

EMPLOYEE STOCK OPTIONS

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Know Your Options



GATHER THE PAPERWORK

ISO or NSO determines when income is taxed and at what rate.



KNOW THE TYPE

The grant agreement, W-2 codes and Form 1099-B tell the full story.



PLAN BEFORE EXERCISE

Cost, taxes, liquidity and concentration all drive the decision.

Important Disclaimer

This presentation is for general educational purposes and is based on the referenced articles.

It is not individualized investment, tax, legal, accounting, or financial advice. As a Volunteer for SCORE, I cannot give Tax Advice. Use of this Presentation does not constitute a relationship or contract. It is the Property of the Score Tax Forum. Clients should consult qualified tax and legal professionals before making decisions involving exercise, sale, or transfer of equity compensation.

Stock-option plans differ materially by company and grant agreement. The plan documents control.

Tax treatment can depend on option type, holding period, exercise timing, jurisdiction, and individual circumstances.

This Presentation is not meant to serve as any tax or accounting opinion or tax return position. The information in this presentation is not meant to engage in rendering legal, tax, accounting or other professional services and we will not be held liable for any actions or suits based on this presentation.

The most important recommendation I can make during this presentation is to find a competent tax professional, a CPA or EA (Enrolled Agent). Interview Them. Make certain you are comfortable with them and that they have Your Best Interest in Mind. The Wrong Guy will cause You Much Harm.

Every Tax Season, the Same Reaction



I don't know about You, but every time I Saw Something Related to Employee Stock Options, I gasped and said, Here We Go Again. Oh No, Not These.

The Questions Start All Over Again

We Begin to Ask All Those Questions All Over Again!

- **What Type are They? Are They Incentive Stock Options (ISOs) or Non Qualified Stock Options or is This an RSU?**
- **Is there a W2 to see if there is any Reference to a Code or the like and I search for the Transaction Paperwork?**
- **Is there a 1099B from the Employer Brokerage Firm that Handles These Transactions? Because We Don't Know if They Cashed In All the Shares to Pay the Taxes or Held on to Some of the Shares.**
- **How much Should I reflect on Schedule D, as I don't want my client to get one of those Ugly Letters in the mail from the IRS.**

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What Clients Say When You Ask

How Many of You Run into this. And When You Ask Your Client for This Information,

- They Have this Look Horrified Look of Hopelessness
- Don't Know Where to Get This Information.
- Don't Know That it Exists
- They've got this Dazed Look Upon Their Face
- They Say, Well it's Your Job to Know How to Find it
- They Do Not Know Where to Turn



Unless Your Client Is an Engineer



Unless of Course, They are an Engineer. Then They Have So Much Information, But They Don't Want to Give it to You. (Have You Ever Experienced this with an Engineer?)

How Can You Identify an Engineer? They Hold onto the File Until the Last Second and Hand It Over at the Last Second With Reluctance and Regret

We had spent over 20 minutes discussing what He Had for paperwork. He Had His Hands Around the File and Wouldn't Let Go. **I finally had to literally Ply it from Him.** I will Never Forget the Lost Look on His Face.)

Trained to Dot the i's and Cross the t's

I Don't Know About You, But for Me Having Been an Arthur Andersen Auditor in Hartford, CT in **my Early Days, (Which are Way Behind Me – Ha Ha)** I was Taught to Dot my i's and cross my t's. Nothing moved on the Audit Side in Hartford, CT.

I was Taught to Do it Right! As a Result, in Running my Own Tax Practice, I usually went beyond what was Required, and Didn't Want my Client to get a Letter in the Mail with regards to 1099B, Proceeds not Reported.

So How Many of You Run into this.

***(Arthur Andersen: Zealous Supporter of High Standards –Stickler for Honesty)
Andersen & Delany 1913, 1918 Arthur Andersen Irony of the Times, Andersen Consulting Accenture***



Arthur E. Andersen

Why We are Discussing this Today

Simple Area, Yet So Little Education in this Area.

The Real Reason I am Here Today, is:

- **Refresh All of You in This Area**
- **Help Those who struggle Like Me in this Area.**
- **Since I had Such a Difficult Time, I thought I would Lay it Out and Explain Some Things**
- **Many Have Learned it Through Experience**
- **Thought this would be a Good Topic for New Professionals and Experienced Professionals**

**Lets Discuss Employee Stock Option Plans and
Employee Stock Purchase Plans Why Do
Employers Issue These Plans and Why Do Employees Come to Like Them,**

Who Actually Educates the Employee?

