

Reporting Your Nonqualified Option Exercise and Same-Day Sale on Your Tax Return

This document provides information about federal income tax reporting requirements that generally apply when you exercise a nonqualified stock option and sell the shares at the same time (i.e., on the same day). This may seem like a single event, but your income tax reporting will reflect two transactions, (i) exercising an option and (ii) selling the shares. Income related to the option exercise should be included in the Form W-2 you receive from your employer. You must also report the sale of the shares on your US Individual Income Tax Return (Form 1040), Schedule D.

The discussion that follows provides some general guidelines for U.S. individual taxpayers about reporting income from the exercise of nonqualified options and same day sale of stock. **This discussion should not be construed as legal, accounting, or tax advice. You should review your personal circumstances with your tax and legal advisors. E*TRADE FINANCIAL Corp., its subsidiaries and affiliates including E*TRADE FINANCIAL Corporate Services and E*TRADE Securities LLC, and its employees do not provide legal, accounting, or tax advice.**

What You Need

- Your Form W-2 for the current year
- Consolidated Form 1099 issued to you by E*TRADE Securities LLC
- IRS Form 1040 (the full 1040, not the 1040EZ or the 1040A)
- IRS Form 1040 Schedule D: Capital Gains and Losses
- IRS Form 8949 Sales and Other Dispositions of Capital Assets
- An amendment is required by your employer if non reporting is identified
- Your exercise or trade confirmation or similar statement you received when you exercised the options and acquired the underlying shares

Before You Begin

For Covered Securities¹

Cost basis for covered securities will be reported on your Form 1099. You can also view cost basis for covered securities by logging on to etrade.com, selecting the Employee Stock Plans tab, the portfolios sub-tab, and then click the 2011 Year-End Snapshot page.

For Non-Covered Securities¹

You will need the following information for each exercise and sale:

What was the purchase date? This is the day you exercised the option.

What was the date of the sale? Normally, this would be the same as the purchase date if you requested a sale of the shares at the same time you exercised the option, but a delay to a later date is possible. You should have received a sale confirmation document with this date.

How much did you pay for the stock that you sold? To calculate your gain or loss, you'll need to know how much you paid to exercise your option. This is your option price (also sometimes referred to as your exercise price). Shortly after your exercise was completed, you probably received a trade confirmation or a similar statement from your employer. This statement should reflect your option price.

How much income was reported on your Form W-2 for the sale? You'll also need to know how much of the income reported on your Form W-2 is attributable to your exercise and sale. This income is combined with your salary and other compensation for the year in Box 1. The amount of income that was included in Box 1 of Form W-2 for nonqualified stock option exercises should also be indicated in Box 12 of that form with code "V". If you engaged in more than one exercise, you'll need to break down this amount for each separate exercise. Your employer may have given you a separate statement with this information. If you have questions, you should request more details from your employer.

The following illustration shows a Form W-2 for an employee that earned salary of \$50,000 and realized a gain of \$20,000 on a non-qualified option exercise.

Form W2

The income from your option exercise is reported in Box 1, which also includes your salary, commissions, bonus, and other compensation.

Bonus, and other compensation.

a Employee's social security number		OMB No. 1545-0008		Safe, accurate, FAST! Use 		Visit the IRS website at www.irs.gov/efile	
b Employer identification number (EIN)				1 Wages, tips, other compensation 70,000		2 Federal income tax withheld	
c Employer's name, address, and ZIP code				3 Social security wages		4 Social security tax withheld	
				5 Medicare wages and tips		6 Medicare tax withheld	
				7 Social security tips		8 Allocated tips	
d Control number				9		10 Dependent care benefits	
e Employee's first name and initial		Last name		Suff.		11 Nonqualified plans	
						12a See instructions for box 12 V 20,000	
						12b	
f Employee's address and ZIP code						13 Statutory employee ☐ Retirement plan ☐ Third-party sick pay ☐	
						14 Other	
						12c	
						12d	
15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

In addition to reporting the income from your exercise in Box 1, your employer may also have listed it separately in Box 12. If you engaged in multiple exercises during the year, however, your employer probably aggregated all the exercises into one amount – you'll need to know how much income was reported on your Form W-2 for each separate exercise.

