed with the right processes and controls in place.

2. Including the discount amount at the time of an ESPP purchase in W-2 income on qualifying dispositions

An obvious corollary to #1, again, some companies do not know of the requirement, while others may track the disposition, but for terminated employees report the income on a 1099. The requirement is, unfortunately, clear that it must be reported on a W-2, even for terminated participants.

3. Treating non-US participants the same as US participants for taxation

For example, often companies do not tax international ESPP participants at the time of purchase, when taxes are often due. Remember that the special tax treatment of a 423-qualified plan applies only for US taxation. In many (all right, most) international jurisdictions, purchasing shares at a discount is a taxable event and taxes must be reported and/or withheld or otherwise collected.

4. Participant communications for Section 6039 compliance with all the required elements

We often run into administrators who say "when did that become a requirement?" or "is that new?" and in fact is has been required for many years. The requirement will be changing soon, as noted in our August Edition of SOS Xtra, but in the meantime, you are still required to send communications to participants regarding the effects of ISO exercises and ESPP transfers.

5. Incorrectly calculating ESPP modification expense for plans that have "Modification" features

Many plans have automatic withdrawal and re-enrollment features and/or allow participants to increase contributions during the purchase period. Under FAS 123(R), these sorts of features require modification accounting. The change is treated as a cancellation of the old "option" and the grant of a new option. The incremental expense of the new option above the value of the old option at the time of cancellation is then accrued over the remaining service period. Unfortunately many softwares and systems that perform accounting calculations for ESPP plans are still unable to accommodate this requirement.

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