- Like the World of Investment Planning and Advisory Services, I Know, because as a CPA, I never wanted to Become a Financial Advisor. My Clients Asked Me to Do So.
- I Apologize to those Advisors, Who Do Right by Their Clients and are True Fiduciaries, but when I met the Speaker at a Conference at St Anslem's, He Asked me Why I Would NOT Wish to Become a Financial Advisor.
- I Said, **“They’re all Sharks, all They Want to Do Is Fill Their Pockets with Commission.”** His Comment – **“So You are Going to Be One of Those,”**
- I Angrily Responded, “I would Not” **“Well The More Reason for You To Be in the Business”,** He Replied, and **I felt Like He Had Just Poured a Bucket of Cold Water On ME.** One of Those **“AH-HAH” Moments in Life that Changes You Forever.**
- Through HD Vest and Subsequently Cambridge Research out of Iowa, I Did So.

A Little About Me

- Quit College After 2 years towards an Elementary Teaching Degree
- Enlisted in the Air Force as a Weather Observer. I Had No Idea What I wanted to do with my life. Fortunate, as I spent 4 years at Griffiss AFB, Rome NY, During the Vietnam War.
- Back to college and got my Accounting Degree at Western New England College; My Graduate MBA Degree at the University of Hartford.
- Arthur Andersen & Co/Price Waterhouse Coopers/many hats in industries.
- At 45, My Employer downsized. My wife Asked me what I wanted to do. I said “When I Retire, Open up my own Tax Practice” Started **Schoenrock & Company, CPA, LLC** and **Schoenrock Financial & Associates, LLC** (Investment Advisory/Planning Firm). With the Grace of God, I Sold the Firms that We Built 26 years later. Life Has Been Extremely Good to Me and Now we Live in Portsmouth, NH and Kayak on the Piscataqua.

Frank A (Skip) Schoenrock, CPA, MBA

- Weather Observer, USAF – Griffiss AFB, NY
- Grew up in Western Massachusetts – Southwick
- Western New England College/University of Htfd - MBA
- Arthur Andersen & Co/Price Waterhouse Coopers
- Corporate Auditor, Controller, VP Finance, Aetna Life & Casualty, First Hartford Realty Corp, Connecticut National Life, Orion Corp. David Chase Enterprises
- Schoenrock & Company CPA, LLC, Granby, CT
- Schoenrock Financial & Associates, LLC, Granby, CT
- Sanders & Karcher, CPA, Portsmouth, NH
- Certified Mentor NHBusinessMentors
- Knights of Columbus- Assistant Grand Portsmouth, NH



Why This Topic Is Personal

- So Many Employees know Very Little of the Complexities and Risks relating to
 - Employee Stock Options
 - Employee Stock Purchase Plans
 - RSU's
 - And This is Part of My Story
- My Wife and I have Celebrated 46 years of Marriage We Have 1 Daughter.
- My Wife Worked for the Hartford Insurance Company and
 - We were able to Use RSU's related to Compensation to Pay for our Daughters Undergraduate Degree at Western New England University and Masters Degree at those Great Basketball Programs at UCONN.

Who Actually Educates the Employee?

- Employers Give these to their Employees. Oftentimes just an email from HR and some paperwork is handed to them when they are hired.
- Employers Need to Educate Employees On Their Use and Understanding of their Complexities and Risks.
- Employees Need to take the initiative to Reach Out To Personnel That Can Help Them Better Understand These Plans and How to Derive the Benefits from Them.
- Investment Advisors/Financial Planners also have a Responsibility to Do Right Here. They need to educate their clients as well and make this part of their Process. When They put together the Financial Plan they need to do the right thing with these options on a ongoing basis, and not just get commission/fees for their own products

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Recent News - Employee Stock Option Plans

- July 2026 AICPA TAX Advisor – Stock based compensation is one of the most significant and misunderstood components of Compensation Packages
- Employees range from early Career Professionals to Senior Executives, many who have accumulated substantial wealth on paper, but remain uncertain about....
 - How, When or Even Whether to Act on the Exercise of these items
 - For some, it is the complexity of the compensation itself and how little intentional Planning surrounds it.

Employee Stock Option Plans

- HR Quarterly September 2025 article referenced in the Gale Business Entrepreneurship, noted that Employers are paying attention: “How to Empower Employees and Reduce Stress with Innovative Financial Tools”.
- More than 80% of HR Leaders are concerned that worker’s financial worries are impacting workplace activity per a Morgan Stanley Survey
- More than 80% are also worried that employees will be looking for a different job if the company can’t offer benefits that address and help solve these problems.
- More than 90% of Executives and 85% of Employees said their companies need to boost their efforts to educate employees on understanding and maximizing the benefits.

