

Advanced Planning Strategies for Equity Compensation

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Today's agenda

- Identify three common types of equity compensation
- Review the basics of restricted stock units (RSUs)
- Discuss some advanced planning strategies for RSUs

The need for financial and tax planning advice around equity compensation has never been greater.



92% of companies surveyed granted time-based restricted stock units or awards, at all levels

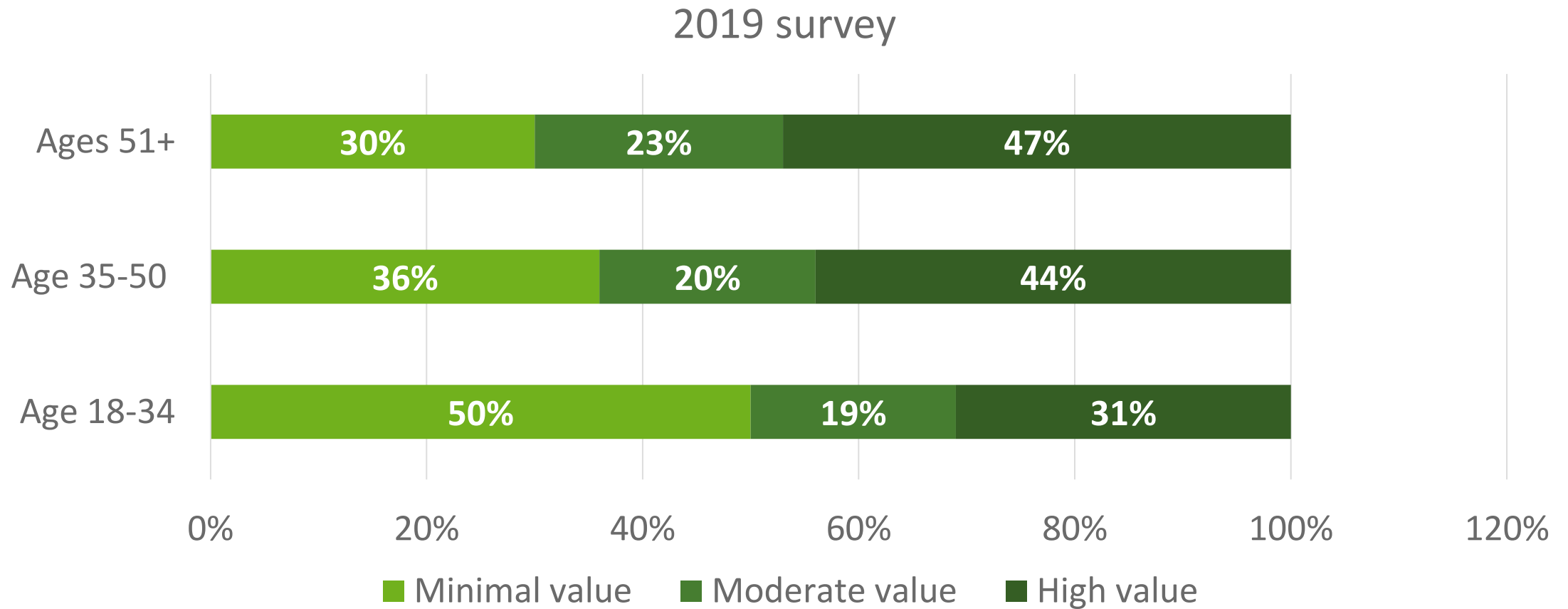


85% granted performance awards, more common at the executive level



54% granted time-based stock options, more common for middle-management and exempt employees

Many employees don't understand the value of equity compensation



Education and advice improve satisfaction

46% of employees received education on their equity compensation

41% on received advice on their equity compensation.

