sage
FINANCIAL ADVISORS
Secure your future wisely. SM

Sudden money and option planning

By Brian Loy, CFA, CFP
Reno Gazette-Journal, June 21, 2010

To help promote entrepreneurial spirit and to attract and maintain superstar talent, companies – from cash-strapped start ups to old-line firms – offer employee stock options. The goal is to reward an individual's skill and creativity which enhance the value of the company.

Options enable an employee to buy company stock at a specified price, for a predetermined time period.

They generally have a vesting schedule and may be subject to legal restrictions. And the objective is stock value appreciation. Say you're awarded 10,000 options when the stock is worth $10 a share. They vest and the stock is worth $15. You then exercise the options and receive $150,000 of stock, for an implied benefit of $50,000.

Tax treatment is the key difference between the nonqualified stock offering and incentive stock offering. Generally, the NQO is taxed at higher rates and more quickly than the ISO. The exercise of ISOs generally doesn't trigger an immediate tax, and if the acquired shares are sold in a year or later, any gain might be taxed at favorable capital gains tax rate. However, the ISO exercise qualifies you for the complex world of alternative minimum tax and associated credits.

Employee stock options can provide significant windfall, and headache. The key variable in wealth creation for option holders is the price of the stock when sold. Often, diversification becomes a major issue should the majority of your wealth tied to the price of a single stock. Throw in the legal restrictions on exercise and selling shares, plus the complex tax and cash issues, you've got a handful of planning areas to manage. My best advice is to seek qualified tax, financial, and legal counsel.

My general planning tips regarding employee option planning include reviewing your goals (including retirement, career changes, college planning, etc.), knowing the details, considering the variables, developing the strategy, then monitoring, and executing.

Stock option strategies include:
- Exercise early;
- Spread the exercise;
- Sell the shares upon exercise;
- Hold the shares, then sell after meeting the long term capital gain requirements;
- Risk management strategies for concentrated stock positions;
- Or a combination of the above.

If you are an option holder, congratulations! In the land of nirvana, you'd be granted ISOs, you exercise them early, hold the stock for a year or more, the stock skyrockets, you sell before the share price plummets back to earth, and you spread your chips.
However, most of us live elsewhere, and this is an area ripe with uncertainty. Life's full of surprises. Get your experts involved.