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EQUITY PLAN SOLUTIONS SERIES:
Expert Q&A Roundtable:

ACING TAX SEASON– WHAT TO KNOW AND HOW TO DO IT

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With the new year well underway, now is the time for employees, companies, and their equity plan administrators to begin preparing in earnest for tax season. Equity compensation continues to evolve, become more complex and as a result, more tax-relevant in its delivery. At the same time, it has steadily risen to constitute a more important and sizeable share of overall remuneration that issuer companies provide to employees. The stakes, in other words, have never been higher.

AST's Maria Acevedo-Pichardo highlights the key challenges and subtleties for tax season survival, before adding some expert tips and tools that companies can provide to assure efficient, accurate and painless filing in 2020.

To begin, what are the elements to watch for and plan for with respect to tax treatment and equity compensation? Where do the challenges crop up?

Before getting into calculations or filling matters, you simply have to know what you're working with. Equity compensation has become more common, so some folks may simply be unfamiliar with what they have in their plan. It also comes in more flavors–meaning different structures, incentives, vesting calendars and conditions, and potential taxable capital gains–than ever before.

Start with the type of compensation you have from an issuer perspective. There are at least four types in play at this point. First, restricted stock awards (RSAs) or units (RSUs) are taxed at vesting rather than award, with the full market value (FMV) viewed as employee compensation. Likewise, when these are sold, the difference between their cost basis (we'll get into that more below) and the proceeds is viewed as a capital gain. Similarly, these can be linked to and triggered by employee performance rather than restricted by time. That is the second type.

Third are employee stock purchase plans, or ESPPs, which can come in qualified or unqualified varieties–affecting their tax treatment. Here again, there are timing concerns in terms of purchase and holding, and capital gains and discounts to account for depending on disposition. Finally, we have more traditional stock options. Even these, like ESPPs, can be unqualified, and bring a number of additional considerations to bear for discount and calculating taxable compensation.

These complexities will likely affect how much the company, its employees, or its broker may be involved in the filing process. So, first things first, answering these questions carefully will take you down the right path.

Once you have determined what is in scope and how to treat it, what about the actual filing? What are some pitfalls to avoid as employees begin their preparation?

From an individual filing standpoint, making sure you have the right information and process in place also presents its own wrinkles. There is much to do as you go about completing your W-2, Forms 3921 and 3922 (for stock option exercise and ESPP purchases respectively), and 1099s—which report data on all stock and stock option sales.

Each activity around equity compensation will require different computation, minimums to report, specific forms, and dates to electronically or paper file—which typically arrive before April 15th. Ultimately an employee, or their tax advisor or accountant, will be responsible for filing, but there are a couple of particular areas to cover here as well for company issuers.

One is making sure your equity compensation program is ready in terms of who is responsible for what. For instance, the broker will be responsible for sales and redemptions transacted, whereas the employer will need to provide information on stock acquired either via an option or ESPP for forms 3921 and 3922. That is not only a matter of information delivery but also making sure employees know what to look out for, and from whom.

The other matter goes back to deadlines. This information is due to recipients, in some cases, as early as January 31st or February 15th, so it will typically test your company's process and team well before filing season begins—even during the prior calendar year. So it's best to get a jump on it early.

While determining the right data and calculations to use, the sticky issue of cost basis seems to continue to come up—what exactly is that, and how can companies and their partners help simplify it?

True, cost basis can be tricky. But it's important. In the U.S. taxpayers pay income tax on gross proceeds of stock sales minus the cost basis. The term refers to the cost of the investment, and may include numerous components, depending on the stock plan: the cash paid for the investment; the taxable compensation element of a stock grant; taxes withheld on the compensation element; fees, commissions or other costs of acquisition; and adjustment for corporate actions, e.g., returns of capital or spin-offs.

There are still more subtleties from a filing perspective. For your 1099-B, some equity compensation tools (e.g. RSAs and RSUs) are non-covered from a reporting standpoint, even though their actual cost basis is their market value at exercise. Others will take a different reporting formula than their actual basis, entirely.

Once again, this comes down to optimizing your process and partnering with stock plan partners who can aggregate, automate, and disseminate this information accurately and quickly. Of course, knowing what is applicable and having relevant documentation available is crucial in figuring out the final taxable amount—and in many instances, more information will decrease that amount.

What else can companies and their equity plan teams do at a practical level to help employees get organized and solve for the challenges we've identified so far?

In the end, the employee reconciliation process is critical in preventing tax overpayments. In short, they must assure the data is correct, current and complete. However, many upstream activities involving their company and broker can make or break that outcome, and the many moving parts in equity compensation can conspire against those goals. So, as a general matter, clearly allocating responsibilities and regularly communicating are most important.

Issuers and employers must report on employee income, acquisitions of relevant equity instruments, adjustments to cost basis for corporate actions or wash sales and communicate to brokers when shares are directly transferred. All of this translates into a bevy of different forms and provides foundation for the math that comes later. Filers must know what to look out for, what might be missing or misreported, and whom to work with to resolve any reconciliation issues. They need their equity plan partners to step up.

Which leads naturally to the last question: how should companies go about developing and implementing an effective communications strategy around these topics?

It's about keeping organized and reducing confusion. Employers need to realize that participants will receive a lot of information in the first few months of the year—from brokers, transfer agents (these may be new to them, entirely), employers, preparers and even ads. They'll need support and guidance regarding what to pay attention to, and when. To that point, timing is important. Ideally, they should ramp up this communication drive in middle to late February, once W-2s are out but before many folks begin filing.

At the other extreme, employers should also make clear what they can and *can't* do. For instance, addressing frequently asked questions and listing key documents is appropriate, as well as adding contacts for key resources like brokers or transfer agents, and the IRS. On the other hand, companies should always emphasize that, at the end of the process, it is down to the participant to ensure their filing is correct and sent through. Legal disclaimers and reminders are prudent.

Today, it is more important than ever that companies and employees ace tax season in partnership—not least with equity compensation administrators who are capable of delivering on the above. Going forward, this area stands to grow only larger, as these benefits are increasingly identified as key for both careers, corporate performance and recruiting, too.

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