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How Tech Execs Can Minimize Tax Exposure

San Jose, Calif. – September 24, 2012 – According to CPA Bill Melton of the Silicon Valley accounting firm Abbott, Stringham & Lynch, the top personal income tax area of concern for tech executives he sees in his client base is equity compensation. "Like all of us, tech executives care about how much tax they're paying, and there are ways to minimize their tax exposure when receiving stock awards," says Melton.

The most common stock awards Melton sees are restricted stock units (RSUs), nonqualified stock options (NSOs), and incentive stock options (ISOs). Here are three strategies tech executives, working with their CPA and investment advisor, can consider when looking to minimize their tax exposure due to stock awards:

RSUs: File an 83(b) election before restrictions have lapsed.
Consider filing an 83(b) election before restrictions have lapsed on RSUs to start the holding period for long-term capital gain tax treatment. This strategy carries some risk, as the RSUs become taxable as compensation at the time of the 83(b) election. However, if there is an expectation of a substantial increase in the value of the stock, filing an 83(b) election can result in lower taxes upon later sale.

NSOs: Exercise and sell NSO shares on the same day.
What many executives, especially young executives, don't realize is that income tax can apply when there is a *purchase* of stock, not just when there is a sale. The spread on nonqualified stock options ("NSOs"), i.e., the difference between the lower option price and the stock value at the time of actual purchase, becomes taxable upon exercise. Therefore, a common strategy is to exercise (i.e., purchase shares of company stock at the (lower) option price offered to the executive when the employment agreement was made), and then sell the NSO shares on the same day. This strategy provides maximum leverage as you haven't committed any capital to the exercise (no need to make cash payment for the shares) and payment of related income tax until the time of exercise. So, you can ride the appreciation of the stock with no cash outlay, and then pull the trigger on a same-day sale at the earlier of the expiration date of the NSOs or whenever the stock hits your price target.

ISOs: Don't forget about the Alternative Minimum Tax.
The issue here is exposure to the Alternative Minimum Tax (AMT). While the spread on ISOs is not taxable upon exercise for regular income tax purposes, it is taxable for AMT purposes. This gives

rise to an AMT credit that can be used in subsequent years when AMT is calculated to be less than regular tax. Therefore, the game is all about managing exposure to AMT and recovery of the AMT credit.

Melton says that tax savings can be substantial for tech executives who work with finance professionals to employ the best strategies and timing for stock option management. “The idea is to develop an awareness of when to file an election, when to exercise and sell, and keep the alternative minimum tax option in mind as appropriate.” For additional information on managing stock option awards, Melton suggests contacting your CPA and investment advisor.

About Abbott, Stringham & Lynch (ASL)

Abbott, Stringham & Lynch (ASL), founded in 1977, is one of the leading local CPA firms in the Silicon Valley. ASL provides emerging and mid-market private companies and their executives with accounting and audit, tax, estate and wealth planning, and consulting services. ASL’s clients include construction, technology, and real estate businesses among others. ASL is a member of PKF North America, a network of independent CPA firms.

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