Withholding Taxes, Reporting and Penalties on Equity Compensation

The following chart may be used as a guideline when considering how to report and what taxes to withhold when employees, former employees and independent contractors receive various forms of equity compensation. Also included is a summary of the penalties for the failure to report, withhold and remit payroll taxes. If you have questions, contact your Andersen engagement team, Dennis Minich, Managing Director at 312.357.3940 or Amber Salotto, Managing Director at 202.461.3620.

Type of Equity	Income Recognized and Timing	Reporting Requirement for Employee (Former Employee)	Reporting Requirement for Non-Employee
Nonqualified Stock Options (Fair Market Value (FMV) Not Readily Ascertainable)	If the option is fully vested and the individual purchases fully vested stock, compensation income is recognized at the time of exercise for income taxes, social security taxes and Medicare taxes. If there is an early exercise and the individual purchases stock subject to a substantial risk of forfeiture (SROF), then compensation income is recognized at the time the SROF lapses, or if a Sec. 83(b) election is made, at the time of exercise for income tax, social security tax and Medicare tax purposes. The amount of compensation income recognized is equal to the difference between the FMV of the stock on the recognition date and the amount paid for the stock.	Compensation income is reportable on Form W-2 in Boxes 1, 3, 5, and 17 (state purposes). The employer must withhold the appropriate amount of federal and state income taxes as well as social security taxes and Medicare taxes. The income is also reportable in Box 12 with a Code V. Federal income taxes may be withheld at the supplemental rate (22% on the first $1 million of supplemental wages and 37% on the excess) or, the company may treat as regular wages and withhold pursuant to the Form W-4 on file. To the extent the employee or the former employee worked in multiple states during the period from grant to exercise, the company may have to withhold state income taxes for various jurisdictions.	Compensation income is reportable on Form 1099-NEC in Box 1 (Non-Employee Compensation). No income tax withholding is required unless the non-employee is subject to backup withholding (for example, if the company fails to obtain a Form W-9).
Stock Appreciation Rights (SARs)	Compensation income is recognized at the time of exercise of the SAR for income taxes, social security taxes and Medicare taxes. The amount of compensation income recognized is equal to the difference between the FMV of the stock on the exercise date and the FMV of the stock on the grant date of the SAR.	Compensation income is reportable on Form W-2 in Boxes 1, 3, 5, and 17 (state purposes). The employer must withhold the appropriate amount of federal and state income taxes as well as social security taxes and Medicare taxes. Federal income taxes may be withheld at the supplemental rate (22% on the first $1 million of supplemental wages and 37% on the excess) or, the company may treat as regular wages and withhold pursuant to the Form W-4 on file. To the extent the employee or the former employee worked in multiple states during the period from grant to exercise, the company may have to withhold state income taxes for various jurisdictions.	Compensation income is reportable on Form 1099-NEC in Box 1 (Non-Employee Compensation). No income tax withholding is required unless the non-employee is subject to backup withholding (for example, if the company fails to obtain a Form W-9).

Type of Equity	Income Recognized and Timing	Reporting Requirement for Employee (Former Employee)	Reporting Requirement for Non-Employee
Incentive Stock Options (ISOs)	No income is recognized at the time of exercise except for alternative minimum tax (AMT) purposes. The difference between the FMV of the stock on the date of exercise and the amount paid for the stock is an adjustment for AMT purposes. If the stock acquired upon the exercise of an ISO is disposed within one year of exercise or two years of grant (a disqualifying disposition), then for the year of disposition the employee or former employee recognizes compensation income equal to the lesser of (i) the difference between the FMV of the stock on the date of exercise and the amount paid for the stock, or (ii) the difference between the FMV of the stock on the date of disposition and the amount paid for the stock.	In the year of exercise, the company is required to issue the employee a Form 3921 for each exercise. To the extent the employee recognizes compensation income upon a disqualifying disposition, such compensation should be reported only in Boxes 1 and 17 (state purposes) on the Form W-2. The compensation income is not subject to federal or state income tax withholdings or social security and Medicare taxes.	Not applicable – not entitled to receive incentive stock options.
Restricted Stock Awards	For income taxes, social security taxes and Medicare taxes, compensation income is recognized on the earlier of when the stock is transferable or is no longer subject to a substantial risk of forfeiture (SROF). A person can elect, within 30 days of receipt of the stock, to recognize the income, for income taxes, social security taxes and Medicare taxes, on the date of receipt rather than when the stock becomes transferable or is no longer subject to a SROF (Sec. 83(b) election). The amount of income recognized is equal to the difference between the FMV of the stock on the recognition date and the amount paid, if any, for the stock.	Compensation income is reportable on Form W-2 in Boxes 1, 3, 5, and 17 (state purposes). The employer must withhold the appropriate amount of federal and state income taxes as well as social security taxes and Medicare taxes. Federal income taxes may be withheld at the supplemental rate (22% on the first $1 million of supplemental wages and 37% on the excess) or, the company may treat as regular wages and withhold pursuant to the Form W-4 on file. To the extent the employee or the former employee worked in multiple states during the period from grant to vesting, the company may have to withhold state income taxes for various jurisdictions.	Compensation income is reportable on Form 1099-NEC in Box 1 (Non-Employee Compensation). No income tax withholding is required unless the non-employee is subject to backup withholding (for example, if the company fails to obtain a Form W-9).

