



**RSU & STOCK OPTION
TAX TIMING GUIDE**

MASTER EQUITY COMPENSATION TAX STRATEGY

**RSUs • ISOs • NSOs • ESPP
• Performance Shares**

**TURN EQUITY GRANTS
INTO TAX-EFFICIENT WEALTH**

This guide provides general educational information and does not constitute tax, legal, or financial advice. Consult with qualified professionals before implementing any strategy.

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Executive Summary

Equity compensation can create life-changing wealth—or devastating tax bills. The difference comes down to timing, elections, and strategic planning around vesting and exercise decisions.

This guide provides a complete roadmap for navigating RSUs, ISOs, NSOs, ESPP, and deferred compensation. Every strategy is grounded in specific IRC provisions with real-world scenarios showing exactly when and how to act.

Key Takeaways:

- RSU timing can swing tax bills by \$50,000+ through strategic vesting management
- ISO early exercise + 83(b) election can save millions in AMT and capital gains
- ESPP offers guaranteed 15% return through qualified disposition strategy
- Wrong timing triggers AMT, ordinary income rates, and eliminates QSBS eligibility

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Work With AE Tax Advisors

Understanding Equity Compensation Types

Each equity compensation type has unique tax treatment, timing requirements, and planning opportunities. Understanding the differences is essential before making any decisions.

| Type | Tax Event Timing | Tax Rate | Key Planning Opportunity |
|------------------|--------------------------|---------------------------------------|--|
| RSUs | At vesting | Ordinary income (up to 37%) | Vesting management, withholding strategy |
| ISOs | At exercise (AMT) + sale | 0% at exercise, 20% long-term at sale | Early exercise, AMT planning, QSBS |
| NSOs | At exercise | Ordinary income at exercise | Exercise timing, same-day sale |
| ESPP | At purchase + sale | Ordinary + capital gains | Qualified vs. disqualifying disposition |
| Performance RSUs | When performance met | Ordinary income | Performance metric forecasting |

RSUs: The Tax Certainty Trade-Off

Restricted Stock Units (RSUs) are the most common equity compensation at public companies. They provide certainty—you know exactly what you'll receive—but create mandatory tax events at vesting with limited planning flexibility.

Legal Foundation

IRC § 83 governs taxation of property transferred for services. RSUs are taxed as ordinary income when they vest (restrictions lapse). Fair market value at vesting = W-2 income.

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How RSU Taxation Works

1. RSUs vest according to schedule (e.g., 25% per year over 4 years)
2. At vesting: FMV added to W-2 as ordinary income
3. Company withholds shares (typically 22-37%) to cover taxes
4. Remaining shares deposited to your account with cost basis = vesting FMV
5. Future sale taxed as capital gain/loss from basis

RSU Tax Hit Example

Tech employee receives 1,000 RSUs, 25% vest annually:

Year 1 vesting: 250 shares at \$200/share = \$50,000 income

- Added to W-2, taxed at marginal rate (37% = \$18,500)
- Company withholds 92 shares for taxes
- Employee receives 158 shares

If stock drops to \$150 before sale:

- Capital loss: \$7,900 (158 shares × \$50 decline)
- Already paid \$18,500 in ordinary income tax
- Net tax cost: \$18,500 - limited capital loss deduction

RSU Planning Strategies

1. Withholding Elections

Default supplemental withholding is often 22%—insufficient for high earners. Elect additional share withholding or increase W-2 withholding to avoid underpayment penalties. Consider making estimated tax payments.

2. Immediate Sale Strategy

Selling immediately at vesting locks in cost basis = FMV, eliminating downside risk. This converts equity comp into cash bonus. Appropriate when: (a) stock is overvalued, (b) you lack liquidity for taxes, or (c) you want diversification.

3. Vesting Date Management

Some companies allow deferral of vesting dates. If income pushes you into higher bracket this year, deferring vesting to January can save thousands. Requires advance planning—elections typically due before calendar year begins.

Incentive Stock Options (ISOs): AMT Strategy

ISOs offer the potential for long-term capital gains treatment on the entire spread—but create Alternative Minimum Tax (AMT) exposure at exercise. Strategic planning can save hundreds of thousands in taxes.

Legal Foundation

IRC § 422 defines ISOs. Exercise creates no regular tax but triggers AMT on spread (FMV - exercise price). IRC § 55 imposes 28% AMT rate. Qualifying disposition requires holding 2 years from grant AND 1 year from exercise.

