Disclosure

The following presentation and the views expressed by the presenters are not intended to provide legal, tax, accounting, investment, or other professional advice. The information contained in this presentation is general in nature and based on authorities that are subject to change. Applicability to specific situations should be determined through consultation with your investment, legal, and tax advisors. The information contained in these materials is only current as of the date produced. The materials have not been and will not be updated to incorporate any changes since the production date.
Asking Questions

Enter your question into the Questions pane on the GoToWebinar control panel.
Housekeeping

› Eligible for CPE for Taxes credit
  - Must stay for entire presentation
  - Must participate in all three poll questions during presentation

› Presentation is being recorded
  - Email will be sent to all attendees with link to recording and presentation

› Please take our survey!
Today’s presenter

Bruce Brumberg, Editor-in-Chief and Co-Founder, myStockOptions.com

- Award-winning online resource center, has received a patent and has been featured in publications ranging from the San Francisco Chronicle to Money magazine.
- Human Resource Executive magazine featured myStockOptions.com as one of the 10 Best HR Products.
- Past President of the Boston NASPP chapter
- On the NASPP Advisory Board, and contributor to the Stock Plan Advisor.
- Producer of the “Think Twice” insider trading prevention videos (www.insidertradingvideos.com).
- Editor of another site on nonqualified deferred compensation at www.myNQDC.com.
- Bruce graduated from the University of Michigan and University of Virginia School of Law.
Content and tools for companies, participants, stock plan professionals, and financial advisors
Special resources for tax season
New in 2018!

Our one-day conference Financial Planning for Public Company Executives & Directors is a must-attend event for professionals working with or seeking to advise executives, directors, and high-net-worth employees who have stock compensation and holdings of company stock.

Leading industry experts will discuss:
- Trends of importance to advisors
- Tax, estate, and SEC-related planning challenges
- Methods for successfully attracting and advising high-net-worth clients
- And much more

CE credits are available!
Computershare 2017 Tax Form Reference Guide

Find it on the education section of Employee Online

2017 Tax Form Reference Guide

Non-Qualified Stock Options (NQ)

Listed below are the tax documents you can expect to receive and the dates the forms are to be issued if you have Non-Qualified Stock Options, are a U.S. taxpayer (W-2 certified), and had exercise activity in 2017.

The forms you will receive are based on your account activity. If you have an option transaction, the income will be reported on Form W-2 or Form 1099-MISC whereas the actual sale of shares will be reflected on Form 1099-B.

NOTE: On all charts, Company refers to the company that issued you the stock option or grant, or the company within whose employee stock purchase plan you participate.

| COMPENSATORY INCOME (regardless of exercise method) |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|
| Status                          | Expected Tax Form | Amounts          | Issued by       | Form Deadline   |
| Employee                        | W-2             | ($Pd exercise price x # options exercised), all payroll withholding deducted | Company         | Jan. 31, 2018   |
| Non-employee                    | 1099-MISC       | ($Pd exercise price x # options exercised), usually no withholding | Company         | Jan. 31, 2018   |

SHARES SOLD UPON EXERCISE

<table>
<thead>
<tr>
<th>Transaction Type</th>
<th>Expected Tax Form</th>
<th>Amounts</th>
<th>Issued by</th>
<th>Form Deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cashless for cash</td>
<td>1099-B</td>
<td>Net proceeds ($Sale price x # shares sold) - transaction fees</td>
<td>Computershare</td>
<td>Feb. 15, 2018</td>
</tr>
<tr>
<td>Cashless hold (sell-to-cover)</td>
<td>1099-B</td>
<td>Net proceeds ($Sale price x # shares sold) - transaction fees</td>
<td>Computershare</td>
<td>Feb. 15, 2018</td>
</tr>
<tr>
<td>Net exercise (withheld shares for option cost and taxes)</td>
<td>N/A</td>
<td></td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Stock swap</td>
<td>N/A</td>
<td></td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Cash buy</td>
<td>N/A</td>
<td></td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Roadmap for presentation

› What’s new for the 2018 tax-return season (reporting for tax year 2017)

› Review of rules for cost-basis reporting

› Common questions and errors

› Communication and education for employees and executives
Polling Question #1

How does the Tax Cuts & Jobs Act, adopted in late 2017, impact tax return reporting for 2017 income?

a. The rates and rules under it fully apply
b. It does not apply. It starts with 2018 income
c. Only the tax bracket rates apply to 2017 income
d. You can elect to apply the 2018 tax rates and rules
Polling Question #1

How does the Tax Cuts & Jobs Act, adopted in late 2017, impact tax return reporting for 2017 income?

a. The rates and rules under it fully apply
b. It does not apply. It starts with 2018 income
c. Only the tax bracket rates apply to 2017 income
d. You can elect to apply the 2018 tax rates and rules
Three main points for employees about the Tax Cuts & Jobs Act (“Tax Reform”)  

1. No impact on tax-return reporting for 2017 income. Rules the same!
Three main points for employees about the Tax Cuts & Jobs Act (“Tax Reform”)

2. Flat rate used for stock compensation income withholding (what we pros call supplemental wage income) is now 22% (37% for amounts over $1 million per year).

