

To Schedule D or Not To Schedule D...

A little-known IRS revenue procedure has caused some discussion around the SOS office of late. We thought we'd get the word out about the revenue procedure and what it MIGHT mean to your stock plans and participants.

Revenue Procedure 2002-50 (see page 61 of the PDF) exempts your brokerage firm from sending out 1099-B forms to your participants for same-day sale exercises if the gain of the transaction is calculated based on the sales price of the shares.

To rely on this exemption, your brokerage firm must:

- 1) receive from your company written certification that any compensation income generated by the exercise will be reported on a W-2 form and
- 2) furnish to the participant a written statement that includes
 - a. the gross sales price
 - b. fees charged by the broker on the sale; and
 - c. a description of how gain or loss is calculated and how to report the gain or loss on a federal income tax return.

Why might your company care about this obscure revenue procedure?

In some cases, it may spare your participants the pain of completing a 1040 long form instead of the 1040EZ, just because of an option exercise. If the participant does complete a Schedule D for the exercise, they are reporting only the small capital loss that results from the fees charged by the brokerage firm. The rest of the income is reported on the W-2 form. (If given a choice many participants might "pass" on completing a 1040 long and a Schedule D to recoup only a small amount of tax.)

We have had some clients assert that because the income from the exercise is reported on the W-2, the participant is no longer "required" to complete the Schedule D, and thereby can avoid using the longer 1040 form. The underlying logic is that the IRS publications that seem to require the completion of the schedule D are not law and while income and gains must be reported, participants do not have to report deductions and losses if they don't wish to use them. Other practitioners have asserted that the Schedule D reporting is still required, but that since the transaction is not reported to the IRS on a 1099-B, there is no penalty assessed for failure to complete the form. (It's required, but you won't be penalized if you don't do it?)

Some clients have also reported that, since participants do receive a 1099-B and a W-2, in some cases that income gets reported to the IRS twice, and subsequently taxed twice since some tax professionals do not understand that the income from the same-day sale is already included in the W-2 income. No longer sending a 1099-B to the participant should help to reduce this confusion as well.

In any case, if your brokerage firm can support it, you might want to discuss the possibility of the exemption and what it means for your participants with your legal counsel. It might save your participants a lot of pain every April.

If you have questions on any portion of this article, please e-mail us at: xtra@sos-team.com.

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