

FRACTIONAL SHARES ON AN ESPP - PROS & CONS - ONE CONSULTANT'S THOUGHTS

The Client Question:

If the vendor can handle, are there any challenges with purchasing fractional shares with no carry-forward?

The Consultant's Answer:

I find allowing fractional shares on ESPP purchases to be uncommon in practice. Most plans I see limit to whole shares only. If you wanted to write that flexibility into a plan, I'd have more than a few administrative concerns.

1. Can your tracking software handle it? I think most of them can, but to how many decimal places? To truly make this work with no carry forward, you'd have to be able to track to probably 6 decimals on both the shares and prices and even then I'm not sure you'd avoid the carryforward.
2. Can your broker handle accepting fractional shares?
3. If not at the broker, where would this fractional share be held? Some TA's will keep, but you may end up setting up individual shareholder accounts at the TA to track these. Then each purchase you would add fractions to that account, then once the full share is reached you'd need to get that full share out the employee.
4. How would you track the tax basis of these fractional shares? I'm not sure how TA's and Brokers would accommodate this in the new world of cost basis reporting.
5. Is the company a dividend payer? How are fractional shares handled for dividend payments?
6. How would fractional shares be handled in the event of a stock-split, merger or other corporate restructuring?
7. What would you do with the fractional share if the employee wants the value before it reaches a full share? At some point, the company would probably have to pay cash-in-lieu for any fractional share held and you'd need a process and funding available for that.
8. Communication with employees would become a nightmare - having to explain the impact of the fraction, the tax basis and reporting for later sale...
9. How do these fractional shares impact items like your outstanding common stock numbers, Basic EPS? I've never actually had to work with fractional ESPP shares, so I'd want to have a thorough discussion with legal/accounting/TA, etc. to determine the impact.
10. I'm not sure how you'd work this into the Section 6039 reporting - I think for the IRS you have to utilize whole shares only and true dollars and cents.
11. While I cannot think of any off the top of my head, one concern I always have is international jurisdictions and their rules. I'm not sure fractional shares would cause any issues here, but when you have to look at newly issued vs. previously held and

repurchased by the company vs. open market purchases to meet all the variables world-wide, I usually just throw up the warning flag on every item and say "we need to look at this from a non-US perspective" and hope someone knows the answers.

12. Disposition tracking and reporting - similar concerns to some of the above- can I enter a disposition for a fractional share in my ESPP system? (Some systems allow you to purchase fractional shares, but not enter a disposition of the fraction, so it just hangs out there). How does the holding period/tax basis for calculation of income work with fractional shares?
13. Wash Sale rules. I'm not sure how/if this could work if we are keeping fractions until a whole share is reached, so the shares would each have a different purchase date, tax basis for the fractions included.
14. How would you tell an employee/track how long they have held the "share" created via multiple fractional purchases for QD/DD purposes?

I personally would advise against fractional shares. I don't think they will accomplish what the client is looking for and could lead to major administrative burdens. I don't see the harm in allowing fractional share purchases in the plan document should all the issues ever be resolved, but the processes/procedures should specify whole shares only.

Questions or comments? Please email us at xtra@sos-team.com

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Susan Garvin is a Senior Equity Compensation Consultant with Stock & Option Solutions (SOS). Susan is a frequent speaker on equity compensation related topics; including events sponsored by the NASPP, the Certified Equity Professional Institute, and the National Center for Employee Ownership. She also created/delivered the "Stock Admin 101" seminar while with Salomon Smith Barney. Susan has been in the equity compensation field since 1993, with a wide range of experience, from IPOs to Mergers and Acquisitions to daily stock administration and training of new administrators. She is currently a member of NASPP, GEO and NCEO, received her CEP designation in 1994 and volunteers with the CEPI in many capacities. Susan has a BA from San Jose State University.

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