



# Employee Stock Plans: RSU, ESPP, ISO, NQSO

Lawrence Pon

CPA/PFS, CFP, EA, USTCP, AEP

Pon & Associates

[www.larryponcpa.com](http://www.larryponcpa.com)

[linkedin.com/in/lawrencepon](https://www.linkedin.com/in/lawrencepon)

# Today's Presenter

- Lawrence Pon
- Lawrence Pon is a Certified Public Accountant, Personal Financial Specialist, Certified Financial Planner, Enrolled Agent, United States Tax Court Practitioner, and Accredited Estate Planner in Redwood Shores, CA
- Mr. Pon has been in practice since 1986 and speaks regularly to tax professionals on the latest tax planning and preparation topics throughout California and nationally.
- Mr. Pon received his BS in Business Administration from UC Berkeley and MS in Taxation from Golden Gate University in San Francisco

# What We are Covering

- Restricted Stock Units
- Employee Stock Purchase Plans
- Incentive Stock Options
- Non qualified Stock Options
- QSBS – 1202 stock

# Restricted Stock Units

- Form of compensation issued by employer to employee in the form of company shares
- Vesting plan
- Required performance milestones
- Based upon a particular length of time
- Combination of the above
- Taxed as compensation
- Supplemental income withholding
- Federal = 22%
- If over \$1 million = 37%
- Page 19-20 Circular E

# Restricted Stock Units

- Stock grants
  - Usually at hire
  - Performance reviews
  - No tax at the time of the grant

# Examples of Vesting

- Annually
- Quarterly
- Monthly
- Cliff
- Three years
- Five years

# Restricted Stock Units

- Tax planning
  - Will the supplemental withholding be enough?
  - Review Underpayment of Estimated Tax Penalty rules
    - Additional withholding on paycheck?
    - Adjust withholding % for vesting?
    - Make estimated payments?

- Underpayment of estimated tax safe harbor

## Restricted Stock Units

- Sell shares at vesting?
  - Hold for long term capital gains?
  - What about stock market risk?



# Performance Stock Units

- Given to managers & executives only if certain company-wide performance criteria are met
- Earnings per share
- Cashflow
- Stock price
- Not time based like RSUs
- Amount varies based upon these metrics
- Hard to plan ahead
- After the fact

# Employee Stock Purchase Plans

- Employees purchase company stock at a discounted price
- Payroll deductions
- Discount can be as high as 15%
- Offering period
  - Also known as grant date
- Purchase date

# Employee Stock Purchase Plans

- Maximum is \$25,000 per year
- Maximum is 10% of pre-tax salary
- Disqualifying disposition
  - Gain reported on W-2
  - Income Tax Consequences upon Qualifying Dispositions
  - Sale of more than two years from the date the options were granted and
  - One year after the options were exercised (purchase date)

# Employee Stock Purchase Plans

- Compensation income equal to lesser of:
- The FMV of the stock at the time the options is granted
- Over the option price
- Or the excess of the FMV stock at the time of sale over the price paid for the stock
- There is no federal withholding on this compensation

# ESPP Qualifying Dispositions

- The excess, if any, of the sales price of the stock over the employee's basis in the stock is a capital gain.
- Basis =
- Price paid for stock plus
- Amount included in income as compensation.

# ESPP Disqualifying Dispositions

- Sale within two years of grant or
- Less than one year of purchase
- Ordinary compensation income for the difference between the FMV of the stock at the exercise date
- Minus the amount the employee paid to purchase stock
- Ordinary income is included in Box 1 of W2.
- Difference between stock sales price and basis is capital gain
- Basis = amount paid for stock plus amount included in compensation

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☐ VOID☐ CORRECTED

CORPORATION'S name, street address, city or town, state or province, country, and ZIP or foreign postal code		1 Date option granted	OMB No. 1545-2129  <b>Form 3922</b>  (Rev. September 2016)	<b>Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under Section 423(c)</b>  <b>Copy A</b> <b>For Internal Revenue Service Center</b> <b>File with Form 1096.</b>  For Privacy Act and Paperwork Reduction Act Notice, see the <b>current version of the General Instructions for Certain Information Returns.</b>
		2 Date option exercised		
CORPORATION'S federal identification number	EMPLOYEE'S identification number	3 Fair market value per share on grant date	4 Fair market value per share on exercise date	
EMPLOYEE'S name		\$	\$	
		5 Exercise price paid per share	6 No. of shares transferred	
		\$		
Street address (including apt. no.)		7 Date legal title transferred		
City or town, state or province, country, and ZIP or foreign postal code		8 Exercise price per share determined as if the option was exercised on the date shown in box 1		
Account number (see instructions)		\$		

