

The Tax Man Cometh: Commonly Asked Participant Tax Questions & How to Answer Them

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Bio – Anthony J. Eppert

Winstead PC:

Shareholder, Compensation & Benefits practice group.

His legal practice focuses on executive compensation and employee benefit arrangements in the United States and internationally

Prior to entering private practice:

Served as a judicial clerk to the Honorable Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit

Obtained his LL.M. (Taxation) from New York University

Obtained his J.D., cum laude, (Tax Concentration) from Michigan State University College of Law

- Editor-in-Chief, Journal of Medicine and Law
- President, Tax and Estate Planning Society

Additionally, Tony is a leading writer for Compensation Committee Corner, a blog tailored to compensation committee members of boards of directors. See www.CompensationCommitteeCorner.com

Bio – Jennifer Namazi, CEP

Stock & Option Solutions

- Director, Strategic Solutions
- IPO and M&A Assistance and Guidance
- Proxy Reporting Assistance
- Participant Communications
- Infrastructure Analysis/Guidance
- Vendor Analysis
- Best Practice Assessment / Implementation
- Plan Design / Implementation

Industry

- 15 years of stock plan experience
- Certified Equity Professional (CEP)
- CEPI Advisory Board Member, 2002 – 2009
- Past Program Chair, San Francisco NASPP

Materials

A link to the materials was sent to all registered attendees.

If you did not receive the email, materials are also available here:

<http://www.sos-team.com/pdfs/taxman.pdf>

Please note that the URL is *case-sensitive!*

Disclaimer

The following discussion and examples do not necessarily represent the official views of **Stock & Option Solutions, Inc. or Winstead PC**, with respect to any of the issues addressed. Moreover, this presentation and the views expressed by the individual presenters should not be relied on as legal, accounting, auditing, or tax advice. The outcome of any individual situation depends on the specific facts and circumstances in which the issue arises and on the interpretation of the relevant literature in effect at the time.

Anyone viewing this presentation should not act upon this information without seeking professional counsel and/or input from their advisors.

Agenda

The dos and don'ts of Participant Tax Communications

- The line between assistance and advice
- Answering common questions
- General guidance for year-round inquiries
- Best practices for communication

The Fine Line: Assistance or Advice

“just tell them how the **Company** is required to handle their award”

“just use your judgment about what to say or not”

“not everyone has a tax advisor, you’ll need to give information on how to reconcile things like broker 1099s and W-2s”

“don’t give any information; they’ll need to learn it from their tax advisor”

The Fine Line: Assistance or Advice?

“As a general rule, how do I know what I can say?”

- Is there a threshold for advice?
 - Discretionary vs. Ministerial
 - Are you interpreting, or just stating facts?
- How do I know if I’ve crossed the line?
 - Interpreting ventures into advice territory
- How can my words be used against me?

The Fine Line: Assistance or Advice?

So, what CAN I say, and HOW?

- WHAT:
 - Explain the process
 - Statement of facts
 - Can't give them the answer if you have to make an interpretation to get there
 - Supply information and let them figure out the answer
- HOW: Written communication ideal
 - Consistent
 - You don't know who is fielding the question or how they are answering it when it's verbal
 - An FAQ developed with or by advisors can go a long way

Common Questions: Answered

“I’ve got participants lined up outside my door asking equity related questions about their 2010 transactions, what can I do NOW to assist them?”

Analysis:

- It is better to point people to something, lead them there and let them form their own answer than to give them the answer.
- If you’re going to give them the answer, you’d better be right
- Statement of facts, without interpretation, is not advice

Common Questions: Answered

Participant: “What is a form 3921/3922 and what do I do with it?”

Analysis

Discretionary: “You need it because you need to fill out a schedule D to your tax return.”

Ministerial: “The IRS requires the Company to provide a written information statement to an employee and to file a return with the IRS whenever the Company has either (i) transferred stock to the employee in connection with the exercise of an incentive stock option (“ISO”) (Form 3921) OR (ii) recorded the transfer of stock acquired by an employee under the Company’s employee stock purchase (“ESPP”) plan (Form 3922). These forms are furnished to you as *informational* statements.”