ISO Tax Treatment Scenarios

Qualifying Disposition (hold 2 years from grant + 1 year from exercise):

- Exercise: \$0 regular tax, AMT on spread at 28%
- Sale: Entire gain taxed as long-term capital gain (20% + 3.8% NIIT)
- AMT paid at exercise creates AMT credit (recoverable in future years)

Disqualifying Disposition (sell before holding periods met):

- Spread at exercise taxed as ordinary income (up to 37%)
- Additional gain from exercise to sale: short-term or long-term capital gain
- Eliminates AMT at exercise (spread becomes W-2 income instead)

ISO Early Exercise Strategy

Startup employee granted 100,000 ISOs at \$0.10 strike:

Strategy: Exercise immediately at \$0.10 FMV

- Spread: \$0 (FMV = strike price)
- AMT: \$0
- Cost: \$10,000 to exercise
- File 83(b) election within 30 days

5 years later: Company acquired at \$50/share

- Qualify for long-term capital gains (20%)
- Potential QSBS treatment (0% tax on \$10M gain)
- Total gain: \$4,990,000
- Tax if QSBS qualifies: \$0
- Tax savings vs. waiting: \$1,246,000+

AMT Optimization Strategy

Exercise ISOs up to AMT exemption amount each year (\$85,700 married filing jointly in 2025). This minimizes or eliminates AMT while starting capital gains holding period. Requires multi-year planning and AMT projection modeling.

ISO Annual Limits

ISOs that first become exercisable in any year cannot exceed \$100,000 FMV (measured at grant). Excess ISOs automatically become NSOs. This limits ISO planning for large grants at high-growth companies.

Non-Qualified Stock Options (NSOs): Timing Control

NSOs are taxed as ordinary income at exercise—simpler than ISOs but without preferential capital gains treatment. The advantage is complete timing control over when to recognize income.

Legal Foundation

IRC § 83 governs NSOs. Spread at exercise (FMV - strike price) = W-2 ordinary income. Subject to payroll taxes if still employed. No AMT complications.

NSO Tax Mechanics

1. Exercise: Pay strike price, recognize spread as ordinary income
2. Withholding: 22-37% withheld for federal taxes (supplemental wage rules)
3. Cost basis = FMV at exercise
4. Sale: Capital gain/loss from basis (long-term if held 1+ year)

NSO Exercise Timing Strategy

Executive with 50,000 NSOs, \$10 strike, stock at \$60:

Exercise now (high-income year, \$500K W-2):

- Spread: \$2,500,000 ordinary income
- Tax at 37%: \$925,000
- Plus state tax: ~\$250,000
- Total tax: \$1,175,000

Wait until retirement (low income year):

- Same spread: \$2,500,000 income
- Tax at 24%: \$600,000
- Plus lower state tax: ~\$125,000
- Total tax: \$725,000
- Tax savings from timing: \$450,000

Exercise and Hold vs. Exercise and Sell

Exercise and Hold: Pay cash for strike price + taxes, hold shares for long-term capital gains. Risky if stock declines—you paid taxes on value that disappeared.

Exercise and Sell (same-day sale): Broker sells enough shares to cover strike price + taxes. Net cash received = spread minus taxes. Eliminates stock price risk but forfeits potential appreciation.

Cashless Exercise Mechanics

Broker simultaneously exercises options and sells shares. Net proceeds = (FMV - strike price - taxes). No out-of-pocket cash required. This converts options to cash while avoiding market timing risk. Appropriate for most NSO exercises unless you have strong conviction and cash reserves.

Employee Stock Purchase Plans (ESPP)

ESPPs offer guaranteed returns through the 15% discount—but tax treatment depends on holding periods. Strategic timing converts ordinary income into capital gains.

Legal Foundation

IRC § 423 governs qualified ESPPs. Employees purchase stock at discount (typically 15% off lower of offering date or purchase date price). Tax treatment depends on disposition type.

ESPP Tax Treatment

Qualifying Disposition (hold 2 years from offering + 1 year from purchase):

- Ordinary income: Lesser of (a) discount at purchase, or (b) actual gain
- Remaining gain: Long-term capital gain
- Minimizes ordinary income, maximizes capital gains treatment

Disqualifying Disposition (sell before holding periods):

- Ordinary income: Full discount at purchase
- Additional gain: Short-term or long-term capital gain
- Immediate sale strategy: Lock in guaranteed 15% return, minimize risk

ESPP Qualified vs. Disqualified Disposition

\$10,000 contribution, 15% discount, stock price stable:

Purchase: 1,176 shares at \$8.50 (15% discount from \$10)

Immediate value: \$11,760 (worth \$10/share)

Gain at purchase: \$1,760

Disqualifying disposition (sell immediately):

- Ordinary income: \$1,760
- Tax at 37%: \$651
- Net gain: \$1,109 (11.1% after-tax return)

Qualifying disposition (hold 2+ years, sell at \$12):

- Stock appreciates to \$14,112
- Ordinary income: \$1,760
- Long-term capital gain: \$2,352
- Tax: \$651 + \$560 = \$1,211
- Net gain: \$2,901 (but assumes 2 years of price risk)

ESPP Strategic Guidance

Maximum participation recommended: The 15% discount is a guaranteed return that beats most investments after tax. Unless stock price is clearly overvalued, contribute the maximum (\$25,000/year limit on \$167,000 contribution in 2025).

