



Late Tax Deposit Penalty Waiver in Connection with Stock Option Exercise & Stock Settled Equity Award Payouts

March 2024

Late Tax Deposit Penalty Waiver in Connection with Stock Option Exercise & Stock-Settled Equity Award Payouts

Employers who issue stock-settled awards may soon be required to pay withholding taxes within a different timeframe than IRS procedures currently provide. This is due to SEC and IRS rule changes summarized below.

SEC Settlement Date: Brokers will soon be required to settle many securities transactions within one business day due to SEC rule changes effective May 28, 2024. As of that date, employee stock option exercises and stock-settled awards (RSUs/PSUs) will settle the day after exercise or delivery is initiated (“t+1”), rather than within two days afterwards (“t+2”).

IRS Employment Tax Liability Date: On March 11, 2024, the IRS updated its [internal procedures](#) for remitting required next-day withholding taxes on stock-settled awards. Under the Tax Code and applicable regulations, employers who incur \$100,000 or more in employment tax liability must deposit those taxes by the next banking day. In the case of stock-settled awards, including stock options and RSUs/PSUs, the new internal procedures provide that the IRS will treat the settlement date as the “liability incurred date” as long as the settlement date occurs within the SEC’s current “t+2” timeframe. This IRS treatment is simply an enforcement waiver, rather than formal guidance changing the liability date.

Implications of the Changes: There are potentially significant implications of these updates.

Employers’ deadline for depositing necessary tax withholdings on nonqualified stock options generally will be shortened by a day. Although the newly revised IRS procedures use a “t+2” settlement period, they will presumably be interpreted to incorporate the SEC’s shift to a “t+1” settlement period effective May 28, 2024.

The guidance formally aligns other stock-settled awards (SARs, RSUs, PSUs) with the treatment of stock options. Prior to this guidance, the IRS guidance was more muddled. A 2020 Chief Counsel memorandum had applied this more favorable rule only to stock options. Relying on this guidance, some taxpayers concluded that tax withholding on other stock-settled awards needed to be remitted by the day after delivery was initiated, even though a later proposed update in 2020 indicated the IRS would apply its enforcement waiver consistently to all types of awards. Any such taxpayers may now consider remitting withholding within the more favorable, settlement-based timeframe.

Regardless of when the tax is remitted, the tax result for employees remains the same, because the taxable amount is still based on the date stock delivery is initiated (often the vesting date) or, for an option, the date of exercise.

For those interested in the detailed description of the IRS position and approach, attached is a redline that shows the changes formally incorporated into the IRS Internal Revenue Manual on March 11, 2024.

Contact us. If you have reactions or comments or would like more information, we would be happy to hear from you.

Internal Revenue Manual

20.1.4.26.2 (~~07-17-2015~~03-11-2024)

