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Carta Liquidity Tax Guide for Sellers

January 2022

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Overview

Carta Liquidity — the liquidity platform that's directly integrated with Carta's ownership platform — facilitates private market liquidity programs for companies of all stages. This guide will provide you with helpful context and information on three of the main aspects of tax considerations when selling your shares or stock options[1] on Carta, as well as tax basics for those new to selling equity. Note that this guide is informational only and should not be considered tax advice. Please consult your tax advisor before making any tax decisions.

Carta Liquidity is operated by Carta Capital Markets, LLC ("CCMX"), a registered broker-dealer and a wholly-owned subsidiary of Carta, Inc. Tax related documents produced as a result of sales on Carta will be delivered to Sellers, Companies, and the Internal Revenue Service ("IRS") by CCMX. As with most financial transactions, selling equity or options on Carta Liquidity comes with several tax considerations. This guide is designed to help Sellers understand the basics about taxes of private equity sales, as well as the details around tax reporting and tax withholding resulting from a sale occurring on Carta.

[1]Note: For clarity, stock options themselves are not sold on Carta. For the purposes of this document, when we refer to "selling" or "sales" of stock options, we are referring to "cashless exercise" transactions where the option is exercised and the underlying stock is sold immediately thereafter through the Carta Liquidity platform.

Tax Basics

What resources are available to understand the terms that affect tax treatment?

Tax lot

A tax lot (commonly referred to as a "lot") is a group of shares that are purchased (or sold) together and have the same attributes for tax reporting purposes (cost per share, acquisition date, holding period, sale date, and sale price). In Carta, the shares represented by a single certificate or grant (e.g., CS-101, ES-123) are considered a lot. (Read more)

- How to choose which tax lot to sell on Carta
- See the Tender Offer Sellers Guide for more information on setting Settlement Instructions
- See the Carta Cross Sellers Guide for more information on setting Settlement Instructions

Cost basis

Cost basis is the price paid to purchase a security plus any additional costs such as fees and commissions. The cost basis for an option is the exercise price. (Read more)

- How is cost basis calculated?
- When is cost basis determined?
- How do stock splits impact cost basis?

Acquisition date

The date a stock holding is acquired. For private company stock, the acquisition date begins with the receipt of title. When an option is exercised, the acquisition date of the resulting shares is the date of the exercise. The holding period for a lot begins on the day after the acquisition date.

How long is the whole transaction? When do I get the shares or units I purchased?

The amount of time elapsed between the acquisition of shares and the disposal (i.e., sale or transfer) of the same shares. The holding period begins on the day after the acquisition date and includes the day it is disposed of. Capital gains are either long-term or short-term (for taxation purposes) depending on the length of the holding period. The holding period is measured in calendar months, not days; thus, one month has elapsed on the same date of the succeeding month as the date of purchase, regardless of the number of days in the month. For example, Sally acquired stock on December 16, 2020 and sold the stock in a transaction that settled on December 16, 2021. Sally has held the stock for exactly one year; any gain will be short-term capital gain.

- When does the holding period begin for a stock?

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Settlement date

The day of transfer for a transaction when shares are transferred from the seller to the buyer and sale proceeds are transferred from the buyer to the seller. Settlement occurs on or after the trade date. For private company stock, the settlement date marks the last day of a lot's holding period.

Gross proceeds

The total proceeds from the sale of an asset before any acquisition costs (e.g., the cost to cashless exercise an option during a sale) or fees (e.g., broker's commission). For example, selling 100 options that have a $1 strike price at $10 through a cashless exercise would result in gross proceeds of $1,000 (100 x $10 = $1000).

Gross profit

Also known as income from a sale, represents the proceeds from a sale after paying the acquisition cost. Continuing with the above example, the cost to exercise the 100 options above is $100 ($1 x 100 = $100), therefore the gross profit for the sale is the gross proceeds minus the cost of acquisition, or $900 ($1,000 - $100 = $900).

How long is the whole transaction? When do I get the shares or units I purchased?

