2016 YEAR-END EXECUTIVE COMPENSATION MATTERS: Recent Developments and Annual Reporting Requirements Applicable to Equity Awards

This Alert highlights certain compensation, tax and related matters relevant now that 2016 has concluded, including certain annual reporting requirements applicable to equity compensation that may need to be addressed by clients early in 2017

Reminder of Annual Reporting of ISO Exercises and ESPP Purchases

Employers must file information returns with the IRS and provide employees with information statements related to incentive stock option exercises that occurred during the 2016 calendar year. Similarly, employers (typically relevant only for public companies) must file information returns with the IRS and provide employees with information statements related to initial transfers of stock acquired during the 2016 calendar year under an employee stock purchase plan that complies with Internal Revenue Code Section 423.

The information returns to be filed with the IRS are Form 3921 (for incentive stock option exercises) and Form 3922 (for transfers of shares acquired under an employee stock purchase plan). Employers may satisfy the requirement to provide employees with an information statement (formerly referred to as a Section 6039 statement) by delivering to the employee "Copy B" of the applicable Form 3921 or 3922 or they may use substitute forms for the employee information statements, provided that the substitute forms meet published IRS guidance as to form and content.

The delivery and filing deadlines are as follows:

> January 31, 2017 – Deadline to furnish an information statement to employees.
> February 28, 2017 – Deadline to file return, if filing a paper copy.
> March 31, 2017 – Deadline to file return, if filing electronically with IRS.

Companies reporting 250 or more transactions (applied separately to transactions under each of Form 3921 and Form 3922) in a year are required to file electronically. Note that each option exercise or stock transfer is a separate transaction, and therefore multiple transactions by a single individual trigger multiple filings.

The penalties for late and incorrect filings range from $50 to $260 per form, with a maximum penalty of $3,193,000. The increased penalty for intentional disregard of these requirements is $530 per form, with no maximum. The IRS will grant an automatic 30-day extension upon filing a Form 8809, which must be filed electronically or by paper by the applicable deadline. Companies may request an additional 30-day extension due to a claimed hardship, but such extension will not be automatically granted by the IRS.

Third-party vendors are available to assist companies with preparing and filing Forms 3921 and 3922. If you need assistance finding a third-party vendor for your Forms 3921 and 3922 filing needs, please contact the Gunderson Dettmer attorney with whom you regularly work.

Section 83(b) Elections No Longer Required to be Filed with Tax Returns

Section 83 of the Internal Revenue Code sets forth rules regarding the taxation of property, including employer stock, transferred in connection with the performance of services. In general, the fair market value of the property transferred, less the amount paid, is included in gross income in the year in which the property first becomes vested. Section 83(b) allows an individual performing service to elect to recognize taxable income immediately upon receipt of the unvested property. Such an election must be made within 30 days after the date of transfer, and can serve as a valuable tax planning tool to begin a capital gain holding period.

The regulations under Section 83 require that a written copy of the Section 83(b) election be filed with the Internal Revenue Service office with which the taxpayer files his or her return. Additionally, prior to 2016, the regulations required the individual performing services to submit a copy of the Section 83(b) election with his or her federal income tax return for the year of transfer. This meant that taxpayers wishing to file their tax returns electronically were unable to do so due to the requirement that the Section 83(b) election be submitted with the return and inconsistent commercial tax preparation software.

In 2016, the IRS released final regulations that eliminate the requirement that the taxpayer file a copy of the Section 83(b) election with his or her income tax return for the year in which the property is transferred. A taxpayer is still required, however, to file the Section 83(b) election with the IRS no later than 30 days after the property is transferred as well as provide a copy of the Section 83(b) election to his or her employer.

The final regulations are effective for property transferred on or after January 1, 2016, meaning the relief is available to taxpayers when filing their 2016 federal income tax returns.

