

Stock-Based Compensation

Chiu & Wang, Inc.
Premier Tax Services

June 22, 2007



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Forms of Stock-Based Comp

- Statutory options
 - n Incentive Stock Options
 - n Employee Stock Purchase Plan
- Nonstatutory options
 - n An option, other than statutory option, which is granted in connection with the performance of services, to buy stock at a bargain.
 - n Outright transfer of stock to employees with restrictions.

Tax Consequences: Nonstatutory Stock Options (NSOs)

- Employee: Recognize ordinary income as compensation to the extent the fair market value of the stock on the date of exercise exceeds exercise price.
 - n If no option is granted but the stock is subject to restrictions, employee recognize ordinary income in the first year in which the stock is transferable or is not subject to a substantial risk of forfeiture, whichever occurs earlier.
 - n Employee will recognize capital gain or loss on the difference between the basis of the stock (i.e. exercise price + ordinary income recognized) and the sale price.
 - n If the option has a readily ascertainable fair market value at grant, subject to the restricted property rules, the employee may recognize ordinary income when the option is granted.
- Employer: Deduct compensation expense for ordinary income recognized by employee
 - n Required to withhold and pay income and payroll taxes.



What About US Sub of Foreign Parent?

- o If the employees of US sub are granted options to purchase foreign parent's stock:
 - n The employees are required to recognize ordinary income, and the US sub can deduct compensation expense for tax purposes.
 - n US sub is required to withhold and pay income and payroll taxes (i.e., FICA, FUTA).
 - n US sub is also required to report compensation expenses (i.e., W-2, 940, 941).



Nonqualified Deferred Compensation Plans (NQDC)

- o Amount deferred under a NQDC is includible in gross income of an employee to the extent not subject to substantial risk of forfeiture and not previously included in gross income, unless the plan meets specified distribution, acceleration of benefits, and election requirements; and is operated in accordance with these requirements
 - n There is an interest and penalty charge for not complying with the rules



What is a NQDC?

- It is a plan that provides for the deferral of compensation, other than
 - n Qualified employer plan (e.g., qualified retirement plan, etc.)
 - n Any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan
 - n Annual bonuses paid within 1 ½ months after the later of a service recipient's or service provider's tax year
 - n Statutory stock options
- Nonstatutory stock options are similarly excepted if the exercise price may never be less than then FMV of the underlying stock when the option is granted and there is no other deferral feature

Contact Us

Main Office:

13181 Crossroads Pkwy N.
Suite 270
City of Industry, CA 91746
Tel: (562) 463-3818
Fax: (562) 463-3328

Silicon Valley Office:

39931 Cedar Boulevard, No. 304
Newark, CA 94560
Tel: (510) 226-7666

www.chiu-wang.com

