Employee Stock Options

Restricted Stock Units (RSUs)

Overview

As the name suggests, employee stock options give you the right, but not the requirement, to buy company stock at a fixed price, known as the strike price or exercise price. If you choose to exercise these employee stock options: non-qualified (NQSOs) and incentive stock options (ISOs). You can compare them in more detail here. For either, because you have the right, but no requirement, to buy your employer’s stock options to buy stock options, you have flexibility over how to manage the process.

RSOs are not options to buy stock shares, they are instead promised to you once the vesting and are delayed, often as shares of stock. RSOs typically vest over a period of several years, and you can use those options to buy stock shares, or you can sell your shares at any time for a profit. Because RSOs are generally taxed when they vest, when your shares are deposited into an account in your name.

There is no tax impact when you are granted your stock options. There is no tax impact when you are granted your stock options. They are not taxed as you vest unless you actually exercise your option to purchase shares of stock at that time. See the next entry for more details.

ISOs: In the year you exercise your options, you pay ordinary income tax on the difference between the exercise price of the options, the fair market value at exercise. You incur this tax whether you exercise your options, or sell and settle the stock.

NQSOs: When NQSOs cost basis.

Gain or Loss

The spread between the exercise price of the option vs. the fair market value at exercise may be an adjustment for calculating the AMT. See the next entry for more details on tax and AMT adjustments at sale.

Tax Treatment at Grant

Stock options are not taxed as you vest unless you actually exercise your option to purchase shares of stock at that time. See the next entry for more details.

ISOs: Depending on ISOs is not itself a taxable event for figuring ordinary income. Therefore, if you choose to sell your stock at any time for a profit, you’ll pay ordinary income taxes on the difference between the exercise price of the option vs. the fair market value at exercise. You may be an adjustment for calculating the AMT. See the next entry for more details on tax and AMT adjustments at sale.

NQSOs: "Qualified" sales are taxed at capital asset tax rates; "disqualified" sales likely incur a combination of capital gain and ordinary income tax rates. Each sale type is also subject to different AMT treatments. Read more here.

Once your RSOs have vested and you’ve received your stock shares, they are treated as any other cash wages, which are subject to social security and Medicare taxes. As described above, neither employee stock options nor RSOUs create a tax event at granting. Both also share similar characteristics with respect to their availability and vesting. But of course, not all offers are the same. Here’s a summary to compare the two most common kinds of equity compensation: employee stock options vs. Restricted Stock Units (RSUs).

Cash Flow at Share Transfer

For both NQSOs and ISOs, you may be able to arrange for a tax-efficient, cashless exercise or sell your shares. This means using an exercise and sell of shares to cover the cost of the stock purchase, potential tax with-holdings, and the Federal AMT taxes. Careful financial and tax planning is advised.

For ISOs: The full value of the vested units is taxed as ordinary income when they vest (when your RSUs have vested and you’ve received your stock shares, they are treated the same as any other cash wages, which are subject to social security and Medicare taxes).

If your options are eligible for early exercise, you can file an 83(b) election. However, since there are no ordinary income taxes due at exercise, the early exercise is only effective for calculating AMT.

If your options agreement provides for it, you may be eligible to early exercise your option if you file an 83(b) election, accelerating the tax impact to occur now as opposed to later. If your company is early exercise, the strike price, your taxes may be tax low as a percentage of options. For ISOs, 83(b) is not eligible for 83(b) election (although restricted stock awards may be).

If you file an 83(b) election, you may have tax consequences at the time of exercise. You’ll need to exercise the vested options within 30 days after the exercise date to retain ISO status.

Availability

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If You Leave the Company

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No tax is withheld at final sale.

At exercise: When you exercise NQSOs, income taxes are withheld at statutory rates (usually 22%, or 25% if statutory income exceeds $1 million). No tax is withheld when you exercise ISOs.

At final sale: No tax is withheld at final sale.

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