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**COMPARISON OF INCENTIVE STOCK OPTIONS
TO
NONQUALIFIED STOCK OPTIONS**

1. NON-QUALIFIED STOCK OPTIONS ("NSOS").

- **No income on grant.** The holder has no income at the time of the grant of the NSO.
- **Exercise of NSO.** Taxable income for holder upon exercise equal to spread between stock fair market value and exercise price. Taxable at ordinary income rates (top rate over 39%). The employer must withhold income and payroll taxes on this income and treat the income as wage compensation reportable on Form W-2 (regardless of whether the holder is an employee at the time of exercise).
- **Corresponding deduction for employer.** The employer gets a corresponding tax deduction at the time of exercise equal to amount of income recognized by holder.
- **Subsequent sale of stock.** On subsequent sale of stock, the holder recognizes capital gain or loss equal to difference between the sales price and the fair market value of the stock at time the NSO was exercised. This gain or loss will be long-term capital gain or loss (and eligible for reduced tax rates) if the stock is sold more than one year after the exercise of the NSO.
- **AMT.** No alternative minimum tax ("AMT") repercussions on exercise or sale of stock.

2. INCENTIVE STOCK OPTIONS ("ISOS").

- **Exercise of ISO.** No taxable income for holder upon exercise for regular tax purposes. However, the excess of the stock fair market value over the ISO exercise price may be taxable under the AMT rules.
- **Sale of shares received on exercise of ISO.**
 - Qualifying disposition - capital gain income. Holder taxable at long-term capital gain rates if shares sold more than two years after the ISO was granted and more than one year after the ISO was exercised (the "holding period requirements"). Long term capital gains from shares held more than 12 months are taxed at a top rate of 20%. The amount

of capital gain or loss for each share equals the difference between the sales price of the share of stock and the exercise price.

- Disqualifying disposition - ordinary income. If stock is sold before the holding period requirements are met (a "disqualifying disposition"), then the holder is taxed on the sale of the shares (similar to the tax imposed on an NSO holder at exercise) as follows: The holder will have ordinary income equal to the excess of the fair market value at the time of the exercise over exercise price (but in no event will the ordinary income exceed the gain recognized on the sale). The remainder of the gain, if any, is capital gain. (Special rules apply to disqualifying dispositions that are not arms'-length sales.)

Sample Preview