What this means:
› The 24% tax bracket starts with yearly income over $165,000 for joint filers and over $82,500 for singles. Most employees with stock compensation are in a higher tax bracket.
› Need to know the tax bracket for total income and assess need to put money aside or pay estimated taxes.
Three main points for employees about the Tax Cuts & Jobs Act ("Tax Reform")

3. AMT or how it applies to ISOs is not repealed. New key numbers in the AMT calculation:
   - The AMT income exemption amount rises to $70,300 (from 54,300) for single filers and to $109,400 (from 84,500) for married joint filers.
   - AMT income exemption starts to phase out begins at $500,000 for individuals (up from $120,700 in 2017) and $1,000,000 (up from $160,900) for married filers.

What this means: Much less likely to trigger AMT from ISO exercise and hold.
# Key bracket thresholds for federal income tax

Tax thresholds for 2017 ordinary income, capital gains, and dividends, along with phaseouts on personal exemptions and itemized deductions.

<table>
<thead>
<tr>
<th>TAX RATE</th>
<th>YEARLY INCOME THRESHOLD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top ordinary income rate (39.6%) &amp; capital gains/ dividend rate (20%)</td>
<td>Taxable income of $418,400 (single) or $470,700 (joint)</td>
</tr>
<tr>
<td>Income where 25% rate for supplemental withholding will not cover taxes owed (28% bracket rate starts)</td>
<td>$91,900 (single) or $153,100 (joint)</td>
</tr>
<tr>
<td>Medicare surtax on investment income (3.8%)</td>
<td>Modified adjusted gross income of $200,000 (single) or $250,000 (joint)</td>
</tr>
<tr>
<td>Additional Medicare tax on earned income (0.9%)</td>
<td>Earned income of $200,000 (single) or $250,000 (joint)</td>
</tr>
<tr>
<td>Phaseout of limit itemized deductions and personal exemptions</td>
<td>Adjusted gross income of $384,000 (single) or $436,300 (joint)</td>
</tr>
</tbody>
</table>
**AMT: Important for ISOs**

**Alternative minimum tax (AMT):** The income exemption amounts, the phaseout ranges, and the threshold for the higher 28% rate are now all indexed for inflation. The table below, prepared by myStockOptions.com, shows the 2017 figures.

<table>
<thead>
<tr>
<th>Filer status</th>
<th>AMT income exemption amount</th>
<th>AMT income exemption phaseout starts</th>
<th>AMT income exemption phaseout ends</th>
<th>Threshold where AMT rate rises from 26% to 28%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single</td>
<td>$54,300</td>
<td>$120,700</td>
<td>$337,900</td>
<td>$187,800 ($93,900 for married but filing separately)</td>
</tr>
<tr>
<td>Joint</td>
<td>$84,500</td>
<td>$160,900</td>
<td>$498,900</td>
<td>$187,800</td>
</tr>
</tbody>
</table>
No changes in the rules and forms for tax-return reporting this year

› **Similar to last year:** Form W-2, Form 1099-B, Form 8949, Schedule D

› Same restrictions in what brokers can report for the cost basis on Form 1099-B

› **More good news:** The core reporting rules for Form 8949 and Schedule D have not changed
Polling Question #2

What is the box on the 1099-B that reports cost basis?

a. Box 3
b. Box 1e
c. Box 1g
d. Box CB
Polling Question #2

What is the box on the 1099-B that reports cost basis?

a. Box 3
b. **Box 1e**

rephrasing the choice:
c. Box 1g
d. Box CB
Cost Basis Reporting: IRS Form 1099-B core boxes (brokers use substitute statement with columns)

<table>
<thead>
<tr>
<th>Description of property (Example: 100 sh. XYZ Co.)</th>
<th>1b Date acquired</th>
<th>1c Date sold or disposed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds</td>
<td>$</td>
<td></td>
</tr>
<tr>
<td>Accrued market discount</td>
<td>$</td>
<td></td>
</tr>
<tr>
<td>Copy B</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

Applicable check box on Form 8949

OMB No. 1545-0715

2017

Form 1099-B

Proceeds From Broker and Barter Exchange Transactions

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

www.irs.gov/form1099b Department of the Treasury - Internal Revenue Service

(Keep for your records)
What is the cost basis?

Cost basis (also called the tax basis) is the total cost of an acquired security:

Price paid to acquire shares + compensation recognized for acquiring them (reported on W-2)

When you sell a security, you **need to know the cost basis** to determine whether you have a capital gain or a capital loss for tax purposes.

**NET PROCEEDS - COST BASIS = CAPITAL GAIN OR LOSS**

Cost basis too low: you **overpay** taxes
Recap of regulations on cost-basis reporting

- Cost-basis-reporting regulations were implemented as part of the Emergency Economic Stabilization Act of 2008
- **IRS Goal:** capture lost tax revenue from capital gains and losses
- 2011: regulations require brokers to compute and report on Form 1099-B the cost basis of **covered securities**
- Initially, broker **had the choice** to include compensation income amounts in the cost basis they reported on Form 1099-B
Covered and uncovered securities

Key IRS distinction
A covered security: acquired for cash on or after January 1, 2011.