Global Concerns/Demand for Talent - Employee Stock Option Plans

- Global HR Concerns/Growing Global Demand for Talent Driving the Need for Compensation to be met to obtain/retain top talent. Economist April 2026
- Europe getting over its reluctance to let Techies make lots of Money. “New Geography of Innovation,” published last year, Mehran Gul of the World Economic Forum notes that Skype, a European Startup, created just 11 millionaires in the early 2000s. Pay Pal, gave more money to their employees and created 100 millionaires. They in turn invested in Silicon Valley Startups.
- European Tech Firms giving more options. Established Tech Tycoons are helping Youngsters make fortunes. Nikolay Storonsky, founder of Revolut, backed the French Startup Spiko and Biorce, a Spanish Medical Tech Firm.
- Recent layoffs are driving American Talent to Europe and with it the European Need for Such Programs like these to get and retain top talent

Non Qualified Stock Options (Cont'd)

Recruiting: equity can supplement cash compensation and help compete for talent.

Retention: vesting can encourage employees to remain with the company over multiple years.

Alignment: employees participate in the potential upside created by company growth.

Motivation: ownership can connect day-to-day decisions with long-term company value.

But plan design matters: communication, administration, tax education and clear terms are critical to employee understanding.

Key message

Equity works best when employees understand what they own, when it vests, what it may be worth, and what decisions are theirs to make.

What is an employee stock option?

An employee stock option gives the holder the right—but not the obligation—to purchase company shares at a predetermined price.

The predetermined price is commonly called the strike price, exercise price, or grant price.

Holding options does not mean the employee owns the shares yet; the employee generally becomes a shareholder only after exercise.

Options are usually governed by a formal grant agreement specifying shares, price, vesting, expiration and other restrictions.

Simple formula

Potential spread = Market/FMV – Strike price

The five things clients should understand

1. An option is not a share

It is the right to buy company stock later at a set exercise/strike price.

2. Vesting matters

You generally earn the right to exercise over time; leaving early can mean forfeiting unvested options.

3. Exercise creates decisions

Cost, taxes, liquidity, concentration and the company outlook all matter.

4. Tax treatment differs

ISOs and NSOs have materially different tax rules and potential outcomes.

5. Equity is not guaranteed value

Options can become highly valuable—or expire with little or no economic value.

How the Process Works

- How the Process Works
- The Grant: Your employer awards you the option to buy a set amount of shares at a locked-in strike price (usually equal to the market value on the day you are granted them).
- The Vesting Period: You earn your options gradually over time (such as over 3 to 4 years) as long as you remain employed. If you leave the company before they vest, you typically lose them.
- The Exercise: Once your options vest, you can choose to buy the shares at the strike price. You typically do this if the current market price is higher than your strike price, allowing you immediate profit potential.
- The Sale: After you buy (exercise) the shares, you can sell them on the market—or hold onto them—subject to company rules and tax laws.

A simple example: where the value comes from

Grant

1,000 options
Strike price: \$2/share
Vested and exercisable

Company value rises

Current FMV: \$10/share
Spread: \$8/share
Theoretical spread: \$8,000

Exercise cost

$1,000 \times \$2 = \$2,000$
You pay the strike price to acquire shares.

The \$8,000 figure is a gross spread, not necessarily cash in hand.

At a private company, shares may be illiquid and may not be sellable until a liquidity event or approved secondary transaction.

Taxes, fees, restrictions and future stock-price changes can materially change the outcome.

Vesting: earning the right to exercise

Vesting is the process by which an employee earns access to the options granted.

A common structure is four years, sometimes with a one-year cliff; the exact schedule is controlled by the plan and grant agreement.

If employment ends before options vest, the unvested portion is generally forfeited.

After leaving, vested options may have a limited post-termination exercise period—often much shorter than the original option term.