Reporting Your Ordinary Income

Any ordinary income resulting from your exercise should already be included in Box 1 of your Form W-2. You report the total amount indicated in Box 1 on Line 7 of IRS Form 1040.

Form 1040

Income	7 Wages, salaries, tips, etc. Attach Form(s) W-2	7 70,000
	8a Taxable interest. Attach Schedule B if required	8a

Income from Box 1 of your Form W-2 is reported on Line 7 of Form 1040.

Reporting Your Capital Gain or Loss

Although income from the exercise of your option should appear on your Form W-2, you must also report the subsequent sale of shares on your U.S. Individual Income Tax Return (Form 1040), Form 8949 and Schedule D. Any resulting gain or loss will appear on Line 13 of Form 1040. The income from the exercise reported on Form W-2 will be added to your purchase price in determining your gain or loss on sale, so you should not pay double tax on this income.

Form 8949 is divided into two parts: Part I is for short-term capital gains and losses and Part II is for long-term capital gains and losses. An exercise and sale of stock on the same day results in a short-term capital gain or loss, which is reported in Part I. You generally have to hold your stock for more than one year after you exercise the options to qualify for long-term capital gain or loss.

To report your capital gain or loss, you will need to check the appropriate box and complete the columns in Part I of Form 8949:

BOX (A) Short-term transactions reported on Form 1099-B with basis reported to the IRS

BOX (B) Short-term transactions reported on Form 1099-B but basis not reported to the IRS

BOX (C) Short-term transaction for which you cannot check box A or B

Column (a) DESCRIPTION OF PROPERTY: Describe the stock that you sold. This should be the number of shares you sold and the name of the company or its ticker symbol.

Column (b) CODE, IF ANY, FOR COLUMN (g).

Column (c) DATE ACQUIRED: Enter your exercise date (this is the date you acquired the stock that you sold).

Column (d) DATE SOLD: Enter the date you sold the shares (normally the same as the date of the exercise if you requested a simultaneous sale).

Column (e) SALES PRICE: Enter the proceeds from your Consolidated Form 1099 that you received from E*TRADE Securities. This is your total sales price less any fees or commissions that you paid on the sale.

Column (f) COST OR OTHER BASIS: Enter your cost basis. This is the amount you paid for the stock (your purchase price per share multiplied by the number of share you sold) plus the amount of income reported on your Form W-2 for the sale.

For Covered Securities¹ The cost basis for covered securities that is reported on your Form 1099 already includes the amount you paid for the stock plus the amount of income reported on your Form W-2. It does not need to be adjusted to account for income reported on your Form W-2.

For Non-Covered Securities¹ It is very important that you include the income reported on your Form W-2; otherwise you could end up paying tax on this income twice.

Column (g) Adjustments to Gain or Loss, if any.

Sum the totals of column e, f and g and enter on Schedule D, line 1 (if box A was checked), line 2 (if box B was checked) or line 3 (if box C was checked).

Wash Sales

You generally will not be able to deduct the loss from the sale of the stock if it is a so-called wash sale. A wash sale occurs when you sell stock or securities (including a contract or option to acquire or sell stock or securities) at a loss and, within 30 days before or after the sale or disposition, acquire substantially identical stock or securities in a fully taxable trade, or enter into a contract or option to acquire substantially identical stock or securities. If the sale is a wash sale, you cannot deduct any resulting loss. However, you will generally be allowed to increase your basis in the new stock or security by the amount of loss that was disallowed.

For more information on wash sales, see IRS publication 550 and consult your tax advisor.

The following illustration shows a Form 8949 for an employee of ABC Company. The employee exercised and sold 1,000 shares of a nonqualified stock option on July 15. His option price was \$10 per share (his total option price was \$10,000). He sold the stock at \$30 per share (his total sales price was \$30,000) and he paid fees and commission of \$100 for the sale. ABC Company reported \$20,000 of income for the exercise on his Form W-2. See example below.

