

**COMMENTS ON DEPOSIT REQUIREMENTS FOR
EMPLOYMENT TAXES IN CONNECTION WITH THE
EXERCISE OF NONSTATUTORY STOCK OPTIONS**

The following comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or of the Section of Taxation.

The comments were prepared by individual members of the Committee on Employment Taxes of the Section of Taxation (the "Committee"). Principal responsibility was exercised by Kurt L.P. Lawson. The comments were reviewed by other members of the Committee, Russell A. Hollrah, Chair of the Committee, G.J. Stillson MacDonnell, Vice Chair of the Committee, Bruce D. Pingree of the Section's Committee on Government Submissions, and Thomas A. Jorgensen, Council Director for the Committee.

Although many of the members of the Section of Taxation who participated in the preparation of these comments have clients affected by the legal principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

Contact Person: Kurt L.P. Lawson
(202) 663-8152 (telephone)
(202) 663-8007 (fax)

Date: May 10, 2004

EXECUTIVE SUMMARY

These comments were prepared to assist the Internal Revenue Service (the “IRS”) and the Department of the Treasury in providing guidance on the deposit requirements for employment taxes in connection with the exercise of nonstatutory stock options, which is one of the items listed on the agencies’ 2003-2004 Priority Guidance Plan.

These comments suggest that the guidance should allow employers to treat wages resulting from the exercise of a nonqualified stock option as “paid” for employment tax and employment tax deposit purposes on a pay period, quarterly, semi-annual, annual or other basis as long as all payments are treated as made on or before December 31 of the year in which the stock option was exercised. These comments also suggest clarification of certain reporting and penalty provisions.

COMMENTS

I. BACKGROUND

Several things need to happen to complete the exercise of a stock option. The employee needs to notify the employer and execute whatever forms are required under the terms of the stock option plan, the employee needs to pay the exercise price to the employer, and the employer needs to take the steps necessary for the employee to become the legal and record owner of the option shares (either by issuing stock certificates to the employee or the employee’s broker and recording the employee as owner on its books or, in a paperless system, simply recording the employee as owner on its books).

Exactly how these things are accomplished and in what order varies from plan to plan. Under some plans, the employer does not have to take the steps necessary for the employee to become the legal and record owner of the option shares until the plan administrator receives the required notice and forms plus the exercise price in whatever medium is permitted under the plan (which itself varies widely). Other plans require the employer to do so once the plan administrator receives the required notice and forms plus a copy of irrevocable instructions to the employee’s broker to simultaneously sell the option shares and deliver the exercise price to plan when the sales proceeds are received. Some plans even require the employer to do so as soon as the plan administrator receives the required notice and forms.

In the case of plans that require receipt of the exercise price before the employee can become the legal and record owner of the option shares, there is no limit on the length of the delay between the date that the required notice and forms are submitted and the date that the exercise price is paid, unless the plan imposes one. We have encountered situations (usually involving non-public companies) where the exercise price is regularly paid weeks or even months after the required notice and forms are submitted.

The length of the delay can depend on how the payment is financed. In the case of publicly-traded shares, the exercise of the stock option is often broker-assisted. Typically, when this is done (1) the employee gives the broker a copy of his exercise notice and instructions to the employer to deliver the option shares to the broker, (2) the broker advances the exercise price to

the employee on the security of those documents and makes a contract to sell a sufficient number of option shares to cover the exercise price, (3) the employee gives the employer the exercise price and the employer delivers the stock certificates for the option shares to the broker before the settlement date for the sale.¹ The settlement date is the date when the buyer actually pays the sales price to the seller and the seller actually delivers the stock certificates to the buyer. SEC regulations require the settlement date for sales executed by a broker on an organized exchange or an automated quotation system like the NASDAQ to be no more than three days after the sales contract was made, “unless otherwise expressly agreed to by the parties at the time of the transaction”.² (This is known as the “T+3” rule.) Thus, in the case of a broker-assisted exercise, the delay is typically no more than three days.

How employers handle the tax aspects of nonqualified stock options also varies. Some employers calculate the income resulting from the exercise of a nonqualified stock option based on the value of the stock on the date indicated by the employee on the election notice and forms. Other employers calculate that income based on the value of the stock on the date that the election notice and forms were placed in the employer’s internal mail system. Still other employers calculate it based on the value of the stock on the date that the election notice and forms are received by the plan administrator. Finally, some employers calculate it based on the value of the stock on the date that the exercise price is paid or the employer takes the steps necessary for the employee to become the legal and record owner of the option shares.