80% who received personalized advice felt good about their financial situation

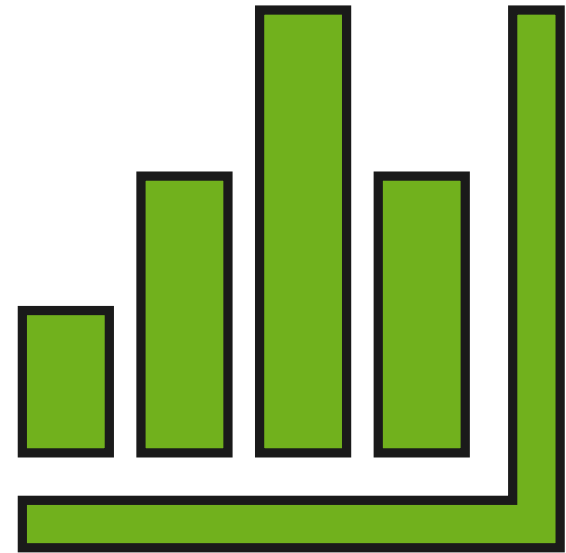
58% who did not receive such advice felt good about their financial situation

“These figures suggest that companies should put greater effort towards efforts and resources aimed at helping employees understand the organization’s equity compensation programs, including their individual awards.”

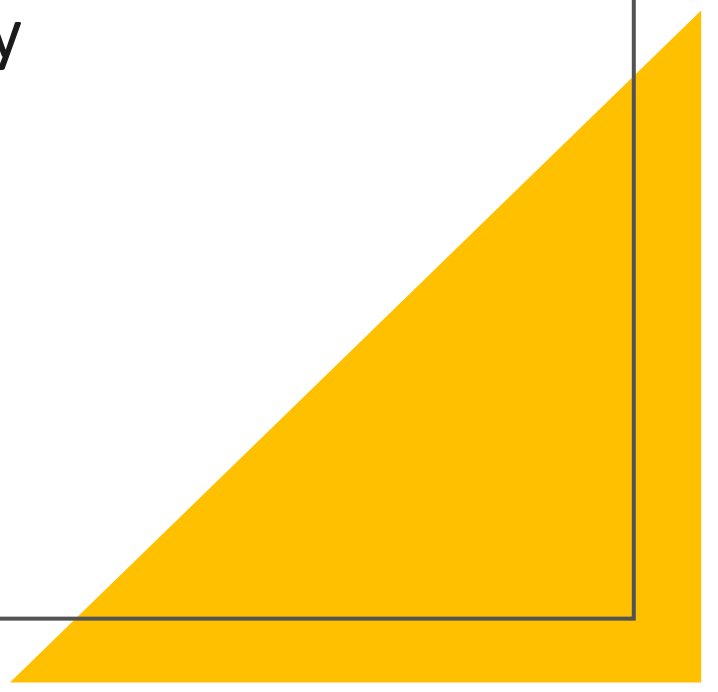
-- *National Association of Stock Plan Professionals, July 2020*

Types of equity compensation

- Restricted stock units or awards (RSUs)
- Non-qualified stock options (NQSOs)
- Incentive stock options (ISOs)



What is an RSU?

- A type of compensation
 - A contractual right to receive shares of company stock in the future (or a cash payment of equivalent value)
 - A promise of future value
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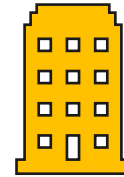
RSU Overview



1. **Company grants RSUs** as part of a compensation package



2. **Restricted period begins.** Employee does not control shares: no taxes, dividends, or voting rights



3. **RSUs vest.** Employee owns shares. (Owes taxes, receives dividends, has voting rights)



4. **Taxed as ordinary income,** subject to both Social Security and Medicare tax.

RSU tax planning

Hypothetical example:

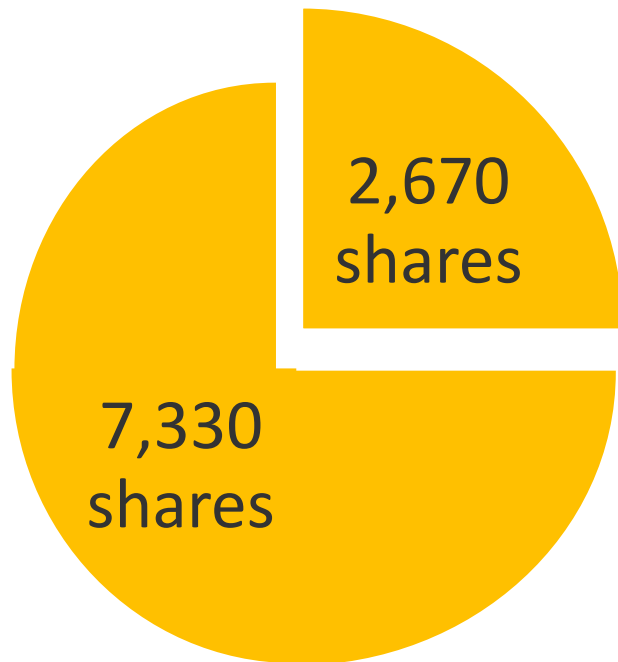
- 10,000 vested RSUs
 - \$25/share FMV
 - \$250,000 value

This is a hypothetical example and is for illustrative purposes only. No specific investments were used in this example. Actual results will vary. Past performance does not guarantee future results.