Securities acquired through stock plans

<table>
<thead>
<tr>
<th>Covered securities</th>
<th>Noncovered securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Option exercise</td>
<td>1. Restricted stock/RSUs vesting</td>
</tr>
<tr>
<td>2. ESPP purchase</td>
<td>2. Performance share/PSUs vesting</td>
</tr>
<tr>
<td></td>
<td>3. Stock appreciation right (SAR) exercise</td>
</tr>
</tbody>
</table>
Final cost-basis regulations

› The IRS wanted to reduce inconsistency in cost-basis reporting among brokers.

› The final regulations, adopted April 18, 2013, include this statement:

  A broker may not increase initial basis for income recognized upon the exercise of a compensatory option or the vesting or exercise of other equity-based compensation arrangements, granted or acquired on or after January 1, 2014.

› Removed the flexibility to increase the basis to include compensation income.

› Consistency comes at a price: **If the basis on Form 1099-B is not adjusted for the W-2 income, you risk over-reporting gains and overpaying taxes.**
What this means for tax-return reporting

- Compensation income will not be included in the basis reported on Form 1099-B for grants made starting 1/2014

- **Compensation income recognized**: The cost-basis value will be incomplete in every scenario

- **Need to know**: How will the broker report the cost basis of shares acquired between the start of 2011 and the end of 2013?
  
  **Trend is standardization**: not adding W-2 income to basis for option exercises or ESPP purchases that occurred during this period

- Brokers provide supplemental information on basis and tax guides to help with tax-return reporting
Risk of overpaying taxes

There are **only three disposition scenarios** in which the cost basis will *not* be understated:

- qualifying dispositions of ISOs (all capital gain)
- disqualifying dispositions of ISOs, with shares sold at a loss (all capital loss)
- qualifying dispositions of ESPPs, with shares sold at a loss (all capital loss)

In other scenarios, the cost basis will be understated or omitted (i.e. the box will be blank). Unless participants and tax professionals are aware of this, taxpayers risk:

- over-report of capital gains
- paying more taxes than they owe!
Ten tax-return issues and errors

1. Not reporting stock sales on Form 8949/Schedule D
2. Not reporting tax basis correctly on Form 8949
3. Double-counting income from W-2
4. Forgetting about AMT calculation or AMT credits
5. Sell-to-cover exercises
6. Share withholding for restricted stock/RSUs
7. Dividends with restricted stock
8. Not reporting ordinary income with ESPP sales
9. Netting of income
10. Extensions
Tax Center

As featured in WebCPA and Plansponsor, our Tax Center includes the withholding, reporting, and filing rules for stock options, restricted stock/RSUs, ESPPs, and SARs. Browse a section below, or explore the subtopics to the left.

- Test and improve your knowledge with our NEW! Tax quiz.
- Test and improve your knowledge with our Taxes quiz.
- Listen to our podcast on tax return tips & avoiding reporting mistakes!
- Check out our podcast and video on the tax forms and reporting rules for stock sales.

Restricted Stock & RSUs: 10 Tax-Return Mistakes To Avoid

The myStockOptions.com Tax Team

**UPDATES!** The 2017 tax season has the potential to be confusing if you sold stock in 2016. This article explains common errors to avoid when reporting stock sales on your tax return and provides helpful guidance on other tax topics involving restricted stock and RSUs.
Polling Question #3

If employees sold stock during the calendar year, which tax forms do they file with their IRS Form 1040 to report the sale?

a. Form 1099-B and Schedule A
b. Form 8949 and Schedule D
c. Form 6251 and Schedule C
d. Form 1099-MISC and Schedule C
Polling Question #3

If employees sold stock during the calendar year, which tax forms do they file with their IRS Form 1040 to report the sale?

a. Form 1099-B and Schedule A  

b. Form 8949 and Schedule D  
c. Form 6251 and Schedule C  
d. Form 1099-MISC and Schedule C
1. Not reporting stock sales on Form 8949 and Schedule D

- **Event:** Sell all stock at exercise (i.e. a cashless exercise), restricted stock/RSU vesting, or ESPP purchase.

- **Employee may think:** No “gains” beyond what’s on W-2 for ordinary income. May not realize there are **two reportable events**.

- **Result of incorrect thinking:** employee does not report sale on Form 8949/Schedule D.

- IRS gets 1099-B from broker. IRS computers note no Form 8949/Schedule D reporting for it.

1. Not reporting stock sales on Form 8949 and Schedule D

› Company and broker meet certain conditions: employee may not receive a Form 1099-B.
› Employee must still file Form 8949/Schedule D to report sale.
› **Employee may even have small gains or losses** for any commissions and fees for the stock sale.
1. Not reporting sales on Form 8949 and Schedule D

Example: Exercised options and sold 2,000 shares on August 14.