Form 8949 Department of the Treasury Internal Revenue Service (99)	Sales and Other Dispositions of Capital Assets ▶ See Instructions for Schedule D (Form 1040). ▶ For more information about Form 8949, see www.irs.gov/form8949 ▶ Attach to Schedule D to list your transactions for lines 1, 2, 3, 8, 9, and 10.	OMB No. 1545-0074 2011 Attachment Sequence No. 12A
Name(s) shown on return		Your social security number

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

Note: You **must** check **one** of the boxes below. Complete a *separate* Form 8949, page 1, for **each** box that is checked.

***Caution.** Do not complete column (b) or (g) until you have read the instructions for those columns (see the Instructions for Schedule D (Form 1040)). Columns (b) and (g) do not apply for most transactions and should generally be left blank.

☒ **(A)** Short-term transactions reported on Form 1099-B with basis reported to the IRS
 ☐ **(B)** Short-term transactions reported on Form 1099-B but basis not reported to the IRS
 ☐ **(C)** Short-term transactions for which you cannot check box A or B

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Code, if any, for column (g)*	(c) Date acquired (Mo., day, yr.)	(d) Date sold (Mo., day, yr.)	(e) Sales price (see instructions)	(f) Cost or other basis (see instructions)	(g) Adjustments to gain or loss, if any*
100 Shares of ABC Company		7-15-11	7-15-11	29,900.00	30,000.00	

↑
 The date the employee exercised and sold the stock.

↑
 Gross proceeds (total sales price less fees and commissions). Reported on Form 1099.

↑
 Option price plus the amount of income reported on Form W-2. Reported on Form 1099 for covered securities.

2 Totals. Add the amounts in columns (e) and (f). Also, combine the amounts in column (g). Enter here and include on Schedule D, line 1 (if box A above is checked), line 2 (if box B above is checked), or line 3 (if box C above is checked) ▶	2	29,900.00	30,000.00	
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For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 37768Z Form **8949** (2011)

SCHEDULE D (Form 1040) Department of the Treasury Internal Revenue Service (99)	Capital Gains and Losses ▶ Attach to Form 1040 or Form 1040NR. ▶ See Instructions for Schedule D (Form 1040). ▶ Use Form 8949 to list your transactions for lines 1, 2, 3, 8, 9, and 10.	OMB No. 1545-0074 2011 Attachment Sequence No. 12
Name(s) shown on return		Your social security number

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

Complete Form 8949 before completing line 1, 2, or 3.
 This form may be easier to complete if you round off cents to whole dollars.

(e) Sales price from Form(s) 8949, line 2, column (e)	(f) Cost or other basis from Form(s) 8949, line 2, column (f)	(g) Adjustments to gain or loss from Form(s) 8949, line 2, column (g)	(h) Gain or (loss) Combine columns (e), (f), and (g)
1 Short-term totals from all Forms 8949 with box A checked in Part I	29,900.00	(30,000.00)	(100.00)
2 Short-term totals from all Forms 8949 with box B checked in Part I		()	
3 Short-term totals from all Forms 8949 with box C checked in Part I		()	

4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824	4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your Capital Loss Carryover Worksheet in the instructions	6	()
7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back	7	(100.00)

If you exercised more than one option on the same day, when reporting the exercises on Form 8949, you can report each exercise on a separate line or you can aggregate all of the day's transactions on a single line. If you chose to list each exercise on a separate line, you'll need to allocate your aggregate sales proceeds to each individual option exercise. To do this, divide your total proceeds by the total number of shares you sold. This restates your proceeds as a per share amount. Then multiply this per share amount by the number of shares in each option exercise to determine what portion of the proceeds should be allocated to each exercise. If you choose to aggregate all of the day's transactions on the same line, add together the total amount you paid for the stock and income reported on your Form W-2 for all the exercises when you compute the cost basis reported in column (e).

Exercises that occurred on different days should be reported on separate lines of Form 8949.

After reporting each exercise, you'll add up the amounts in columns (e) (f) and (g). Enter the amounts on Schedule D, line 1 (if box A was checked), line 2 (if box B was checked) or line 3 (if box C was checked).

Combine amounts in column (e), (f), and (g) and report total in column (h). Report the total for column (h) on line 7.

