



# Equity Compensation Masterclass

SESSION 4:

Private Company Issues/Other Equity Awards

Concentrated Stock/NUA

**Presented by Aric Jacobson, J.D. LL.M.**

Proprietary & Confidential

FINANCIAL EXPERTS  
NETWORK

# PRIVATE COMPANY EQUITY AWARD FEATURES

- Lack of liquidity—no liquid market for private cos—doesn't impact tax liability
- Valuation issues with private cos—409A valuation
- Typically stock options vs RSUs—more likely to see ISOs
- Potential early exercise feature coupled with 83(b) election
- If have RSUs will be “double trigger”
- Restrictions on transfer of stock—co right of repurchase, right of first refusal, lockups
- Exercise method typically limited to cash—potential for third party financing, company loan
- Possibility of QSBS treatment if meet criteria

# EQUITY DURING PRIVATE COMPANY LIFECYCLE

Provision	Pre-IPO	Around IPO	Post-IPO	Mature Company
Vehicle Use	Stock options	Mix of stock options and RSUs	Heavier emphasis on RSUs and some PSUs for execs	Mostly RSUs and PSUs
Denomination	# shares/% of company	Mixed	Dollar value	Dollar value
Grant Timing	Large grant on hire	Transition to formal annual grant	Formal annual grant	Formal annual grant
Participation	High level	Dependent on company culture	Materially reduced	Limited
Differentiation	Limited	Moderate	Significant	Significant

# 409A VALUATION

- 409A regulates nonqual deferred comp and applies to discounted stock options
- Important to have options granted at current stock value to avoid 409A penalties
- Private company needs third party appraisal valuation
- Can use valuation for up to 12 months unless material development such as funding round or product milestone occurs
- Check with company before exercise to confirm current valuation accurate and when new one expected



# LIQUIDITY CONCERNS

- Lack of liquidity does not impact tax liability—usu need cash to cover ex price and taxes
- Restrictions on transfer—co has rt of first refusal, repurchase rts and lock-up post-IPO
- Trend of companies staying private longer
- Private cos may offer internal liquidity—buyback, add'l financing round, 3<sup>rd</sup> party purchase, secondary trading platform
- Tender offer—current/former ee participation, limits on amt sold.
- Cash from sale can be used to exercise/hold ISOs
- Tender offers above 409A valuation—if with third party and arms-length—all gain likely treated as cap gains, if with company/related party/significant investor—premium likely compensatory and ord inc

# FINANCING OPTION EXERCISE

- No cashless or sell to cover exercise available to pay for exercise cost and taxes for private cos
- Promissory note from company—if non-recourse not considered to be exercised for tax purposes until loan substantially repaid
- Third party financing may be available where stock pledged as collateral—e.g., Equity Bee, ESO Fund, SecFi—give up some of upside
- Loan forgiveness results in taxable income

# EARLY EXERCISE/83(B) ELECTION

- If co allows and file 83(b) election—w/in 30 days---to accelerate tax/AMT to exercise
- Income tax on difference between FMV and ex price for NQSOs/AMT for ISOs
- ISOs still need to satisfy 2 yrs from grant/1 yr holding period from exercise for LTCG treatment—NQSOs are LTCG after 1 yr from exercise
- Consider cash outlay—works best with low priced options
- Early exercise best when spread at or near zero—reduce or eliminate taxes and AMT and starts LTCG/QSBS holding period—question whether effective for starting QSBS clock at exercise for ISOs?
- Shares still subject to vesting--termination before vesting—co repurchases shares at lesser of FMV and exercise price
- Early exercise may result in violation of \$100k limitation—excess loses ISO status

# EARLY EXERCISE EXAMPLE

Timing	No 83(b)	File 83(b)
October Grant of 10,000 ISO shares, \$1 ex price, vest 50% each year	No tax	\$10,000 cost of exercise and \$0 tax liability—\$1 FMV-\$1 ex price=0
1 yr—FMV=\$10 and 5000 shares vest	No tax	No tax even though 5000 shares vest
2 yr—FMV=\$51 and remaining 5000 shares vest	Exercise all 10,000 shares--\$50 spread X 10,000 shares== \$500,000 potential AMT	No tax even though remaining 5000 shares vest
2.5 yr—FMV=\$101 at liquidity event--acquisition	Sale at acquisition—less than one yr from exercise—disq disp-- \$500k ord inc and \$500k STCG	\$1 million LTCG on sale—101-1=\$100 X 10,000 shares
Total tax	AMT liability at exercise, \$500k ord inc and \$500k STCG on disq disp	All gain above \$1 ex price LTCG=\$1 million

# NQSO EARLY EXERCISE

	No 83(b) election	83(b) election
Taxes on spread at exercise	Deferred until exercise after vesting	At early exercise
Income taxed at exercise	Ordinary income on spread at exercise after vesting	Ordinary income on spread at early exercise
Capital gains holding period	Starts at exercise after vesting	Starts at early exercise
QSBS treatment	Holding period starts at exercise after vesting	Holding period starts at early exercise