The date as of which employers calculate the income resulting from the exercise of a nonqualified stock option is not necessarily the same as the date as of which they treat any employment tax wages resulting from the exercise as having been paid. Based on our experience and information from others, we believe that most employers do not treat the wages as having been paid, and thus do not deposit FICA taxes and withheld income taxes on the wages, until after the employer takes the steps necessary for the employee to become the legal and record owner of the option shares. A significant number of employers treat the wages as having been paid on the first pay date following this date. Other employers treat the wages as having been paid over two or more pay periods following that date in order to avoid having to withhold all or a very large percentage of a single paycheck.

A. Income Taxes

Section 83 provides that, if property is transferred to an employee in connection with the performance of services, the excess of the fair market value of the property over the amount the employee paid for the property is included in the employee’s gross income in the first taxable year in which the employee’s rights in the property are transferable or are not subject to a substantial risk of forfeiture. Treas. Reg. § 1.83-1(a) clarifies that, in such a situation, the property is not subject to tax under section 83(a) until it has been transferred. Treas. Reg. § 1.83-

¹ 12 C.F.R. Part 220 (Regulation T), § 220.3(e)(4).

² 17 C.F.R. § 240.15c6-1 (Rule 15c6-1).

3(a) provides that, for purposes of section 83 and the regulations thereunder, “a transfer of property occurs when a person acquires a beneficial ownership interest in such property”.³

Neither section 83 nor the regulations thereunder defines a “beneficial ownership interest”. However, other guidance suggests that a person has beneficial ownership of property when he or she has substantially all of the benefits (and burdens) of ownership, which need not include actual legal title.⁴ In the case of stock purchased on an exchange or in the “over the counter” market, this typically has been held to occur on the date on which the contract to buy or sell the security is made, and not on the settlement date for the trade.⁵

In the case of a transfer of stock pursuant to the exercise of a stock option, this can conceivably occur as soon as the option is exercised if, as a result of the exercise, the optionee has an unconditional right to receive the stock.⁶

Of course, treating the stock as transferred when the stock option is exercised and not when actual ownership is transferred makes sense, and should only apply, in situations where

³ Cf. Treas. Reg. § 1.421-1(f) (in the case of a transfer of a share pursuant to the exercise of an ISO, transfer means “the transfer of ownership of such share, or the transfer of substantially all the rights of ownership. Such transfer must, within a reasonable time, be evidenced on the books of the corporation.”)

⁴ Stanley v. United States, 436 F. Supp. 581 (N.D. Miss. 1977), aff’d, 599 F.2d 672 (5th Cir. 1979); Rolfs v. Comm’r, 58 T.C. 360 (1972), aff’d, 488 F.2d 1092 (9th Cir. 1973); cf. IRS Field Service Advice Memorandum 200111011 (March 16, 2001) and the cases cited therein.

⁵ E.g., Anderson v. Comm’r, 527 F.2d 198 (9th Cir. 1975) (holding period of stock); Rev. Rul. 70-598, 1970-2 C.B. 168 (holding period of stock); Rev. Rul. 66-97, 1966-1 C.B. 190 (holding period of debentures).

⁶ E.g., Becker v. Comm’r, 378 F.2d 767 (3d Cir. 1967) (holding period of stock for capital gains purposes began when optionee put notice of exercise and full payment of exercise price in employer’s mail system, because at that point his acceptance of the option became binding on the employer); Swenson v. Comm’r, 309 F.2d 672 (8th Cir. 1962) (holding period of stock for capital gains purposes began when optionee exercised stock option and paid exercise price even though option plan said participants had no interest in option shares until certificates were issued and certificate was not delivered until later, because he acquired “substantial contractual rights” in the stock at that time); compare Sommers v. Comm’r, 63 F.2d 551 (10th Cir. 1933) (holding period of stock acquired through subscription agreement for capital gains purposes did not begin until stock was issued, because agreement was binding on subscriber but not corporation); Rolfs, 58 T.C. at 364 (holding period of stock for capital gains purposes did not begin until optionee paid exercise price, because option plan required payment as condition of issuance of shares, and “parties considered it a major condition respecting [employer’s] duty to perform”); cf. Theophilos v. Comm’r, 85 F.3d 440 (9th Cir. 1996) (holding that binding contract requiring service-provider to purchase service-recipient’s non-public stock was “property” for purposes of section 83).