If the total in column (h), reported on line 7, is a positive amount, you have a capital gain. You will report the capital gain on Line 16 of Schedule D Form 1040 Part 3 (See below)

As in the example above, if the total in column (h) is a negative amount, you have a capital loss, which you'll report on Line 16 of Schedule D form 1040 Part 3 (please see below). If your capital loss is less than or equal to \$3,000, you will also report it on Line 21 of Schedule D Form 1040 Part 3.

1040 Schedule D Part 3

Part III Summary

16	Combine lines 7 and 15 and enter the result	16	<100.00>
	• If line 16 is a gain, enter the amount from line 16 on Form 1040, line 13, or Form 1040NR, line 14. Then go to line 17 below. • If line 16 is a loss, skip lines 17 through 20 below. Then go to line 21. Also be sure to complete line 22. • If line 16 is zero, skip lines 17 through 21 below and enter -0- on Form 1040, line 13, or Form 1040NR, line 14. Then go to line 22.		
17	Are lines 15 and 16 both gains? ☐ Yes. Go to line 18. ☐ No. Skip lines 18 through 21, and go to line 22.		
18	Enter the amount, if any, from line 7 of the 28% Rate Gain Worksheet in the instructions . . . ▶	18	
19	Enter the amount, if any, from line 18 of the Unrecaptured Section 1250 Gain Worksheet in the instructions ▶	19	
20	Are lines 18 and 19 both zero or blank? ☐ Yes. Complete Form 1040 through line 43, or Form 1040NR through line 41. Then complete the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for Form 1040, line 44 (or in the instructions for Form 1040NR, line 42). Do not complete lines 21 and 22 below. ☐ No. Complete Form 1040 through line 43, or Form 1040NR through line 41. Then complete the Schedule D Tax Worksheet in the instructions. Do not complete lines 21 and 22 below.		
21	If line 16 is a loss, enter here and on Form 1040, line 13, or Form 1040NR, line 14, the smaller of: • The loss on line 16 or • (\$3,000), or if married filing separately, (\$1,500) Note. When figuring which amount is smaller, treat both amounts as positive numbers.	21	(<100.00>)
22	Do you have qualified dividends on Form 1040, line 9b, or Form 1040NR, line 10b? ☐ Yes. Complete Form 1040 through line 43, or Form 1040NR through line 41. Then complete the Qualified Dividends and Capital Gain Tax Worksheet in the instructions for Form 1040, line 44 (or in the instructions for Form 1040NR, line 42). ☐ No. Complete the rest of Form 1040 or Form 1040NR.		

Schedule D (Form 1040) 2011

If you have a net capital loss that is more than \$3,000, you won't be able to claim the entire loss this year, but you can generally carry-forward any unclaimed losses to future years. You can report a loss of up to \$3,000¹ on Line 21 of Schedule D and Line 13 of Form 1040. When you prepare your tax return for the following year, complete the Capital Loss Carryover Worksheet in the IRS instruction booklet for Schedule D.

¹\$1,500 if married filing separately.

Question and Answers

Q: I thought I already paid tax on my exercise, why do I have to report the sale and pay tax again?

A: Your employer may have withheld taxes when you exercised your stock option. If so, any amounts that were withheld are reported on your Form W-2. This withholding is usually based on a minimum required withholding percentage set forth under the tax law and is just an estimate of your tax liability. You file a tax return to reconcile your actual tax liability for the year with the taxes that your employer withheld from your compensation or that you paid as estimated taxes. Because your employer generally doesn't withhold based on your actual tax bracket, the amounts that have been withheld may be too much (in which case, you'll be entitled to a refund from the IRS) or too little (in which case, you'll owe an additional payment to the IRS).

Q: The income that my employer reported on Form W-2 does not equal the difference between my total option and sales prices. Did my employer report the wrong amount of income for my exercise on my Form W-2?

A: The amount of income reported on your Form W-2 is the difference between your option price and the value of the stock on the date of exercise. When determining the current value of the stock, some employers use the closing or average price on the day your exercise occurred; other employers use the closing price of the preceding day or the sales price. In your case, your employer may have used the closing or average price of the stock to determine its current value, rather than the actual sales price you realized when selling your shares.