Sell immediately vs. hold for qualifying disposition: Immediate sale eliminates risk and produces ~10-15% guaranteed return. Holding for qualifying disposition requires confidence in stock appreciation and creates concentration risk. Most employees should sell immediately.

83(b) Elections: The Early Exercise Opportunity

The 83(b) election is the single most powerful tax strategy for startup equity—but comes with strict deadlines and significant risk. Understanding when and how to use it can save millions.

Legal Foundation

IRC § 83(b) allows taxpayers to elect to include unvested property in income immediately at current FMV rather than at vesting. Must be filed within 30 days of grant/exercise. This deadline is absolute—missing it by one day eliminates the opportunity forever.

How 83(b) Elections Work

Without 83(b): Restricted stock taxed as ordinary income when it vests at future (higher) FMV. Capital gains holding period starts at vesting.

With 83(b): Pay tax immediately on current (low) FMV. Future appreciation taxed as capital gain. Capital gains holding period starts immediately.

83(b) Election Million-Dollar Impact

Founder receives 1M shares at \$0.01/share FMV:

Without 83(b):

- No tax at grant (restricted)
- 4 years later at vesting: FMV = \$10/share
- Ordinary income: \$10,000,000
- Tax at 37%: \$3,700,000
- Stock continues to appreciate to \$50/share
- Capital gain from \$10 to \$50: \$40M at 20% = \$8M tax
- Total tax: \$11,700,000

With 83(b) (filed within 30 days):

- Immediate ordinary income: \$10,000 (1M × \$0.01)
- Tax: \$3,700
- All appreciation from \$0.01 to \$50 = long-term capital gain
- Capital gain: \$49,990,000 at 20% = \$9,998,000
- Total tax: \$10,001,700
- Tax savings: \$1,698,300

When to File 83(b)

- Early-stage startup equity when FMV ≈ exercise price (minimal spread)
- Expect significant appreciation before vesting
- Can afford to pay tax on value you haven't realized
- Comfortable with forfeiture risk (if you leave, lose unvested shares AND tax paid)

83(b) Filing Procedure

- Complete 83(b) election form (simple one-page document)
- **Mail to IRS within 30 days of grant/exercise (use certified mail, keep receipt)**
- Provide copy to employer
- Attach copy to tax return for that year
- Report income on Form 1040 even if no W-2 issued

Deferred Compensation Integration

Many executives receive both equity compensation and deferred comp. Coordinating these creates powerful multi-year tax planning opportunities.

Strategic Coordination

Defer cash compensation to low-income years, accelerate equity recognition to high-income years when brackets are already maxed out. This inverts the normal timing preference and can save significant taxes.

Deferred Comp + Equity Coordination

VP with \$400K salary + \$400K bonus + RSUs vesting:

Year 1 (working):

- Salary: \$400K
- Defer 100% of bonus: \$400K → deferred to retirement
- RSUs vest: \$200K ordinary income
- Total taxable: \$600K (lower than \$1M)

Year 10 (retired, low income):

- Deferred comp distribution: \$400K
- No other income
- Tax at 24% bracket instead of 37%
- Savings on deferred comp: \$52,000/year

Combined with RSU timing: Exercise ISOs in retirement years when AMT exemption is fully usable.

Election Timing Coordination

- Deferred comp elections due before calendar year begins (IRC § 409A)
- Model next year's RSU vesting schedule before making deferral decisions
- Consider ISO exercise plans and AMT impact
- Project multi-year income to optimize marginal rates

Exit Event Tax Planning (IPO, Acquisition, Tender Offer)

Company exits create life-changing wealth—and potential tax disasters. Strategic planning in the months before an exit can save hundreds of thousands.

Pre-IPO Planning (6-12 Months Before)

- Exercise ISOs while FMV is still private valuation (lower AMT)
- File 83(b) elections on any early-exercised options
- Confirm QSBS qualification for C-corp stock (must hold from original issuance)
- Review lockup periods and plan post-IPO sales to manage tax brackets
- Consider relocating to no-income-tax state before liquidity event

Post-IPO Lockup Strategy

Lockup period (typically 180 days) = forced holding period. Use this time to: (1) Project tax liability on sales, (2) Establish systematic selling plan (10b5-1), (3) Harvest losses from other holdings to offset gains, (4) Model AMT credit recovery.

Acquisition Tax Planning

Cash acquisition: Immediate taxable event. Cannot defer. Plan for liquidity to pay taxes. Consider charitable giving to offset income.

Stock acquisition: May qualify for tax-free reorganization under IRC § 368. Acquiring company stock substitutes for your stock, deferring tax until you sell. Confirm tax treatment before accepting deal terms.