# ISO EARLY EXERCISE

	No 83(b) election	83(b) election
Income taxes on spread at exercise	Deferred until sold	Deferred until sold
AMT taxes	Deferred until exercise after vesting	At early exercise
Tax at exercise	AMT on spread at exercise after vesting	AMT on spread at early exercise
Capital gains holding period	Starts at exercise after vesting	2 years from grant/one year from early exercise
Disq disp	Exercise after vesting spread taxed as ord inc and change in value after vesting is short/long CG depending on holding period	Spread at vesting—not exercise—taxed as ord inc and change in value after vesting is short/long CG depending on holding period
QSBS	Holding period starts at exercise after vesting	Holding period likely starts at vesting?

# DOUBLE TRIGGER RSUS

- Two triggers for full vesting —service and liquidity event
- Taxation when both conditions satisfied
- Liquidity—acquisition or IPO
- Statutory withholding at 22% may not be sufficient
- Tax due when vesting occurs and may not have actual liquidity due to lock up after IPO
- Issues when meet service vesting but liquidity event delayed—expiration date if liquidity not attained

# QSBS

- Capital gains exclusion if meet QSBS requirements
- Company is active business incorporated as US C corp
- Company has gross assets of no more than \$75 million when equity issued—new limit as of 7/4/2025 up from previous \$50 million
- At least 80% of assets actively used in qualified trade or business—excludes most service type activities

# QSBS CONTINUED

- For shares issued after 7/4/2025, shares must be held for at least 3 years for 50% exclusion, 4 years for 75% exclusion and 5 years for 100%—previously held 5 years for 100% exclusion
- Exclusion up to greater of \$15 million (increased from \$10 million after 7/4/2025) or 10X cost basis—portion of gain may be subject to AMT and some states such as PA and CA not eligible for QSBS exclusion at state level
- For RSAs/RSUs—shares need to vest or for RSAs, effective 83(b) election to start holding period
- For NQSOs/ISOs—options need to be exercised—for NQSOs, early exercise with effective 83(b) will start holding period—not clear for early exercise ISOs—may need to wait for shares to vest

# SARS AND PHANTOM STOCK

- Stock Appreciation Rights (SARs)—right to receive appreciation from grant of number of company shares
- At exercise, receive current FMV over exercise price in cash or stock—no payment for exercise price
- Spread taxed same as NQSOs—ord inc w/withholding
- Phantom Stock—right to receive appreciated value of company stock
- Awarded as units equivalent to shares of stock
- Awards typically settle in cash at triggering or vesting point—usually includes full value of equivalent shares
- Value received taxable as ord inc w/withholding

# PROFITS INTERESTS

- Equity-like grant of interest in LLC—right to share in appreciation of underlying entity above liquidation threshold or hurdle rate—no rights to assets upon liquidation as with capital interests
- Vesting schedule may be time or performance-based or both
- IRS safe harbor—grant not taxable if receipt of prof int not related to certain and predictable stream of income, prof int not sold w/in 2 yrs of grant and prof int not ltd partnership interest in publicly traded partnership—no tax at vest if safe harbor met
- Best practice is to make protective 83(b) election to ensure tax treatment attaches at grant where 0 tax due—no value at grant and no consideration made
- Restrictions on transferability until liquidity event—sale or IPO
- Capital gains tax at liquidity event if meet 2 yr holding period

# SPACEX TENDER OFFER EXAMPLE 1 OF 2

- Private company tender offer in 2026 @\$421/potential IPO later in 2026 @\$800?
- Impact on RSUs/ISOs/NQSOs/ESPP shares
- Company offers tender offers twice a year—compensatory vs non-compensatory for any premium above 409A valuation
- RSUs not double trigger
- ISOs—partial disq disp taints entire grant

# SPACEX TENDER OFFER EXAMPLE 2 OF 2

- Large potential AMT on ISO exercise due to substantial price increase—some states—CA—also have AMT
- Ord inc from NQSO exercise/RSU vesting provide added cushion for more ISO exercises to minimize AMT
- ESPP shares likely at low basis
- Be aware of holding period of any shares tendered and minimizing taxes

# TENDER CONSIDERATIONS

- Need for cash
- Concentrated position—need for diversification
- Risk tolerance
- Likelihood of future liquidity event
- Future potential upside

# CONCENTRATED STOCK POSITIONS

- Too much wealth concentrated in one asset
- Can result from stock and equity awards from employer
- Adds risk and volatility to portfolio
- Need to manage taxes triggered by sale and attachment to stock—assess pros and cons of holding concentrated position
- Consider strategies to mitigate risks

# CONCENTRATED STOCK STRATEGIES

- Hedging
- Monetization
- Tax-efficient diversification
- Income enhancement
- Tax efficient giving

