What you need to know

Qualified & Non-qualified Stock Options

RPB CPAs
A century of new ideas

What you need to know:

Qualified & Non-qualified Stock Options

Many companies incentivize their employees and potential hires through stock options, giving them the right to purchase shares of stock at a specified price. These options usually come in the form of either Qualified Stock Options (QSO) or Non-Qualified Stock Options (NQSO) with each having different tax treatments. While both types of options have advantages, there are many restrictions and rules that the IRS and SEC enforce.

FAST FACTS

- Grant date: The date in which the stock option is issued to the employee
- Grant price: The price at which the employee can purchase a certain number of shares of the company's stock.
- Exercise date: The date the employee has the right to buy or sell the option at a specified price also known as the exercise price.

Learn more about Tax at:

RPBLLP.com

How it Works

Both types of stock options are popular forms of equity and a way to compensate employees with tax advantages for both employees and the company.

Rules

While Non-Qualified Stock Options are available to anyone, Qualified Stock Options issued by a company can only be given to employees of that company. QSOs must be nontransferable and must have an exercise price that is not lower than the fair market value of the stock at the time the option is granted. These options must also be exercised within ten years from the date the options are granted to the employee. If the employee owning a stock option has their employment terminated, the option must be exercised within three months of termination. For full detail on rules that apply to qualified and non-qualified stock options, contact our tax professionals.

Tax Implications

Earnings on QSOs are taxed at the long-term capital gains tax rate which is lower than the ordinary income tax rate in most cases. Non-Qualified Stock Options are not eligible for this tax break; gains are treated as ordinary income.

Non-qualified Advantages

Although NQSOs don't receive the same favorable tax treatments as QSOs, they do have advantages as they can be exercised at any time. They can also be extended to those outside of the firm such as suppliers or the Board of Directors. A major advantage for the issuing company is that it can deduct costs incurred on NQSO's as an operating expense on its tax return.

Contact our Tax team at

414.271.7800 with any questions

FYI

With things always changing, be sure to talk with Reilly, Penner & Benton LLP to see what the most current rules, regulations and changes may apply to you when working with qualified and non-qualified stock options.

Qualified Advantages

The major advantage of Qualified Stock Options is that, in theory, the company will grow as a result of a shared interest between employees, management, and shareholders. With no income to report when the option is exercised, employees reap the benefits of postponing tax into future long-term capital gain(s). With QSOs, grant prices typically being lower, employees are often rewarded in the end with larger profits.

No income is recognized by employees when they are granted the option. If the employee holds the option for one year, the gain is taxed as a long-term capital gain; otherwise it's ordinary income. NQSO is always treated as ordinary income.