

2018 Year-End Executive Compensation Matters: Annual Equity Compensation Award Reporting Reminders And Other Compensation Developments

Insights

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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 calendar year 2018. 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 2018 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 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, 2019 – Deadline to furnish an information statement to employees.

- February 28, 2019 – Deadline to file return, if filing a paper copy.
- April 1, 2019 – 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 \$250 per form, with a maximum penalty of \$3 million. The increased penalty for intentional disregard of these requirements is \$500 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 and does not extend the due date for delivering “Copy B” of the applicable form to the employee.

Forms 3921 and 3922 are available through the IRS website; instructions for completing and filing the forms can be obtained through this link:

<https://www.irs.gov/pub/irs-pdf/i3921.pdf>. Third-party vendors are available to assist companies with preparing and filing Forms 3921 and 3922. For a list of vendors, please contact the attorney with whom you regularly work at Gunderson Dettmer.

Tax Deferral Election for Private Company Equity Compensation Awards

A new deferral election enacted in late 2017 as part of the Tax Cuts and Jobs Act and hailed as a positive development for facilitating broad-based stock ownership at private companies has so far proven disappointing due to its complexity and several internal faults in the statute as adopted. Section 83(i) of the federal tax code, available for the first time in 2018, allows eligible (non-executive) employees of private companies to elect to defer for up to five years their individual federal income tax resulting from exercise of stock options or settlement of restricted stock units (RSUs) on “qualified” stock. The statute also imposes certain notice requirements on employers issuing “qualified” stock.

In December 2018, the IRS issued initial guidance on certain aspects of the Section 83(i) deferral election rules (Notice 2018-97). This guidance addresses how employers are to determine whether they have satisfied the rule’s requirement that 80% of US employees must receive options or RSU grants in order for the company’s

stock to be eligible to utilize the deferral, how employers are to comply with federal income tax withholding rules in connection with such deferrals, and how employers may opt out of Section 83(i).

We remain underwhelmed by this deferral election. Those clients that did undertake during 2018 the review necessary to determine whether their equity awards could qualify for deferral were for the most part frustrated with the complexity of the statute's requirements, unable to conclude that their stock qualified, or both. That said, we continue to await tax regulations that might simplify the statutory requirements. In the meantime, we are advising private company clients that early in 2019 they should decide if they want to opt out of the statutory regime. If not, clients will need to analyze whether their equity awards can qualify for the Section 83(i) deferral opportunity.

Please contact the Gunderson Dettmer attorney with whom you work if you would like additional information regarding Section 83(i).

Reminder of Reporting Requirements that Apply to Acquisitions of Large Amounts of Stock

In light of a \$600,000 civil penalty paid during 2018 by an executive who failed to timely report required information regarding his acquisitions of employer stock awards, we again wanted to offer a reminder that federal anti-trust laws impose certain advance filing requirements (as well as stiff penalties for filing failures) in connection with large-value stock acquisitions, including when such acquisitions take place outside of the mergers and acquisitions context. These requirements can be triggered by a company's issuance of stock to employees pursuant to equity compensation awards, and they apply to acquisitions of stock in public and in private companies.

The Hart-Scott-Rodino Antitrust Improvement Act (HSR Act) requires companies and individuals (including officers and employees) to give advance notice to the Federal Trade Commission and the Antitrust Division of the Department of Justice when they acquire voting securities that meet certain dollar thresholds. Including as a result of the continuing robust investment environment for non-publicly traded companies, these thresholds are being achieved more frequently. For 2018, the filing requirement applied if the total aggregate amount of voting stock that the person will hold after making the acquisition is greater than \$84.4 million, with additional filing thresholds (and significantly higher penalties kicking in) at \$168.8 million and \$834.9 million. These thresholds will adjust in early 2019.

Stock acquisitions triggering the HSR filing include exercise of a stock option, settlement of a restricted stock unit (RSU), grant of restricted stock, and purchasing stock in a public or a private transaction, including from the company. The filing is required to be made at least 30 days prior to the proposed acquisition. This means that the stock acquisition should not close until expiration of that 30-day period (or earlier if “early termination” of the period is granted). For equity compensation awards that trigger the filing requirement, this means that the filing must be made 30 days *prior to* the planned exercise of an option, the scheduled settlement date of a RSU, or the grant date of a restricted stock award.

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