



DISCLAIMER

This presentation contains general information only and the respective speakers and represented firms are not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. The respective speakers and firms shall not be responsible for any loss sustained by any person who relies on this presentation.

This presentation focuses only on the payroll tax aspects related to employees, other compliance areas including other areas of tax, securities law, labor law, data privacy etc. are not addressed.

2





Basic Concepts

Common Award Types Tricky Situations



BASIC CONCEPTS





SUPPLEMENTAL WAGES



Supplemental wages are payments to an employee that are not regular wages. They can include bonuses, commissions, overtime pay, severance pay, awards, back pay, and stock compensation

Supplemental wages can be subject to income tax withholding:

- If paid with regular wages, as a regular income
- If paid separately, subject to supplemental income tax rates
 - W-4 ignored for withholding at supplemental income tax rates

Supplemental rate is not available for former employees who receive payments in the second calendar year after termination

Must withhold at the former employee's W-4 rate





WITHHOLDING RATES



Federal:

- 22% on supplemental income paid in the year up to \$1,000,000
- 37% on supplemental income paid in the year over \$1,000,000

State:

- California 10.23% (bonuses and stock compensation), 6.6% other supplemental income
- New York 9.62%
- Some states do not have supplemental withholding rate. Employers should withhold at W4 (or state equivalent) withholding rate

Social security and Medicare:

Withhold as for regular wages

Local:

Varies





DEPOSIT RULES



In general the Federal tax deposit rules for stock compensation follows the company's regular deposit schedule; BUT if the cumulative Federal tax deposit for all employees exceeds \$100,000, the amounts withheld must be deposited with the IRS by the next business day

Federal tax deposit generally includes:

- Federal income tax withheld
- Social security withheld
- Medicare tax withheld

- Employer's portion of social security
- Employer's portion of Medicare

Some states have similar rules; e.g.

 California: Next day deposit required if subject to the Federal next day deposit plus \$500 in California PIT



DEPOSIT TIMING FOR STOCK COMPENSATION



Tax event date requiring Federal deposit:

- Incentive stock options: none
- Non-qualifying stock options: settlement (if no later than the third business day after exercise)
 - 2003 IRS Field Directive*
 - For this purpose business day = day stock exchange is open
- RSAs: vest date unless s83b election made
- RSUs: release date
- Employee stock purchase plan: none

^{*}Assertion of the Penalty for Failure to Deposit Employment Taxes Field Directive March 14, 2003



COMPLIANCE FOR COMMON STOCK COMPENSATION TYPES



STOCK OPTIONS





Nonqualified Stock Options – Tax Basics



At exercise: the difference between the exercise price and the fair market value (FMV) of the shares is taxed as compensation

The company must:

- Withhold Federal, state, FICA, Medicare, local taxes as appropriate
- Report the income on Form W-2 for the year of exercise
 - Box 12 Code V

At sale:

- Increase in the FMV on stock held after exercise is taxed as a capital gain
- Decrease in the FMV on stock held after exercise is taxed as a capital loss

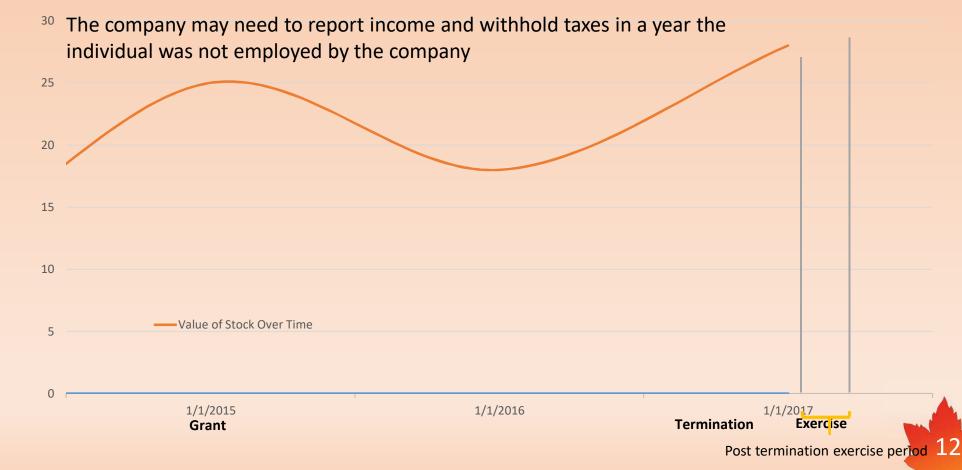
The broker must

Report the proceeds from sale of shares on Form 1099-B





Nonqualified Stock Options



FALLING FOR PAYROLL



INCENTIVE STOCK OPTIONS - TAX BASICS



At exercise:

- No income tax consequences to the employee
- However, the difference between the fair market value at exercise and exercise price is a preference item for Alternative Minimum Taxable (AMT) unless the subsequent sale of stock is in the same tax year as the ISO exercise. AMT is payable by the employee and not subject to tax withholding by the employer

At sale:

- The sale is a "Qualified Disposition" and the income is taxed as a capital gain when the employee sells the shares under both these conditions:
 - > 2 years from the date of the option grant
 - > 1 year from the date of exercise
- The sale is a "Disqualifying Disposition" when it does not meet the definition of a "Qualified Disposition" and the gain is taxed at income tax rates, up to 37% in 2018



INCENTIVE STOCK OPTIONS



ISO Timeline Example Exercise One Year After Grant

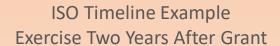


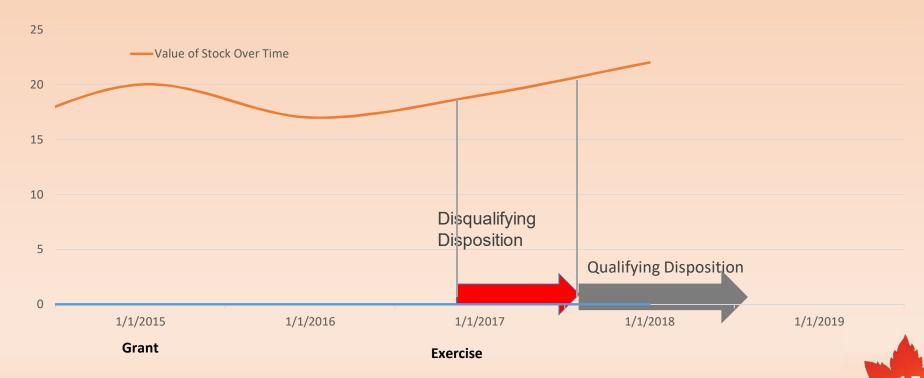
FALLING FOR PAYROLL



INCENTIVE STOCK OPTIONS







FALLING FOR PAYROLL



INCENTIVE STOCK OPTIONS



Remember:

Company must report exercise on form 3921

Company must report on W-2 for disqualifying disposition only

Ohio requires withholding on disqualifying dispositions

Pennsylvania does not recognize the qualifying nature of ISOs and ESPP





STOCK OPTIONS - TAX SUMMARY



	NSOs	ISOs
Subject to income tax at exercise	Yes	No
Preference item for alternative minimum tax at exercise	No	Yes
Subject to income tax at sale	No	Yes – if disqualifying disposition
Subject to capital gains at sale	Yes	Yes
Corporate tax deduction for company	Yes*	Yes* - if disqualifying No - if holding period respected

^{*}Subject to 162(m) rules



RSAs AND RSUs





RESTRICTED STOCK AWARDS (RSAS) - TAX BASICS



At grant: if the employee makes a s83b election, the fair market value (FMV) of the shares is taxed as compensation

- Must be made within 30 days of grant
- Irrevocable election even if the employee later forfeits the shares

At vest/release: if no s 83b election is made, the fair market value (FMV) of the shares is taxed as compensation income

At sale:

- Increase in the FMV on stock held after taxing point is taxed as a capital gain
- Decrease in the FMV on stock held after taxing point is taxed as a capital loss





RESTRICTED STOCK UNITS (RSUS) - TAX BASICS



At vest: the fair market value (FMV) of the shares is taxed as compensation income for social security and Medicare purposes