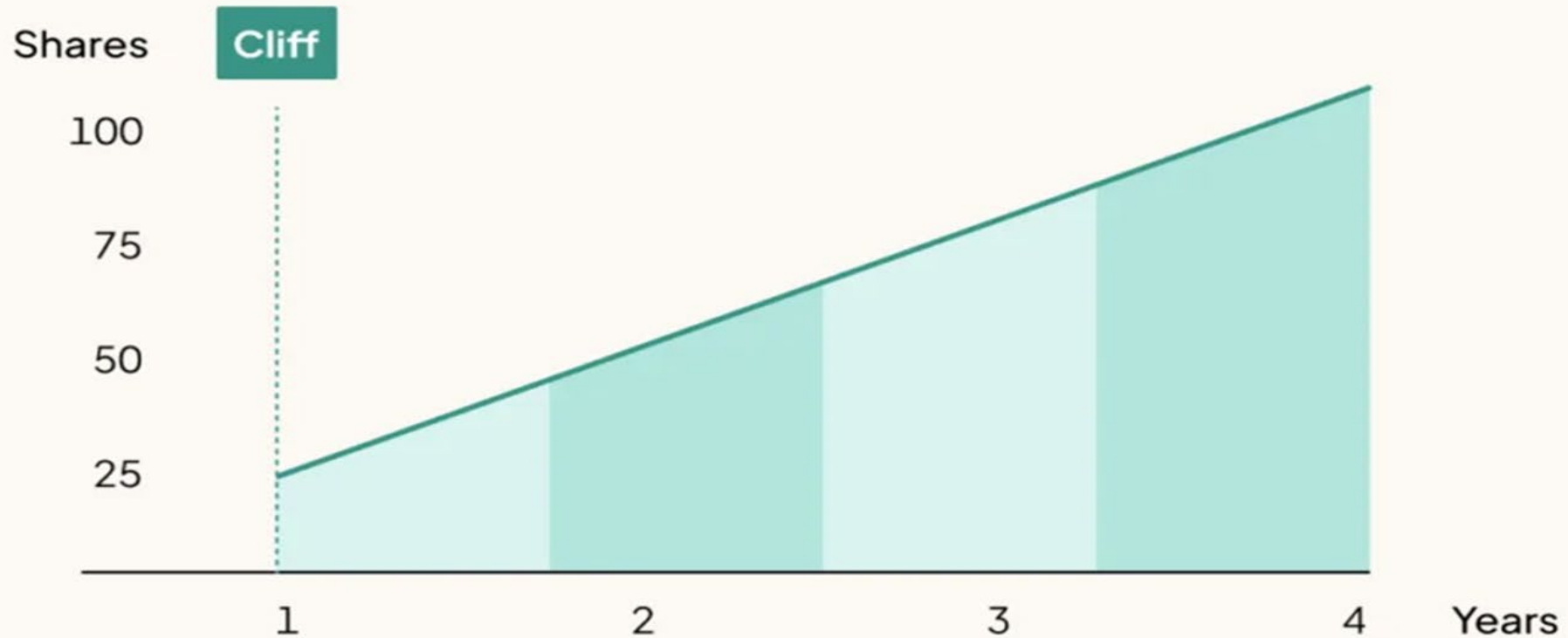


Vesting Schedules

A time-based vesting schedule typically includes a one-year cliff before you earn any equity. For corporations, the most common structure for equity grants is a four-year schedule with a one-year cliff. At least 95% of cliffs happen at the one-year mark.

This structure encourages long-term commitment from employees, and many companies also use equity refresh grants to further incentivize tenured employees.

Vesting Schedules Example



Main Types of Stock Options

Main Types of Stock Options

- **Incentive Stock Options (ISOs):** Offered only to employees and can qualify for favorable long-term capital gains tax treatment if strict holding rules are met.
- **Non-Qualified Stock Options (NSOs):** Can be given to employees and contractors; the profit at the time of exercise is generally taxed as ordinary income.

Statutory Stock Options (Incentive Stock Options)

Stock options:, grant the employee the right to purchase stock at a set price when the option vests. Stock options are the right to *buy*, not *earn*, the stock and come in several varieties.

Statutory stock options:

Incentive stock options (ISOs) - most structured stock compensation packages

- numerous rules apply (Sec. 422).

- Option to purchase the stock must be non-transferable and expire after 10 years.
- Individual must be an employee on the date the stock options are received and must exercise

the options while remaining an employee or within three months of leaving the company.

- the strike price cannot be less than fair value the day the options are granted.

Options offered through an employee stock purchase plan (ESPP).

Incentive Stock Options (Cont'd)

If the ISO requirements are met, the holding period rules discussed previously will make the gain or loss from all future sales of the stock received from an ISO exercise taxed at long-term capital gain rates.

For regular tax purposes, the basis of the stock sold will be the amount the employee paid to acquire the stock (i.e., the strike price paid to exercise the ISOs). The basis of the stock for AMT purposes from the sale of stock received from the exercise of ISOs is calculated separately. The AMT basis of the stock sold will be the amount the employee paid to acquire the stock plus the amount the employee included as an AMT adjustment for the exercise of ISOs when the ISOs were exercised

Incentive Stock Options

- Nothing included in regular taxable income in year the options are granted/exercised**
- **Nothing reported on the W-2.**
 - **Alternative minimum tax (AMT) adjustment for the exercise of ISOs amount is required to be included on Form 6251, *Alternative Minimum Tax — Individuals*.**
 - **Form 3921, Exercise of Incentive Stock Option noting Exercise price per share, the FMV per share on the date of exercise, and the number of shares transferred reported to EE.**
 - **Difference between the fair value of the stock and the amount the employee paid to exercise the options would be the “discount” (called spread) and is a positive AMT adjustment for the exercise of ISOs in the year the option is exercised.**