New Form W-2 Filing Deadline and Delay for Refund of Certain Tax Credits

The Protecting Americans from Tax Hikes Act that was enacted in December 2015 requires employers to now file their copies of Form W-2 by January 31st. Employers previously had until the end of February to file their copies if doing so by paper or the end of March if filing electronically. The new deadline also applies to certain Forms 1099-MISC utilized for reporting non-employee compensation such as payments to independent contractors. Employers will want to take note of this new deadline and plan accordingly, as only one 30-day extension is available and it is not automatic (Form 8809 must be completed and filed by January 31st if such an extension is necessary).

Additionally, some people will get their refunds later than in prior years due to the Protecting Americans from Tax Hikes Act. The Act requires the IRS to hold the refund for any tax return claiming either the Earned Income Tax Credit or Additional Child Tax Credit until February 15th – which will impact the entire refund, as the IRS is required to hold the entire refund, not just the portion associated with the two credits, until February 15th.

Pending Legislation for Start-Up Company Equity Awards

Legislation entitled the Empowering Employees through Stock Ownership Act has quietly been approved over the second half of 2016 by both houses of Congress. This legislation would allow employees to defer by up to seven years the taxes that arise in connection with certain private company equity awards (exercise of certain stock options and vesting/settlement of certain restricted stock unit awards).

In the uncertain political environment, it is difficult to predict whether or not this bill will become law. However, the Empowering Employees through Stock Ownership Act does appear to have bi-partisan support and we will continue watching its progress in 2017.

Publicly-Traded Companies: Notable Items for 2017 Proxy Season

Say-on-Frequency Vote

Section 14A(a)(2) of the Securities Exchange Act of 1934 requires public companies to solicit the preference of their stockholders as to whether future Say-on-Pay votes should be held every one, two or three years (often referred to as the "Say-on-Frequency" vote), with future Say-on-Frequency votes to be held no later than the annual meeting of stockholders (or other meeting at which directors are to be elected and for which compensation disclosure is required) that is held in the sixth calendar year after the last Say-on-Frequency vote.

Given that the first year a Say-on-Frequency vote was required was 2011, public companies that conducted their initial Say-on-Frequency vote that year should be mindful that they will need to conduct another Say-on-Frequency vote during the 2017 proxy season.

As with the initial Say-on-Frequency vote, the company's board of directors will want to make a recommendation as to the frequency for future Say-on-Pay votes and take into consideration the advantages and disadvantages of votes every one, two or three years – including what the company's prior voting frequency was, what support was received for the Say-on-Frequency vote as well as the Say-on-Pay votes over the last six years, what constitutes the company's stockholder base and whether support will be needed from either institutional stockholders or proxy advisory services.

As a reminder, companies that are emerging growth companies do not need to satisfy the Say-on-Frequency (or Say-on-Pay) vote requirement.

CEO Pay Ratio Disclosure

In 2015, the SEC adopted Item 402(u) of Regulation S-K to implement Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (requiring public companies to disclose the relationship between the annual total compensation of their CEO and the median of the annual total compensation of all of their employees). Item 402(u) applies to compensation provided for the first full fiscal year beginning on or after January 1, 2017, meaning that companies with calendar year fiscal years will first need to provide such CEO pay ratio disclosure required by Item 402(u) during the 2018 proxy season (for 2017 compensation). Additional disclosure will be required every three years thereafter.

Although disclosure will not be required until the 2018 proxy season, and although the current political environment tempts us to anticipate the repeal of this portion of the Dodd-Frank Wall Street Reform and Consumer Protection Act (as meaningful attempts to repeal the Act have been launched since its adoption), public companies should be preparing for such disclosure by running preliminary calculations to prepare for the explanation to both internal and external audiences of the ratio that is likely to be disclosed and to determine any potential data collection and methodology issues.

As with the Say-on-Frequency vote requirement described above, emerging growth companies are exempt from the CEO pay ratio disclosure under Item 402(u). Smaller reporting companies and foreign private issuers are also exempt.

Gunderson Dettmer's lawyers are available to assist in addressing questions you may have regarding the issues discussed in this Alert. Please contact the Gunderson Dettmer attorney with whom you regularly work. Contact information for our attorneys can be found at www.gunder.com.