Withholding Taxes, Reporting and Penalties on Equity Compensation

Type of Equity	Income Recognized and Timing	Reporting Requirement for Employee (Former Employee)	Reporting Requirement for Non-Employee
Restricted Stock Units (RSUs)	For income tax purposes, compensation income is recognized when the stock is transferred to the person after the RSU is no longer subject to a substantial risk of forfeiture. However, income is recognized when the RSU vests for purposes of social security taxes and Medicare taxes. The amount of income recognized is equal to the difference between the FMV of the stock on the recognition date and the amount paid, if any, for the stock.	Compensation income is reportable on Form W-2 in Boxes 1, 3, 5 and 17 (state purposes). The employer must withhold the appropriate amount of federal and state income taxes as well as social security taxes and Medicare taxes. Federal income taxes may be withheld at the supplemental rate (22% on the first $1 million of supplemental wages and 37% on the excess) or, the company may treat as regular wages and withhold pursuant to the Form W-4 on file. To the extent the employee or the former employee worked in multiple states during the period from grant to payment, the company may have to withhold state income taxes for various jurisdictions.	Compensation income is reportable on Form 1099-NEC in Box 1 (Non-Employee Compensation). No income tax withholding is required unless the non-employee is subject to backup withholding (for example, if the company fails to obtain a Form W-9).

ANDERSEN

Withholding Taxes, Reporting and Penalties on Equity Compensation

Failure to File or Furnish Form W-2	Failure to Withhold Taxes	Failure to Timely Deposit	Negligence	Interest-Free Adjustments
Employers are required to file Form W-2 with the Social Security Administration (SSA), as well as furnish a copy to the employee. The amount of penalty is based on when the correct Form W-2 is filed after the due date to both the employee and the SSA: • Within 30 days - $50 per Form W-2 (maximum $588,500, $206,000 for small businesses); • August 1 - $110 per Form W-2 (maximum $1,766,000, $588,500 for small businesses); • After August 1 - $290 per Form W-2 (maximum $3,532,500, $1,177,500 for small businesses). For intentional disregard of the filing requirements, the penalties are increased to $580 from $290 with no maximum penalty.	An employer who fails to withhold federal income taxes and social security taxes and Medicare taxes (FICA taxes) remains liable for the taxes that should have been withheld. This liability may be abated if the employer can establish that the wage payments were reported on the employee's federal income tax return and that all federal income tax and FICA taxes due on that return were paid. A Form 4669 can be used for this purpose. Unless the employee states that self-employment tax was paid on such wage amounts, the employer remains liable for both the employee and employer share of FICA taxes. Even if the tax liability is abated, the employer remains liable for penalties related to the failure to withhold FICA taxes.	Employers are required to make timely deposits with IRS of federal income tax and FICA taxes withheld from employees' wages, as well as the employer share of FICA taxes. The penalty can range from 2%-10% depending on the length of time between when the taxes were withheld and deposited with IRS. A 15% penalty can apply if the deposit is unpaid more than 10 calendar days after the date of the first notice requesting payment or unpaid on the day a notice for immediate payment is received. Interest may also be charged on penalties. If taxes were not withheld from the payment of wages to an employee, the penalty for failure to timely deposit does not apply. However, the late deposit penalty would still apply to the employer share of FICA taxes and the employer may still be liable for the taxes that should have been withheld (See Failure to Withhold Taxes).	A 20% penalty can be imposed on an underpayment of tax required to be shown on a return if the underpayment is attributable to negligence. Negligence includes a taxpayer's failure to make a reasonable attempt to comply with the rules or to exercise ordinary and reasonable care in the preparation of a tax return.	An employer who has made an error and underpaid FICA taxes may have the opportunity to correct the error on an interest-free basis. This interest-free adjustment is made by filing a Form 941-X by the due date for filing the Form 941 for the calendar quarter during which the error is ascertained and paying the underpayment. The FICA tax adjustments can be made by filing a Form 941-X for any open tax period. Income tax adjustments can only be made during the calendar year in which the wages were actually paid.