Income from the sale of a capital asset (e.g., 100 shares of common stock) is considered capital gains. The IRS requires individuals to report capital gains on which a capital gains tax is levied. The holding period of the capital asset will determine whether the income from the sale of a capital asset is taxed at the long-term or short-term rate. Capital assets sold after a holding period of more than one year are long-term capital gains, while those sold with shorter holding periods are short-term capital gains. The tax rate applied to long-term capital gains is lower than the tax rate for short-term capital gains. (Read more)

- What is a capital asset?
- What is a capital gain?

Net proceeds

The total amount of cash received as a result of selling an asset, after deducting any acquisition costs (e.g., the cost to cashless exercise an option during a sale) or fees (e.g., broker's commission). Continuing with the above example, with $900 of gross profit after the sale of 100 options, the sale is subject to short-term capital gains and is taxed as ordinary income so our employer withholds 40% of the gross profit to cover their federal, state, and city tax obligations, thus the net proceeds are $540 ($900 x 60% = $540), assuming no additional fees.

Carta Liquidity tax reporting

What will Carta report on a Seller's tax-related information?

After year end, CCMX will issue Sellers a 1099-B Substitute Statement, which is a document summarizing and matching the transaction data reported in the 1099-B form provided by CCMX to the IRS. A 1099-B Substitute Statement is generated for each Seller, whether an individual or legal entity, who sold equity on Carta and will include all transactions during the reporting year. Sellers will be notified when the statement becomes available in the Documents section on the Carta portal by February 15 or the first business day thereafter.

How should Sellers interpret their Carta Liquidity 1099-B?

A Seller may use their 1099-B Substitute Statement to help complete the Investment Income/Loss portion of their annual tax return.

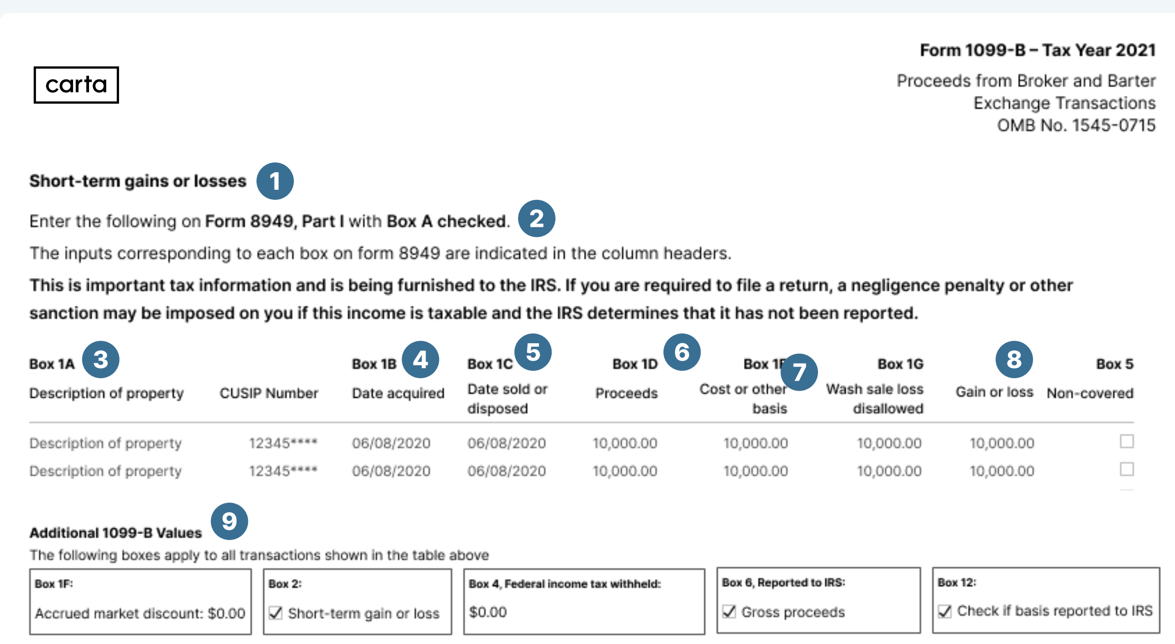
Most individuals and entities will use the 1099-B to fill out their [IRS Form(s) 8949](). **Please note that you should consult your tax advisor before completing Form 8949**. Some common considerations may include, but are not limited to:

- Using Boxes (f) and (g) to adjust your cost basis to reflect the portion of transaction proceeds that were previously taxed as Ordinary Income (see: "End of Year Carta 1099-B and Company Tax Document Interconnectivity" below); and
- Accounting for Long-Term vs. Short-Term Capital Gain characterization.

