



Executive Insights

Double Tax Trap on Shares from Equity Compensation

Is it possible you paid tax twice on your equity compensation and did not know it? If your CPA was calculating your tax liability only off the 1099-B provided by the brokerage firm administering your equity compensation plan, the answer is yes.

The potential for tax traps was created when the IRS revised Regulations 1.6045-1. It requires brokers to list the initial basis (exercise price) on Form 1099-B for income recognized upon the exercise of equity-based options or the vesting or exercise of other equity-based compensation arrangements, granted or acquired after 2013. How they report Pre-2014 grants vary per custodian, and we have even found some inconsistencies within the same custodians.

Equity Compensation Over-Reporting of Income

Description	Share Information	NSO or ISO Options Reported on W2	RSU/RSA PSU/PSA Reported on W2
Equity Award Shares	20,000	20,000	20,000
FMV on date of exercise or vest	\$54.00	\$1,080,000	\$1,080,000
Equity Award Acquisition Price	\$24.00	\$480,000	\$0
Compensation element	\$30.00	\$600,000	\$1,080,000
Reported basis on brokerage 1099-B	\$24.00	\$480,000	\$0
Actual basis to correct on Form 8949	\$54.00	\$1,080,000	\$1,080,000
Over Reporting of Income		\$600,000	\$1,080,000

*chart is for example purposes only. Non-statutory Stock Options (NSO), Incentive Stock Options (ISO), Restricted Share Units (RSU), Restricted Share Awards (RSA), Performance Share Units (PSU), Performance Share Awards (PSA)

This creates two possible traps.

The first trap is in the year of exercise. This one is less likely to happen due to the exercise and sale happening in the same year. The executive's CPA will often pick up the extra income on the W2 detail showing the equity compensation and be able to match the income shown on the 1099-B that will be the same or close to the extra W2 income. CPAs can have you pay tax twice in the event they don't have or match up your payroll detail or notice that the acquisition date and disposition date are the same. The executive will be paying short-term capital gains that is equal to the option income.

The second, and more likely trap, is when the executive sells the shares acquired through the equity-based compensation years later. The brokerage firm are required to report the basis of the sale as the exercise price vs. the true basis of the fair market value at the time of exercise. For most executives this means they could pay long-term capital gains on gains they may not *actually* owe. Any stock they acquired after 2013 will likely be the incorrect basis reported by the brokerage firm. Although reporting the basis was discretionary prior to 2014,, when the pre-2014 basis is shown , it is most often the correct fair market value at exercise.

What's Your Net Worthwhile?™



Who is keeping track of this for the executive? How is this handled on the tax returns? Is there any way to fix this issue? We will explore what this looks like in the exhibits below.

In the example below, example Form 1099-B, note the transaction on January 16, 2018. It is erroneously showing a gain of \$600,000 when there is no gain. The true basis is \$1,080,000 vs. the \$480,000 shown. In the event someone completed their own taxes and plugs data into tax software, or the CPA does not pay attention to the dates, it will be overstating their taxable income by \$600,000.

Form 1099-B

Form 1099-B		2018 PROCEEDS FROM BROKER & BARTER EXCHANGE TRANSACTIONS						(OMB NO.)	
		1b. Date Acquired	1c. Date Sold or Disposed	1d. Proceeds	1e. Cost Basis	1f. Accrued Market Discount	1g. Wash Sale Loss Disallowed	Gain or Loss	
SHORT TERM CAPITAL GAINS AND LOSSES - 1099-B Line 2 - Box 6 Net Proceeds									
COVERED TRANSACTIONS - Cost basis reported to IRS - Form 8949, Part 1, (A)									
ABC COM		CUSIP		191216122					
20,000,000	Sale	01/16/18	01/16/18	1,080,000.00	480,000.00	0.00	0.00	600,000.00	
3,680	Sale	08/10/17	08/02/18	196,880.00	174,318.00	0.00	0.00	22,562.00	
Security Subtotal				1,276,880.00	654,318.00	0.00	0.00	622,562.00	
Covered Short Term Capital Gains and Losses Subtotal				1,276,880.00	654,318.00	0.00	0.00	622,562.00	
NET SHORT TERM CAPITAL GAINS AND LOSSES				1,276,880.00	654,318.00	0.00	0.00	622,562.00	
COVERED SHORT TERM GAINS/LOSSES								622,562.00	

Source: irs.gov

Below are example brokerage statements that reflect the potential of the more likely trap where the executive or their CPA prepares their taxes based on the information provided by their brokerage firm. The brokerage firms are required to report the basis of the sale as the exercise price vs. the true basis of the fair market value at the time of exercise. The statement is over reporting capital gains by \$981,929.

