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Twitter's Dorsey Made Innovative Share Give-Back

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There is no mistaking the excitement that [Jack Dorsey](#) is now CEO, though his first step was [cutting jobs, giving 336 Twitter employees the ax](#). The market reacts well to Mr. Dorsey. Often, so do employees, and it is worth remembering something he did in 2013. Back then, with his other company [Square](#), [Mr. Dorsey returned 10% of his shares](#). He may be cutting jobs at Twitter, a move he says is right. But as founder/CEO of Square, he actually *gave back* 10% of his shares to the company.

Yes, he did it voluntarily—not to charity or family—but back to Square. It's beyond rare, a move designed to expand shares for employee compensation and acquisitions. Announced at a party in 2013, it made Mr. Dorsey even more popular with employees, job applicants and investors. In effect, he 'diluted the dilution' that occurs with incentives. In Square, Mr. Dorsey owned approximately 30% and gave back about 3% of the company's equity. The shares Dorsey returned were worth between \$100 million and \$150 million, based on estimates. It gave new hires larger incentives, existing employees an uptick in theirs, and allowed additional equity grants.



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

Mr. Dorsey wanted to reward success broadly and to encourage employees to take risks. 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, Mr. Dorsey didn't make his generous 2013 give-back for tax reasons. Still, shouldn't an exec who hands in \$100M in shares for employees get a deduction? You would think so, but it turns out that's complicated.

A business expense deduction might be possible. Your first thought might be

to look at the clawback tax rules. After all, under Sarbanes-Oxley and in other contexts, 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, 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. Doesn't that sound like something that should be deductible? 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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