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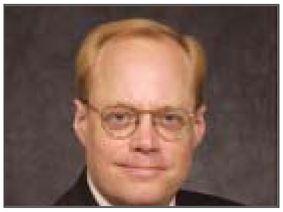

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Jack Dorsey's 10% $100M+ Square Stock Give-Back Isn't About Taxes

As Fortune reported—Square's Dorsey returns 10% of his shares—Jack Dorsey, founder/CEO of Square, is giving back 10% of his shares to the company. Voluntarily, not to charity or family, but back to Square. It's rare and should expand shares for employee compensation and acquisitions.

Announced at a party, it makes Mr. Dorsey popular with employees, job applicants and investors, diluting the dilution that occurs with incentives. Mr. Dorsey was also Twitter's co-founder and CEO from 2006 to 2008. His stake in Twitter alone made him a billionaire.

In Square, Mr. Dorsey owns approximately 30% and he is giving back about 3% of the company's equity. The shares Dorsey is returning are worth between $100 million and $150 million based on estimates. It means new hires might receive larger incentives, existing employees see an uptick in theirs, and could get additional equity grants. Mr. Dorsey said he wanted to reward success broadly and encourage employees to take risks.

Square has grown from 400 to 700 employees, and the payments company processes billions of dollars in payments. It also has new products, including a Market platform for retailers. Cash allows individuals to transfer money sans fee, while Stand turns an iPad into a point of sale system.

Clearly, Mr. Dorsey didn't make this generous gesture for tax reasons. Yet taxes ought to be considered in just about everything. Here, they are as unusual as his action. Shouldn't an exec who hands in $100M in shares for employees get a deduction? It's complicated.

A business expense deduction might be possible, and your first thought might be to look at the clawback tax rules. After all, under Sarbanes-Oxley, lawsuits, etc., execs may have to cough up money they earned and on which they paid taxes. Every tax year stands by itself, and that's a problem since most clawbacks happen one or more years after payment.

Besides, this payment is voluntary, not required. Claiming a business expense deduction? Sure, but it might be a miscellaneous itemized deduction subject to the 2% adjusted gross income floor. That also means alternative minimum tax (AMT), which can mean no deduction.

Amending a prior tax return is only possible within three years of filing the original, or within two years of the date the tax was paid, whichever is later. And amending a prior return is generally allowed only to correct a mistake. This clearly isn't that.

Section 1341 is the usual clawback provision, attempting to put you back where you would have been on your taxes had you never received the income. You must have reported income in a prior year when you had an unrestricted right to it then. You must learn in a later year you did not have an unrestricted right after all (i.e., you have to give it back).

Thus, Section 1341 is probably no help here either. For one thing, voluntary give-backs like Mr. Dorsey's don't fit. It's clear Mr. Dorsey's actions are unusual, but at least the tax code does recognize that sometimes a shareholder makes a transfer of shares to employees.

Restricted stock under Section 83 usually comes from the company, but occasionally from shareholders. One might argue that's what will happen here. Strangely, enough, the tax regulations say that where shareholders hand stock to employees, the company can claim the compensation deduction.

To handle the odd 3 party situation, the law considers the shareholder to have made a capital contribution of the stock, and then the company makes the issuance to the employee. It’s complex, but even if that’s what afoot here, does Mr. Dorsey get a tax deduction?

There’s enough money involved that someone will surely look closely at this on his behalf. However, my suspicion is that Mr. Dorsey is treated as making a capital contribution to Square. Yup, that would mean no deduction. And that doesn’t seem fair, especially since he’s doing this to recognize and award employees and recruits.

But even if I’m right, Mr. Dorsey should get a basis increase in his remaining Square stock. And that should mean when he eventually sells it, he has a much higher basis. A delayed tax benefit, after all, is always better than no tax benefit at all.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.