Withholding	Rate	Amount
Federal tax	22%	\$55,000.00
Medicare tax	1.45%	\$3,625.00
Social Security tax*	6.20%	\$8,853.60
Total Tax withheld:		\$67,478.60
*In 2021, the Social Security limit is \$142,800		

How will the taxes be paid?

Shares withheld for taxes



Taxes paid out-of-pocket



RSU cash flow planning

Taxes withheld: \$67,478.60

Taxes owed:

- 32% rate / \$80,000 = \$12,521.40 shortfall
- 35% rate / \$87,500 = \$20,021.40 shortfall
- 37% rate / \$92,500 = \$25,021.40 shortfall

Rate	Single	Married filing jointly
32%	\$164,926 to \$209,425	\$329,851 to \$418,850
35%	\$209,426 to \$523,600	\$418,851 to \$628,300
37%	\$523,601 or more	\$628,301 or more



Double-trigger RSUs

Private companies' RSUs may not be liquid when vested. Double triggers offer protection.

1. Time-based vesting schedule
2. Company liquidity event

Stock options

When clients receive options, they have a right (not an obligation) to:

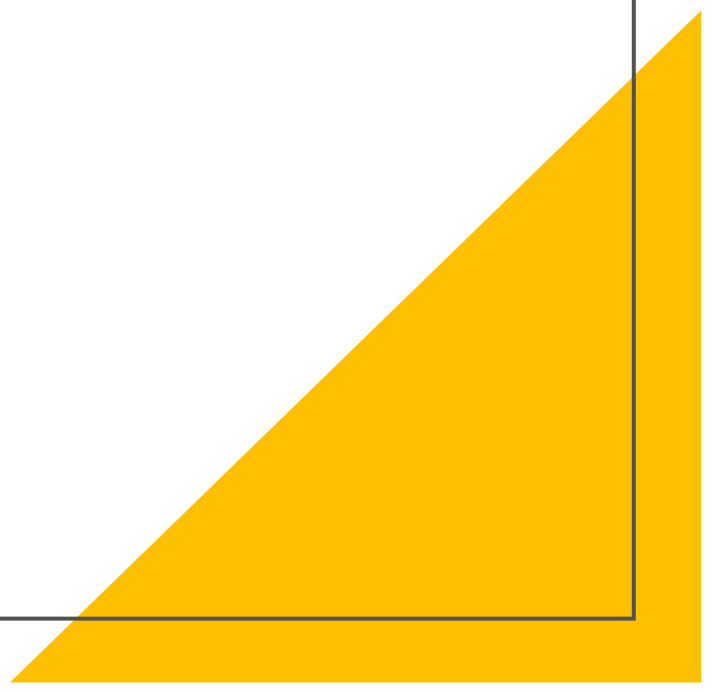
1. Buy shares of stock at the strike price of the option
2. Have a reportable tax event
3. Can keep or sell the stock



Terms to Know

- **Grant date:** The date a person is given the option to buy stock
- **Exercise price:** The price at which they can exercise the option and buy stock
- **Expiration date:** The latest date on which they can exercise the option and buy stock. If they don't exercise the options by that date, the options "expire"
- **Vesting Schedule:** This schedule details when a person obtains the right to sell shares and how quickly they can do so. In most cases, a person cannot exercise their right to buy shares until the shares are vested.
- **Bargain element:** Also known as the "compensation element", this is the profit a person makes on the exercise of stock options. It is the difference between the option's exercise price and the current market price of the stock when stock options are exercised.

What is an NQSO?

- A type of compensation
 - A contractual right to purchase shares of company stock in the future
 - May be offered to employees and non-employees
- 
- A large yellow right-angled triangle is positioned in the bottom right corner of the slide, with its hypotenuse running from the bottom left towards the top right.

NQSO Overview



1. **Company grants NSQOs** as part of compensation package



2. **Grant date.** Employee receives NSQOs and vesting schedule. Strike price is established.



