JANUARY 17, 2025

Approaching Deadline: Reporting for ISO Exercises and ESPP Stock Transfers Due Beginning January 31, 2025

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This alert is a reminder of the approaching deadlines for certain year-end reporting requirements applicable to corporations that issue stock to employees (including former employees) upon the exercise of certain stock options or have employees (including former employees) who purchase the stock through an employee stock purchase plan (ESPP). If, during the 2024 tax year, an employee of a corporation (public or private) received stock of the corporation in connection with the exercise of incentive stock options (ISOs), or purchased stock under an ESPP, Section 6039 of the Internal Revenue Code (Code) requires the corporation to file returns with the Internal Revenue Service (IRS) and provide information statements to the employee.

Form 3921 – Reporting for ISO Exercises

A corporation must furnish each current and former employee who exercised an ISO in 2024 with a written statement containing certain details regarding the exercise, including the date the option was granted, the exercise price per share, the fair market value of the shares at the time of exercise, and the number of shares transferred pursuant to the exercise. This notice must be given by January 31, 2025, using Form 3921, Copy B (Copy A is filed with the IRS and Copy C should be retained by the corporation for its records). A separate notice is required for each transfer of stock following an exercise. For example, if an employee exercised ISOs on multiple dates in 2024, the corresponding number of Forms 3921 would be necessary.

Even though an optionee does not have income for purposes of regular income tax in connection with the exercise of an ISO, the spread between the fair market value and the exercise price is considered income for computing an optionee's alternative minimum taxable income. The information contained in Form 3921 is important for the optionee to determine whether any additional alternative minimum tax is due on the optionee's 2024 income tax return.

Form 3922 – Transfers of Stock Under an ESPP

A similar notice must be furnished to an employee if, in 2024, the corporation recorded the "first transfer of legal title" to shares of stock acquired by the employee pursuant to an option granted under an ESPP and the exercise price either (i) was less than 100 percent of the fair market value of the shares on the date of grant or (ii) was not fixed and determinable on the date of grant. This notice must be given by January 31, 2025, using Form 3922, Copy B (Copy A is filed with the IRS and Copy C should be retained by the corporation for its records).

Regulations under Section 6039 of the Code provide that the "first transfer of legal title" that triggers the reporting requirements includes an immediate deposit of the shares acquired under the plan into a brokerage account established for the employee. Thus, in cases where the plan provides that shares are immediately transferred into a brokerage account upon purchase, the participant's "first transfer of legal

title" will occur on the ESPP purchase date. For corporations who issue shares acquired under an ESPP in certificate or book-entry form, the "first transfer of legal title" occurs when the employee subsequently sells the shares or transfers them to a brokerage account.

Note that if the ESPP is not qualified under Section 423 of the Code, income equal to the spread between the fair market value and the exercise price of the stock should be reported in the same manner as is reported for nonstatutory stock options (discussed further below).

IRS Filing Requirements Applicable to Both Forms 3921 and 3922

In addition to furnishing the employee information statements as discussed above, corporations must file each Form 3921 and Form 3922 with the IRS by February 28, 2025 (or March 31, 2025, if filed electronically). Form 3921 and Form 3922 must be filed electronically by any corporation required to file 10 or more of each form. If a corporation is filing fewer than 10 of a particular type of form, the corporation may file the form either electronically or in paper form. Corporations that do not outsource the filing of Forms 3921 and 3922, will need to obtain a transmitter control code (TCC) to enable them to electronically file their Forms 3921 and/or 3922 on the IRS's Filing Information Returns Electronically (FIRE) system. Obtaining a TCC can take in excess of 45 days.

It is possible to receive an automatic 30-day extension to the due date for filing information returns by filing Form 8809 with the IRS no later than the filing deadline. Note that this extension applies only to the due date for filing the returns with the IRS, not the due date for issuing statements to employees.

Obtaining the Forms

Sample Form 3921 and Form 3922 are available on the IRS's website for informational purposes. Downloaded copies of the sample forms cannot be used to submit a filing to the IRS. Instead, official printed versions of the forms may only be obtained from the IRS by calling 1-800-TAX-FORM (1-800-829-3676) or by ordering them online here. The IRS may impose penalties for filing information returns that cannot be scanned.

Potential Penalties

A corporation may be liable for penalties of up to $330 per notice for (i) the failure to file the required form with the IRS by August 1, 2025 (the penalty is $60 per notice that is filed up to 30 days late and $130 per notice that filed is between 31 days late and before August 1, 2025), (ii) the failure to include all required information in the notice, or (iii) the failure to include correct information in the notice regarding the ISOs or ESPPs transfers. In the case of an intentional disregard of the reporting requirements, a corporation may face a penalty of at least $660 per failure, with no maximum. In addition, a corporation will also be liable for a separate penalty of up to $330 per notice in each instance where the corporation fails to furnish the complete and correct required notice to each employee who exercised an ISO or transferred legal title to shares acquired under the ESPP in 2024. The exact amount of the penalty depends on the length of time that the notices were late. These penalties may be waived if the corporation can show reasonable cause for the failure.

Nonstatutory Stock Option Reporting

The exercise of a nonstatutory stock option generally results in income that must be reported on Form W-2 (for employees) or on Form 1099-NEC (for nonemployees, such as a consultant or director). The deadline for providing Forms W-2 and 1099-NEC for 2024 to individuals is January 31, 2025. For any late filings, the corporation could face penalties for each Form W-2 or Form 1099-NEC.

If you have any questions regarding the reporting requirements discussed above, please reach out to a

member of the Kilpatrick Employee Benefits team.