PRE-MEETING OVERVIEW

EQUITY COMPENSATION AT WORK

Whether someone is employed at a startup company in pre-initial public offering (IPO) mode or a well-established publicly held company, equity awards can be an important part of compensation.

Key points to know before your meeting:

The employee recipient of an equity award or grant should recognize the award in two ways:

First, as compensation where the acquisition of the stock generates W-2 income in addition to base and bonus compensation. It is subject to income and payroll taxes just like base and bonus compensation.[1]

Second, once acquired, it becomes an equity investment with the potential to increase in value. But it comes with employer restrictions. **Equity awards can come in two types and different forms under each type:**

- **Exercisable awards** in the form of options (incentive stock options or non-statutory options) or stock appreciation rights.
  - Incentive stock options are primarily offered by pre-IPO companies.
  - Stock appreciation rights are primarily offered by publicly held companies.
  - Non-statutory options are found in both. To acquire the stock, you must exercise the option.
- **Restricted stock** in the form restricted stock awards (RSA), restricted stock units (RSU) or performance share units (PSU).
  - RSAs are increasingly rare in public companies but are still offered in pre-IPO companies.
  - PSUs have become more popular in public companies as executive level compensation that can payout in stock, cash or both.
  - RSUs are awarded in both pre-IPO and public companies.

Understanding the different types of awards, when they vest, how you acquire the stock and the tax implications are important to get the most value out of this form of compensation. Your financial advisor can help you make informed decisions if you provide the proper information.

[1]The exercise alone of an incentive stock option will not generate W-2 income though it does generate alternative minimum tax income (AMTI).

You must be an employee of record when the grant vests (there are possible exceptions for death or disability).

With restricted stock, you will acquire the stock at or soon after vesting. For an option or stock appreciation right, you can exercise what has vested to acquire the stock.

Questions to review before your meeting

Q: If this adds to my W-2 income at work, does the company withhold taxes?

A: Yes. Your company may offer more than one way to fulfill the required withholding for income and payroll taxes.

Q: Is there an acquisition cost?

A: There is a cost of acquisition for ISOs and NSOs. It's the exercise price multiplied by the number of exercised shares. There is no acquisition cost for SARs, RSAs, RSUs or PSUs.

Q: What determines the amount of income from acquiring the stock?

A: For exercisable awards, it's the spread (difference) between the exercise price and the fair market value (FMV) multiplied by the number of exercised options.

For RSAs, RSUs and PSUs, it's the FMV of the stock shares the day they are delivered into your possession.

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Checklist to complete before your meeting

Your financial advisor can help you better understand your equity compensation awards and design a strategy to get the most out of each award. Before your meeting, please gather the following documents:

- [ ] The overall stock or equity plan document for the company. It may be called a *long-term incentive plan*. It will explain the general rules of the plan and what could be awarded.
- [ ] A stock or long-term incentive award brochure, if there is one
- [ ] Each award agreement (certificate) you've received. It should contain the specific grant type, amount, vesting schedule, rules and any exceptions to the general equity plan document.
- [ ] A list of your equity awards. Many companies have a stock plan administration website where you can review and download your awards.

For more information, read our *Ins and outs of equity compensation for pre-IPO or publicly held companies* or our *Equity compensation* white paper.

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