Form 3922 (Rev. 9-2016)

Cat. No. 41180P

www.irs.gov/form3922

Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**

Form 3922

## ESPP

- Grant date or offering date
  - 12 months or 18 months
- Exercise date of purchase date
  - Generally six month purchase periods
  - Stock purchase at 85% of the closing price on the lower of the first day of the offering period and the last day of each purchase period



# ESPP Tax Preparation

- Are you done when you just take the information from the 1099-B issued by the brokerage firm?
  - Look out for the disqualifying or qualifying dispositions.
  - Number one mistake by DIY

# Incentive Stock Options

- No tax consequence when options are granted
- No compensation income when ISO is exercised
- However AMT adjustment upon exercise
- Employee recognizes taxable income when the stock is sold.
- Character of income depends upon the holding period.

# Incentive Stock Options

- Requirements for ISO Plan
- Approved by shareholders
- Specifies number of shares of options stock to be issued
- Eligible employees
- 10 year rule
- FMV exercise price
- Nontransferable
- Only employee can exercise ISO during lifetime

# Incentive Stock Options

- \$100,000 per Employee Limit
- The FMV of any stock exercisable under an ISO during a calendar year cannot exceed \$100,000
- Limit is based on the value of the stock at the grant date.
- If \$100,000 threshold is exceeded,
- Stock options treated as nonqualified stock options • Warning – although stock labeled as ISO may not be ISO.
- Check with stock admin

# Incentive Stock Options

- Qualifying Disposition
  - Capital gain on sale of stock
    - At least two years of grant date or
    - At least one year of the exercise date
  - Gain would be a long-term capital gain.

# Incentive Stock Options

- Disqualifying disposition
- Same day sale
- AKA Cashless exercise
- Compensation income included in Box 1 of W2 • No federal or state withholding
- Tax planning!

# ISO Disqualifying Disposition

- Ordinary income
  - FMV of stock on exercise date – exercise price
  - Compensation to employee
- Capital Gain
  - Sale of stock – FMV of stock on exercise date.

# AMT and ISO

- Bargain element of exercised ISO is AMT income. • Keep track of AMT and Regular tax Cost Basis
- An issue post TCJA?
- Less so, but still considered
- AMT exemption
- MFJ = \$114,600
- Single = \$73,600
- Phase Outs - \$523,600 for Single & \$ 1,047,200 for MFJ
- Break even calculations



# AMT & ISO

- Minimize AMT on exercise of ISO
  - Run break-even analysis
    - Stagger exercises over number of years
    - Stagger sales over number of years

# Form 3921

☐ CORRECTED (if checked)

TRANSFEROR'S name, street address, city or town, state or province, country, and ZIP or foreign postal code		1 Date option granted	OMB No. 1545-2129 <b>Form 3921</b> (Rev. October 2017)	<b>Exercise of an Incentive Stock Option Under Section 422(b)</b>
		2 Date option exercised		
TRANSFEROR'S TIN	EMPLOYEE'S TIN	3 Exercise price per share	4 Fair market value per share on exercise date	<b>Copy B For Employee</b>  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 item is required to be reported and the IRS determines that it has not been reported.
EMPLOYEE'S name		\$	\$	
		5 No. of shares transferred		
Street address (including apt. no.)  City or town, state or province, country, and ZIP or foreign postal code		6 If other than TRANSFEROR, name, address, and TIN of corporation whose stock is being transferred		
				Account number (see instructions)

Form **3921** (Rev. October 2017)

(keep for your records)

[www.irs.gov/Form3921](http://www.irs.gov/Form3921)

Department of the Treasury - Internal Revenue Service

# ISO & 83(b) elections

- Early exercise of unvested options
- Best when very little gain
- Start capital gains clock
- Send 83(b) election document to IRS within 30 days after the issuing of the restricted shares

## Section 83(b) Election

- No income when employee receives restricted stock.
- Employee may elect to recognize compensation income at the date of the receipt.
- Income = the excess of the stock's value upon receipt over the amount, if any, the executive paid for the stock.