At release: the fair market value (FMV) of the shares is taxed as compensation income for income tax purposes

At sale:

- Increase in the FMV on stock held after release is taxed as a capital gain
- Decrease in the FMV on stock held after release is taxed as a capital loss



EMPLOYEE STOCK PURCHASE PLAN





ESPP - TAX BASICS



At purchase:

- No income tax consequences to the employee
- ESPP is not an Alternative Minimum Taxable (AMT) preference item

At sale:

- The sale is a "Qualified Disposition" where the income is taxed partly as income and partly as a capital gain. The sale will be a Qualified Disposition if the employee sells the shares and meets these two conditions:
 - > 2 years from the offering date
 - > 1 year from the date of purchase
- The amount subject to income tax is the amount of the discount as calculated at the time of offering (or the actual discount if less)
- If an employee does NOT hold the stock for the required periods, the disposition is referred to as a "Disqualifying Disposition" and the discount is taxed at income tax rates, up to 37% in 2017



EMPLOYEE STOCK PURCHASE PLAN



The employee's purchase price is the lower of

- a) 85% of the stock price on the offering date
- b) 85% of the stock price on the purchase date



Example:

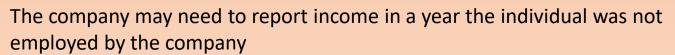
- Fair market value on first day of offering period: \$15
- Fair market value on purchase date: \$20
- Purchase price: \$12.75 (85% of \$15)

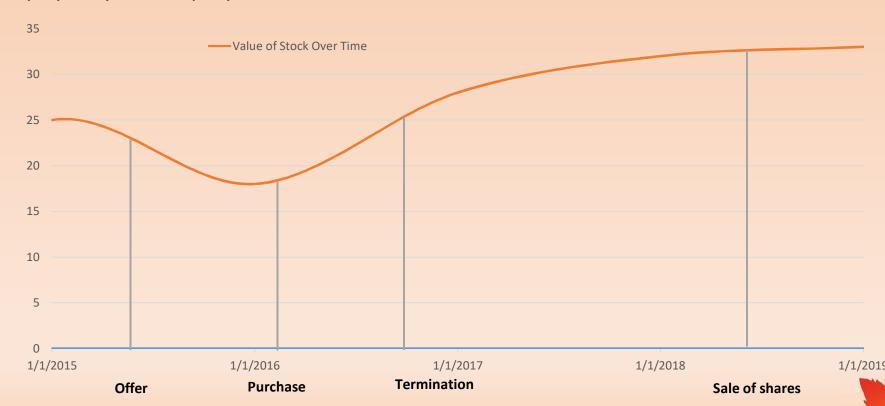


FALLING FOR PAYROLL



ESPP - TAX BASICS





FALLING FOR PAYROLL

REPORTING AND WITHHOLDING SUMMARY







	Grant	Vest	Exercise /Release /Purchase	Sale
Non-qualifying Stock Options	-	-	Withholding W-2 Reporting	1099B Reporting
Incentive Stock Options	-	-	3921 Reporting*	W2 Reporting If Disqualifying Disposition** 1099B Reporting
Restricted Stock Awards	§83(b): Withholding W-2 reporting	No §83(b): Withholding W-2 reporting	-	1099B Reporting
Restricted Stock Units	-	FICA Withholding & W-2 Reporting	Income Tax Withholding & W-2 Reporting	1099B Reporting
Employee Stock Purchase Plan (§423)	-	-	3922 Reporting*	W2 Reporting** 1099B Reporting

^{*}Withholding and reporting required for PA

^{**} Disqualifying disposition withholding required for OH

FALLING FOR PAYROLL

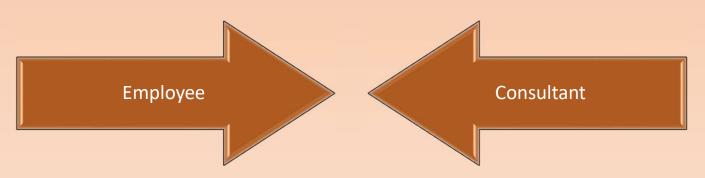
TRICKY SITUATIONS

CHANGE OF STATUS
DEATH
DIVORCE
MOBILITY





CHANGE OF STATUS



In general, allocate the income based on time from grant to vest and treat accordingly

