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by Schuyler M. Moore

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Schuyler M. Moore is a partner at Greenberg Glusker LLP in Los Angeles.

In this article, Moore analyzes the potential tax consequences of Tesla's reissuance of stock options to Elon Musk after a Delaware court rescinded the options in January, and he concludes that, depending on the effective date of issuance, the options could result in a hefty tax bill for Musk.

Elon Musk may owe 57 percent tax attributable to the value of his Tesla stock options that were approved by the shareholder vote on June 13. He was originally granted the options in 2018, but on January 30, 2024, a Delaware court held that the options had not been validly authorized and expressly rescinded them: "The court last turns to the remedy, concluding that Plaintiff is entitled to rescission of the Grant [of options] in its entirety."¹

In response, the Tesla board decided to ratify the prior issuance of the options. The proxy statement sent to Tesla shareholders in advance of the June 13 vote stated that the board had approved that ratification on April 16 subject to shareholder approval, which occurred on June 13.

A critical question for tax purposes is the effective date of the issuance of the options. Musk and Tesla will no doubt take the position that the options should be deemed issued on the original issuance date in 2018. Toward that goal, the proxy statement says that the original issuance of the options was a "defective corporate act" that can be retroactively cured by subsequent proper ratification under section 204(f) of the Delaware corporate code, which expressly provides that the subsequent ratification "shall be effective

retroactive to the date of the defective corporate act."

However, the date of issuance for tax purposes depends on the substance of the transaction, regardless of the determination under state law. The original issuance of options was expressly rescinded by the Delaware court on January 30, so for almost half a year Musk held no options. Thus, in substance the options may be viewed as reissued on June 13. Additionally, and particularly relevant for this article, under section 409A, the modification of a stock option to increase the shares subject to the option is treated as the grant of new options regarding the additional shares.² As of January 30, Musk had no right to exercise the options, and on June 13 he could exercise all of them. Thus, all the options may be treated as issued on June 13.

Stock options are treated as deferred compensation under section 409A, and if the options are treated as issued on June 13, they don't meet any exceptions to section 409A because (1) they were fully vested on June 13, (2) they were "in the money" on that date, and (3) Musk's discretion for the date of exercise eliminates other potential exceptions.

If the options are treated as issued on June 13, section 409A would result in two dramatic tax consequences:

- Section 409A triggers the immediate taxation of the full value of deferred compensation on the date it is vested, well before the deferred compensation would be taxable under normal rules. Thus, the value of the options would be subject to full 37 percent income tax on June 13. The value is not just the spread between the value of the stock and the exercise price (approximately

¹*Tornetta v. Musk*, 310 A.3d 430 (Del. Ch. 2024).

²Reg. section 1.409A-1(b)(5)(v)(H).

\$56 billion), but it would also include substantially more value for the options under the Black-Scholes model.

- To add insult to injury, section 409A would impose an additional 20 percent tax on the value, so the total federal tax rate on the value would be 57 percent.

These adverse tax consequences cannot be avoided even if the options are exercised in 2024, since even the short-term deferral exception does not apply once an in-the-money stock option is granted. Indeed, this precise fact pattern is stated to not qualify for that exception in reg. section 1.409A-1(b)(4)(iii) (Example 8).

The only sure way that Musk could avoid this issue is to get the trial judge to reverse the decision (which Tesla has requested) or to successfully appeal it, since it should then be viewed as a nullity. A lot will be riding on those attempts. ■

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