Example: Incentive Stock Option

- **Grant Date (Year 0):** Company gives you **1,000 ISOs** with a strike price of **\$5 per share**. FMV of stock is also **\$5**. No taxes are owed at this stage.
- **Vesting (Year 2):** You stay with the company, and your options finish vesting. You still have not bought any shares, so you owe **no taxes**.
- **Exercise (Year 3):** The company grows, and the stock price jumps to **\$20 per share**. You decide to exercise your options.
 - You pay the company: **1,000 shares × \$5 strike price = \$5,000**
 - The actual value of the stock is: **1,000 shares × \$20 = \$20,000**
 - The "bargain element" (paper profit) is: **\$20,000 - \$5,000 = \$15,000**
 - **Tax at exercise:** You pay **zero** regular income tax on that \$15,000 profit, though the \$15,000 bargain element may count toward the **Alternative Minimum Tax (AMT)**.

Example: Incentive Stock Option (ISO) Cont'd

- **Sale (Qualifying Disposition):** You hold the shares for at least 1 year after exercising and 2 years after the grant date, then sell all 1,000 shares later when the price reaches **\$25 per share**.
 - Total sale proceeds: **$1,000 \times \$25 = \$25,000$**
 - Your total gain (\$25,000 sale price minus \$5,000 original strike price = **\$20,000**) is taxed at lower **long-term capital gains rates** rather than ordinary income tax rates.
- **What Happens If You Sell Too Soon? (Disqualifying Disposition)**
- If you sell the shares **before** meeting the required holding periods (at least 2 years from the grant date and 1 year from the exercise date), it becomes a **disqualifying disposition**.
- The bargain element at exercise (\$15,000) is taxed as **ordinary income** (W-2 income).
- Any additional gain after exercise is treated as a short-term or long-term capital gain depending on how long you held the actual shares.

ESPPs – Employee Stock Purchase Plans

ESPPs

Employees purchase stock, with 5% to 15% discount, through payroll election (Sec. 423).

- Employee makes an election, and the employer reduces the employee's net paycheck and purchases stock on employee's behalf with the amount taken from the paycheck.
- Employers “collect” funds from an employee for 6 months before purchasing the stock, creating a lookback period, where stock price could increase/decrease.
- Date of Purchase will affect discount amount as FMV of stock increase/decreases.
- Option price does not change - set price based on % of FMV when option granted.

Holding period - Same Holding Period Rules apply for both ISOs and ESPPs

- Employee cannot sell the stock until two years after the grant date and
- at least one year after exercising the option (that is, purchasing the stock).
- can be an overlap between these periods. Under Regs. Secs. 1.422-1(a)(1)(i)(A) and 1.423(a)(1)(a), the *later* of the two events determines the holding period that must be met in order to retain qualified (i.e., statutory) treatment.

Example: Employee Stock Purchase Plan (ESPP)

- **ESPP Example**
- Imagine you work for a publicly traded company that offers a **15% discount** through an ESPP with a **6-month purchase period**.
- **Payroll Contributions:** You decide to contribute **\$200 from each of your twice-monthly paychecks** (\$400 per month). Over the 6-month period, you save a total of **\$2,400**.
- **Stock Price at Purchase Date:** At the end of the 6 months, the market price (Fair Market Value) of your company's stock is **\$20 per share**.
- **Applying the Discount:** With a 15% discount ($\$20 \times 0.85$), your purchase price is **\$17 per share**.
- **Shares Purchased:** The company uses your accumulated \$2,400 to buy shares at the discounted \$17 price:
$$\left(\frac{\$2,400}{\$17}\right) \approx 141.18 \text{ shares}$$
- **Instant Value:** If you look at the market value of those 141.18 shares right away:
$$(141.18 \times \$20 = \$2,823.60)$$
- **Your Immediate Gain:** You spent \$2,400 and received stock worth \$2,823.60—an immediate paper profit of **\$423.60** (roughly a 17.6% return on your contribution) before taxes or selling fees.

Example: Employee Stock Purchase Plan Key Terms

- **Offering Period / Enrollment Period:** The span of time during which your payroll deductions add up (often 6 to 12 months).
- **Purchase Date:** The specific day your accumulated money is actually used to buy the discounted stock.
- **Look-Back Provision:** A feature in some plans that calculates your 15% discount using the lower stock price from either the *start* of the offering period or the *end* of the offering period, giving you an even bigger potential discount.
- **IRS Limit:** You can generally contribute up to **\$25,000** worth of stock (based on its market value at the start of the offering period) per calendar year.
- Treatment of Gain Similar to ISO Treatment Discussed Earlier

Ex: Tax Treatment, Employee Stock Purchase Plan (ESPP)

Offering Date (Grant Date) Fair Market Value (FMV): \$100 per share
Purchase Price (with a 15% discount): \$85 per share ($\$100 \times 0.85$)
Sale Date FMV / Sale Price: \$150 per share

Scenario A: Qualifying Disposition:

- To qualify, you must sell the stock **at least 2 years** after the offering date and **at least 1 year** after the purchase date.
- **Ordinary Income:** The lesser of the actual gain ($\$150 - \$85 = \$65$) or the original discount off the offering date FMV ($\$100 - \$85 = \$15$). Your ordinary income is **\$15 per share**, which is reported as wages.
- **Long-Term Capital Gain:** Any profit above the ordinary income amount ($\$150$ sale price - $\$85$ purchase price - $\$15$ ordinary income = $\$50$). Your long-term capital gain is **\$50 per share** and is taxed at lower capital gains rates.

