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Speaker 1

Welcome, my name is Andrew Baron, and this is Well… It Depends! The podcast where I present the pros and cons of different financial decisions so that you, the audience, feel better informed when you are confronted with these decisions in your own life. In this episode, I ask the question, how is my equity compensation taxed? But before we begin a short disclaimer, this is being recorded on May 23rd, 2023.

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The contents of this podcast are strictly for informational purposes only, and nothing said should be taken as investment, tax or legal advice it is important to discuss your situation with a professional before making any financial decisions as the strategies discussed may not be suitable for you specifically.

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Let's start off by looking at stock options which come in two main varieties, either incentive stock options or ISO's or non-qualified stock options.

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As you can imagine, there are differences between the two. With incentive stock options, you are not taxed when the option is granted or exercised, and instead the gain is determined by when you sell the underlying stock. If you hold the stock for two years after the option was granted and one year after the option was exercised, all of the gains are considered long term capital gains.

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If you don't satisfy these thresholds, the gains are considered ordinary income. With non-qualified stock options, you are taxed when the options exercised at ordinary income rates. When you go to sell the stock, any additional gain or loss is determined by how long you hold the stock for either short term or long term capital gains.

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Now let's talk about restricted stock units or RSU’s. The taxation here is more straightforward. When RSU’s invest, they are considered income and taxed accordingly. When you go to sell the stock, any additional gain or loss is determined by your holding period for either short term or long term capital gains.

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An employee stock purchase plan is another form of equity compensation. This is where you can buy company stock at a discounted rate. There is no taxation when you buy it. However, when you go on to sell the stock, the taxation is determined by your holding period for either short term or long term rates.

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To recap how equity compensation is taxed is largely determined by the type of equity granted and when you decide to sell. Planning is essential. Timing your sales correctly can lead to lower taxes. This is a complicated subject, and by working with a professional who understands your specific situation and tax liability can be extremely beneficial. So to answer the question, how is my equity compensation taxed? Well… It depends!

Speaker 1: Andrew Baron, CFP®, EA