<table>
<thead>
<tr>
<th>Exercise price</th>
<th>$10 per share ($20,000 total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock price at exercise/sale: $35</td>
<td>$70,000 proceeds, minus $500 commission ($69,500 net on Form 1099-B)</td>
</tr>
<tr>
<td>What appears on Form W-2</td>
<td>$50,000 income [($35 - $10) x 2,000]</td>
</tr>
<tr>
<td>Tax basis</td>
<td>$70,000 ($20,000 + $50,000). But what is on 1099-B? $20,000 or $70,000?</td>
</tr>
<tr>
<td>Schedule D (Part 1)</td>
<td>Included as a $500 short-term capital loss</td>
</tr>
</tbody>
</table>

If sale is not reported: IRS gets 1099-B with the $70,000 proceeds and sends employee letter looking for taxes on that full amount!
**NQSO: Cashless Exercise**

**Form 8949**

**Sales and Other Dispositions of Capital Assets**

Information about Form 8949 and its separate instructions is at www.irs.gov/form8949.

File with your Schedule D to list your transactions for lines 1b, 2, 3b, 6b, and 9, and 10 of Schedule D.

Social security number or taxpayer identification number

Before you check Box A, B, or C below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

**Part I**

**Short-Term.** Transactions involving capital assets you held 1 year or less are short term. For long-term transactions, see page 2.

Note: You may aggregate all short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 1a; you aren’t required to report these transactions on Form 8949 (see instructions).

You must check Box A, B, or C below. Check only one box. If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box. If you have more short-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

<table>
<thead>
<tr>
<th>Box A</th>
<th>Box B</th>
<th>Box C</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see Note above)</td>
<td>Short-term transactions reported on Form(s) 1099-B showing basis wasn’t reported to the IRS</td>
<td>Short-term transactions not reported to you on Form 1099-B</td>
</tr>
</tbody>
</table>

1. **Description of property**
   - (a) [Example: 100 sh. XYZ Co.]
   - (b) [Date acquired (Mon., day, yr.)]
   - (c) [Date sold or disposed of (Mon., day, yr.)]
   - (d) [Proceeds (sales price + instructions)]
   - (e) [Cost or other basis: See the Note below and see Column (f) in the separate instructions]
   - (f) [Code(s) from instructions]
   - (g) [Amount of adjustment]

2. **Gain or (loss)**
   - (h) [Subtract column (e) from column (d) and combine the result with column (g)]

3. **Basis in Box 1c of 1099-B is correct**
   - Column (e): Basis in Box 1c of 1099-B
   - Column (f): Code B
   - Column (g): Omitted amount (e.g., W-2 compensation not included). Put in parentheses to indicate a negative number (as this amount reduces gain or increases loss). For NQSOs, this is the exercise spread.

4. **Basis in Box 1c of 1099-B is too low or blank**
   - Column (e): Basis in Box 1c of 1099-B
   - Column (f): Code B
   - Column (g): Omitted amount (e.g., W-2 compensation not included).

5. **If Box A is checked:**
   - Column (e): Basis in Box 1c of 1099-B
   - Column (f): Code B
   - Column (g): Omitted amount.

6. **If Box B is checked:**
   - Column (e): Correct basis of the sold shares (exercise price – income on W-2 for the exercise spread of shares sold)***
   - If the basis is blank or 0:
     - Column (f): Leave blank
     - Column (g): Leave blank
   - If the basis is incorrect:
     - Column (f): Code B
     - Column (g): Enter "."
Annotated diagrams of Form 8949 and Schedule D on myStockOptions.com and in Knowledge Center
2. Not reporting tax basis correctly

Cost-basis reporting is now more complex, confusing, and vulnerable to errors!

Error by type of grant that leads to OVERPAYING TAXES:

› Mistake with NQSOs, SARs, or ISO (DD) : Using exercise price only
› Mistake with ESPP: Using purchase price only
› Mistake with Restricted stock or Performance shares: Using purchase price of (usually $0).

<table>
<thead>
<tr>
<th>Grant type</th>
<th>Mistake with reporting basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>NQSOs, SARs, ISOs (DD)</td>
<td>Exercise price only</td>
</tr>
<tr>
<td>ESPP</td>
<td>Purchase price only</td>
</tr>
<tr>
<td>Restricted Stock/RSUs</td>
<td>$0 as no purchase price</td>
</tr>
</tbody>
</table>
Amount of **ordinary income** recognized: reported on Form W-2

<table>
<thead>
<tr>
<th>Grant type</th>
<th>Income reported on W-2</th>
</tr>
</thead>
<tbody>
<tr>
<td>NQSOs</td>
<td>Spread at exercise</td>
</tr>
<tr>
<td>Restricted stock, RSUs, performance shares</td>
<td>Value at vesting and share delivery</td>
</tr>
<tr>
<td>Section 423 (qualified) ESPP</td>
<td>Depends on holding period</td>
</tr>
<tr>
<td>ISO in disqualifying disposition</td>
<td>Depends on the sales price relative to the market price at exercise</td>
</tr>
</tbody>
</table>
Cost-basis confusion: three situations

1. Stock purchases before 2011: **No cost basis reported to IRS.**

2. Securities not purchased with cash (restricted stock or RSUs): **No cost basis reported to IRS.**

3. Compensation part of cost basis for stock compensation: **Cannot be part of basis reported to IRS for stock acquired or granted starting 1/ 2014.**
Reporting tax basis on 1099-B: Timeline of changing IRS rules
What to do on Form 8949: Depends on 1099-B (myStockOptions.com Interpretation of Rules)

