

Reminder: Employers Must Report 2018 ISO and ESPP Transactions

Deadlines are approaching for employers to report last year's employee exercises of incentive stock options and employee stock purchase plan purchases.

Corporations that offer incentive stock options (ISOs) or maintain a tax-qualified employee stock purchase plan (ESPP) have an obligation to file returns with the IRS and to deliver information statements to employees and former employees regarding the acquisition of shares under such arrangements. These filing obligations are intended to provide employees and former employees with sufficient information to enable them to calculate their tax obligations. These forms are due regardless of any partial shutdown of the Federal government.

How are the reporting requirements satisfied?

The IRS has issued two forms (and instructions): Form 3921 is used to report ISO exercises, and Form 3922 is used for ESPP share purchases. A separate form must be provided and filed for each exercise or purchase during the calendar year. So, for example, if an employee exercised more than one ISO, the employee must receive multiple copies of Form 3921, and the corporation will be required to make multiple return filings with the IRS.

What must be included in the returns and information statements?

The applicable form is used for both the return and information statement (filing Copy A of the applicable form with the IRS, providing Copy B to the employee or former employee, and retaining Copy C for the corporation's records).

- **Form 3921: Returns and Information Statements Related to ISOs.** The information corporations must report on Form 3921 with respect to ISO exercises includes:
 - The name, address, and employer identification number of the corporation transferring the shares (and the corporation whose shares are being transferred, if different)
 - The name, address, and taxpayer identification number of the employee or former employee to whom the shares are transferred
 - The grant date, exercise price per share, date of exercise, fair market value per share on the date of exercise, and the number of shares acquired upon exercise of the ISO
- **Form 3922: Returns and Information Statements Related to ESPPs.** The information employers must report on Form 3922 with respect to ESPP share purchases includes:

- The name, address, and taxpayer identification number of the employee or former employee purchasing the shares
- The name, address, and employer identification number of the corporation whose shares were purchased
- The initial offering date under the ESPP for the shares, the fair market value per share on the initial offering date, the purchase price paid per share, the purchase date, the fair market value per share on the purchase date, the date the legal title to the shares was acquired by the employee or former employee, and the number of shares purchased
- These requirements apply only to the first transfer of such shares (including if directly into a brokerage account at a broker or other financial institution). The corporation is required to identify the shares purchased under an ESPP in a manner sufficient to enable the accurate reporting of the transfer of record title of such shares.

How are the information statements delivered to employees and former employees?

Copy B of the form is provided as the information statement and may be sent electronically or by mail to the employee's or former employee's last known address, or it may be delivered in person. Forms may be delivered electronically only with the person's consent and in accordance with other specified procedures.

What is the deadline?

The deadline for furnishing Copy B of Forms 3921 and 3922 to the employee or former employee for ISO exercises or ESPP shares purchased during 2018 is January 31, 2019.

The deadline for filing Copy A of Forms 3921 and 3922 with the IRS depends on whether the returns are required to be filed electronically or manually. Corporations that are filing 250 or more copies of Form 3921 or 3922 (and these forms are considered separately for purposes of determining whether the 250-form threshold has been met) must file Copy A of the forms electronically through the IRS FIRE system. The deadline for electronic filings is March 31, 2019. Corporations filing fewer forms can elect to file either manually or electronically, but manual filings must be made by February 28, 2019. An automatic 30-day extension of time to file Copy A of Forms 3921 and 3922 may be requested by completing Form 8809 no later than the due date of the return. An extension to furnish Copy B of Forms 3921 and 3922 to employees or former employees may also be requested from the IRS.

Are there penalties for noncompliance?

The Code imposes a penalty of between US\$50 and US\$270 for each statement that is not timely and/or correctly filed (with the penalty increasing within that range depending on the degree of delay beyond the deadline), up to an aggregate annual limit of US\$3,275,500. If an employer intentionally fails to provide a required statement or the correct information on the statement, the penalty is a minimum of US\$540 per statement, with no maximum penalty. These penalties will apply separately for the information statement to be provided to the employee or former employee and the return to be filed with the IRS. If a corporation fails to provide both, the penalties and cap are doubled. Smaller penalties apply to "small businesses" (generally those that have average annual gross receipts of US\$5 million or less for the three most recent tax years (or for the period in existence, if shorter) ending before the calendar year in which the information returns were due).

Are there any exceptions?

Yes. A filing is not required for either non-resident aliens or anyone to whom the corporation is not required to provide a Form W-2 for any calendar year within the time period beginning with the first day of the calendar year in which the option was granted to the employee and ending on the last day of the calendar year in which the employee exercised the option or purchased the shares. Further, penalties will not apply to any failure that the corporation can show was due to reasonable cause and not to willful neglect.

Are there any other reporting requirements related to incentive stock options and ESPP shares?

The reporting obligations described above are in addition to any reporting obligations that arise upon the disqualifying disposition of shares acquired under either an ISO or an ESPP or upon the exercise of an option that does not qualify as an ISO. In particular, the IRS generally requires that the income of an employee from a disqualifying disposition of shares acquired under either an ISO or an ESPP be reported on Form W-2 as “other compensation” in order for the corporation to take a federal income tax deduction for the amount of income recognized by the employee upon a disqualifying disposition, as well as to satisfy the corporation’s reporting obligations.

Upon the exercise of options that are not ISOs, the positive difference between the fair market value per share on the date of exercise and the exercise price is includible in the holder’s income and is reported on Form W-2 in the case of employees or, Form 1099-MISC in the case of non-employees, along with appropriate withholding.

Where can employers find Forms 3921 and 3922?

Copies of Form 3921¹ and 3922² and detailed instructions³ on the filing requirements of such forms are available on the IRS website and are provided for informational purposes only. Only an official printed version of Form 3921 and 3922 can be scanned by the IRS and used by employers filing manually. Downloaded copies that are printed and filed with the IRS cannot be scanned by the IRS and therefore may not be used for filing with the IRS. A penalty may be imposed for filing with the IRS information return forms that cannot be scanned. Official IRS information returns can be ordered online from the IRS website at www.irs.gov/orderforms or by calling the IRS at 1-800-TAX-FORM (829-3676).

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Endnotes

¹ <https://www.irs.gov/pub/irs-pdf/f3921.pdf>.

² <https://www.irs.gov/pub/irs-pdf/f3922.pdf>.

³ <https://www.irs.gov/pub/irs-pdf/i3921.pdf>.