PLANNING ESSENTIALS

Taking stock

Restricted stock and employee stock purchase plans overview

An increasingly critical component of employee compensation and benefits involves company stock. Understanding the different types of stock benefits is critical when undertaking comprehensive financial planning. Leaving this area out of planning conversations can negatively affect your income taxes and diversification.

FORMS OF COMPANY STOCK			
Stock options	Restricted stock & RSU's	Employee stock purchase plans	Individual stock ownership

This *Planning Essentials* article focuses on restricted stock, Restricted Stock Units (RSU's) and employee stock purchase plans.

UNDERSTAND THE DIFFERENCES BETWEEN RESTRICTED STOCK, RESTRICTED STOCK UNITS, AND EMPLOYEE STOCK PURCHASE PLANS

Restricted stock and Restricted Stock Units (RSU's)	Employee stock purchase plans (ESPPs)

• Shares of company stock given to employees as a form of compensation to help reward and retain them.
• Restricted stock is a grant of stock that becomes available upon vesting. It includes voting rights and access to dividends.
• Restricted Stock Units are not technically shares of stock, but units that are transferrable to stock at vesting. They are an unfunded promise to issue. They can also be settled in cash.
• There is typically a vesting period before the employee has rights to the underlying stock with both restricted stock and RSU's. Both are taxed as ordinary income in the year they vest based on market value of the stock
• Capital gain taxes are due on stock then held and subsequently sold (based on holding period).
    • Future capital gain taxes are paid on the difference between the price the stock was sold for and the price of the stock when it was vested with the employee.
• With restricted stock (not RSU's), some situations allow the employee to file an 83(b) election with the IRS.
    • Employee pays ordinary income tax at the time of granting (done in hopes that the income tax will be lower at granting because of significant future appreciation).
    • Capital gains rule applies when stock is sold. This decision involves risk and should only be made with the guidance of a CPA or tax advisor. Specifically, the employee could pay taxes at granting, see the value of the shares decline, and face a tax bill for greatly reduced or potentially worthless holdings.
	• A company stock plan in which employees buy stock at a discount through payroll deductions up to 15% of salary.
	• The discount is typically 15% from the real market price.
	• Funds accumulate and are used for stock purchase at six-month intervals.
	• Plans may be pre-tax or after-tax.
	• With a qualified 423 plan, the employee is only taxed when shares are sold.
	• Shares held more than one year after purchase, and two years or more, from the initial offering can be sold at favorable long-term capital gain rates.
	• After-tax ESPPs are taxed similar to non-qualified stock options. Taxed as ordinary income at the time of purchase (stock price minus the price paid), with future gains taxes as either short- or long-term capital gains, depending on the holding period.

KNOW THE IMPACT OF EMPLOYEE STOCK ON DIVERSIFICATION

While income taxes are often front and center in your mind when discussing various employee stock compensation plans, it is vital that the importance of asset diversification is stressed. It is not unusual to see situations where 10–20% or more of an investor's investable assets—if not net worth—is tied to the value of their company stock. Should the company experience a significant downturn in terms of stock price, this can have a devastating impact on their financial situation.

LEARN HOW CLIENTS CAN UTILIZE COMPANY STOCK PROCEEDS

As far as diversification alternatives, company stock proceeds can be directed to a wide variety of vehicles, including, but not limited to: brokerage accounts, investment advisory accounts, annuities, life insurance, and 529 plans. Alternatively, proceeds can be used to pay down debt, donate to charity, fund a vacation home purchase, or to pursue other goals.

With more companies focusing on rewarding and retaining key employees, understanding employee stock options is essential for a comprehensive planning approach. You can seek education and advice on this key area of planning with your financial advisor since it can improve your ability to meet short- and long-term objectives.

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