Administrative Waivers

5. 26 CFR 31.6302-1(c) requires an employer to deposit employment taxes on the next business day after \$100,000 or more of employment taxes have been accumulated during the deposit period. The ~~Service allows for an administrative waiver of the FTD penalty in certain circumstances where the FTD penalty is asserted on a~~ employer's employment taxes are accumulated for determining the \$100,000 next-day deposit obligation ~~of once the liability incurs; the employee's~~ employment taxes arising from the exercise of a nonqualified stock option (NQSO) within a deposit period are accumulated once they are withheld. See 26 CFR 31.6302-1(e) and Rev. Rul. 75-191.
- A. Consistent with IRC 83 and the employment tax treatment of most forms of non-cash compensation, the employer becomes liable for its share of employment taxes and must withhold the employee's employment taxes, ~~including~~ (income and tax withholding and employee share of FICA taxes;) at the time that a ~~NQSO~~ nonstatutory stock option (NSO) or stock appreciation right settled in stock (stock-settled SAR) is exercised. If or when an employer initiates payment of a restricted stock unit settled in stock (stock-settled RSU). See GLAM 2020-004.
- B. The IRS allows for an administrative waiver of the FTD penalty in certain circumstances where the FTD penalty is asserted on a \$100,000 next-day deposit obligation of employment taxes arising from the exercise of a ~~NQSO~~ NSO, the exercise of a stock-settled SAR, or payment of a stock-settled RSU within a deposit period, ~~the penalty figured on. Pending further guidance, consult Counsel if an employer asserts that~~ the \$100,000 next-day deposit obligation may qualify for an administrative waiver applied at a different date to the employee's employment taxes because they were not withheld.
- C. ~~b.~~ To figure the amount of abatement applicable penalty that may be abated due to the administrative waiver, the penalty must be recalculated on the \$100,000 next-day ~~liability amount~~ deposit obligation (arising from the income/wages inclusion ~~of a NQSO with respect to a NSO, stock-settled SAR or stock-settled RSU~~) using the settlement date of the ~~NQSO~~ NSO, stock-settled SAR or stock-settled RSU as the liability incurred date for determining the \$100,000 next-day deposit obligation.
- D. ~~c.~~ The ~~In the case of a NSO or stock-settled SAR, the~~ taxpayer must provide the exercise date and settlement date of the NQSO prior to consideration. In the case of a stock-settled RSU, the taxpayer must provide the payment initiation date and settlement date prior to consideration. Accept the settlement date provided when settlement occurred within ~~three-two~~ three-two business days of: (i) the exercise date for a NSO or stock-settled SAR or, (ii) the payment initiation date for a stock-settled RSU. Otherwise, use the ~~third-second~~ third-second business day after the exercise date or payment initiation date, as applicable, if the settlement date occurred more than ~~32~~ 32 business days after the exercise date or payment initiation date.
- E. ~~d.~~ Command code FTDPN can be used to recalculate the FTD penalty figured on the \$100,000 next-day ~~liability amount~~ deposit obligation (arising from the income/wages inclusion ~~of a NQSO with respect to a NSO, stock-settled SAR or stock-settled RSU~~) using the settlement date of the ~~NQSO~~ NSO, stock-settled SAR, or stock-settled RSU as the liability incurred date. In order to correctly recalculate the FTD penalty using CC FTDPN, two separate penalty calculations must be initiated and combined per the following steps:

FTD Penalty Recalculation Steps	FTD Penalty Recalculation Action
(1) From the FTDPN liability screen,	<p>A. Remove the cumulative daily liability amount(s) within the deposit period that created the \$100,000 next-day deposit obligation arising from a NQSO NSO, stock-settled SAR, or stock-settled RSU.</p> <p>B. Move the cursor to the last liability listed for the quarter and transmit (Page Up).</p>
(2) Page over to the FTDPN credit screen,	<p>C. Remove the corresponding deposit(s) designated for the liability amount(s) removed in (1) above.</p> <p>D. Move the cursor after the last deposit listed on the credit screen and transmit (Page Up) for the penalty result.</p> <p>E. Add the resulting penalty amount to the second penalty computation amount figured in (3) and (4) below:</p>
(3) Using the blank liability screen accessed through FTDPNA (or FTDPNG if the settlement date used for the recomputation is for a date in the subsequent quarter),	<p>F. Combine the liability amount(s) removed in (1) above.</p> <p>G. Enter the combined amount as a single liability incurred on the settlement date of NQSO the NSO, stock-settled RSU provided by the taxpayer.</p> <p>Note: The time frame for the settlement date is restricted to no later than the third day two days after the exercise date of the NQSO NSO or stock-settled SAR or two days after the payment initiation date for a stock-settled RSU.</p>
(4) Page to the credit screen,	<p>H. Overlay the transaction code of the first credit (to remove all credits on the page) with NNN and transmit.</p> <p>I. Page to the credit screen and enter ONLY the deposit amounts applicable to the liability amounts entered in (3).</p> <p>J. Move the cursor after the last deposit listed on the credit screen and transmit (Page Up) for the penalty result.</p> <p>K. Add the resulting penalty amount to the first penalty computation arrived at from (1) and (2) above.</p>

IPB NOTE: Effective in May 2024, the required settlement date is being updated to one day after exercise or payment initiation date and we expect the IRS to enforce its waiver consistent with this update.