3. **NSQOs vest.** Shares have value if fair market value is above exercise price.

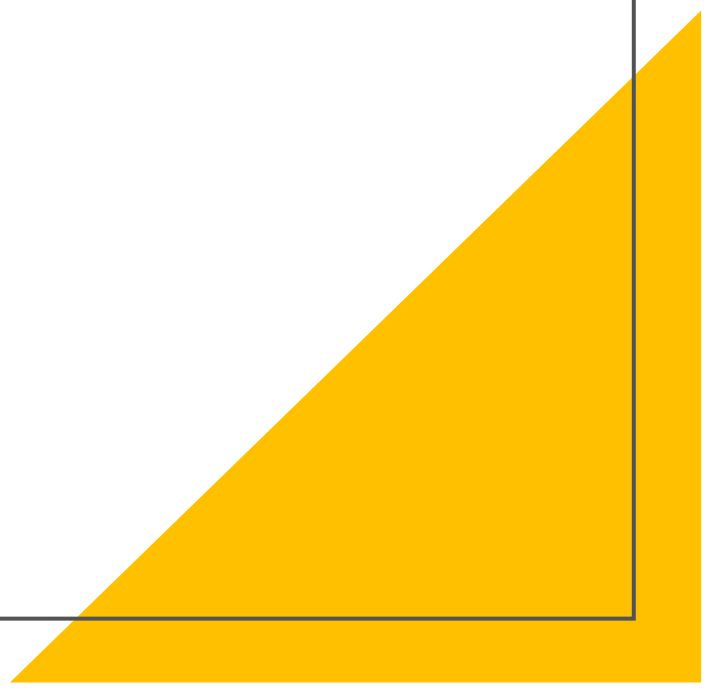


4. **Exercise or don't.** If do, cash exercise, cashless exercise, sell to cover, same day sale, or share withholding.



5. **Taxed as ordinary income,** subject to both Social Security and Medicare tax.

What is an ISO?

- A type of compensation
 - A contractual right to purchase shares of company stock in the future
 - May only be offered to employees
 - May qualify for preferential tax treatment
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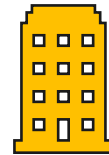
ISO Overview



1. Company grants ISOs. Part of compensation package



2. Grant date. Employee receives ISOs and vesting schedule. Exercise price is established.



3. ISOs vest. Shares have value if fair market value is above exercise price.



4. Exercise or don't. If do, cash exercise, cashless exercise, sell to cover, same day sale, or share withholding.



5. Preferential tax treatment. May qualify for long-term capital gains tax rate.

ISO taxation

Qualifying distributions

- Final sale within two years of option grant date
- Final sale at least one year after the exercise date
- Taxed at long-term capital gains rate
- Bargain element subject to AMT

Non-qualifying distributions

- Final sale doesn't meet qualifying distribution standards
- Taxed as ordinary income
- Bargain element subject to AMT

Advanced Planning Techniques for Vesting RSUs

Strategy 1:

Coordinate ISO strategy with RSU vesting years

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- Married Filing Jointly
- Base income: \$250,000
- 1,500 RSUs vesting, \$140/share
- 1,000 ISOs, strike price of \$5/share

	Tax owed on base salary	Tax owed on base salary + 1,500 RSUs
Income tax	\$42,000	\$101,000
Tentative minimum tax	\$35,000	\$92,000
Delta	\$7,000	\$9,000

This is a hypothetical example and is for illustrative purposes only. No specific investments were used in this example. Actual results will vary. Past performance does not guarantee future results.

How many ISOs can be exercised?

(AMT tax rate: 28%)

WITHOUT RSUs

$$\begin{aligned}\text{Bargain element} &= \text{Delta} / \text{Tax rate} \\ &= \$7,000 / 0.28 \\ &= \$25,000 \text{ (rounded)}\end{aligned}$$

$$\begin{aligned}\text{ISOs exercised and held} &= \text{Target bargain} \\ &\quad \text{element} / (\text{FMV stock} - \text{strike price}) \\ &= \$25,000 / (140 - 5) \\ &= 185\end{aligned}$$

