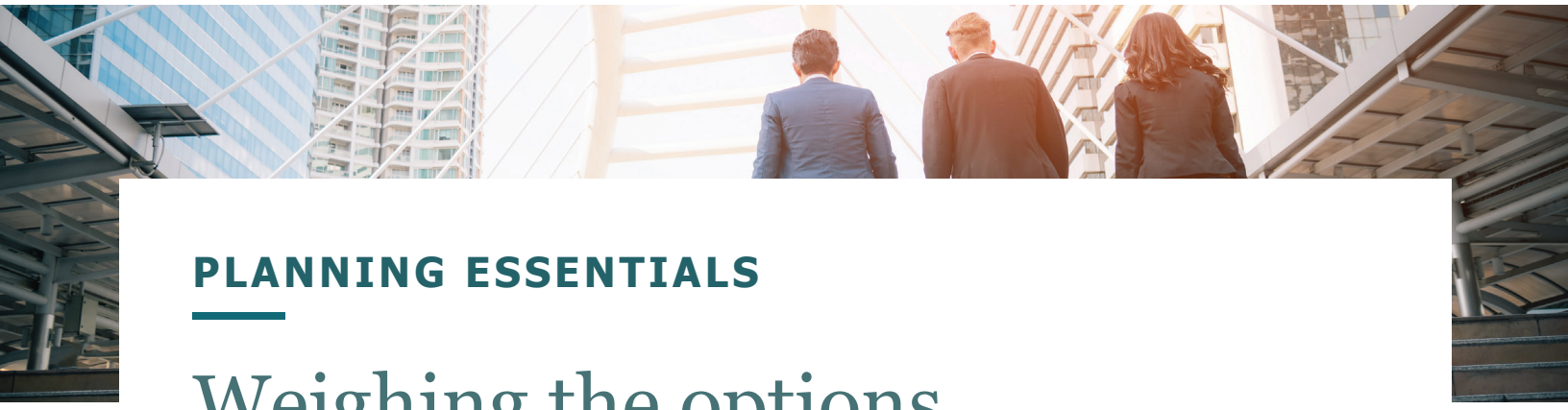


PLANNING ESSENTIALS

Weighing the options

An overview of employee stocks and stock options



An increasingly critical component of employee compensation and benefits involves company stock. This can take on several forms:

Stock options	**Restricted stock**	**Employee stock purchase**	**Individual stock ownership**

When taking a comprehensive planning approach, it is important to have an understanding of these different benefits and how they impact the rest of your financial situation. A lack of planning in this area can lead to adverse income tax and investment diversification consequences.

UNDERSTAND THE TYPES OF EMPLOYEE STOCK OPTIONS

There are two types of employee stock options: non-qualified (NQ) and incentive stock options (ISO). They each have their own unique characteristics.

NON-QUALIFIED STOCK OPTIONS	INCENTIVE STOCK OPTIONS

• More common than ISO.
• Shares are granted to an employee on a specific date.
• Shares have:
  • A specific price the stock can be purchased for, known as the stock exercise price.
  • A vesting schedule, which is the specific time period in which the employee can exercise the options.
  • An expiration date, which is when the option will expire if no action is taken—typically 10 years after granting.
• You would pay income taxes when NQ options are exercised. The difference between the exercise price and the stock price is taxed as ordinary income at exercise.
• Future growth subject to short-term capital gains on the difference between the exercise price and the price of the stock at exercise if you exercise your options and sell the stock within one year.
• Future growth is subject to long-term capital gains if the stock is held for one year or longer.
• If your wish to exercise your options but hold the stock, you will need to have a source of funds to pay for the exercise and any resulting taxes.
	• Less common than NQ stock options.
	• Shares are granted to an employee on a specific date.
	• Shares have:
	  • A stock exercise price.
	  • A vesting schedule.
	  • An expiration date.
	• Taxes are not due at time of exercise (although there are potential Alternative Minimum Tax consequences) unless the stock is sold.
	• Taxed as ordinary income based on the difference between the exercise and stock price if stock is sold in the first year of exercise.
	• Gains are treated as long-term capital gains if stock is held for at least one year after exercise and two years after grant date.

It is essential that your CPA or tax advisor be part of any stock option exercise strategies to confirm any tax consequences.	

AN EXAMPLE OF A NON-QUALIFIED STOCK OPTIONS

On January 1, 2016, you receive the option to buy 500 shares of XYZ company at $20 a share. On July 10, 2020, the stock is at $50.

SCENARIO 1:
You elect to exercise your NQ options via cashless exercise (buying and selling the stock simultaneously).

- You will receive $15,000 (500 x $30 stock price difference).
- This amount will be subject to ordinary income taxes.

SCENARIO 2:
You decide to exercise your options by purchasing the stock and holding it for two years.

- You will pay ordinary income taxes at time of exercise.
- You will pay long-term capital gains taxes on any stock appreciation after exercise.

UNDERSTAND THE IMPORTANCE OF ASSET DIVERSIFICATION

While income taxes are often front and center in your mind when discussing stock option exercise strategies, it is important to understand the importance of asset diversification. It is not unusual to see situations where 10–20% or more of an investor's investable assets—or even net worth—is tied to the value of their stock options.

Even before stock options are factored in, your overall financial well-being can be highly dependent on your company's performance. Your salary, bonus, health insurance, life insurance, disability insurance, and other benefits are all tied to the performance of the company to some degree. Should the company experience significant problems, the impact on the employee can be much more than just the loss of stock options. This is why it is essential for you to have conversations with your advisor about their options and the need for diversification.

LEARN HOW YOU CAN UTILIZE STOCK OPTION PROCEEDS

As far as diversification alternatives, stock option 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, fund a vacation home purchase, or 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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