



## A Trip Down the Tax Turnpike: Avoid the Tolls

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## Agenda

- ▶ Tax Considerations
  - Pre-IPO: Preparing for the Journey
  - During IPO: On the Road
  - Post-IPO: Steering Clear of Roadblocks
  - Best Practices: The Long Way Home

## Preparing for the Journey

- ▶ Set the records straight – private shares
  - Cost basis tracking – required as of 2011
    - Purchase cost
    - Acquisition date
  - Transfers – gifts/inheritances
  - Recognize equity comp differences
    - New IRS regulations prohibit including any compensatory element on the 1099-B starting in 2014



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## Preparing for the Journey

- ▶ RSA/RSU Clarity
  - How are taxes covered?
  - RSA 83(b) elections
    - Advantages – Avoids tax at vesting
    - Disadvantages
      - Illiquidity if no IPO
      - Employee leaves, loses benefit of stock
        - No tax deduction for earlier income inclusion
      - Stock price drops from grant



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## Preparing for the Journey

- ▶ Definition of FMV for compensation
  - Usually based on Plan terms
  - Do they make sense?
    - Sell-to-cover option exercise, with FMV = sales price?
    - Stock-settled SAR exercise, with FMV = sales price?
  - Consider effect on plan participants
    - IRS Rev Proc 2002-50 – stock options
    - Exemption from 1099-B reporting
    - Requires that stock sales price = FMV



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## Preparing for the Journey

- ▶ Incentive Stock Options (ISOs)
  - Great tax advantages if all goes well!
    - Capital gains and payroll tax savings
  - Possible speed bumps include:
    - AMT in year of exercise can surprise employees
    - Early exercise with 83(b) election can eliminate or minimize AMT
      - But benefits are lost if shares are forfeited or sold in disqualifying disposition
    - Tax accounting complexities
    - Form 3921 required reporting



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## Preparing for the Journey

- ▶ 409A: Pay the Toll to Avoid the Penalty
  - Why should I worry about 409A?
    - Applies anytime taxable income event is delayed beyond the vesting date, unless an exception applies
    - Doesn't apply to ISOs, RSAs; may apply to NQs, RSUs
  - 409A Penalty
    - 20% excise tax and income tax when options vest, regardless of when they are exercised!
    - Additional 5% excise tax in CA
    - Employees pay excise tax, but employer may face penalties for failure to report and withhold income tax

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## Preparing for the Journey

- ▶ 409A and Options
  - Applies to NQs if they are issued at a discount
  - IRS looking for cheap stock charges
- ▶ The Toll – Good valuation is key!
  - Valuation must withstand both tax and GAAP scrutiny
  - Ask audit or law firm for recommendations
  - May need more often than annually
  - Consider impact of selling shares pre-IPO in secondary market – may call into question 409A valuation



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## Preparing for the Journey

- ▶ ESPPs implemented at IPO or after?
  - Understand the life cycle of an ESPP
    - IRC Section 423 compliant or non-compliant plan
      - Taxation at purchase or disposition
      - Disposition tracking and reporting



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## Preparing for the Journey

- ▶ Tax certification for employees
  - W-8BEN/W-9
  - Critical for RSUs
    - Prior to vesting if selling shares
- ▶ Payroll issues at first taxable event
  - Reporting transactions
  - Depositing taxes
- ▶ Don't wait until the lock up ends



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## Preparing for the Journey

- ▶ Global mobility
  - Business travel - U.S. State withholding
  - Global country moves & ex-pats
  - Tax complexity and compliance risk



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## Preparing for the Journey

- ▶ Tax Accounting
  - Clean up deferred tax asset (DTA) – auditors asking even private companies for DTA proof
  - Issues to consider:
    - No DTA for ISO/ESPP book expense
    - No DTA for overseas grants
      - Except UK and other countries with recharge
    - Prior repricings/M&A activity adds complexity
    - Consider outsourcing DTA balance calculation
  - Other issues with tax accounting
    - Impact of valuation allowance – including EPS
    - Impact of early exercise: can create DTL and/or permanent addback for future book expense