Please see Figure 1 below for an illustrative sample of a Carta 1099-B for more context on specific aspects of the form:

Figure 1 – 1099-B Illustration

1. Indicates whether the transactions reported on this page are Long-Term vs. Short Term Capital Gains. Transactions will be broken out into separate pages if both are applicable during any given year. Generally, a transaction will qualify for Long-Term Capital Gain status if the underlying security had been held for at least a year by the time of sale.



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Form 1099-B – Tax Year 2021

Proceeds from Broker and Barter Exchange Transactions
OMB No. 1545-0715

Short-term gains or losses 1

Enter the following on **Form 8949, Part I** with **Box A checked.** 2

The inputs corresponding to each box on form 8949 are indicated in the column headers.

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

Box 1A 3 Description of property	CUSIP Number	**Box 1B** 4 Date acquired	**Box 1C** 5 Date sold or disposed	**Box 1D** 6 Proceeds	**Box 1E** 7 Cost or other basis	**Box 1G** Wash sale loss disallowed	8 Gain or loss	**Box 5** Non-covered
Description of property	12345****	06/08/2020	06/08/2020	10,000.00	10,000.00	10,000.00	10,000.00	☐
Description of property	12345****	06/08/2020	06/08/2020	10,000.00	10,000.00	10,000.00	10,000.00	☐

Additional 1099-B Values 9

The following boxes apply to all transactions shown in the table above

Box 1F:	**Box 2:**	**Box 4, Federal income tax withheld:**	**Box 6, Reported to IRS:**	**Box 12:**
Accrued market discount: $0.00	☑ Short-term gain or loss	$0.00	☑ Gross proceeds	☑ Check if basis reported to IRS

2. Form 8949, Part II: Whether a transaction is Long-Term vs. Short-Term will determine its reporting on the Form 8949, which is the section of the Seller's tax filing where they will likely report income/loss from sale of equity.

3. Box 1A: ***Description of property:*** Generally, Sellers can expect a distinct line item for each certificate sold, on a per transaction basis. This should include all transactions completed on CCMX during the reportable tax year. Sellers who sold Options will see this reflected in terms of Shares of the underlying Security.

4. Box 1B: ***Date Acquired:*** This reflects the beginning of the holding period for the equity sold in a transaction. For option sales, this will be the Transaction Settlement date. This indicates when those options are deemed to have been exercised into Stock and subsequently sold.

5. Box 1C: ***Date Sold or Disposed:*** Will be the date that the transaction is settled.

6. Box 1D: ***Total Proceeds:*** Total consideration received by Seller. This amount is net of any transaction fees paid.

7. Box 1E: ***Cost or Other Basis:*** Cost of securities sold in the transaction. Even in instances of Cashless Exercise of Options, this amount will reflect the cost of exercise of options. For non-options, this will be the cost of acquisition, if any, for a stock.

8. ***Gain or Loss:*** Calculated as Box 1D – Box 1E, this is the gain or loss on sale on the Transaction.

9. Though CCMX withholds the taxes from sale proceeds, the taxes are ultimately paid to the IRS, or the Sellers' applicable Taxing Authority, by the Issuer. As such, Sellers can expect a zero value here.

Carta Liquidity tax withholding on behalf of the company

What will Carta report on a Seller's tax-related information?

Just as funds are deducted from an employee's periodic paychecks to cover various income and related taxes, so too might funds be withheld from the proceeds of a Carta Liquidity transaction if they are considered to be Ordinary Income. Whether or not funds are required to be withheld from the proceeds of a transaction is determined by a number of factors. Those considerations include, but are not limited to:

- the characteristics of the equity being sold;
- the timing of the sale vis-a-vis other events, such as equity vesting or exercise (if applicable);
- the Company's internal policies; and
- certain pricing elements of the sale.

For a Seller's year end tax filing, these withheld taxes can be treated as prepaid taxes for each tax jurisdiction (e.g., state versus federal).

For example, if a Seller is a New York City resident who sold stock options during the year, the individual might expect withholdings of Federal, New York State, and New York City tax to be deducted from the cash proceeds generated from their Liquidity transactions.