Watch for:

- What is allowed under the terms of the plan & the awards
- Statutory awards (ISOs and ESPP)
- Change of status to consultant with no real services expected
 FALLING FOR PAYROLL







In general, when the award holder passes away

- Transactions in the year of death: report on Form W-2
 - Withhold social security and Medicare if income recognized in year of death (except accelerated awards)
- Transactions after the year of death: report on 1099-MISC for estate

Watch for:

- Statutory awards (ISOs and ESPP)
- Transferable awards
- Acceleration of awards upon death







In general, where awards are transferred pursuant to a DRO

- Income tax report income in Box 3 Form 1099 MISC for Nonemployee former spouse (NEFS)
- Social security and Medicare report income in boxes 3 and 5 Form W-2 for employee

Watch for:

- Statutory awards (ISOs and ESPP)
- DROs specifying transfer of proceeds from awards (but not awards themselves)





Types of mobile employees include

- Assignees including expatriates, inpatriates, third-party nationals
- Permanent transfers
- Business travelers including commuters
- Telecommuters

Can be domestic or international Individuals can have more than one type of mobility





MOBILITY - SOURCING PRINCIPLES



The general rule is that income is sourced where it is earned or over the "earnings period"

	Earned	Paid
Base salary	Daily	Bi-weekly or semi-monthly or monthly
Bonus	Over bonus performance period or related to the achievement of a goal	Quarterly or annually or achievement of target
Commission	Related to a sale	After sale close
Pension	Daily	Post retirement
Stock options	From grant to vest/exercise	Upon exercise

Each taxing jurisdiction may have a different view of the earnings period particularly for stock compensation





U.S. INCOME TAX SOURCING RULES



Since January 1, 2006 Federal sourcing is based on U.S. workdays from grant to vest

Some treaties state otherwise:

• U.S.: Canada

• U.S.: Japan

• U.S.: U.K.

Specific grants may require different sourcing

• E.g., an award granted for a project undertaken in a particular location

State sourcing may differ

• E.g., Arizona, California





U.S. INCOME TAX SOURCING & TAXATION



U.S. resident or citizen

- Tax entire award
- Allocate award between U.S. and foreign source
- Foreign earned income exclusion and FTCs can be taken against foreign source income
- In general, withhold on entire income less foreign withholding on foreign sourced income

Foreign U.S.
Source Source
Income Income

U.S. non-resident

- Tax on U.S. sourced portion only
- In general, withhold on U.S. source income





DOUBLE TAX TREATIES



Each double tax treaty is different

U.S. has double tax treaties with almost 70 countries

BUT generally an individual is tax exempt if:

- The employee is present in the host country for 183 days or less,
 - In the taxable year concerned or rolling 12 month period
- The employee compensation is paid by or on behalf of an employer which is not a resident of the host country, and
- The compensation is not borne by a Permanent Establishment (PE) or fixed base which the employer has in the host country
- Economic employer









Similar to double tax treaties but focus is social security

U.S. has totalization agreements with 26 countries

Generally, individual can be covered in "Home Country" for up to 5 years

 Requires a document from the social security authorities known as Certificate of Coverage

If "local" employee in new country, income can be subject to social tax in new country only

May mean that income tax and social tax are sourced differently for the same income





INTERNATIONAL ASSIGNEES



Tax equalization process requires special treatment

- Expatriate pays tax only to same extent they would have paid in the their home country
 - Hypo-tax
- Company pays host country and home country actual taxes
- Gross up considerations

Tax impact of equity compensation varies widely due to location at:

Grant, vest, exercise and sale





OTHER ADMINISTRATIVE ITEMS



Shadow payroll for international assignees

Short term mobile employees from non-treaty countries

Short term mobile employees from treaty country with state liability

Tracking and allocating multistate domestic mobile employees

- Permanent transfers
- Business travelers







Marlene Zobayan
Rutlen Associates LLC

mzobayan@rutlen.com

650-868-9282