sharing in any increases (or decreases) in the value of the stock is the most valuable benefit (or burden) of ownership. It makes no sense, and should not apply, where there are other valuable rights such as the right to share in distributions and the right to vote, unless they can somehow be extended retroactive to the date of exercise.⁷

The IRS's position on this issue is often described—even by the IRS itself—as being that tax is always imposed on option stock under section 83 on the date of exercise of the option.⁸ However, that is an over-simplification. In fact, the IRS revenue rulings are consistent with the case law described above dealing with the holding period of stock, which consider the exercise date to be the relevant date only if the optionee has an unconditional right to receive the stock at that time.⁹

B. Employment Taxes

Section 3101(a) and (b) impose social security and Medicare (FICA) taxes on wages received by employees. Section 3102(a) generally requires every employer to deduct and withhold these taxes from the wages when it pays them to the employees. Section 3102(b) makes the employer liable for the payment of the taxes that it is required to deduct and withhold,

⁷ See Stanley, 436 F. Supp. at 583 (holding period for debentures did not begin when taxpayer entered into agreements to buy them because “sole attribute of ownership” that vested in him upon execution of agreements was risk of loss or chance of gain in market value of debentures, whereas sellers retained other valuable rights); compare Comm’r v. Tyng, 106 F.2d 55, 61 (2d Cir. 1939), rev’d on other issue, 308 U.S. 527 (1940) (holding period of stock began when taxpayer agreed to purchase stock and owner delivered certificate indorsed in blank to escrow agent, even though voting and dividend rights were retained by owner, because dividends were retained instead of charging interest on unpaid purchase price, risk of loss was borne by taxpayer, and owner was not entitled to liquidating or extraordinary dividends); Ragghianti v. Comm’r, 71 T.C. 346 (1978), acq., 1979-2 C.B. 2 (individual became sole shareholder of S corporation when he exercised option to purchase prior owner’s stock where prior owner no longer had management responsibilities, no longer participated in management, and no longer shared in the profit or loss of the corporation); cf. Pahl v. Comm’r, 150 F.3d 1124 (9th Cir. 1998) (focusing on individual’s role in management in determining whether he was beneficial shareholder of closely-held S corporation).

⁸ E.g., IRS Field Directive (March 14, 2003) (section 83 and the regulations thereunder “generally point to exercise date as the trigger for inclusion of income from exercise of nonqualified stock options”).

⁹ For example, in Rev. Rul. 70-335, 1970-1 C.B. 111, the IRS ruled, like the court in Swenson, that when an employee delivered a notice of exercise of a stock option and full payment of the exercise price to the employer in conformity with the terms of the option plan, the transfer occurred on the date that the employer received the notice, even though the plan said that the employee had no interest in the stock until the stock certificates were issued. Like the court in Swenson, the IRS reasoned that the employee acquired substantially all of the ownership rights in the stock at that time, since the employer had no legal right to refuse to issue the shares.

i.e., makes it the guarantor for the employees' payment of the taxes. Section 3111(a) and (b) impose FICA taxes in the same amount on the employer. Section 3121(a) provides that the term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash.

Section 3402(a)(1) generally requires every employer to deduct and withhold income taxes from the wages it pays to its employees. Section 3403 makes the employer liable for the payment of the taxes that it is required to deduct and withhold, i.e., makes it the guarantor for the employees' payment of the taxes. Section 3401(a) provides that the term "wages" means all remuneration for services performed by an employee, including the cash value of all remuneration paid in any medium other than cash.

Treas. Reg. § 31.3102-1(a) states that "The employer is required to collect [the employee portion of FICA taxes], notwithstanding the wages are paid in something other than money, and to pay over the tax in money." A corresponding provision for purposes of income tax withholding is found in Treas. Reg. § 31.3402(a)-1(c), which adds that "If wages are paid in property other than money, the employer should make necessary arrangements to insure that the amount of the tax required to be withheld is available for payment in money."

Thus, the focus of the withholding rules is on when wages are paid and received. Treas. Reg. § 31.3121(a)-2 specifies the time at which wages are paid and received for purposes of FICA taxes. It provides that:

(a) In general, wages are received by an employee at the time that they are actually or constructively paid.

(b) Wages are constructively paid when they are credited to the account of or set apart for an employee so that they may be drawn upon by him at any time although not then actually reduced to possession. To constitute payment in such a case the wages must be credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that they may be drawn upon at any time, and their payment brought within his own control and disposition.

A corresponding provision for purposes of income tax withholding is found in Treas. Reg. § 31.3402(a)-1(b).

