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Stock Options 2.0: Twitter CEO Gives His Own Stock To Employees

First Twitter CEO Jack Dorsey announced job cuts, giving 336 Twitter employees the ax. Now, he is giving one-third of his Twitter stock to employees, 1% of the company to “reinvest directly in our people.” This isn’t his first stock give-back. In 2013, Mr. Dorsey returned 20% of his shares in Square, the mobile payments startup. Square will now go public. And Mr. Dorsey may not be done yet.

He evidently plans more stock transfers. It may be a habit for Mr. Dorsey, but is rare for anyone else. With Twitter and Square, it is an explicit recognition that dilution hurts. The move expands shares for employee compensation and acquisitions. When Mr. Dorsey did it at Square, it made him even more popular with employees, job applicants and investors. In effect, he ’diluted the dilution’ that incentives near always suffer. But giving back eight figures is odd even for a billionaire.

Jack Dorsey, CEO and founder of Square and Twitter (Photo credit: JUSTIN TALLIS/AFP/Getty Images)

Mr. Dorsey’s stake in Twitter alone made him a billionaire. As for Square, the payments company processes billions of dollars in payments. Although taxes ought to be considered in just about everything, it is curious to think about Mr. Dorsey's taxes. Plainly, he doesn't take this action for tax reasons. Still, it sure seems as if a CEO who hands back $100M in shares for employees should qualify for a $100M tax deduction! Yet it turns out that's complicated.

Giving new hires incentives, and giving existing employees an expanded stake sure sounds like a business expense. However, 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. For even a more modest income taxpayer, the miscellaneous itemized deduction route is a loser.

Amending a prior tax return to reverse the past probably won't work either. First, it 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, did Mr. Dorsey get a tax deduction? My suspicion is that Mr. Dorsey was treated as making a capital contribution to Square. That would mean no deduction.

And that doesn't seem fair, especially since he did this to recognize and award employees and recruits. Mr. Dorsey presumably got at least a basis increase in his remaining Square stock. That should mean when he eventually sells it, he has a much higher basis. A delayed tax benefit, after all, is better than no tax benefit at all.

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