

It's Time for Companies to Start Preparing for Tax Time: Annual Reporting Requirements Applicable to Equity Awards

Now that 2016 has come to a close, it is time for companies to start preparing for tax time. As we look toward the many upcoming deadlines for filings and reporting, below are three key reminders for companies to avoid fines and penalties in the New Year.

Reminder of Annual Reporting of ISO Exercises

Employers must file information returns with the IRS and provide employees with information statements related to incentive stock option exercises that occurred during the 2016 calendar year.

The information return to be filed with the IRS is on Form 3921. Employers may satisfy the requirement to provide employees with an information statement by delivering to the employee "Copy B" of Form 3921 or they may use a substitute form, provided that the substitute form meets published IRS guidance as to form and content.

The delivery and filing deadlines are as follows:

- ➔ January 31, 2017 – Deadline to furnish an information statement to employees.
- ➔ February 28, 2017 – Deadline to file return, if filing a paper copy.
- ➔ March 31, 2017 – Deadline to file return, if filing electronically with IRS.

Companies reporting 250 or more transactions in a year are required to file electronically. Note that each incentive stock option exercise is considered to be a separate transaction, and therefore multiple option exercises by a single employee trigger multiple filings.

The penalties for late and incorrect filings range from \$50 to \$250 per form, with a maximum penalty of \$3 million. The penalty for intentional disregard of these requirements is \$500 per form, with no maximum. The IRS will grant an automatic 30-day extension upon filing a Form 8809, which must be filed electronically or by paper by the applicable deadline. Companies may request an additional 30-day extension due to a claimed hardship, although such extensions are not automatically granted by the IRS.

Third-party vendors are available to assist companies with preparing and filing Form 3921.

Reporting Obligations by Companies Taking Actions Affecting the Basis of Securities

If a domestic or foreign company engages in an organizational action (such as a stock split, recapitalization, redemption, or merger transaction) that affects the basis of a specified security^[1] owned by a U.S. taxpayer, the company must:

- ➔ File a return with the IRS on Form 8937, and
- ➔ Furnish an information statement to each certificate holder or nominee reporting the effect on basis.

Among other things, Form 8937 requires information about the security, the date and nature of the organizational action, the quantitative effect on basis (e.g., an adjustment per share or percentage of old basis), and supporting data and authorities specifying how the change in basis was determined.

Form 8937 must be filed with the IRS by the earlier of (a) 45 days after the organizational action, or (b) January 15 following the year in which the action occurred. The information statement to each certificate holder or nominee must be delivered by January 15 following the year in which the action occurred, and must include all subsequent holders of record up to the date the return is provided to the security holders.

It is important to note that the foregoing requirements to file a return and furnish information statements are waived if, by the applicable due date, the company posts the appropriate information about the organizational action on its primary public website (or that of any successor organization) for a period of 10 years.

The penalty for late and incorrect filings ranges from \$50 to \$250 per information return, with a maximum penalty of \$3 million. The penalty for intentional disregard of these requirements is \$500 per information return, with no maximum. Acquiring and successor entities are jointly and severally liable for applicable penalties for failure to satisfy these reporting obligations.

Section 83(b) Elections No Longer Must be Filed with Tax Returns

Section 83 of the Internal Revenue Code sets forth rules regarding the taxation of property, including employer stock, transferred in connection with the performance of services. In general, the fair market value of the property transferred, less the amount paid, is included in gross income in the year in which the property first becomes vested. Section 83(b) allows an individual performing service to elect to recognize taxable income immediately upon receipt of the unvested property. Such an election must be

made within 30 days after the date of transfer, and can serve as a valuable tax planning tool to begin a capital gain holding period.

The regulations under Section 83 require that a written copy of the Section 83(b) election be filed with the Internal Revenue office with which the taxpayer files his or her return. In order to facilitate e-filing of federal income tax returns, the IRS has issued new regulations that eliminate the requirement that a copy of the Section 83(b) election be submitted with an individual's federal income tax return. The new regulations apply to property transferred on or after January 1, 2016.

[1] In general, a specified security is any share of stock in a company that is treated as a corporation for U.S. tax purposes. Special rules apply to S corporations, regulated investment companies (RICs), real estate investment trusts (REITs), and situations in which the holders of all securities are "exempt recipients," such as corporations, nonprofit organizations, and foreign holders.