<table>
<thead>
<tr>
<th>The cost basis on Form 1099-B is too low</th>
<th>The cost-basis box on Form 1099-B is blank</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Basis from 1099-B in column (e)</td>
<td>1. Put correct basis in column (e)</td>
</tr>
<tr>
<td>2. Adjustment in column (g)</td>
<td>2. Check Box (B) or (E) near top</td>
</tr>
<tr>
<td>3. Code B in column (f)</td>
<td>3. No adjustments or codes in other columns needed</td>
</tr>
<tr>
<td>4. Check Box (A) or (D) near top</td>
<td></td>
</tr>
</tbody>
</table>
## Cost-basis example: RSUs

<table>
<thead>
<tr>
<th></th>
<th>Per share</th>
<th>Total (1000 shares)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Vesting date price</strong></td>
<td>$10</td>
<td>$10,000</td>
</tr>
<tr>
<td><strong>Compensation income</strong></td>
<td>$10</td>
<td>$10,000</td>
</tr>
<tr>
<td>reported on Form W-2</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Purchase price</strong></td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Cost basis</strong></td>
<td>$10</td>
<td>$10,000 (but $0 on the 1099-B)</td>
</tr>
<tr>
<td><strong>Sale price</strong></td>
<td>$15</td>
<td>$15,000</td>
</tr>
<tr>
<td><strong>Taxable gain and capital gains tax</strong></td>
<td>$15 - $10 = $5</td>
<td>$15,000 - $10,000 = $5000 $5000 x 15% = $750</td>
</tr>
<tr>
<td><strong>Capital Gain: Overpaying using wrong cost basis</strong></td>
<td>$15-$0 = $15</td>
<td>$15,000 - $0= $15,000 $15000 x 15% = $2250</td>
</tr>
</tbody>
</table>
Form 8949

Sales and Other Dispositions of Capital Assets

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File with your Schedule D to list your transactions for lines 1b, 2, 3, 8b, 9, and 10 of Schedule D.

**Part I** Short-Term. Transactions involving capital assets you held 1 year or less are short term. For long-term transactions, see page 2.

**Note.** You may aggregate all short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the total directly on Schedule D, line 1a; you are not required to report these transactions on Form 8949 (see instructions).

**You must check Box A, B, or C below. Check only one box.** If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box. If you have more short-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- **(A)** Short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see Note above)
- **(B)** Short-term transactions reported on Form(s) 1099-B showing basis was not reported to the IRS
- **(C)** Short-term transactions not reported to you on Form 1099-B

<table>
<thead>
<tr>
<th>Description of property</th>
<th>Date acquired (Mo., day, yr.)</th>
<th>Date sold or disposed (Mo., day, yr.)</th>
<th>Proceeds (sales price)</th>
<th>Cost or other basis. See the Note below and see Column (e) in the separate instructions</th>
<th>Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1000 Shares XYZ</td>
<td></td>
<td></td>
<td>15,000</td>
<td>0</td>
<td>15,000</td>
</tr>
<tr>
<td>1000 Shares XYZ</td>
<td></td>
<td></td>
<td>15,000</td>
<td>10,000</td>
<td>5,000</td>
</tr>
</tbody>
</table>

**Report the actual cost basis**
Review: Reporting cost basis on Form 8949 depends on 1099-B

1. **Basis just right**

   Put number from 1099-B in column (e)

   | (e) Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions |
Review: Reporting cost basis on Form 8949 depends on 1099-B

2. Basis too low

- Put number from 1099-B in column (e)
- Adjustment amount in column (g)
- Code B in column (f)
Review: Reporting cost basis on Form 8949 depends on 1099-B

3. Basis blank

Put correct basis
In column (e), including W-2 income (columns (f) and (g) left blank)
2. Not reporting tax basis correctly: commission

- 1099-B does not subtract commissions or other fees from the proceeds (see what's checked in Box 6).
- Do not add it to your cost basis on Form 8949.
- Adjust the amount on Form 8949 in column (g) and add Code E in column (f).

**Starting with 2014 stock sales, less of an issue:** IRS requires reporting sales proceeds net of transaction fees after January 1, 2013.
3. Double-counting income from W-2 in Box 12 or 14

- W-2 income in Box 1 already includes stock compensation income, along with salary, wages.
- Put amount in Box 1 as part of income on line 7 of Form 1040 for “Salary, wages…”

Mistake: Using the amount in Box 12 (NQSOs) or Box 14 to report income on Form 1040 on the line for "Other income" (line 21).

Alert: If you do this, you will be paying tax on the income twice as ordinary income.