Based on this timing rule, stock or other property that is transferred to an employee is not paid or received for FICA and income tax withholding purposes until it actually is available to the employee, notwithstanding that it might be includible in the employee's gross income at an earlier date under section 83. The Chief Counsel's Office of the IRS agreed with this analysis in GCM 38069.¹⁰ Similarly, in Rev. Rul. 79-305,¹¹ the IRS cited this timing rule and held that

¹⁰ (Aug. 28, 1979).

¹¹ 1979-2 C.B. 350.

restricted stock was included in an employee's wages for FICA and income tax withholding purposes when the risk of forfeiture lapsed because at that time "the stock was made available to the employee without any substantial limitation or restriction and was available to be used by the employee at any time". On March 14, 2003, the IRS issued a Field Directive dealing with the due date of employment tax deposits resulting from exercises of stock options which conceded that "while [section 83 and the regulations thereunder] generally point to exercise date as the trigger for inclusion of income from exercise of nonqualified stock options, the FICA and income tax withholding provisions do not impose a withholding obligation on the employer until wages are actually or constructively paid."¹²

Clearly, even absent this timing rule some deviation from the income tax timing rule would be necessary in the employment tax context. First, in some cases the income tax timing rule can impose a withholding requirement before withholding is logically possible, as in the Becker case cited in note 6 above where beneficial ownership of stock was found to have passed when the optionee put his notice of exercise and full payment of the exercise price in the employer's mail system, even though the employer might not have received the items for several days. Such a result might make sense for purposes of calculating an optionee's gross income and the holding period of the option stock, since no immediate action is required for those purposes, but it makes no sense for withholding purposes. Second, the income tax timing rule is based on the very poorly defined concept of "beneficial ownership". Basing employers' employment tax obligations on such a concept would violate the principle announced by the Supreme Court in Central Illinois Public Service Co. v. United States,¹³ that, in interpreting the employment tax provisions of the Code, courts should take into account that Congress intended that an employer's obligation to withhold be "precise and not speculative."

The IRS has recognized in various contexts the difficulty of withholding with respect to non-cash payments and made accommodations. Announcement 85-113¹⁴ allows employers to elect, for FICA and income tax withholding purposes, to treat fringe benefits as paid on a pay period, quarterly, semi-annual, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually. However, this special rule does not apply when the fringe benefit is the transfer of personal property (either tangible or intangible) of a kind normally held for investment, presumably including shares of stock. Of even greater relevance, during the period during which the IRS was attempting to subject the spread on ISOs to FICA taxes, it proposed "rules of administrative convenience" that would have allowed employers to treat FICA wages resulting from the exercise of ISOs as paid on a pay period, quarterly, semi-annual, annual or other basis as long as the deemed payment(s) did not commence before the ISO was

¹² Compare Rev. Rul. 67-257, 1967-2 C.B. 359 (income tax withholding required on option stock when option exercised since at that time employees have unconditional right to receive stock upon payment of option price).

¹³ 435 U.S. 21, 31 (1978).

¹⁴ 1985-31 I.R.B. 31.

exercised and all payments were treated as made on or before December 31 of the year of exercise.¹⁵

C. Deposit Requirement

Section 6302(a) gives the IRS discretion to establish the mode and time for collecting taxes. Treas. Reg. § 31.6302-1(c) requires large employers to deposit employment taxes with respect to a payment on or before the Wednesday or Friday following the payment date, or within one banking day after it accumulates \$100,000 or more of employment taxes. Treas. Reg. § 31.6302-1(e) defines “employment taxes” for this purpose as (i) the employee portion of FICA taxes that are withheld under section 3102, (ii) the employer portion of FICA taxes, and (iii) income taxes that are withheld under section 3402.

On March 14, 2003, the IRS National Office instructed examiners not to challenge the timeliness of deposits of employment taxes relating to the exercise of nonqualified stock options as long as the deposits are made within one day of the settlement date and the settlement date is not more than three days after date of exercise. The National Office explained the employment tax timing rule and noted that “it has been argued that the shares . . . are not available to the exerciser of the options until settlement date, and therefore no actual or constructive payment of wages takes place until that time.” The Field Directive explained that a 3-day safe harbor was justified because “[t]here is generally only a three day delay between time of exercise and time of settlement resulting from such exercise.” The Field Directive does not prohibit agents from accepting longer delays where the settlement date is more than three days from the date of exercise, but it seems to discourage them from doing so.