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## On the Road

- ▶ Ready, Set, Go: Issues during the IPO
  - Covering taxes on RS vesting
    - Share withholding (if cash reserves)
    - Employees pay cash (if savings or liquidity)
    - Sell to cover (if sufficient market volume)
    - Timing of >\$100K tax deposit – IRS 3-day grace period technically only applies to NQ options

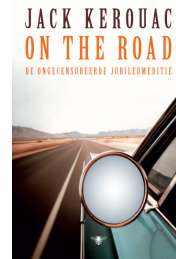


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## On the Road

- ▶ Ready, Set, Go: Issues during the IPO
  - Options
    - Move from ISOs to NQs
    - Market lockup – no risk of forfeiture
    - Early exercises – May see increase in activity if share price going up



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## On the Road

- ▶ ESPPs- Best Practices
  - First purchase
  - Tracking qualifying and disqualifying dispositions
  - \$25K purchase limit monitoring
  - Form 3922 reporting and tracking
    - Transfer agent vs. broker administration
    - Timing of mailing form
    - Who prepares the forms?
    - Communication to employees



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## Steering Clear of Roadblocks

- ▶ Map out compliance with Sec. 162(m) now
  - 162(m) limits tax deductions for compensation to \$1M for CEO and 3 highest-paid execs (not including CFO) for public companies
  - Exception for “performance-based compensation”
- ▶ 3 year grace period following IPO requires full disclosure of plans in S-1 filing
  - Can’t increase share pool during 3-year grace period
  - Can’t increase compensation amounts available under plan as it existed at IPO
  - RSUs may need to pay out before end of grace period to be exempt (pending final IRS regulations)
    - RSAs and stock options just need to be granted during grace period

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## Steering Clear of Roadblocks

- ▶ Communication best practices
  - Personal Tax Advisors
- ▶ Most common tax issues – public to private
  - Tax Reporting
  - Withholding
  - 83(b) elections
- ▶ Transaction summary information
  - Explanations
  - Reporting Info



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## Steering Clear of Roadblocks

- ▶ Rule 144/Section 16 officers
  - Using 10b5-1 plans to cover sales for taxes – RSUs
- ▶ Understanding option tax methods
  - Exercise methods – NQ – no difference in tax amounts
  - Share withholding/Net settled options/Swaps
  - Selling for taxes – brokerage arrangement



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## Steering Clear of Roadblocks

- ▶ RSUs/RSAs
  - Valuing at delivery date vs. vesting date
  - Facebook experience
    - Vesting + six-month lockup
    - FICA obligation at vesting
    - Challenge to find former employees for tax payments
    - Switch from net-settled to sell-to-cover



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## Steering Clear of Roadblocks

- ▶ Tax reporting complexities
  - 1099-Bs
    - Confusing cost basis
    - Risk of overpaying taxes
  - 1099-MISC
    - Directors
    - Non-employees
    - Beneficiaries
  - W-2
    - Even after employee terminated
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## Steering Clear of Roadblocks

- ▶ Employee education
  - What to expect with tax reporting
  - When withholding is or isn't required
    - And when estimated tax payments or increased withholding may be warranted
  - Stock sales – 1099-B/8949/Schedule D
  - Extracting information from admin system
  - Live sessions vs. generic printed material
    - Consider complexities like 83(b) elections, unusual vesting or delivery terms

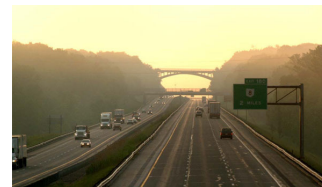


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## The Long Way Home

- ▶ Involving the right parties
  - From design through implementation
  - Inside/outside counsel
  - Finance/auditors
  - Tax internal and external
  - Broker/consultants
  - Transfer agent
  - Human Resources
  - Payroll department
  - Outside administrator
    - In-house software to outsource
    - Still need an administrator in-house



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## The Long Way Home

- ▶ Stay informed and involved in the industry
  - NASPP – National and local chapters
  - GEO
  - NCEO publications
  - CEP institute and exam
  - Stock & Option Solutions
  - Vendor education



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# Q & A

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