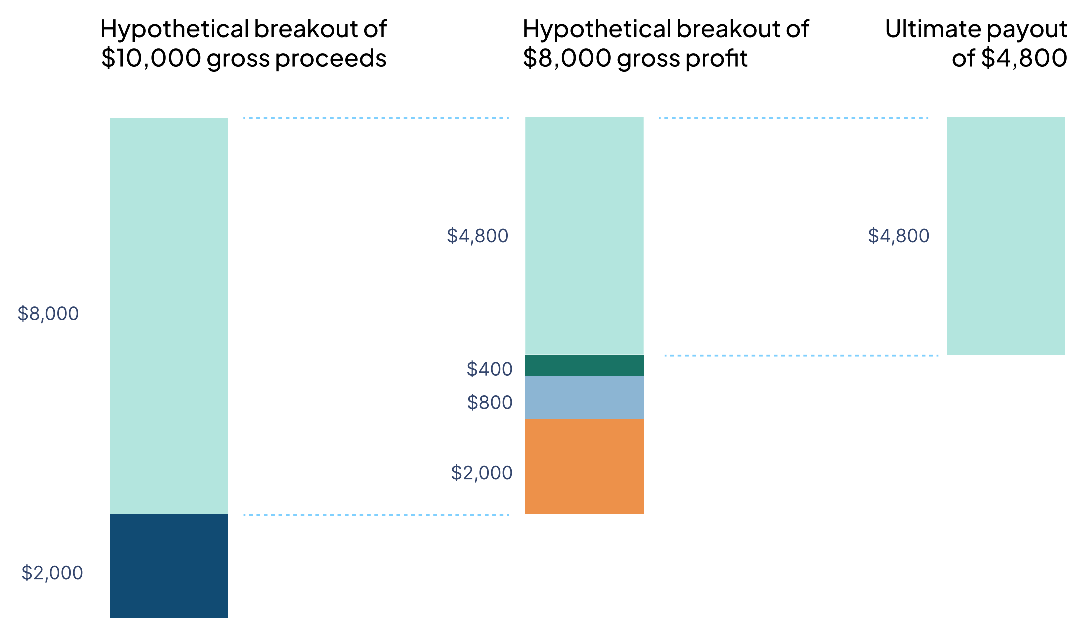
What will Carta report on a Seller's tax-related information?

The Company issuing the stock provides Carta with tax withholding instructions prior to the start of a transaction. These instructions include tax withholding rates for Federal, State, and Local tax jurisdictions. These rates are meant to, as closely as possible, anticipate the eventual tax liability due to any given jurisdiction, as a result of the equity sale.

For example, if a Seller is a New York City resident, the Company might set the Federal tax withholding rate at 25%, State tax liability at 10%, and City tax liability at 5%. Given these rates, and assuming the Seller sold 1,000 Non-Qualified Stock Options ("NSOs") for $10 each with a Strike Price of $2, the Seller might expect a net payout per Figure 2 in the table below:

Figure 2 - Sample Gross Proceeds Breakout

Item	Amount	Calculation
Gross Proceeds	$10,000	$10 Sale Price * 1,000 Options
Cost of Exercise	-$2,000	**$2 Strike Price * 1,000 Options**
Gross Profit	$8,000	Gross Proceeds - Cost of Exercise
US Federal Tax Withholding	-$2,000	Gross Profit * 25%
New York State Tax Withholding	-$800	Gross Profit * 10%
New York City Tax Withholding	-$400	Gross Profit * 5%
Net Proceeds	$4,800	Gross Profit - All Tax Withholdings



Note: For illustrative purposes only. The above graphic buckets taxes broadly based on jurisdiction. There can be multiple withholding tax types, such as Supplemental Income Tax, Unemployment Insurance Tax, Social Security Tax, etc. for any given jurisdiction.

Given:
Quantity: 1,000
Sale price: $10.00
Strike price: $2.00

Given withholding rates:
Federal: 25%
New York State: 10%
New York City: 5%

What are some considerations that can affect my Tax Withholding?