WITH RSUs

$$\begin{aligned}\text{Bargain element} &= \text{Delta} / \text{Tax rate} \\ &= \$9,000 / 0.28 \\ &= \$32,000 \text{ (rounded)}\end{aligned}$$

$$\begin{aligned}\text{ISOs exercised and held} &= \text{Target bargain} \\ &\quad \text{element} / (\text{FMV stock} - \text{strike price}) \\ &= \$32,000 / (140 - 5) \\ &= 237\end{aligned}$$

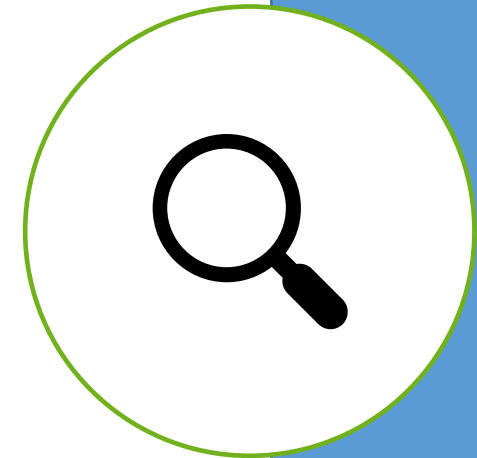
ISO exercise in a high-income year

	Base salary	Base salary + 1,500 vested RSUs	Base salary + 6,000 vested RSUs
Base salary	\$250,000	\$460,000	\$1,090,000
Income tax	\$42,000	\$101,000	\$330,000
Tentative min tax	\$35,000	\$92,000	\$272,000
Delta	\$7,000	\$9,000	\$58,000
28% AMT	\$25,000	\$32,142	\$207,142
ISOs exercised and held	185	237	1,534

Strategy 2: Review the client's NQSO option strategy

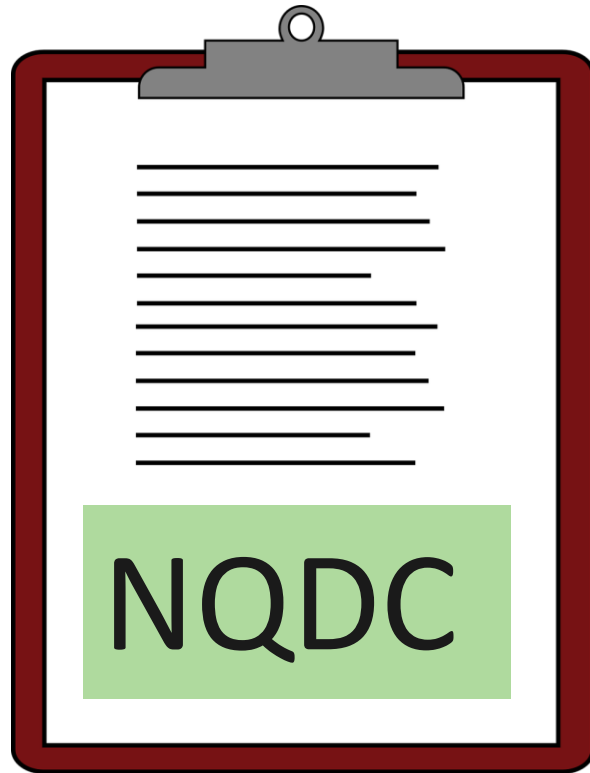
How will the annual income change from this year to next year?

- RSUs vesting
- Promotion
- Bonus



Exercising NQSOs: \$100,000





Strategy 3:

Consider a non-qualified deferred compensation plan

Creates an opportunity to:

- Defer income into the future
- Avoid income taxes until later
- Participate in tax-deferred investment growth, if any

Strategy 4: Make charitable contributions in years when RSUs vest

Charitably-minded clients can:

- Receive all usual benefits of giving
- Increase tax benefits by focusing donations in high-income years
- Consider donor advised funds



Combining giving and RSU vesting can increase tax benefits

Option 1	Year 1 RSUs vest	Year 2	Year 3	Year 4	Year 5	Total
Donation	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$50,000
Tax savings (24%/32% tax bracket)	\$3,200	\$2,400	\$2,400	\$2,400	\$2,400	\$12,800
Option 2						
Donation	\$50,000	0	0	0	0	\$50,000
Tax savings (32% bracket)	\$18,000	0	0	0	0	\$18,000

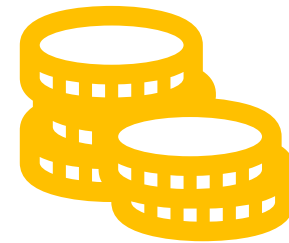
Will the client gift stock or cash?