Q: What are the so-called wash sale rules and do they apply to my sale of stock?

A: You generally will not be able to deduct the loss from the sale of stock if it is a so-called wash sale. A wash sale occurs when you sell stock or securities (including a contract or option to acquire or sell stock or securities) at a loss and, within 30 days before or after the sale or disposition, buy substantially identical stock or securities, acquire substantially identical stock or securities in a fully taxable trade, or enter into a contract or option to acquire substantially identical stock or securities. If the sale is a wash sale, you cannot deduct any loss resulting. However, you will generally be allowed to increase your basis in the new stock or security by the amount of loss that was disallowed. For more information on wash sales, see IRS publication 550 and consult your tax advisor.

Q: I have a capital loss equal to the amount of the fees and commission I paid for the sale. Why is this?

A: Your employer is not allowed to reduce the amount of compensation income from your exercise of the stock option by the cost of selling the stock. When you report the sale of the stock, however, the cost of selling is taken into account and typically produces a small capital loss.

Q: Why didn't my employer withhold enough taxes on my exercise?

A: Even if your employer did withhold taxes, your marginal tax rate may be higher or lower than the rate your employer is required to use to calculate withholding taxes, causing you to owe additional tax or receive a refund when you file your tax return.

Need more information?

For more information regarding the taxation of your nonqualified stock options contact your employer or your tax advisor. You can also learn more about reporting option exercises on your tax return at www.irs.gov (search on "stock options"). You can also learn more about general tax tips in the E*TRADE FINANCIAL tax center at www.etrade.com/taxcenter.

Important Things For You to Know

¹Cost basis will be available for Covered securities online via etrade.com and on your 1099-B. Different securities classes will become "Covered" securities in accordance with the following phase-in schedule:

- Stocks acquired in your E*TRADE account on or after **January 1, 2011** (including ESPP shares purchased after this date and stock options exercised after this date, domestic and foreign stocks, REITs, ADRs and ETFs that are not in a Regulated Investment Company ("RIC") nor connected with a Dividend Reinvestment Plan)
- Stocks in RICs acquired in your E*TRADE account on or after **January 1, 2012** (including Mutual Funds and ETFs, and stocks acquired in connection with a Dividend Reinvestment Plan)
- Options, Fixed Income instruments, Derivatives, Debt instruments and other security classes as specified under the regulations acquired in your E*TRADE account on or after **January 1, 2013**
- Please note that any stock that was acquired before January 1, 2011 is considered a "Noncovered" security and is not subject to the new cost basis reporting regulations. Restricted Stock and shares related to Stock Appreciation Rights are also Noncovered, even if they were acquired on or after **January 1, 2011**.

This article applies only to people who are subject to tax in the U.S. and it applies only to your U.S. federal income tax return. Stock option exercises and sales are reported differently in non-U.S. tax jurisdictions and may be reported differently on your state income tax return. This article applies to calendar year 2011 only. Transactions that occur in other calendar years may need to be reported differently.

This article applies only if you exercised and immediately sold all of the stock that you exercised (sometimes called a same-day sale or a cashless exercise).

This article assumes that fees or commission associated with the sale are deducted from the sale proceeds reported by the broker on Form 1099. E*TRADE Securities LLC always deducts the fees and commissions from the sales proceeds reported on your Form 1099; consult a tax advisor if your broker did not.

The article assumes that your employer has properly reported the income from your exercise and sale on your Form W-2. If your employer did not do this, or should you have any questions concerning the information appearing on your Form W-2, you should consult a tax advisor.

The information published in this article is of a general nature and has been summarized for presentation to a large audience. It is not a complete discussion of all aspects of the laws, rules, regulations, standards, and principles that govern how stock options are reported on your tax return. The contents of this article are neither designed nor intended to be relied upon, and should not be considered, as legal or tax advice. Your specific situation may involve circumstances that cause the laws, rules, regulations, standards, and principles described herein to apply differently. You should consult your own advisors before deciding what, if any, course of action to take in your own particular situation.

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