During a Carta Liquidity transaction, Companies may have an obligation to withhold income and payroll taxes. Generally speaking, Carta Liquidity transactions can give rise to two types of tax - Ordinary Income Tax and Capital Gains Tax. In broad terms, the Company is responsible for any withholding that may be required for the portion of the transaction proceeds that is considered Ordinary Income.

There are several considerations that underpin the determination of income to be Ordinary vs. Capital Gains. Some of them include, but are not limited to:

1. **The fair market value of the equity:** A transaction with a sale price exceeding the current fair market value ("FMV") of the security may give rise to additional Ordinary Income, if the transaction is considered to be a form of Company compensation ("compensatory")[2]. The withholdable Ordinary Income would be calculated as the difference between the FMV and sale price (Figure 3–A below).

Figure 3–A: Tender Offer - Assuming that Sale Price is Greater than FMV at Time of Sale and Transaction is Considered Compensatory

Sample sale data:

Security type	Quantity sold	Strike price	Last FMV	Sale price	Tax withholding rate
Common stock	1,000	$3	$15	$19	25%

Breakdown:

Item		Amount	Calculation
Capital gains	Taxable amount	$12,000	($15 FMV - $3 Strike Price) * 1,000 Shares
	Withholding	$0	No withholding on Capital Gains
Ordinary income	Taxable amount	$4,000	($19 Sale Price - $15 FMV) * 1,000 Shares
	Withholding	$1,000	$4,000 Taxable Amount * 25% Withholding Rate

Figure 3–B: Carta Cross or Tender Offer - Assuming that Sale Price is Greater than FMV at Time of Sale and Transaction is not Considered Compensatory

Sample sale data:

Security type	Quantity sold	Strike price	Last FMV	Sale price	Tax withholding rate
Common stock	1,000	$3	$15	$19	25%

Breakdown:

Item		Amount	Calculation
Capital gains	Taxable amount	$16,000	($19 Sale Price - $3 Strike Price) * 1,000 Shares
	Withholding	$0	No withholding on Capital Gains
Ordinary income	Taxable amount	$0	N/A
	Withholding	$0	N/A

[2]Company controlled transactions structured primarily to benefit employees are generally treated as a form of Company compensation and taxed as if the proceeds were income received as part of a regular paycheck from the Company.

2. **Type of equity sold:** Currently, stock (e.g., Common Stock or Preferred Stock) and options (e.g., Incentive Stock Options and Non-Qualified Stock Options) may be sold on Carta. As Companies are generally responsible for withholding taxes when there is reportable Ordinary Income, Sellers can expect that there may not be withholdings on stock sold during Carta Liquidity transactions, but there may be withholdings after a sale of options. More details on this topic can be found below.

   Sale of stock: Generally speaking, any Ordinary Income, and corresponding payroll tax liability, from stock would have arisen before a Carta Liquidity transaction. This means Carta will not be required to withhold any additional taxes. An exception to this would be the example illustrated in Figure 3–A above, where a portion of a tender offer may be considered Ordinary Income, and in-turn have some portion of the proceeds withheld for taxes.

   Sale of non-qualified options: Ordinary Income generated from the sale of NSOs will usually be calculated as the difference between the Strike Price and FMV. Note that any applicable "compensatory income", as discussed in the section above, will also be considered Ordinary Income (Figure 4–A below). See Figures 4–A and 4–B for samples of Non-Qualified Stock Option breakout:

Figure 4–A: Tax Withholding for the Sale of a Non-Qualified Stock Option and Transaction is Considered Compensatory

Sample sale data:

Security type	Quantity sold	Strike price	Last FMV	Sale price	Tax withholding rate
Common stock	1,000	$3	$10	$15	25%

Breakdown:

Item		Amount	Calculation
Capital gains	Taxable amount	$0	No capital gain; all profit is recognized as Ordinary Income
	Withholding	$0	N/A
Ordinary income	Taxable amount	$12,000	[($10 FMV - $3 Strike Price) * 1,000 Options] + [($15 Sale Price - $10 FMV) * 1,000 Options]
	Withholding	$3,000	$12,000 Taxable Amount * 25% Withholding rate

Figure 4–B: Tax Withholding for the Sale of a Non-Qualified Stock Option and Transaction is not Considered Compensatory

Sample sale data:

Security type	Quantity sold	Strike price	0	Sale price	Tax withholding rate
Common stock	1,000	$3	$10	$15	25%