Ex: Tax Treatment, ESPP, Disqualifying Disposition

Scenario B: Disqualifying Disposition

- If you sell the shares **less than 2 years** after the offering date or **less than 1 year** after the purchase date, it is a disqualifying disposition.
- **Ordinary Income:** The difference between the FMV on the purchase date and your purchase price (\$100 purchase-date FMV - \$85 purchase price = **\$15 per share**). This is added to your W-2 as ordinary income.
- **Capital Gain:** The difference between your sale price and the FMV on the purchase date (\$150 sale price - \$100 purchase-date FMV = **\$50 per share**). Because you failed the holding period, this \$50 gain is treated as a **short-term or long-term capital gain** depending on whether you held the actual shares for more than one year post-purchase.
- Form W-2, Employer includes ordinary income in Box 1.
- Form 1099b and 8949: Report the sale on Schedule D and 8949, using information from form 3922 and form 1099b from your broker to adjust the cost basis.

Non Qualified Stock Options Tax Treatment

Non Qualified Stock Options (NSOs)

- Employee includes nothing in income when option is granted or becomes vested
- Upon exercise, spread (fair value less strike price) is included as W-2 income.
- shown as a Box 12 Code V item on the W-2 and is included in Boxes 1, 3 (up to the Social Security annual limit), and 5,
- The amount the employee included in W-2 income (i.e., the spread) plus the strike price paid (the amount the employee paid to exercise the option) is the employee's basis for future sales of the stock received from the NSO exercises.
- Future sales are predicated on the holding period for capital gains treatment based on the purchase/exercise date.

Non Qualified Stock Options (Cont'd)

Caveat: The above treatment is predicated on the assumption that the stock option does not have a readily determined fair market value (i.e., not traded on a stock exchange), which is the most common case with NSOs. For more information, see IRS Publication 525, *Taxable and Nontaxable Income* (rev. Feb. 7, 2023).

Example: Non Qualified Stock Option (NSO)

- **The Grant:** Company Grants you **10,000 NSO shares** with a strike price of **\$1.00 per share**. (Grant date value = \$0; no taxes are owed at this stage).
- **The Exercise:** Company grows and the FMV of stock reaches **\$5.00 per share**. You exercise all 10,000 options.
 - You pay the company to buy the shares: $\$1.00 \times 10,000 = \text{\$10,000}$.
 - The total market value of those shares is: $\$5.00 \times 10,000 = \text{\$50,000}$.
 - The **spread** (or bargain) is: $\$50,000 - \$10,000 = \text{\$40,000}$.
- **Taxation at Exercise:** **\$40,000** spread treated as ordinary compensation income.
 - Your employer withholds ordinary income tax, Social Security, and Medicare taxes on that \$40,000 (reported on your Form W-2).

Example: Non Qualified Stock Option (NSO) Cont'd

- **Selling Shares Later:**
 - Suppose you hold the shares and sell them later when price rises to **\$7.00 per share** (\$70,000 total).
 - Extra \$2.00 per share (\$20,000 total gain) from \$5.00 to \$7.00 is treated as a **capital gain** (short-term if sold within 1 year of exercise, or long-term if held for more than 1 year).
- **Key Takeaways**
- **Flexibility:** Unlike Incentive Stock Options (ISOs), NSOs can be issued to employees, contractors, advisors, and board members.
- **Cash Requirement:** You need cash (or a "sell-to-cover" arrangement) to pay for the strike price (\$10,000 in the example above) plus taxes at exercise.

Restricted Stock Units (RSUs)

Restricted stock units (RSUs)

- Employer promises the employee stock in the future, contingent on the Employee's effort to *Earn* the stock.
- Grant the employee actual stock on the day it vests
- Employee pays nothing to acquire the stock - part of compensation. The company will specify what amount of stock each RSU is worth once it vests
- standard vesting period for RSUs is three to five years.
- Employee is taxed on the Income included in W-2 equal to the FMV of the RSU's the date they Vest. W-2 reflects the FMV of the RSUs as of the day they vest and is included in Boxes 1, 3 (up to the annual Social Security limit), and 5. Optionally, employers are highly encouraged to indicate in Box 14 the letters "RSU" and the value of the stock included in the W-2 income.