# HEDGING

- Using derivative securities and option strategies—can retain stock position and protect against downside risk
- Protective puts—buy put options to limit potential loss and preserve potential upside
- Collars—buy protective put and sell covered call—premium from selling call helps pay for cost of put
- Options have transaction costs and limited lifespan
- Companies may have restrictions on sale of stock or use of option strategies by insiders

# MONETIZATION

- Generating cash from stock position
- Outright sale—may generate significant capital gains tax
- 10b5-1 plan—acts as affirmative defense to insider trading by having systematic trading plan—has strict SEC guidelines
- Variable prepaid forward—agreement to sell variable number of shares at specified future date in exchange for upfront payment—provide protection against downside but may limit upside

# TAX EFFICIENT DIVERSIFICATION

- Equity exchange funds—swap concentrated position into diversified fund with no immediate taxation—strict net worth requirements and limited liquidity
- Managed account solutions—use portfolio manager to manage tax strategy tailored to individual objectives
- Securities based lending—use stock position to access line of credit—risk if stock position declines in value
- Borrowing on margin—borrow from broker specifically to purchase other securities using stock position as collateral
- NUA—see later discussion for diversifying company stock held in qualified plan

# INCOME ENHANCEMENT

- Create or increase cash flow from concentrated position
- Covered calls—income generated by option premium received—limits upside and provides no downside protection
- Managed account solutions—using portfolio manager to manage covered call strategy to generate additional income

# TAX EFFICIENT GIFTING

- Achieve charitable goal while reducing tax obligation
- Charitable remainder trusts (CRT)—donate stock position to CRT and generate lifetime income stream with remaining assets going to charity—avoids cap gains on sale of stock by CRT
- Pooled income funds and charitable gift annuities—less expensive alternatives to CRTs
- Gifting to family members—Using annual exclusion and lifetime exemption, can shift some or all of stock position to family members while reducing size of own estate

# CONCENTRATED STOCK STRATEGIES

Hedging	Monetization	Tax Efficient Diversification	Income Enhancement	Tax Efficient Gifting
Protective puts	Outright sale	Equity exchange funds	Covered calls	CRT
Collars	Trading plan	Managed account solutions	Managed account solutions	Pooled Income Fund
Options considerations	Variable forward contract	Securities based lending		Charitable Gift Annuity
		Margin borrowing		Gifting to family members
		NUA strategy		

# NET UNREALIZED APPRECIATION (NUA)

- Convert unrealized gains on company stock held in qualified employer plan into LTCGs—typically from 401(k) and ESOP
- Need to follow technical IRS rules to qualify
- Employer plan must allow for NUA
- Special tax treatment on distribution and sale

# NUA REQUIREMENTS

- Distribution of company stock in kind—transfer of actual shares not proceeds—stock moved into nonqualified taxable account—not all or nothing
- Lump sum distribution—entire account balance—not just company stock--must be distributed in single tax year—other assets move into rollover IRA
- Need triggering event
  1. Death
  2. Disability
  3. Separation from service
  4. Attaining age 59 1/2

# TAX TREATMENT

- Cost basis immediately taxable at distribution as ordinary income—if have after-tax contributions, may be used to offset ord inc--10% early withdrawal penalty may apply if under 59 1/2
- Unrealized gain above cost basis always LTCG but not realized until shares sold—not subject to NIIT tax
- Gains after date of distribution taxed as short or long term cap gains depending on holding period since distribution date
- If stock drops after date of distribution—reduces amount of LTCG reported on sale
- Unrealized gain portion not eligible for step up at death although additional gain portion is

# NUA STRATEGIES

- Makes more sense with highly appreciated stock and low basis
- Balance preferential cap gain treatment with continued tax deferral if roll into IRA
- Sale of stock post-distribution flexible—can act as income replacement in future years
- If under 59 ½ 10% penalty may apply to cost basis but not NUA piece
- Most private companies don't allow for NUA treatment—if do allow must sell stock immediately on distribution

# NUA EXAMPLE

- Employee age 61 with 401(k) balance of \$1.5 million, company stock value is \$1 million and cost basis is \$100,000.
- Separates from service—triggering event--and does lump sum distribution following year when stock price \$100/share
- Moves entire stock position into nonqual brokerage acct and remaining funds rolled into IRA
- Taxation of NUA stock--\$100,000 basis taxed at distribution as ord inc
- Assuming stock held for 6 mths post-distribution and stock sold for \$120/share—NUA piece of \$900,000 LTCG and additional \$200,000 gain STCG—if sold more than one year later—additional \$200,000 gain LTCG
- If stock sold for \$800,000 post-distrib—NUA gain would be limited to \$700,000

THANK YOU

Questions?

Aric Jacobson

[aric.jacobson@grantdequity.com](mailto:aric.jacobson@grantdequity.com)