- You use Line 21 only when the company mistakenly omits the stock compensation income from your W-2 or 1099-MISC. That can happen for sales of ESPPs in qualifying disposition.
**EXAMPLE: W-2: ESPP reporting for tax-qualified Section 423 ESPPs**

### Form W-2 Wage and Tax Statement

- **Employee’s social security number**
- **Employer Identification number (EIN)**
- **Employer’s name, address, and ZIP code**
- **Control number**
- **Employee’s first name and initial**
- **Last name**
- **Employee’s address and ZIP code**
- **State**
- **Employer’s state ID number**
- **State wages, tips, etc.**
- **State income tax**
- **Local wages, tips, etc.**
- **Local income tax**
- **Locality name**

#### Wages, tips, other compensation
1. Wages, tips, other compensation
2. Federal income tax withheld
3. Social security wages
4. Social security tax withheld
5. Medicare wages and tips
6. Medicare tax withheld
7. Social security tips
8. Allocated tips
9. Advance EIC payment
10. Dependent care benefits
11. Nonqualified plans
12a. See instructions for box 12
12b. Statutory employee
12c. Retirement plan
12d. Third-party tax pay
12e. Other

#### Notes:
- With ESPPs, no income should be added to boxes for Social Security or Medicare, and no withholding should be included in any boxes (unless the company has voluntary withholding).
- ESPP income included if state/local tax applies.
- Your company may voluntarily report the ESPP income in this box.
**Remind employees about what they need for tax-return reporting**

<table>
<thead>
<tr>
<th>IRS Forms to gather</th>
<th>Additional Information &amp; Forms</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Form W-2</strong> if shares were sold at exercise / vesting / purchase</td>
<td>Exercise/vesting/purchase income reported on <strong>Form 1040</strong> if shares were acquired in a prior year. (Helps with cost-basis calculation.)</td>
</tr>
<tr>
<td><strong>Form 1099-B</strong> from broker or transfer agent</td>
<td><strong>Supplemental information</strong> <em>(if any)</em> provided by the broker to help with the cost basis.</td>
</tr>
<tr>
<td><strong>Form 3921</strong> for ISO exercises; <strong>Form 3922</strong> for ESPP purchases</td>
<td>Exercise, purchase, vesting, and/or trade <strong>confirmations</strong> from the company or the stock plan provider.</td>
</tr>
</tbody>
</table>

**Alert:** Understand how the basis is reported on the substitute statement and to the IRS *(not the same)*. Taxpayer’s responsibility to make adjustments on Form 8949.
4. AMT calculation and credits

- For AMT purposes, always complete **IRS Form 6251 line 14** when ISOs are exercised & held through calendar year of exercise (not on W-2). **Could be last year for AMT!**

  13 Qualified small business stock, see instructions
  14 Exercise of incentive stock options (excess of AMT income over regular tax income)
  15 Estates and trusts (amount from Schedule K-1 (Form 1041), box 12, code A)

- ISO stock is dual-basis stock. Your gain or loss for the AMT system and the regular-tax system will differ when sell.

- For the year when you sell ISO stock, avoid paying or calculating more AMT than is required for your stock sale by reporting (as a negative amount) your adjusted gain or loss on **line 17 of IRS Form 6251**.

  16 Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)
  17 Disposition of property (difference between AMT and regular tax gain or loss)
  18 Depreciation on assets placed in service after 1986 (difference between regular tax and AMT)

- This negative adjustment can reduce the AMT you would otherwise calculate and let you recover more of your AMT credit. The negative adjustment can't be greater than the capital gain for regular-tax purposes plus $3,000.
4. AMT and credits

› Once AMT has been triggered, you must complete **Form 6251** every year, along with **Form 8801** for the AMT credit.

› **It can take years** to benefit fully from the AMT credit if you are selling at a substantial loss. Will change starting in 2018 tax year.

› **Use of AMT credit:** In year when you do not trigger AMT, use credit against regular income tax up to amount of what would be your AMT. *Does not require you sell the ISO stock.*

**Example:**

› Last year ISO exercise and hold triggered $14,000 of AMT

› This year, regular tax is $35,000, while AMT is only $30,000

› $5,000 of the $14,000 credit used, and carry forward $9,000 to future
5. Sell-to-cover exercises

› Broker sells just enough shares from exercise to pay the exercise price, tax withholding, and the broker’s transaction fees.
› Employee receives the remaining shares.
› For the year of sell-to-cover, **report on your Form 8949 only the number of shares sold and their tax basis.**
› Do not report the number and tax basis of all the options *exercised* that are part of W-2 income.
5. **Sell-to-cover example: Exercise NQSOs for 2,000 shares on August 14**

<table>
<thead>
<tr>
<th>Exercise price</th>
<th>$10 per share ($35 stock price)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exercise cost</td>
<td>$20,000</td>
</tr>
<tr>
<td>Tax withholding</td>
<td>$17,500 (combined 35% tax rate on $50,000)</td>
</tr>
<tr>
<td>Brokerage commission</td>
<td>$250</td>
</tr>
<tr>
<td>Total needed</td>
<td>$37,750</td>
</tr>
<tr>
<td>What is included on Form W-2</td>
<td>$50,000 income [(35 - 10) x 2,000]</td>
</tr>
<tr>
<td>Number of shares sold</td>
<td>1,079 (keep 921)</td>
</tr>
<tr>
<td>Form 8949 reporting</td>
<td>$37,515 ($37,765 - $250 commission)</td>
</tr>
<tr>
<td>Tax basis on sold shares</td>
<td>$37,765 (Schedule D includes a $250 short-term capital loss in Part I)</td>
</tr>
</tbody>
</table>

In the future, when you sell any or all of the net shares (921 shares net): report the **tax basis of $35 per share**.
6. Share withholding for restricted stock and RSUs

› **Definitely report a sale for taxes** at vesting if you received a 1099-B that reports the proceeds. Sell-to-Cover for taxes.

