



Important Equity Compensation Reporting and Compliance Reminders

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Authors:

[Patricia M. Plavko](#)

[Alison M. Stemler](#)

[James A. Giesel](#)

Employers are required to annually report to the IRS all Incentive Stock Option (ISO) exercises and share purchases under an Employee Stock Purchase Plan (ESPP) with an exercise price less than 100% of the fair market value of the stock. The employer must report ISO exercises on Form 3921 and ESPP shares purchases on Form 3922 in the year after the exercise or purchase. A separate Form 3921 or 3922 must be filed with the IRS for each transaction, even if a single participant has multiple transactions in a single year (i.e., a separate Form 3921 must be filed for each ISO exercise).

If certain statutory requirements are met, shares of a company's stock purchased by an employee under the terms of an ISO or an ESPP receive special tax treatment. The bargain element of the price paid is not subject to federal income tax until the employee sells the shares, and employers have no tax withholding obligations with respect to shares purchased pursuant to an ISO and an ESPP.

Notice to Employees: Annual information statements on Copy B of Forms 3921 or 3922, as applicable, are due from employers to participants by Jan. 31, 2020 for participants who (i) exercised an ISO and bought shares in 2019 or (ii) purchased shares under an ESPP in 2019, if the price paid was less than the value on the purchase date.

Notice to IRS: Copy A of Forms 3921 or 3922, as applicable, are due to the IRS by Feb. 28, 2020 (for paper filers) or March 31, 2020 (for electronic filers). Companies that must file 250 or more Forms 3921 or 250 or more Forms 3922 must file electronically with the IRS. If a company has not previously filed electronically through the IRS' FIRE System, they must apply to do so on Form 4419 at least 45 days prior to filing a return electronically.

Securities Law Compliance Reminder for Private Companies:

Employers that issue any type of option or provide an employee stock purchase plan, regardless of whether there is a bargain

element in the price, must ensure that awards of options or purchase rights, purchases of securities and other equity compensation are in compliance with federal and state securities registration requirements or an applicable exemption. One such federal securities exemption is Rule 701, available to private (non-traded) employers, under the Securities Act of 1933 (Securities Act), subject to limitations on the number or value of equity issued in reliance on the Rule. [In a prior legal update](#), we reported on the increased threshold for providing additional disclosures to employees when relying on Rule 701. While the threshold has increased, employers should take care to track equity compensation to ensure the disclosure requirements are satisfied.

Rule 701 provides an exemption from the federal registration requirements for offers and sales of securities under certain compensatory benefit plans or written agreements relating to compensation. The exemption covers securities offered and sold by a non-publicly traded company under a plan or agreement with the business' current employees, officers, directors, and certain other service providers. The maximum number of shares that may be sold under the Rule 701 exemption by a business in any 12-month period is the greatest of (a) shares valued at \$1 million, (b) shares equal in value to 15% of the business' total assets or (c) 15% of the business' issued equity shares or units. Rule 701 requires that the individual receiving equity compensation receive a copy of the written benefit plan.

Additional disclosures are required when the exemption is to be used for \$10 million or more of the company's securities in any 12-month period. If the threshold is exceeded, the employer must deliver to employees a summary of the material terms of the plan (or, if the plan is covered by ERISA, the Summary Plan Description); the risk factors associated with the investment; and copies of the employer's (and possibly the parent company's) financial statements within a reasonable period of time before the date of each "sale" (which includes both offers to sell – the greater of an option or purchase right – and actual purchases).

The Securities and Exchange Commission (SEC) has taken several enforcement actions in the last few years penalizing companies that have sought to rely on Rule 701, but failed to comply with the conditions of the exemption. For example, the SEC brought an enforcement action against Credit Karma, Inc. in 2018 (Release No. 10469) that resulted in the imposition of a \$160,000 penalty for failure to meet the requirements of Rule 701. Credit Karma granted stock options with a total value of roughly \$14 million over an 11-month period and failed to provide the financial information and disclosures required under the Rule. Enforcement actions such as the one brought against Credit Karma are an important reminder for privately held companies to ensure that they are paying attention to the limits imposed under Rule 701 and the thresholds for providing additional disclosure to employees.

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