Executives Actual Brokerage Statement with Required Reporting

YOUR ML INDIVIDUAL INVESTOR ACCOUNT ASSETS							30-Jun-18		
CASH		Quantity		Cost Basis		Market Value			
CASH		157,706.79		157,706.79					
EQUITIES									
Description	Acquired	Quantity	Unit Cost	Cost Basis	Market Price	Market Value	Unrealized Gain/(Loss)	Yld.	
ABC Company	11/4/2010	8,600	42.000	361,200	52.000	447,200	86,000	2.80	
	2/21/2012	4,800	43.200	207,360	52.000	249,600	42,240	2.80	
	07/27/12	4,340	47.000	203,980	52.000	225,680	21,700	2.80	
	02/18/14	5,750	24.000	138,000	52.000	299,000	161,000	2.80	
	03/12/15	5,890	22.300	131,347	52.000	306,280	174,933	2.80	
	03/10/16	4,020	26.500	106,530	52.000	209,040	102,510	2.80	
	11/03/16	10,458	30.500	318,969	52.000	543,816	224,847	2.80	
	08/10/17	3,680	33.000	121,440	52.000	191,360	69,920	2.80	
	02/16/18	17,781	34.000	604,554	52.000	924,612	320,058	2.80	
TOTAL		86,964		2,193,380		3,396,588		1,203,208 2.80	

What's Your Net Worthwhile?™

1230 Peachtree Street, NE | Suite 1800 | Atlanta, GA 30309
 521 E. Morehead Street | Suite 330 | Charlotte, NC 28202
 t: 404.253.7600 | f: 404.253.7607 | www.SignatureFD.com



The Executive's True Cost Basis

STATEMENT IF IT HAD REAL BASIS							30-Jun-18		
CASH		Quantity		Cost Basis		Market Value			
CASH		157,706.79		157706.79					
EQUITIES									
Description	Acquired	Quantity	Unit Cost	Cost Basis	Market Price	Market Value	Unrealized Gain/(Loss)	Yld.	
ABC Company	11/4/2010	8,600	42.000	361,200	52.000	447,200	86,000	2.80	
	2/21/2012	4,800	43.200	207,360	52.000	249,600	42,240	2.80	
	07/ 27/ 12	4,340	47.000	203,980	52.000	225,680	21,700	2.80	
	02/ 18/ 14	5,750	47.500	273,125	52.000	299,000	25,875	2.80	
	03/ 12/ 15	5,890	49.250	290,083	52.000	306,280	16,198	2.80	
	03/ 10/ 16	4,020	47.000	188,940	52.000	209,040	20,100	2.80	
	11/ 03/ 16	10,458	48.500	507,213	52.000	543,816	36,603	2.80	
	08/ 10/ 17	3,680	51.000	187,680	52.000	191,360	3,680	2.80	
	02/ 16/ 18	17,781	53.750	955,729	52.000	924,612	-31,117	2.80	
TOTAL		86,964		3,175,309		3,396,588		221,279	2.80

If you or your advisor are keeping track of your true basis how do you correct it?

Brokerage firms are not able to change the reported basis, and even if you transfer shares to a new brokerage firm, the basis received from the old brokerage firm cannot be changed with the exception of death of the owner. It is up to you or your CPA to correct the basis using Form 8949.

Form 8949 Sales and Other Dispositions of Capital Assets OMB No. 1545-0074

▶ Go to www.irs.gov/Form8949 for instructions and the latest information.
▶ File with your Schedule D to list your transactions for lines 1b, 2, 3, 8b, 9, and 10 of Schedule D.

2018
Attachment Sequence No. **12A**

Part I Short-Term. Transactions involving capital assets you held 1 year or less are generally short-term (see instructions). 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, one or more of the boxes, complete as many forms with the same box checked as you need.

On Form 1099-B
 Box A, if basis in Box 1e
 Box B, if there is no basis or it is "0"
 Box C, if there is no basis or it is "0"

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the Note below and see Column (e) in the separate instructions	(f) Code(s) from instructions	(g) Amount of adjustment	(h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g)
			Leave Blank				

Basis in Box 1e of 1099-B needs to be corrected

<p>If Box A is checked:</p> <p>Column (e): Total basis in Box 1e of 1099-B</p> <p>Column (f): Code B as well as M. (Box should read "BM")</p> <p>Column (g): Aggregate omitted amount (e.g. W-2 compensation not included). Put in parentheses to indicate a negative number. For NQOs this is the exercise spread.</p>	<p>If Box B is checked:</p> <p>Column (e): Correct total 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:</p> <p>Column (f): Code M</p> <p>Column (g): Leave blank</p> <p>If the basis is incorrect:</p> <p>Column (f): Code B as well as M. "BM"</p> <p>Column (g): Enter "0"</p>
---	--

Box 1d on 1099-B Gross proceeds from stock sale. If commission and fees not subtracted from this number make a negative adjustment in column (g)

Name of brokerage firm from attached statement, followed by the words "see attached statement"

For each type of sale (Box A, B or C checked above, list all sales of that type together on a separate copy of Form 8949

What's Your Net Worthwhile?™

1230 Peachtree Street, NE | Suite 1800 | Atlanta, GA 30309
 521 E. Morehead Street | Suite 330 | Charlotte, NC 28202
 t: 404.253.7600 | f: 404.253.7607 | www.SignatureFD.com