› When the shares directly withheld by your company (often called “net share withholding”), the situation is different.

› Report this "sale" back to company to cover the taxes if receive a 1099-B. Most companies do not issue these to employees.

› **Rumor**: IRS has informally approved this practice of not issuing 1099-Bs for share withholding.

› **Common Mistake**: Remember to exclude these tax shares when you calculate your capital gains on Form 8949 after you sell the remainder.

See the sections **Restricted Stock: Taxes** and **Restricted Stock: Taxes Advanced** at myStockOptions.com or in the Knowledge Center
6. Share withholding with restricted stock and RSUs: Potential for confusion

<table>
<thead>
<tr>
<th>Description</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,000 shares of restricted stock vest on Aug. 15</td>
<td>Vesting value: $20 per share ($40,000)</td>
</tr>
<tr>
<td>Shares surrendered/ net-settled to pay taxes</td>
<td>625</td>
</tr>
<tr>
<td>Amount your W-2 reports for the vested restricted stock</td>
<td>$40,000 (2,000 x $20)</td>
</tr>
<tr>
<td>Remaining 1,375 share sold the next year at $25 per share (after commissions)</td>
<td>$34,375</td>
</tr>
<tr>
<td>How you calculate capital gain</td>
<td>$34,375 proceeds – $27,500 cost basis (1,375 x $20) = $6,875</td>
</tr>
<tr>
<td>Capital gain reported on Form 8949</td>
<td></td>
</tr>
</tbody>
</table>
7. Dividends with restricted stock

› **Dividends paid:** compensation during vesting period or at vesting. Reported on W-2.

› **Exception:** Employee makes a Section 83(b) election (not available for RSUs). Eligible for the lower 15%/20% rate for qualified dividends. Reported on 1099-DIV.

› **Once the shares vest:** dividends are no longer compensation and instead become dividend income.
7. Dividends: Complications

› Pre-vesting dividends included on W-2 + Double-reported on Form 1099-DIV.

› Can occur if the company's transfer agent routinely issues dividend payments and 1099-DIV as it does to shareholders.

› **The IRS recommends:** list these dividends on Schedule B ("Interest and Ordinary Dividends") of Form 1040. Subtract them from the total with a note that you have already included them in wages.

8. ESPP sales: Not reporting ordinary income

› Tax-qualified Section 423 ESPP: the purchase itself does not trigger tax-return reporting. The sale does.

› **At sale:** need to include the discount from the year of purchase as income.

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**Review of Tax Rules for QD:**

› With qualifying disposition: *Ordinary income in the year of sale* equal to: the lesser of either the actual gain upon sale or the purchase price discount at the beginning of the offering.

› The discount at the beginning of the offering **does not qualify** for capital gains treatment regardless of holding period

› Beyond the discount, all additional gain is long-term capital gain.

For details, examples, and videos see sections **ESPPs: Taxes** and **ESPPs: Taxes Advanced** at myStockOptions.com or in the Knowledge Center
8. Not reporting ordinary income with ESPP sales

**Example:** 15\% discount from the stock price on either first or last day of offering, whichever is lower.

<table>
<thead>
<tr>
<th>Stock price on first day of offering</th>
<th>$10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock price on last day of offering (purchase date)</td>
<td>$8</td>
</tr>
<tr>
<td>Purchase price</td>
<td>$6.80 (85% of $8)</td>
</tr>
<tr>
<td>Net at sale after commission</td>
<td>$18</td>
</tr>
<tr>
<td>Income recognized at sale after meeting ESPP holding periods</td>
<td>$1.50 per share in ordinary income (15% of $10)</td>
</tr>
<tr>
<td>Cost basis</td>
<td>$8.30 ($1.50 ordinary income + $6.80 purchase price)</td>
</tr>
<tr>
<td>Long-term capital gain</td>
<td>$9.70 per share ($18 minus cost basis of $8.30)</td>
</tr>
<tr>
<td>What should be reported on Form W-2</td>
<td>$1.50 multiplied by the number of shares purchased (if this is not reported, still report that amount on your tax return, using the line “Other”). Using Form 3922: Box 3 minus Box 8.</td>
</tr>
</tbody>
</table>

If your sale gain is less than $1.50 per share (i.e. stock price of $8.30 per share or lower), you have just ordinary income for the amount of the actual gain. Sales below a stock price of $6.80 per share are all capital losses.
ESPP: Purchase/sell after holding short-term

Sales and Other Dispositions of Capital Assets

Before you check Box A, B, or C below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either should show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part I Short-Term. Transactions involving capital assets you held 1 year or less are short term. For long-term transactions, see page 2.