Common Questions: Answered

Participant: *“Why does the broker 1099 have the gross amount of my sale? Wasn’t it already recorded on my W-2?”*

Analysis

Discretionary: “The broker reports **all** your gross transactions on a 1099. You **should** reconcile the 1099 to a Schedule D to make sure you’ve properly accounted for everything.”

Ministerial: “Brokerage firms generally report gross sale amounts on a 1099. The Company’s W-2 reporting is a separate process.”

Common Questions: Answered

Participant: *“How do I fill out a Schedule D for the sales of my RSU shares?”*

Analysis

Discretionary: “The Schedule D is for reconciling your equity transactions for the IRS, and is required. This is where you report any income not included on your W-2.”

Ministerial: “The Schedule D reports capital gains and losses to the IRS. It may or may not be required. The Company cannot instruct you on how to complete this form. We encourage you to discuss with your tax advisor any equity plan transactions you had in 2010, including subsequent sales of equity plan shares.”

Common Questions: Answered

Participant: *“I sold my RSU shares for less than the value at vest. Why is the higher amount (spread at vest, not sale) recorded on my W-2?”*

Analysis

Discretionary: “The loss from your RSU shares is a capital loss and **should be** recorded on a Schedule D”.

Ministerial: “The Company is required to report W-2 income equal to the value on the vesting date for RSU shares. This calculation does not factor in any subsequent sale or disposition of the vested RSU shares.

Common Questions: Answered

Participant: “What is the cost basis for my ESPP shares?”

Analysis

Discretionary: “The cost basis is \$xx.xx”.

Ministerial: “The term cost basis can have multiple meanings, depending on where in the life cycle of purchasing and selling shares the transaction occurred. The Company reports no income on your W-2 at the time of an ESPP purchase. If you dispose of ESPP shares within one year of purchase or two years from the grant date (offering date), then the Company reports income on your W-2 equal to the lesser of the spread (between purchase price and fair market value) at the time of purchase, OR 15% of the grant date fair market value.”

Common Questions: Answered

Participant: “What is a disqualifying/qualifying disposition?”

Analysis

Discretionary: “These terms are for determining if holding periods are met for tax purposes. You did not meet the holding period, therefore, you are not eligible for capital gain treatment.”

Ministerial: “The terms disqualifying and qualifying disposition are used for both shares acquired from ISO exercises and ESPP purchases. These terms reference certain holding periods that the IRS has defined to achieve certain tax treatment of the shares. If the holding periods are not met, then the transaction in which the shares have been disposed is considered a “disqualifying disposition”.”

Common Questions: Answered

Participant: “What is AMT and why do I care?”

Analysis

Discretionary: “If you exercise an ISO and hold the shares (no sale in same calendar year), **you’ll be subject to** AMT in the year of the exercise”.

Ministerial: “AMT is short for ‘Alternative Minimum Tax’. The Company does not calculate or determine income for AMT purposes. However, the IRS has widely identified some types of transactions as inclusion items for calculation of AMT, one of which is the exercise of an ISO without a corresponding sale/disposition in the same calendar year.”

General Guidance

The FAQ: Proactive Preparation for Next Tax Season

- Generally, if it's coming from a separate entity, it's not 'advice from the company'
- Contemplate frequent questions and ask advisors to prepare a response
 - Prepared by competent advisors
 - OR, prepare your responses and, at minimum, seek blessing from advisors
- A good rule of thumb: if it's not on the FAQ, don't venture to answer

General Guidance

The FAQ

- You can answer many common questions in the FAQ, such as:
 - What is a form 3921/3922 and what do I do with it?
 - Why does the broker 1099 have the gross amount of my sale? Wasn't it already recorded on my W-2?
 - How do I fill out my schedule D for the sales of my RSU shares?
 - What is the cost basis for my ESPP shares?
 - What is a disqualifying/qualifying disposition?