D. Failure-to-Deposit Penalty

Section 6656 provides that, in case of failure by any person to make a timely deposit of tax imposed under the Code, unless the failure is due to reasonable cause and not to willful neglect, there shall be imposed on such person a penalty equal to the applicable percentage of the amount of the underpayment. The amount of the penalty depends on the length of the delay.

IRS policy is to interpret the “reasonable cause” exception that is found in section 6656 and other civil penalty provisions in a consistent manner. According to the Internal Revenue Manual, Sub-Section 20.1.1.3, “[r]easonable cause is based on all the facts and circumstances in each situation and allows the Service to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercises ordinary business care and prudence in determining their tax obligations but is unable to comply with those obligations.” Furthermore, “any reason which establishes that the taxpayer exercised

¹⁵ Notice 2001-73, 2001-49 I.R.B. 549. Similarly, see Prop. Treas. Reg. § 1.83-6(a), 48 Fed. Reg. 52079 (Nov. 16, 1983) (unadopted regulation would have treated employer as withholding income tax on option stock—which was required at that time for employer to deduct option spread under section 83(h)—if the withholding is done “by the day on which the last withholding payment for [the employer’s] taxable year is due”).

ordinary business care and prudence, but was unable to comply with a prescribed duty within the prescribed time, will be considered.”

In Rev. Rul. 75-191,¹⁶ the IRS concluded that the failure-to-deposit penalty does not apply in case of failure to deposit income taxes and the employee portion of FICA taxes that should have been withheld from compensation paid to employees, but that were not withheld.

E. Reporting Requirement

FICA taxes and withheld income taxes are reported on Form 941, Employer’s Quarterly Federal Tax Return.¹⁷ Form 941 is required to be filed quarterly, one month after the end of each quarter. Form 941 requires the employer to report on line 5 the total amount of income tax actually withheld from wages paid during the quarter. It also requires the employer to report on lines 6 and 7 the total amount of FICA taxes on wages paid during the quarter, whether or not they actually have been withheld.

F. Failure-to-Pay Penalties

If a taxpayer fails to pay any tax that is shown on a tax return by the due date of the return, a penalty is imposed under section 6651(a)(2). If a taxpayer fails to pay any tax that is required to be shown on the return, but is not, within 21 days from the date of notice and demand therefore, a penalty is imposed under section 6651(a)(3). Neither penalty is imposed if the taxpayer shows that the delay resulted from reasonable cause and not willful neglect.

The IRS takes the position that Form 941 is a tax return for this purpose.¹⁸ As noted above, Form 941 does not require an employer to report income taxes that were not withheld from employees’ wages, even if they should have been.

G. Accuracy-Related Penalties

Section 6662 imposes an additional 20% tax on certain underpayments of tax (as defined in section 6664) that are required to be shown on a return but are not. The underpayments to which the penalty applies include underpayments due to negligence or disregard of rules or regulations, and underpayments due to substantial understatements of income tax.¹⁹

The IRS takes the position that the accuracy-related penalty applies to underpayments of employment taxes, including underpayments of income tax withholding.²⁰ In Abbey Carpet Co.

¹⁶ 1975-1 C.B. 376.

¹⁷ Treas. Reg. §§ 31.6011(a)-1, 31.6011(a)-4.

¹⁸ See Rev. Rul. 69-397, 1969-2 C.B. 263.

¹⁹ See also Treas. Reg. §§ 1.6662-3, 1.6662-4.

²⁰ E.g., TAM 200214001 (Oct. 19, 2001).

v. United States,²¹ the Court of Federal Claims agreed with the IRS that an employer that negligently failed to withhold the required amount of income taxes from an employee's wages, and to declare the underpayment on Form 941, was liable for the section 6662 penalty. Nevertheless, this position appears to be wrong to the extent it applies to income tax withholding since Form 941 requires only income taxes that are actually withheld to be shown on the form.

In addition to the requirement under section 6662 that an underpayment be due to negligence or be a substantial understatement, section 6664(c)(1) provides that the accuracy-related penalty may not be imposed with respect to any portion of an underpayment if it is shown that a taxpayer acted in good faith and that there was reasonable cause for the underpayment. The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case by case basis, taking into account all pertinent facts and circumstances. Generally, the most important factor is the taxpayer's effort to assess the proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of the experience, knowledge and education of the taxpayer.²²

II. SPECIFIC RECOMMENDATIONS

Based upon the foregoing, we offer the following recommendations, which we hope will be incorporated in the forthcoming guidance.

