DO YOU HAVE STOCK-BASED COMPENSATION?

As companies try harder to incentivise key employees to concentrate on the goals of the business, and to encourage them to work for the longer term, they are increasingly using stock-based compensation schemes. They come in many forms depending on the size and stage of development of the company. The common characteristic is that in return for continuing to be employed ad work hard, at a future date the employee will be rewarded by being able to acquire that companies shares at a price below the current market price.

In the US such schemes include Incentive Stock Options (ISO), Non-qualifying stock options (NSO), Restricted Stock Units (RSU), Employees Stock Purchase Plans (ESPP). In the UK such schemes include Company Share Option Plans (CSOP), Share Incentive Plans (CIP), Enterprise Management Incentives (EMI, and Save as you Earn (SAYE).

Taxation of stock-based compensation

Both the US and the UK have a broadly similar range of schemes of stock-based compensation that are permitted, but the specific regulations differ. The taxation of the specific schemes varies and can be quite complex. Some broad principles apply to all schemes. They are:

- The difference between the amount the employee gets when they eventually sell the shares and the amount that they paid to acquire them (which is zero for some types of schemes) is taxable income.

- That income is split into two parts
  - The part that is considered as remuneration for continuing to work for the business, which is taxed as employment income (in the US at Federal and State level) including social security / National Insurance contributions.
  - The part that is considered as reward for investing capital in the business that is treated as a capital gain (or loss).

- Under the UK / US tax treaty the part that is considered as employment income is taxable in the country in which the work was done. If the work is performed partially in one country and partial in the other, then the employment income is time apportioned between the two countries. However, a capital gain or loss on the eventual disposal of the shares is taxable in the country of tax residence when the disposal occurs.

There is little that can be done to manage the taxation of the employment income portion which is usually handled through the payroll systems (although if multi -country you need to make sure that they are applying the rules consistently). However, the choice about when and where you make a disposal of the shares gives rise to potential tax reduction strategies on the capital portion of the compensation.

Managing your stock-based compensation

Managing stock-based compensation is far more complex, and important, that just the tax aspects. Where it is a significant part of your income, or represents your best opportunity for capital accumulation, you need to look at them from at least three other perspectives:

- **Your person and financial situation and goals**. That is your current cash flow situation, what major investments or life changes you would like to make, and the adequacy of your long-term financial protections. How much cash to you need or want to take out at the earliest opportunity compared to leaving it invested to grow.

- **Your career.** Are you happy in your job and satisfied it has sufficient growth opportunity for you to stay until your stocks vest, or are their better career options elsewhere so it is worth sacrificing unvested stock, or selling back stock at current prices to make a change in employment.

- **The company's future and your risk appetite.** Should you hold onto the shares or options after they have vested, or should you cash out and diversify your investments. If the company is heading for a major value changing event (a stock market flotation, a major acquisition or new product) it can be sensible to stay in for the ride. However, if the long-term prospects only look to be average, and you don't want to have both your employment and a lot of your financial assets tied up into a company whose prospects are not stellar then you could better manage your risk by selling and diversifying your investments.

IF THIS LOOKS LIKE YOU CONTACT US FOR A CONFIDENTIAL REVIEW OF YOUR SITUATION, AND TO DEVELOP A PLAN TO MANAGE IT