Note: You may aggregate all short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 1a; you aren't required to report these transactions on Form 8949 (see instructions).

You must check Box A, B, or C below. Check only one box. If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box. If you have more short-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

On Form 1099-B:
If basis is in Box 1c (even if basis is incorrect), check Box A here.
If no basis or "0" appears in Box 1c, check Box B here.

(a) Description of property (Example: 100 sh. XYZ Co)
(b) Date acquired (Mc., day, yr.)
(c) Date sold or disposed of (Mc., day, yr.)
(d) Proceeds (basis price) (see instructions)
(e) Cost or other basis (see Note below and see Column (g) in the separate instructions)
(f) Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f).
(g) Gain or (loss). Subtract column (f) from column (g) and combine the result with column (g).

Company ticker/symbol and number of ESPP shares sold [Box 1a on Form 1099-B]
Purchase date [Box 1b on Form 1099-B]
Date stock sold [Box 1c on Form 1099-B]

Gross proceeds from stock sale [Box 1d on Form 1099-B]. If commissions and fees were not subtracted from proceeds, see footnote **

Basis in Box 1e of 1099-B is correct
Column (e): Basis in Box 1e of 1099-B
Column (f): Enter blank
Column (g): Enter blank

Basis in Box 1e of 1099-B is too low or blank
If Box A is checked:
Column (e): Correct basis of the sold shares (purchase price + income on W-2 for the spread at purchase).***
Column (f): Code B
Column (g): Enter blank

If the basis is blank or 0:
Column (f): Code B
Column (g): Enter blank

If the basis is incorrect:
Column (f): Code B
Column (g): Enter "-0-"
9. Netting of capital gain/loss

› Only same kinds of income net each other out.
› Only capital gains and losses net each other out on Schedule D. **Stock compensation income is not capital gains income.**
› Matching capital losses with gains is called “tax-loss harvesting.” Up to $3,000 (joint filers) in capital losses can be netted against ordinary income. Remainder carries forward.

› **Example:** You sold company stock early last year at $9,000 short-term capital loss.
  - You bought and sold this year at a short-term capital gain of $5,000.
  - The loss carryforward and current year’s gain net each other out on your Schedule D, leaving you $4,000 of unused losses.
  - $3,000 is used to offset against ordinary income on your current tax return. $1,000 is carried forward.

Wash sale issues: purchase company stock at gain within 30 days of sale at loss. Easy mistake to make in down markets.
10. Extensions

› IRS Form 4868: automatic six-month extension for the due date of your tax return (until mid-October). No explanation or signature is needed to get the automatic extension.

› To avoid the failure-to-file penalty on what you owe, you must file the extension no later than the original deadline of your return (for details, see IR-2006-58).

› **Payment of the actual tax is not delayed** (just the period for filing the return). Pay 100% of anticipated tax when file the extension to avoid interest and penalties.

› Extensions do not delay estimated tax payments for the current tax year.

› Complications for US expatriates: avoid double taxation by using the foreign earned income exclusion ($102,100 in 2017) or a US tax credit for taxes paid in a foreign country.
12 Tax-Return Mistakes To Avoid With Stock Options And ESPPs

Bruce Brumberg and Lynnette Khalfani

Key Points
1. Stock options and employee stock purchase plans bring their own special issues to your tax return.
2. Common mistakes to avoid include double-counting income, misreporting the cost basis, or miscalculating taxes on ESPP income.
3. Other common errors include messing up the AMT calculation, overpaying AMT, and forgetting to use capital-loss carry-forwards.

The "Tax Cuts & Jobs Act" has no impact on 2017 taxes or 2017 tax returns filed in 2018.

Alert: For stock sales, you must file with your tax return IRS Form 8949 and Schedule D. To avoid overpaying taxes, be aware of the issues involving the cost basis for stock sales reported on IRS Form 1099-B.

By the end of January, you should have received your IRS Form W-2, as usual. It will show any ordinary income received from stock options or employee stock purchase plans.

You must file both Form 8949 and Schedule D when reporting stock sales on your tax return.

For a free copy of our article on tax-return mistakes to avoid, email editors@mystockoptions.com. Available to distribute to employees or clients.
Test Your Knowledge: NEW! Tax Returns Quiz

Take a few minutes to test your knowledge of the tax-return reporting for equity compensation. (Mistakes here are far less costly than errors on tax returns!)

Please answer the following 12 questions. This quiz is also a course of study. The answer key links to content on the topic for follow-up reading.

Skip the quiz and view the answers

1. If you sold stock last year, which of the following IRS forms will you need for your tax return, along with any other information provided by your broker or your company?
   - Form 1099-B (or your broker’s equivalent substitute statement) and Form W-2
   - Form 3921 (if you sold shares acquired from incentive stock options)
   - Form 3922 (if you sold shares acquired from an employee stock purchase plan)
   - All of the above

2. What are the top tax rates on ordinary income and capital gains?
   - 35% and 20%
   - 35% and 15%
   - 39.6% and 20%
   - 39.6% and 15%

Quiz on tax-return reporting: e-learning course
The video appears in the Tax Center