A. Employment Taxes and Deposit Requirement

The forthcoming guidance should allow employers to treat wages resulting from the exercise of a nonqualified stock option as "paid" for employment tax and employment tax deposit purposes on a pay period, quarterly, semi-annual, annual or other basis as long as all such wage payments are treated as made for such purposes on or before December 31 of the year in which the stock option was exercised.

This approach would be consistent with the "rules of administrative convenience" proposed by the IRS during the period that it treated the spread on ISOs as FICA wages, and the approach that it has permitted for years with respect to most non-cash-fringe benefits. It would recognize the difficulty that employers face in determining exactly when the wages are paid for tax purposes and the variety of approaches that employers have adopted for dealing with this uncertainty.

The approach adopted in the March 14, 2003, Field Directive is unduly restrictive. In requiring that deposits be made within one day of the settlement date it either assumes that the employer is subject to the one-day deposit rule for large employers, and therefore provides no guidance to other employers, or indirectly imposes that requirement on other employers. In requiring that the settlement date be not more than three days after date of exercise, it also assumes that there is generally only a three-day delay between the date of exercise and the settlement date. This has a basis in fact only for broker-assisted exercises of publicly-traded

²¹ 97-2 U.S.T.C. ¶ 50,740 (Fed. Cl. 1997).

²² Treas. Reg. § 1.6664-4(b)(1).

stock. Furthermore, even if it were more generally true, it would provide no relief for the many employers and plans for which it is not true. In any event, there is no legal basis for linking the deposit date for employment taxes with the exercise date of an option, which is relevant (to the extent it is relevant at all) solely to the time at which income is recognized for income tax purposes under Section 83.

Finally, the Field Directive fails to take into account the serious financial difficulties imposed on employers and employees in coming up with the funds necessary to pay employment taxes so soon after the exercise date. Not all employees have the funds necessary to pay the taxes or the ability to sell the option shares quickly through a broker-assisted exercise. While an employer can withhold enough shares to pay the employee's taxes without triggering adverse accounting treatment for the stock option, not all plans permit this. Furthermore, not all employers have ability to quickly sell enough shares to cover the employee's or their own taxes. Withholding the employee's taxes from his cash wages helps address these concerns, but in many cases the wages resulting from the exercise of a stock option are much higher than the employee's normal paycheck, requiring the employer to withhold all or a very large percentage of the paycheck.

Even if it does not adopt these "rules of administrative convenience", the forthcoming guidance should clarify that wages resulting from the exercise of a nonqualified stock option are not paid for employment tax purposes, and thus no employment tax deposit requirement can exist, until the stock actually is available to the employee, notwithstanding that it might be includible in the employee's gross income at an earlier date under section 83.

B. Failure-to-Deposit Penalty

The forthcoming guidance should reaffirm the position taken by the IRS in Rev. Rul. 75-191 that the failure-to-deposit penalty does not apply in case of a failure to deposit income taxes or the employee portion of FICA taxes that were not withheld, even if they should have been. Section 6656 applies solely in case of a failure to make a timely deposit of tax, and Treas. Reg. § 31.6302-1(e) clearly limits the deposit requirement to the employer portion of FICA taxes plus income taxes and the employee portion of FICA taxes to the extent they are actually withheld.

Even if it does not adopt the "rules of administrative convenience" suggested in the preceding section, the forthcoming guidance should also provide that, until that guidance is finalized, because of the uncertainty regarding the existing rules employers will be considered to have had "reasonable cause" for depositing employment taxes at any time up to the latest date for depositing taxes with respect to wages paid during the year in which the stock option was exercised.

C. Reporting Requirement

The forthcoming guidance should confirm that Form 941 does not require employers to report income taxes that were not withheld from employees' wages, even if they should have been, or revise the form to state that it does on a prospective basis only.

D. Failure-to-Pay and Accuracy-Related Penalties

If the forthcoming guidance confirms that Form 941 does not require employers to report income taxes that were not withheld, it also should confirm that a failure-to-pay penalty or accuracy-related penalty cannot be assessed against an employer that does not report the income taxes that were not withheld on the form and therefore does not pay the taxes when it files the form. Even if the forthcoming guidance does not confirm that Form 941 does not require employers to report income taxes that were not withheld, it should provide that, until it is finalized, because of the uncertainty regarding the existing rules employers will be considered to have acted in good faith and to have had “reasonable cause” if they did not report those taxes on the form and pay the taxes when they filed the form.