Breakdown:

Item		Amount	Calculation
Capital gains	Taxable amount	$5,000	($15 Sale Price - $10 FMV) * 1,000 Options
	Withholding	$0	No withholding on Capital Gains
Ordinary income	Taxable amount	$7,000	($10 FMV - $3 Strike Price) * 1,000
	Withholding	$1,750	$7,000 Taxable Amount * 25% Withholding rate

2. **Sale of Incentive Stock Options:** when Incentive Stock Options ("ISOs") meet certain criteria, they may be fully exempt from Ordinary Income, with all profits considered Capital Gains. The requirements for preferential tax treatment are:

   1. Waiting at least two years from when the ISOs were granted before selling; and
   2. Exercising the ISOs into stock at least a year before selling the equity.

   Failing to meet either of the above requirements would be considered a "Disqualifying Disposition," which may render the ISO ineligible for preferential tax treatment, therefore making it subject to Ordinary Income tax rates. Note that selling an ISO through a CartaX transaction is likely to be considered a Disqualifying Disposition, as the Option would be exercised and subsequently sold at the time of transaction, thus not meeting the one year holding period before the equity is sold.

   Even in the case of a Disqualifying Disposition, the Company is still not necessarily required to withhold taxes against ISOs. See Figure 5 below for a matrix of potential ISO scenarios:

Figure 5: Incentive Stock Option Dispositions

ISO Grant Date	ISO Exercise Date	Outcome	Included in Ordinary Income	Company Withholding
More than two years before Option Sale Date	More than one year before Option Sale Date	Qualifying Disposition	No	Typically not
Less than two years before Option Sale Date	More than one year before Option Sale Date	Disqualifying Disposition	Yes	Not required, but allowed
More than two years before Option Sale Date	Less than one year before Option Sale Date	Disqualifying Disposition	Yes	Not required, but allowed

The above scenarios are not complete or definitive. There are many considerations that inform tax treatment, so please consult with your tax advisor and the Company about your individual tax circumstance.

How can a Seller see a breakdown of their tax withholding?

Sellers can see their aggregate tax withholdings for any given transaction on their trade confirmation (Figure 6), monthly statements, or in the "Transaction Activity" of their Cash Account page (Figure 7). See screenshots below. Note that Carta does not provide jurisdiction-level detail for tax withholdings. Sellers should contact the Company for that information.

Figure 6: Withholding amount in Trade Confirmation

Trades

Trade ID	Trade reference	Counterparty	Side	Quantity	Price	Principal amount	Transaction fees	Exercise cost	Tax withholding	Net amount
7898	6U9	Laplante Ventures I, LP	Sell	6,000	$20.123	$120,738.00	-$3,622.14	-$1,800.00	-$55,968.03	$59,347.83
7900	6UB	Laplante Ventures II, LP	Sell	4,000	$20.123	$80,492.00	-$2,414.76	-$1,200.00	-$37,311.99	$39,565.25
Totals				**10,000**		**$201,230.00**	**-$6,036.90**	**-$3,000.00**	**-$93,280.02**	**$98,913.08**

Figure 7: Withholding amounts in Cash Management Account

Trade Information

Trade ID	7900
Settlement date	12/22/2021
Order side	Sell

Proceeds

Principal amount	$80,492.00
Cost of exercise	–$1,200.00
Tax withholding	–$37,311.99
Transaction fee	–$2,414.76
Total	$39,565.25

Close

Trade Information

Trade ID	7898
Settlement date	12/22/2021
Order side	Sell

Proceeds

Principal amount	$120,738.00
Cost of exercise	–$1,800.00
Tax withholding	–$55,968.03
Transaction fee	–$3,622.14
Total	$59,347.83

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Carta Liquidity and company tax reporting in context

Is there a possibility that Carta will report transaction proceeds on a Seller's 1099–B that have been previously reported as compensation income by the Company?

Yes. As a brokerage platform, Carta is required to report all transactions on Form 1099–B and does so without adjusting for any amounts that may have been previously reported as Ordinary Income by a Company. We strongly recommend that Sellers work with the Company and their tax advisors to determine what amount of previously taxed income, if any, should be used to increase the effective tax basis of a security through an adjustment on Form 8949.