# Section 83(b) Election

- Income and employment taxes are withheld.
- Advantages of §83(b) election
  - Avoid recognizing income when the stock vests
    - No tax consequences when the stock vests
- Convert future appreciation to capital gain

# Section 83(b) Election

- Be treated as the owner of the stock
  - Possible dividends
  - Disadvantage of 83(b) election
  - Income recognized at time of election
  - No cash from transfer

# Section 83(b) Election

- If stock forfeited, no deduction to recover previously recognized income.
- When 83(b) election makes sense
  - Shares have nominal value at transfer date
  - Exercise price is equal to fair market value
    - No gain

# Section 83(b) Election

- Significant stock value appreciation is likely
  - Make an 83(b) election before IPO
- When 83(b) does not make sense
  - Recognize substantial income
  - Stock may not appreciate or lose value



## Section 83(b) Election

- Employee may not satisfy the conditions creating a substantial risk of failure.

# ISO Exercises

- Exchanging existing stock
- Use previously held stock to exercise options
- Check if plan allows for this
- No out of pocket cash to exercise options
- Carry over basis and holding period
- Shares received in exchange will have a zero basis
- Perfect shares to donate to charity

# Nonqualified Stock Options

- NQSOs are stock options that do not meet requirements of ISO
- Plan only offers NQSO
- Less favorable, but more flexible than ISOs
- No tax consequence at grant of NQSOs.
- No tax consequence when NQSOs vest
- Compensation when NQSO exercised
- Even if no sale

# Nonqualified Stock Options

- §83(b) election for NQSO?
- On top of cost to exercise stock, also need to pay for tax withholding
- Generally recommend same day sales
- Stock market risk
- Tax planning
- Using shares to exercise
- Possible, but never seen it allowed in any plans

# Review Stock Plan

- Eligibility
  - ISOs
  - NQSOs
- Administration
- Grant date
- Exercise Period
- Exercise Price

# Review Stock Plan

- Method of Exercise
  - Written stock option exercise agreement
  - Number of shares
    - Whole number of shares
- Termination
- Right of First Refusal
- Early Exercise

## Review Stock Plan

- Payment for Share Purchases
- Cash
- Cancellation of debt
- Past services rendered to the Company
- Surrendering Shares
- Promissory Note
- Loan Guarantees
- Same day sale
- Net exercise arrangement

# Review Stock Plan

- Withholding Taxes
  - Cash or stock withholding
- Stock ownership privileges
  - Voting & dividends
  - Financial statements
- Transferability of awards
  - Death



## Review of Stock Plan

- Corporate transactions
- Dissolution or liquidation
- Successor or acquiring company
- Parachute payments
- Acceleration of vesting
- Definitions
- Cause
- Good reason
- Termination or terminated

# §1202 Stock

- Qualified Small Business Stock
  - Exclude up to 100% of the realized gain on the sale of qualified small business stock if:
    - Stock issued after August 10, 1993, and
    - Held more than five years
  - Qualified small business • Domestic C-corporation if:

# §1202 Stock

- The aggregate gross assets of such corporation (or any predecessor thereof) at all times on or after 8/9/1993 and before issuance did not exceed \$50,000,000.
- The aggregate gross assets of such corporation immediately after the issuance do not exceed \$50,000,000, and
- Such corporation agrees to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section.

# §1202 Stock

- Stock acquired at its original issuance in exchange for money or other property or as compensation for services provided to such corporation
- As of the stock issuance, the corporation is a qualified small business, and
- The corporation meets the active business requirement during substantially all of the taxpayer's holding period.
- Gain excluded:

# §1202 Stock

- 100% = After September 27, 2010
- 75% = Between February 17, 2009 and September 28, 2010
- 50% = Before February 18, 2009 and after August 10, 1993
- Limitations on gain exclusions
- Eligible gain

# §1202 Stock

- Gain from any one issuer in any given tax year to the extent it does not exceed the greater of;
- \$10 million, reduced by the aggregate amount of eligible gain for prior taxable years for that stock, or
- Ten times the aggregate adjusted basis of the stock
- MFS = \$5 million
- \$10 million limitation is on the gain prior to taking into account any exclusion percentage, not the amount actually excluded from income

# Employee Stock Tax Planning

- Get a copy of the stock plan document
- Calculate the amount of vesting for the year
- Estimated tax planning
- Review financial goals
- Be a resource to your clients
  - Get lots of referrals

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