Low-cost-basis shares

No capital gains tax

Deduct full value of shares



Cash donation

Possible capital gains tax

Strategy 5: Contribute the maximum to 401(k)s and HSAs

During high income years, clients should contribute the maximum amount to:

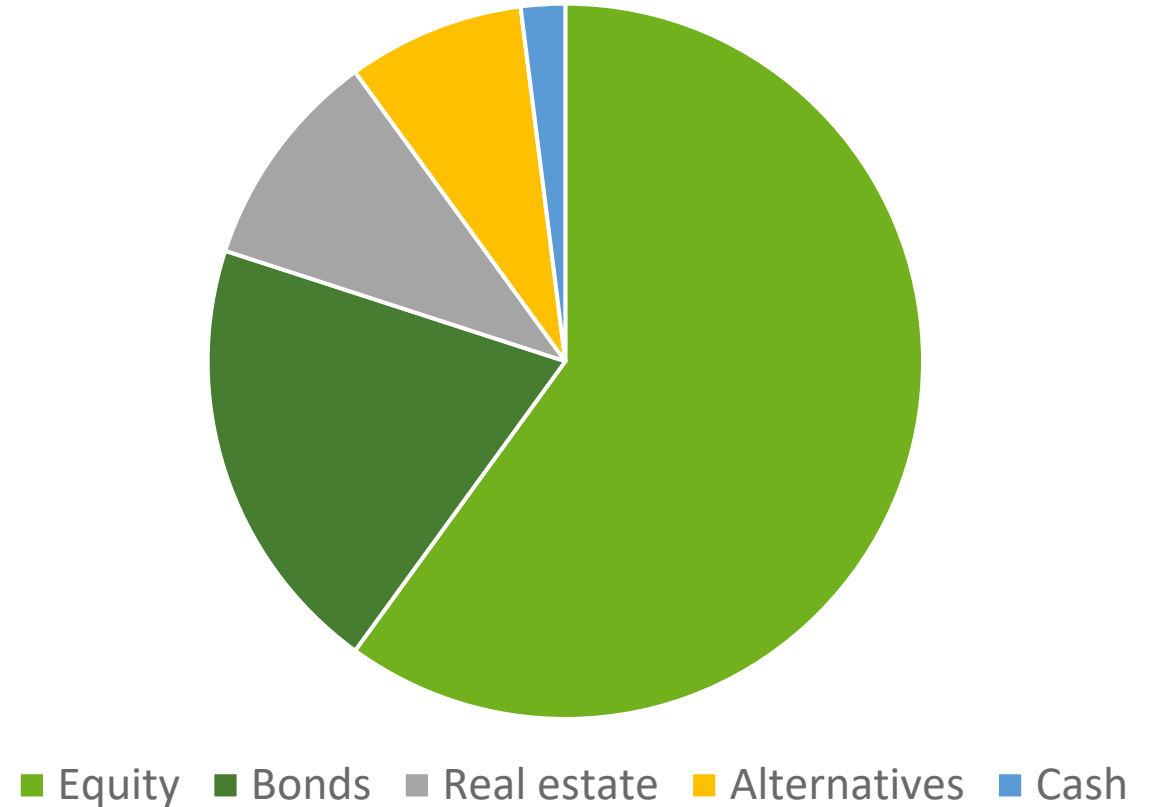
- 401(k) plans: 2021 max: \$19,500 with \$6,500 in catch-up contributions
- After-tax contributions, if plan allows
- Health savings accounts: 2021 max: \$3,600 for an individual, \$7,200 for a family)
- Employee stock purchase plans



Strategy 6: Manage concentration risk

The client's tax situation will be influenced by share management decisions. Will the client:

- Retain the shares
- Sell shares to limit tax consequences
- Sell some or all shares to fund other goals and objectives
- Sell some or all shares to reduce concentration risk



Plan for tax consequences when shares are sold.

Short-term capital gain

- Taxed as ordinary income

Short-term capital loss

- Deducted to offset ordinary or earned income

Long-term capital gain

- Taxed at the long-term capital gains tax rate

Long-term capital loss

- Can offset current and/or future long-term gains



Any
questions?



Disclosures

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