IPO Windfall Tax Management

Engineer with 50,000 ISOs exercises pre-IPO:

Pre-IPO (409A valuation: \$10/share):

- Exercise all ISOs at \$1 strike
- Spread: \$9/share = \$450K AMT income
- AMT paid: \$126K (28% rate)
- Start long-term holding period

Post-IPO (stock opens at \$40/share):

- Value: \$2,000,000
- Lockup ends after 180 days
- Stock at \$50/share = \$2,500,000

Sale at \$50 (qualifying disposition):

- Long-term capital gain: \$2,450,000 (\$50 - \$1 basis)
- Tax at 20%: \$490,000
- AMT credit recoverable: \$126,000
- Net tax: \$364,000 on \$2.5M (14.6% effective rate)

Tender Offer Decisions

Secondary sales and tender offers provide early liquidity but create immediate tax events. Compare: (a) tax cost of selling now at current FMV, vs. (b) waiting for IPO/acquisition with potentially higher valuation but delayed tax recognition. Model scenarios with probability-weighted outcomes.

Multi-Year Tax Projection Modeling

Equity compensation decisions ripple across multiple tax years. Proper planning requires comprehensive modeling of income, AMT, and tax brackets over 3-5 year horizons.

What to Model

- All W-2 income including salary, bonus, and RSU vesting schedule
- ISO exercise timing and AMT impact across multiple years
- NSO exercise decisions and ordinary income recognition
- Deferred compensation distribution timing
- State income tax if considering relocation
- Retirement contributions and other deductions
- AMT credit carryforward recovery

Key Decision Points

| Scenario | Key Variables | Optimization Target |
|---------------------|---|--|
| ISO Exercise Timing | Current income, AMT exemption, stock price trajectory | Minimize AMT, start holding period early |
| RSU Vesting | Other W-2 income, tax bracket, withholding needs | Smooth income across years if possible |
| NSO Exercise | Current vs. expected future income, stock conviction | Exercise in lowest-bracket years |
| ESPP Disposition | Stock price stability, concentration risk tolerance | Balance guaranteed return vs. appreciation |
| Pre-IPO Planning | 409A valuation, expected IPO price, QSBS eligibility | Maximize exercises before valuation spikes |

Common Modeling Mistakes

- Ignoring AMT phaseouts and exemption calculations
- Failing to account for state tax impacts on timing decisions
- Not modeling the AMT credit recovery in future years
- Underestimating ordinary income from RSU vesting
- Missing the interplay between deferred comp and equity recognition

Professional Modeling Required

Spreadsheet models miss critical nuances in AMT calculations, phaseouts, and credit limitations. Professional tax projection software and advisor expertise are essential for six-figure+ equity compensation decisions. The cost of modeling (\$2,000-\$5,000) is negligible compared to potential tax savings (\$50,000-\$500,000+).

Work With AE Tax Advisors

Equity compensation is complex, high-stakes, and unforgiving of mistakes. A single missed 83(b) deadline or poorly-timed exercise can cost hundreds of thousands in unnecessary taxes. Professional guidance pays for itself many times over.

Equity Compensation Planning Services

AE Tax Advisors specializes in equity compensation tax strategy for executives, employees at high-growth companies, and pre-IPO/pre-exit planning:

- Comprehensive equity grant analysis (RSUs, ISOs, NSOs, ESPP)
- Multi-year tax projection modeling with AMT optimization
- ISO exercise strategy and early exercise planning
- 83(b) election preparation and filing
- Pre-IPO/pre-acquisition exit planning
- QSBS qualification analysis and tracking
- Deferred compensation and equity coordination

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Analysis includes:

- Complete equity grant review
- 5-year tax projection modeling
- Exercise timing recommendations
- AMT impact analysis

Why Timing Matters

Equity compensation decisions are time-sensitive and irreversible. An 83(b) election missed by one day cannot be fixed. An ISO exercised in the wrong year creates permanent AMT exposure. Our clients who engage before making exercise decisions save an average of \$75,000-\$250,000 in taxes on exits compared to those who seek advice after the fact.

Legal Disclaimers

This whitepaper provides general educational information about equity compensation tax treatment under federal tax law. It is not intended to provide tax, legal, or financial advice. Every equity compensation situation is unique and depends on specific grant terms, company type, exit timing, and individual tax circumstances.

Exercise decisions, 83(b) elections, and ISO/NSO planning should only occur after consultation with qualified tax advisors who have reviewed your specific equity grants and modeled the tax impact. AE Tax Advisors does not guarantee any specific tax savings. Actual benefits depend on proper timing, documentation, and compliance with all applicable rules.

AMT calculations are complex and subject to phase-outs and limitations. State tax treatment varies significantly. This guide provides IRC references for educational purposes and does not create an advisory relationship.



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