Session #1: Equity Compensation and Stock Options - Introduction/Restricted Shares/RSUs/ESPPs

- Agenda
  - Session 1
    - Overview
    - Restricted Stock Awards (RSAs) and Restricted Stock Units (RSUs)
    - Employee Stock Purchase Plans (ESPPs)
  - Session 2
    - Nonqualified Stock Options (NQSOs)
    - Incentive Stock Options (ISOs)
  - Session 3
    - Exercise Strategies
    - Tax Reporting
    - Termination Events
  - Session 4
    - Private Company Issues
    - Other Equity Awards
    - Net Unrealized Appreciation (NUA)
- Types of Equity Awards
  - Stock Options—NQSOs and ISOs
  - Restricted Stock—RSAs and RSUs
  - ESPPs
  - Stock Appreciation Rights (SARs) and Phantom Stock
  - Profits Interests
- Discussion Topics
  - Features of Awards—terms and conditions for each type of award

  - Taxation—consequences at grant, exercise and sale
  - Strategies—timing for exercise of options
  - Termination and Job and Life Events—treatment of each type of award at each event
  - Other Considerations
- Documents—importance of gathering essential documents
  - Plan Document—general terms and conditions
  - Award agreement—specific terms of award
  - Client statements—summary of awards
  - Employment Agreement—usually for top executives
  - Tax returns—helps to gauge tax considerations
- Public vs Private Company
  - Liquidity—primary difference between public and private
  - Valuation—challenge with private companies
  - Types of Awards—trend from options to RSUs as company matures
  - Strategies—different focus with private vs public
  - Entity type—can impact type of awards

Restricted Shares and RSUs

- Key features
  - How are awards restricted—compare to restricted securities
  - Full value award—no exercise price
  - When are awards taxed—at vesting and sale
- Restricted Stock Awards (RSAs)
  - Stock issued at grant
  - Voting rights and dividends
  - No ability to deferral

    - Potential 83(b) election—accelerate taxation to grant
- Restricted Stock Units (RSUs)
    - Common in public companies—predominant type of award
    - When is stock issued—at release as opposed to grant
    - Vesting—service-based, performance, double trigger
    - Voting rights and dividends—dividend equivalents
    - No 83(b) election
    - Potential deferral—strict rules under 409A
    - Potential 83i deferral—rare benefit
- Taxation
    - At grant—83(b) election for RSAs but not RSUs
    - At vesting/release—full value as W-2 income
    - Withholding obligation--usually with shares—make sure sufficient
    - At sale--short or long-term capital gain or loss
    - Tax reporting—W-2/1099-B/cost basis issues
    - Private company double-trigger RSUs
- Performance Shares (PSUs)
    - Award recipients—tend to be executives
    - Performance determines payout—can be at different levels
    - Types of performance measures—flexible criteria
    - Taxation—similar to RSUs

ESPPs

- Key features
    - Qualified 423 vs Non-qualified
    - Post-tax salary reduction for offering period/purchase period
    - $25,000 limit—examples of how calculated

    - Discount up to 15%
    - Purchase price—lookback feature
    - Tax consequences upon sale—qualifying vs disqualifying disposition
    - Terminology
- Taxation
    - No taxation at purchase—data on Form 3922
    - Taxation upon sale—W-2 income/short or long-term capital gain/no withholding or FICA
    - Disqualifying disposition with examples
    - Qualifying disposition with examples
    - Non-qualified ESPP taxed like NQSO

Session #2: Equity Compensation and Stock Options - NQSOs and ISOs

<u>Restricted Stock/RSUs vs Stock Options</u>

- Determining value
    - RSUs—at vest
    - Options—stock FMV over exercise price
- Payment
    - RSUs—none
    - Options—pay exercise price
- Dividends/Voting rights
    - Upon grant only with restricted shares—not RSUs
    - Only after exercise option
- Ownership
    - Own restricted shares at grant—RSUs upon vest
    - Own options upon exercise

- Taxation
    - At vest for restricted shares/RSUs unless 83(b) election for restricted shares
    - At exercise for NQSOs and for ISOs—AMT at exercise, income taxation at sale

<u>Stock Option Features</u>

- Two types—NQSOs and ISOs
- Grant of right to purchase underlying stock
- Exercise right to buy number of shares at exercise price for set period
- Exercise upon vesting—may have early exercise in private companies
- Vesting features—right but not obligation to purchase shares
- Exercise methods—cash, cashless, sell-to-cover
- Own shares upon exercise
- Termination triggers post-termination rules

<u>NQSOs</u>

- Can be granted to employees, directors and consultants
- No favorable tax treatment
- Spread at exercise W-2 ordinary income
- Withholding for federal, state and FICA
- Capital gain/loss on sale-1099-B
- Examples of taxation

<u>ISOs</u>

- Only grant to employees
- $100,000 limit
- Preferential tax treatment
- AMT on spread at exercise
- Qualifying vs disqualifying disposition—examples
- No withholding/FICA taxes

Session #3: Equity Compensation and Stock Options - Grant/Exercise Considerations/Tax Reporting/Termination Events

Considerations at Grant and Exercise

- Public vs private company
- NQSOs vs ISOs
- Additional grants
- Insider trading and ownership guidelines—mainly applies to executives
- Exercise methods available
  - Cash
  - Cashless/sell to cover
  - Net exercise
  - Note/third party funding
  - Stock swap
- Personal factors
  - Liquidity
  - Investment risk
  - Intrinsic value
  - Time until expiration
  - Tax situation—ordinary income and withholding for NQSOs/AMT for ISOs
  - Concentrated position
- NQSO Exercise
  - Strategies
  - No tax advantage
  - Exercise and hold
  - Cashless/sell to cover
  - Stock swap--example

- ISO Exercise
  - Strategies
  - Tax advantaged
  - AMT considerations
  - Timing of exercise
  - Stock swap--example

<u>Tax Reporting</u>

- Forms for compensation
- Forms for sale
- Forms for exercise/purchase
- AMT reporting
- Tracking cost basis

<u>Termination Events</u>

- Life events
  - Death
  - Disability
  - Divorce
- Job events
  - Voluntary/involuntary termination
  - Termination for cause/good reason
  - Retirement
  - Mobility issues
- Post-termination exercise considerations
- Change of control
  - Treatment of awards
  - Taxation

    - Golden parachutes

- Public vs private companies

Session #4: Equity Compensation and Stock Options - Private Company Issues/Other Equity Awards/Concentrated Stock/NUA

Private Company Features

- Lack of liquidity
- Valuation issues—409A
- ISOs more common
- Early exercise/83(b) election—strategies for NQSOs and ISOs
- Double-trigger RSUs
- QSBS considerations
- Exercise alternatives--cash, loan, financing
- Liquidity programs--tender offer, private markets, share repurchase
- Non-corporate entities--profits interests

Other Equity Awards

- SARs
- Phantom Stock
- Profits Interests

NUA

- Company stock in employer plan—401(k), ESOP, profit sharing
- Strategy—low basis/highly appreciated stock
- Need triggering event/lump sum distribution
    - Attaining 59 ½
    - Separation from service
    - Death
    - Disability

- Taxation upon distribution and sale
    - Cost basis—potential 10% penalty if under 59 1/2
    - Appreciation within plan--LTCG
    - Appreciation after distribution—STCG/LTCG
    - Example
- Treatment of after-tax contributions
- Private company NUA issues

Checklists

- Restricted stock and RSUs
- Stock options
- ESPP
- Private company equity awards
- Termination of employment
- Common mistakes