Stock Options—Same Day Sales

Sprague & Jackson
ACCOUNTANTS AND ENROLLED AGENTS
The Seneca Building • 121 E Seneca St • Ithaca, NY 14850

David W. Sprague, EA, ABA Principal
Angie Jackson, EA, MSA Principal

Phone: (607) 273-5322
Fax: (607) 273-8138
Email: Admin@sprjac.com

Employee Stock Options

A stock option allows (but does not obligate) an employee to buy a specified number of shares of stock from a company for a specified price during a specified period of time. There are two categories of stock options.

- Nonstatutory (nonqualified) stock options.
- Statutory (qualified) stock options. Statutory stock options include incentive stock options (ISOs) and employee stock purchase plan options (ESPPs).

The employer determines the type of option offered to an employee.

The term "nonqualified stock option" is a technical term describing certain types of stock options granted to employees. The term refers to how the gain is taxed, not to the legitimacy of the transaction.

Qualified Stock Options

Qualified stock option plans offer tax advantages and must comply with specific IRS rules. For most qualified stock option plans, you must actually purchase the stock and hold it for at least one year before selling, after which time any gain on the sale is subject to favorable capital gain tax rates.

Nonqualified Stock Options

Nonqualified stock options have fewer restrictions than qualified stock option plans. If you purchase stock at a discount under a nonqualified stock option plan, the bargain element (the difference between the option price and market value) is taxable to you as wages at the time the option is exercised.

Same Day Sales

When an employer grants a stock option to you, you are often eligible for a same-day sale, allowing you to simultaneously exercise the option and sell the stock. In a same-day sale, you are not required to pay for the stock up front, but you receive cash in the amount of the difference between the exercise price and the value of the stock.

Example: *Diamond, Inc. grants its employee, Dennis, a stock option to purchase company stock for $17,000. The stock is worth $25,000. Dennis chooses to cash it out in a same-day sale. Even though he was not required to provide any payment up front, the transaction is treated as if Dennis paid $17,000 for the stock and sold it for $25,000. Dennis reports the stock sale on his return and Diamond, Inc. includes $8,000 ($25,000 – $17,000) as additional compensation on Dennis' Form W-2.*

Taxation of a Same-Day Sale

Because of an unusual quirk in reporting for a same-day stock sale, the proceeds are reported to you twice—once as taxable wages on Form W-2, *Wage and Tax Statement,* and again as proceeds from a stock transaction on Form 1099-B, *Proceeds from Broker and Barter Exchanges Transactions.* Every year, taxpayers get bills for a balance due from the IRS because they did not properly report proceeds and basis from stock options in addition to their income on Form W-2.

Form W-2

The "bargain element," which is the difference between the exercise price and the stock value, is taxable to you as wages and subject to federal and state withholding. The bargain element is included in box 1 of your Form W-2, and is included in wages on line 1a, Form 1040. Since the amount is already included in taxable wages, no additional steps need to be taken to report the bargain element on your tax return.