Restricted Stock Units (RSUs) (Cont'd)

Restricted stock units (RSUs)

- If not reflected in Box 14, the Employee must make the accountant aware of this amount for tracking basis for future sales.
- The Employer may take a deduction on its tax return for the amount included in the Employee's W-2.
- Future Sales, the Basis of the stock received will be the amount the taxpayer included in taxable income. Holding period rules apply when the stock is later sold with capital gain treatment when held for more than 1 year.

Example: Restricted Stock Units (RSU)

- **The Grant:** You join a company January 1, 2026; receive a grant of **1,000 RSUs**.
- **The Vesting Schedule:** You have a standard 4-year vesting schedule
 - with a 1-year cliff. This means 25% of the shares vest each year.
 - **Year 1 (Cliff):** On January 1, 2027, 25% (250 shares) vest.
 - **Year 2:** On January 1, 2028, another 25% (250 shares) vest.
 - **Year 3:** On January 1, 2029, another 25% (250 shares) vest.
 - **Year 4:** On January 1, 2030, the final 25% (250 shares) vest.
- **What Happens at Vesting:**
 - On January 1, 2027, your first 250 shares vest.
 - If the stock price on that day is **\$50 per share**, the total value is **\$12,500**.
 - This \$12,500 is treated as **ordinary income** (like a cash bonus) on your paycheck. The company typically withholds a portion of the shares to cover federal, state, and FICA taxes, and deposits the remaining shares into your account.

Example: Restricted Stock Units (RSU) Cont'd

- **Selling the Shares:**
 - If you sell the 250 shares immediately for \$50 each, you owe little to no capital gains tax because the sale price matches the value when they vested.
 - If you hold the shares and sell them later when the price rises to \$60 per share, the \$10-per-share gain (\$2,500 total) is taxed under **capital gains rules**.

Impacts from One Big Beautiful Bill

- Larger Itemized Amount for Taxes could mean lower spread; Need to avoid AMT Tax.
- Penalizes Higher Income and could Impose a greater marriage penalty
- Qualified Small Business Stock (QSBS) increased Eligibility for Gross Asset Test to \$75million and the amount of excludable capital gains to \$15 million
- Given higher Eligibility in Gross Asset Test, Holders of RSU's with a later stage startups could qualify for QSBS given longer holding periods as a result of IPO, tender offer, or M&A agreement
- Shorter Stock Holding Periods of 50% for 3 years, 75% for 4 years, and 100% if held for 5 years

Elections & Other Considerations (Cont'd)

Net Unrealized Appreciation.

- Employer stock in the 401(k) - it might be beneficial to think about an NUA treatment. The stock in the 401(k) is rolled over to a non-retirement account (atypical brokerage account, trust, etc.). The cost basis of the shares is included in ordinary income (since it had been tax deferred in the 401(k)).
- The individual could then sell the stock out of the traditional brokerage. The basis of the shares in this sale would be the amount included in income when the shares are distributed from the 401(k).
- Gain would be taxed at long-term capital gain rates immediately — no holding period required. Stays in the 401k – Ordinary Income

Elections and Other Considerations

- **Sec. 83(b) election.**
- Stock received from Exercising an NSO with a Vesting period, is included in the Employee's gross income on the vesting date, rather than the Exercise Date.
- Sec. 83(b) election allows the shift the inclusion of income from the Vesting Date to the Exercise Date, including the fair value of the stock (less any strike price paid) in taxable income earlier than it otherwise would.
- If FMV is expected to Increase substantially during the vesting period, it may make sense to pay tax on the FMV at the date of exercise, before the stock appreciates.
- Gain is taxed at capital rates and, typically, it is better to have more gain taxed at capital rates rather than ordinary income rates.
- Awareness of State Tax treatment which can vary dramatically.
- Election Timeline - Effective Client Communication to avoid missing potential tax strategy.

Elections & Other Considerations (Cont'd)

Caveat –

- Unlike RSUs, most stock options are traditionally included in income upon exercise day. This is important because the five-year period begins on vest day, *regardless* of when the option is exercised.
- By default, since an option is taxable at exercise, which is after Vest Day, there is an inherent “built in” postponement when compared to RSUs. This built-in postponement will reduce the benefit of the five-year deferral for Stock Options since their nature is already to be taxed after Vest Day.
- Nonetheless, this election may still provide a year or two more tax deferral for Stock Options (it simply depends upon the length of time between vesting and exercise).

