

IRS PROVIDES GUIDANCE ON NEW PRIVATE COMPANY EQUITY GRANTS

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February 1, 2019

Practices & Industries

Employee Benefits

The 2017 Tax Cuts and Jobs Act included a new provision on the tax treatment of certain stock options and restricted stock units (RSUs). After 2017, privately held companies may make grants of stock options or RSUs to certain non-executive employees, and those employees may elect to defer income tax inclusion on those grants for up to 5 years, provided certain requirements are met. The deferral election will not be available to 1% owners, current or former chief executive officers and chief financial officers (as well as their family members), or certain highly compensated officers. The IRS has issued guidance on this new Section 83(i) of the Internal Revenue Code.

One requirement that is addressed is that options or RSUs must be granted to at least 80% of the company's U.S. workforce. The 80% requirement must be satisfied on the basis of a single calendar year (a multi-year approach is not permitted) and the workforce must be measured over the entire calendar year (a snapshot date test is not permitted). Also addressed is the mechanism for tax withholding on the deferred income. The IRS guidance requires the establishment of an escrow account which would hold the shares until the time the tax obligation is triggered.

The use of these qualified equity grants has not seemed to generate much interest for private companies. Some companies were concerned that they could inadvertently fall within these rules. Under the IRS guidance, this concern can be avoided by not establishing the escrow account; by not having an escrow account, the options and RSUs would then not meet the requirements of Section 83(i).

The IRS anticipate that the guidance in the Notice will be incorporated into future regulations that, with respect to issues addressed in the Notice, will apply to any taxable year ending on or after December 7, 2018. IRS Notice 2018-97 <https://www.irs.gov/pub/irs-drop/n-18-97.pdf>