THE FINANCIAL SIDE OF RETIREMENT PLANNING

What to know when equity is part of your incentive compensation package

Four common types of incentive compensation

In an effort to attract, retain and motivate employees, many companies offer equity and “equity-like” compensation. Companies may also use these alternative types of compensation to provide additional retirement funding for key employees and/or to defer an employee’s earnings for income tax purposes.

Incentive compensation can be a tangled and nuanced web of considerations and decisions. It is important to understand the implications of the various types of compensation and how they fit into your overall wealth management plan.

1) Restricted stock

- This is a pure grant of company stock, but the stock is not owned by the employee until certain vesting restrictions (typically time and/or performance) have been met.
- If the stock pays a dividend, those dividends are typically paid to the employee during the holding period.
- The value of the stock will be taxed to the employee as ordinary income at the time that the stock vests. If the employee has made a Section 83(b) election under the Internal Revenue Code, however, the employee will recognize ordinary income at the time the stock is granted based on the value of the stock at that time.

2) Non-qualified stock options (NQSOs)

- An NQSO is the right to acquire (“exercise”) a fixed number of shares at a fixed price for a specific period of time.
- NQSOs are typically subject to vesting restrictions based on the recipient’s service to the company.
- They can be granted to employees and nonemployees, such as directors and consultants.
- The recipient will recognize ordinary income on the difference between the exercise price and the fair market value of the shares at the time of exercise.
- The exercise is also subject to payroll taxes, such as Social Security and Medicare taxes.
- If the employee later sells the shares, the sale will be treated as a capital gain or loss, with the basis of the shares being equal to the fair market value of the shares at exercise.

3) Incentive stock options (ISOs)

- An ISO is the right to acquire a specific amount of stock at a predetermined price *at least equal* to the fair market value of the stock at the time that the ISO is granted.
- They can only be granted to employees.
- Unlike other types of equity compensation, ISOs are taxed when the stock is sold.
- If the stock is held until the later of two years from the grant date or one year from the exercise date, the sale receives long-term capital gains tax treatment; if either of those requirements are not met, then the spread at exercise is taxed as ordinary income, and any excess appreciation is taxed as capital gain.
- Alternative minimum tax issues can arise with exercise and a subsequent disposition.

4) Equity-like compensation

- This type of compensation typically provides a monetary benefit based on the appreciation and/or dividends of the company's underlying stock, rather than giving a right to the stock itself, although in some cases there may be a future right to receive stock.
- Common forms of equity-like compensation include restricted stock units (RSUs), stock appreciation rights (SARs) and phantom stock.
- These types of compensation are generally subject to ordinary income taxes as interests vest or cash is received.
- These equity-like interests do not qualify for an IRC Section 83(b) election as they are not considered "property."

Equity and equity-like compensation are often subject to complex rules and restrictions. If such incentives are a part of your compensation, it is important that your financial and tax advisors work together so that you can leverage your total compensation package to maximize your wealth potential. **For more information about executive compensation, visit our Financial Side of Retirement Planning resource page.**

CIBC Private Wealth Management includes CIBC National Trust Company (a limited-purpose national trust company), CIBC Delaware Trust Company (a Delaware limited-purpose trust company), CIBC Private Wealth Advisors, Inc. (a registered investment adviser)—all of which are wholly owned subsidiaries of CIBC Private Wealth Group, LLC—and the private wealth division of CIBC Bank USA. All of these entities are wholly owned subsidiaries of Canadian Imperial Bank of Commerce. This document is intended for informational purposes only, and the material presented should not be construed as an offer or recommendation to buy or sell any security. Concepts expressed are current as of the date of this document only and may change without notice. Such concepts are the opinions of our investment professionals, many of whom are Chartered Financial Analyst® (CFA®) charterholders or CERTIFIED FINANCIAL PLANNER™ professionals. Certified Financial Planner Board of Standards Inc. owns the certification marks CFP® and CERTIFIED FINANCIAL PLANNER™ in the U.S. There is no guarantee that these views will come to pass. Past performance does not guarantee future comparable results. The tax information contained herein is general and for informational purposes only. CIBC Private Wealth Management does not provide legal or tax advice, and the information contained herein should only be used in consultation with your legal, accounting and tax advisers. To the extent that information contained herein is derived from third-party sources, although we believe the sources to be reliable, we cannot guarantee their accuracy. The CIBC logo is a registered trademark of CIBC, used under license. Investment Products Offered are Not FDIC-Insured, May Lose Value and are Not Bank Guaranteed.