



COMPANY STOCK OPTIONS



WHAT IS AN EQUITY INCENTIVE PLAN?

Purpose of the Equity Pool

- A portion of the company's ownership set aside for employees, advisors, and consultants
- Used to attract, retain, and reward team members as the company grows

How It Works

- Shares come from the company, not from founders' personal holdings
- Awardees earn equity over time by staying with and contributing to the company



BIG IDEA

- Equity aligns employees with the long-term success of the company

Key Documents

- Equity Incentive Plan a/k/a Stock Option and Grant Plan
- Stock Option Agreement
- Exercise Notice
- 83(b) Notice

WHAT ARE STOCK OPTIONS

Definition

A stock option is the right to buy company stock in the future at a fixed price



Key Features

- Awardee doesn't own shares immediately
- Awardee chooses whether to buy shares later
- If the company grows in value, options may become valuable

WHAT ARE STOCK OPTIONS

Incentive Stock Options (ISOs)

- Typically granted to employees only
- Not generally taxed at exercise for ordinary income tax purposes*
- If IRS holding requirements are met, taxed at lower long term capital gains rate when shares are sold
- Subject to annual limits and other IRS requirements

Non-Qualified Stock Options (NSOs)

- Can be granted to employees, advisors, or consultants
- Ordinary income tax generally applies at exercise
- More flexible, but usually less favorable tax treatment

*may be subject to Alternative Minimum Tax

COMPARISON CHART

	Incentive Stock Option *	Non-qualified Stock Option
Employees Only	X	
Natural persons only	X	
Issuer must be Corporation	X	
Must be exercised w/i 3 months of termination of employment	X	
Tax at Grant		
Tax at Exercise		X (ordinary income)
Tax at Vesting		
Capital Gains Tax at Sale	X	X
Issuer Tax Deduction		X
Only Transferable Upon Death	X	
10 Year Expiration of Award	X	
Eligible for 83(b) for an early exercise	X	X

*Additional rules for ISOs only:

- Only \$100k can be exercisable in any one calendar year per employee
- For any shareholder that owns greater than 10% of the issuer's shares, the exercise price must be at least 110% of the FMV and the option term must be 5 years or less.
- To qualify for long term capital gains, employee must hold stock for both (x) more than 1 year after exercise and (y) more than 2 years after grant.

KEY STOCK OPTION TERMS

Exercise Price (Strike Price)

- The price you pay per share when you choose to buy your stock
- Set on the grant date and generally does not change

Fair Market Value (FMV)

- The company's estimated value per share at a specific point in time
- Used to set the exercise price and to determine taxes at exercise

Grant Date

- The date your stock option is officially awarded to you
- Determines your exercise price and starts certain tax and vesting clocks

Vesting Commencement Date

- The date your vesting schedule begins
- May be the same as, or earlier than, your grant date

Vesting Schedule

- The timeline over which awardee earns the right to exercise options
 - Standard time period is 4 years
- "Cliff":
 - Time period during which no options vest
 - Usually the first 12 months after the grant of the options.
- After the "Cliff":
 - Large amount of options vest, usually 25%
 - Remaining options vest equally at an agreed interval, usually monthly or quarterly
- Example: On March 3, 2028, John is granted ISOs to purchase up to 100k shares of X Corporation. 25% of the shares vest on the one-year anniversary of the grant, with the balance vesting quarterly over the remaining 36 months.
 - March 3, 2029, John has the vested right to purchase 25,000 shares.
 - Beginning June 3, 2029, and on each quarterly vesting date thereafter through March 3, 2032: John vests in an additional 6,250 shares per quarter, so long as he remains employed by X Corporation.

Final Exercise Date (Expiration Date)

- The last date you can exercise your options
- Typically 10 years from grant (shorter if you leave the company)





83(b)

What Is an 83(b) Election?

- An 83(b) election is a tax filing that allows you to pay taxes earlier on stock that is subject to vesting
- It applies only if you receive actual shares that are restricted, typically through early exercise of options

When Does 83(b) Apply?

- Only if:
 - The company allows early exercise of options, and
 - You receive shares that vest over time
- Most employees will not need to file an 83(b) unless they early exercise

Why Someone Might File an 83(b)

- You pay tax based on the current (usually low) value of the shares
- Future appreciation may be taxed at capital gains rates instead of ordinary income
- Can reduce total taxes if the company's value increases

Important Risks & Deadlines

- Must be filed within 30 days of receiving the shares
- Irrevocable once filed
- If you leave the company early, taxes paid are not refunded

FURTHER QUESTIONS

- Are you an employer or an equity award recipient with questions about equity compensation?
- Schedule a FREE consultation with Faison Law Group to:
 - design or review an equity incentive plan
 - understand stock options, vesting, and tax considerations
 - evaluate grants, exercises, or exits with confidence

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