

Top Three Stock Plan Taxation "Surprises"

Based on the number of questions we get about and audience reactions to presentations about some of the topics below, we've compiled a list of issues that seemed to "surprise" stock plan clients and audiences the most:

1. Retirement eligibility provisions on restricted stock programs can accelerate the taxable event

Though this is a well-known issue now for tax practitioners and consultants, it seems to catch many stock plan professionals off guard. If you grant restricted stock or restricted stock units and your plans contain a retirement-eligibility provision that either accelerates vesting at retirement or allows continued vesting (the participant will not forfeit the shares when s/he retires), the taxable event is accelerated from the vesting date to the date the participant becomes retirement-eligible. This occurs because the taxable event is deemed to occur when there is no longer any "substantial risk of forfeiture". Since a retirement-eligible employee can choose to retire at any time, and since they will not forfeit the shares when they choose to retire, there is no longer a substantial risk of forfeiture and the participant owes tax immediately. The good news is that if the instrument is a restricted stock unit rather than restricted stock, only FICA/FUTA taxes are due in the year of retirement-eligibility. Federal and state taxes will only be due at the time the shares are released/delivered. For restricted stock, however, all the tax is due at the time the participant becomes retirement-eligible.

2. Federal income taxes are due the next business day for any transactions other than a same-day sale of a non-qualified option if your cumulative tax liability exceeds \$100,000

Though many people are aware of the requirement to remit taxes the next business day when cumulative Federal payroll taxes exceed \$100,000, what seems to surprise people is that the widely-relied upon exception to this rule based on an IRS field directive that allows you to remit taxes within one day after settlement from the brokerage firm (generally the day after T+3) does not apply to any restricted stock transactions, nor to any transactions that are not a same-day sale of a NQ option. The field directive very specifically names NQ stock options, so if your taxes are due from a large vesting of restricted stock or units or from any other transaction, such as a net exercise (where a same-day sale is not involved), proceeds are due nearly immediately.

3. You must withhold at the statutory minimum rate or the W-4 rate for the participant. No other rate is permissible

By even SOS personnel, this area had been considered a "gray area" in equity compensation for many years. Is it permissible to allow your participants to withhold at a different rate than either the 25% flat rate or their W-4 rate for supplemental wages under \$1,000,000?

Some issuing firms allow their participants to increase their withholding from the flat 25% rate to a higher rate for a single exercise or share release/delivery by allowing them to enter a higher rate when they enter the transaction on the brokerage website (or even just by written communication with the stock plan group). Some tax practitioners said it was not permissible to request a higher rate, unless you file an amended W-4 with your company, but many companies allowed it, based on input (or lack thereof) from their own counsel.

Barb Baksa, of the NASPP, finally cleared this up at the 2008 NASPP conference in her session "The Dark Side of Tax Withholding & Reporting": "

Publication 15 (Circular E) Employer's Tax Guide specifically states (on page 13) that no other rate is permitted."

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

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