Elections & Other Considerations (Cont'd)

- To make the election to postpone tax, an individual will attach a statement (similar to the 83(b) statement) to the tax return for the year of election and provide a copy to his or her employer.
- Employee will indicate their Name, Address, TIN, a Description of the Property, Dates transferred, the tax year for the election, the nature of any restrictions, the FMV at the time of transfer, and the Amount Paid.
- IRS Publication 525.

Elections & Other Considerations (Cont'd)

Qualified equity grants.

- The TCJA created an election that permits qualified employees to defer income taxation for up to five years from the *vesting* date (Sec. 83(i)).
- The corporation must have a written plan providing stock options or RSUs (not a combination of the two) to at least 80% of U.S. employees and certain other requirements must be met.
- The election defers the date for recognizing the income but does not change the income's amount or character.

Tax implications of stock-based compensation

	Restricted stock units	Incentive stock options	Employee stock purchase plan	Non-statutory stock options
Amount employee pays to acquire	Nothing	Strike price	Strike price	Strike price
Amount included in income and when	Vest day — fair value of stock	Exercise day — AMT adjustment (positive) for spread	Sale year — discount/spread	Exercise day — discount/spread
Tax form	Included in W-2 Box 1, 3, and 5 (and optionally Box 14)	Form 3921	Form 3922 and W-2 Box 1 (discount)	Included in W-2 Box 1, 3, and 5 and Box 12 Code V
Basis on future sales	Amount included in W-2 income	Strike price for regular tax. FMV at exercise for AMT	Spread (amount included in income) plus strike price	Spread (amount included in income) plus strike price
Employer	Deducts amount included in W-2 employee income	No deduction	Deducts amount included in W-2 employee income	Deducts amount of the spread

The stock-option lifecycle



ISOs vs. NSOs: why the distinction matters

Topic	ISO	NSO
Who may receive them	Generally employees	Employees plus certain nonemployees, such as contractors/advisors
At exercise	Generally no regular income tax, but AMT may apply	Spread is generally ordinary compensation income
At sale	Potential long-term capital-gain treatment if holding period is met	Additional appreciation generally becomes capital gain
Planning issue	AMT, holding periods and the ISO \$100K rule can be tricky	Exercise creates current taxable income even if shares are not sold

Exercising: a financial decision, not an automatic win

Cost

How much cash is required for the exercise price—and potentially taxes?

Tax

Could exercise trigger ordinary income, AMT or other tax consequences?

Liquidity

Can you sell the shares now, or could your capital be tied up for years?

Risk

What happens if the company value falls after exercise?

Concentration

How much of your net worth and future compensation is tied to one company?

Time

What is the expiration date and what happens if you leave the company?

The risks clients should not overlook

Market / company risk: options may never become valuable.

Liquidity risk: private-company shares may be difficult or impossible to sell when you want.

Tax risk: exercising can create a tax bill before shares can be sold.

Concentration risk: salary, career and investment exposure may all depend on the same company.

Expiration risk: options can expire; leaving the company can shorten the exercise window.

Timing risk: exercising early can have benefits, but it can also create opportunity cost and loss of flexibility.

Client checklist: questions to ask before acting

What type of options do I have—ISO or NSO?

How many options are granted, vested, and currently exercisable?

What is my strike price, current fair market value, and expiration date?

What is my post-employment exercise window?

What would the exercise cost in cash?

What taxes could arise at exercise and at sale?

If I exercise, how long might my money be tied up?

How much company-stock exposure is appropriate within my overall financial plan?

What does my plan document say about liquidity events, transfers, repurchase rights and restrictions?

A practical framework for client conversations

Understand

Grant terms,
vesting, expiration,
liquidity

Quantify

Exercise cost,
current spread, tax
scenarios

Diversify

Evaluate total
company exposure

Decide

Compare exercise
now, later, or not at
all

Coordinate

Work with tax/legal
professionals where
appropriate

Sources & further reading

Carta — How employee stock options work (Aug. 13, 2026)

<https://carta.com/learn/equity/stock-options/>

J.P. Morgan Workplace Solutions — Why giving employees share options will help your business thrive (Sept. 4, 2024)

<https://www.jpmorganworkplacesolutions.com/insights/share-options-will-help-your-business-thrive/>

Fidelity — What are stock options from employers? (Oct. 3, 2025)

<https://www.fidelity.com/learning-center/smart-money/stock-options>

Investopedia — Understanding Employee Stock Options: Your Complete Guide to ESOs (updated Apr. 30, 2026)

<https://www.investopedia.com/terms/e/eso.asp>

Know Your Options



GATHER THE PAPERWORK

ISO or NSO determines when income is taxed and at what rate.



KNOW THE TYPE

The grant agreement, W-2 codes and Form 1099-B tell the full story.



PLAN BEFORE EXERCISE

Cost, taxes, liquidity and concentration all drive the decision.

SUMMARY/QUESTIONS.....

LOTS COVERED HERE....