General Guidance

The FAQ

- Review and update each tax season to reflect current questions/environment
- Be sure to anticipate questions around special or unusual events, or areas where education has been minimal or complex
 - Merger or Acquisition?
 - New plan or equity type?
 - First time trading? IPO?

The Fine Line: Assistance or Advice?

“The FAQ approach doesn’t work for my Company. How do I field the questions coming in?”

- Develop FAQ, use it as a script
- Self educate the reader on where to find the info (for FAQs) – tell the caller where to find the information
- Leverage vendor library and Intranet to post information

The Fine Line: Assistance or Advice

The dreaded can of worms: Is there such a thing as too much information?

- You want to communicate, but are afraid to because you fear the participant questions
- Should I send a year end statement?
 - Overcome your fears, and remember the goals of your equity program
 - Attract, reward, retain employees
 - Anticipate participant questions and be ready to answer
 - If you disagree, send at minimum what is required

In General, To Say...or Not to Say throughout the year about Taxation

- 83(b) elections on restricted stock awards
 - More companies are prohibiting 83(b) elections in Award Agreement
 - Some allow top 5 or 10 employees to do it
 - No trend of proactive information regarding 83(b) elections
- AMT on ISOs not sold in same calendar year as exercise
 - When someone does a cash exercise, does Company need to warn about inclusion in AMT if not sold in same calendar year?
 - Some companies address this in exercise notice
 - Alternative is Prospectus or FAQ document

Best Practices

Putting together a solid year end communication package:

- Stick to the facts, no interpretation
- Avoid terms like “you should” or “it means”
- Avoid making it individually specific
- Summarize COMPANY treatment of events throughout the year
- Prepare FAQ aimed at anticipating participant questions
- Provide summary statement of transactions and Company withholdings, if possible
 - Required for certain transactions
 - Do it voluntarily where not required?

Best Practices

- If you have an equity email box, consider putting an 'auto reply' or 'out of office' reply during tax season that addresses FAQs (or a link to FAQs on an intranet):

EXAMPLE AUTO REPLY:

Thank you for your message. Your email is important to us and we will reply as soon as possible. Most inquiries will receive a response within 24 business hours.

DO YOU HAVE A FREQUENTLY ASKED QUESTION?

To expedite answering some questions that fall into a category of 'common' inquiries, we've posted answers to some of our most frequently asked questions below:

1) WHY DID I RECEIVE A 1099 FROM THE BROKER?

"I sold my RSU shares and received a 1099 from the broker. I thought I had already had taxes withheld by the Company for these shares at the time of vesting? Isn't this income on my W-2?"

Answer: Brokerage firms generally report gross sale amounts on a 1099. The Company's W-2 reporting is a separate process, and I encourage you to discuss these documents with your tax advisor."

Questions?

SOS Suite of Solutions

Projects/Consulting

- Best Practice Assessment / Implementation
- Equity Accounting Assistance
- Custom Reporting
- Software Upgrades
- Stock Plan Training
- Participant Education & Communication

Transactions

- Mergers & Acquisitions
- Option Exchanges / Repricings
- Vendor Analysis & RFP
- Vendor or System Conversions
- IPO (pre and post)

Applications

- SOS Email Xpress
- SOS Xchange –data exchange
- SOS 6039 Xpress
- Tender Offer Website
- Online Grant Agreements
- Plan Participant Websites/Intranets

SOS People/Staffing

Tactical to senior experienced consultants

- Day-to-day assistance
- Coverage for vacancies
- Vacation, medical, maternity leaves
- Project assistance
- Backing during high-volume
- Throughout United States

Flexible lengths of assignments

- Full or part-time assistance
- On-site or remote
- Temp to perm Services

Dedicated call centers

- Tender offers
- New plan implementations
- High-activity periods

SOS Outsourcing

- A new kind of outsourcing
- Manage some or all aspects of your stock plans
- Financial, Accounting & Tax Reporting
- Special Projects and Onsite Needs

Contact Information



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