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New York • Chicago • Los Angeles

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EITF Requires Compensation Cost For Excess Stock-for-Tax Withholding Transactions

The Emerging Issues Task Force (EITF) on March 24-25 reached a decision on "stock-for-tax withholding" that may require immediate action for companies that wish to avoid compensation expense when they permit or require shares to be withheld to satisfy tax obligations arising from the exercise of stock options or the earnout or vesting of other "fixed plan" stock-based awards. The EITF decision requires companies to recognize as compensation expense the value of shares withheld in excess of the "minimum required" federal and state tax withholding rates, i.e., the current 28 percent federal and other applicable state supplemental wage payment rates.[1] The decision is intended to curb evolving practice whereby, despite existing accounting guidance to the contrary, many companies now withhold amounts in excess of the minimum required rate without incurring compensation expense.[2] The EITF decision is effective for stock-for-tax withholding transactions occurring after March 25, 1999, and applies to all stock options and other stock-based awards previously granted and still outstanding, and further to awards newly granted on or before December 31, 1999.

Meanwhile, the EITF's parent organization, the Financial Accounting Standards Board (FASB), has itself decided to address the issue of excess stock-for-tax withholding in a more punitive fashion. In a tentative decision reached just last month, the FASB has proposed to require "variable plan" mark-to-market accounting for the entire stock option or stock-based award if shares can be, or actually are, withheld in excess of the minimum required rate.[3] The FASB's proposal, which has been subsumed into its broader stock compensation project dealing with an interpretation of APB Opinion No. 25, would apply to grants of stock options and other stock-based awards made after December 31, 1999.[4]

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General questions about this letter can be addressed to Fred Cook in New York (212-986-6330) or Tom Haines in Chicago (312-332-0910). Specific questions should be addressed to the company's professional accountants. Copies of this letter and other published materials are available on our web site, www.fwcook.com.

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[1] The minimum required rate limitation presumably also includes applicable Federal Insurance Contributions Act (FICA) taxes

[2] Refer to EITF Issue No. 87-6 Section C, for which this decision is a clarification

[3] See our letter dated March 10, 1999

[4] FASB Exposure Draft of proposed interpretation "Accounting for Certain Transactions involving Stock Compensation - an interpretation of APB Opinion No. 25," released March 31, 1999