LIFE CYCLE COMPARISON OF CERTAIN EQUITY AWARDS[1]

The following is NOT legal advice, and instead is provided to facilitate the webinar entitled "Comparing and Contrasting Equity Awards: A Life Cycle Approach," that was held on May 9, 2024.

Subject/Topic	ISOs	NSOs	RSAs	RSUs/SARs	Profits Interest
GENERAL CHARACTERISTICS:					
Value of Award:	Appreciation-only award. This means the participant receives the difference between the exercise price and the FMV of the underlying stock as of the date the underlying stock is sold.	Same as ISOs.	Full-value award. This means the participant receives the difference between $0.00 and the FMV of the underlying stock as of the date the underlying stock is sold.	RSUs are full-value awards, and SARs are appreciation-only awards.	Appreciation-only award. This means the holder receives the difference between the initial threshold value and the FMV of the underlying equity as of the date of a liquidation event. Typically, the threshold value is equal to the liquidation value of the Company.
Type of Award:	Share-based award only.	Share-based award only.	Share-based award only.	Cash-based or share-based award, at the discretion of the Company. However, equity classification for accounting purposes (which is typically desired) cannot be maintained if the award is to be settled in cash or if the	Equity-based award.

[1] Legend: **AMT** = Alternative Minimum Tax **FMV** = Fair Market Value **ISO** = Incentive Stock Option **NSO** = Nonqualified Stock Option
RSA = Restricted Stock Award **RSU** = Restricted Stock Unit **SAR** = Stock Appreciation Right **IPO** = Initial Public Offering

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				Company has the discretion to settle the award in cash (i.e., the presence of a cash settlement feature triggers liability classification for accounting purposes).	
Impact on Shareholder Dilution:	Compared to full-value awards, ISOs are more dilutive because, due to the "at the money" strike price associated with the grant of an ISO, more shares are typically required in order for the recipient to have a stated level of perceived value.	Same as ISOs.	Compared to appreciation-only awards, RSAs are less dilutive (assuming any purchase element is $0.00 or par value) because, as a full-value award, RSAs have a direct correlation between the FMV of the award on the date of grant and the perceived value of the RSA by the recipient.	No equity dilution if the RSU/SAR is settled in cash. If stock-settled, then SARs have a similar impact as ISOs, and RSUs have a similar impact as RSAs.	Current equity dilution, but only as to the appreciation from threshold value.
Any Required Cash Outlay by the Participant?:	Yes, unless a net exercise feature is implemented. An alternative design feature is for the Company to loan the employee money to help him or her finance the exercise.	Same as ISOs.	Generally no, though a payment equal to par value could be required under the Company's Articles of Incorporation or Bylaws.	Generally no.	Generally no.

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	To comply with applicable federal income tax laws, the loan would have to be structured to be at least 50% recourse vis-à-vis the employee. See Treas. Reg. § 1.83-3(a)(2). And 100% of the stock would be pledged as security/collateral under the note.				
TAX RAMIFICATIONS:					
Date of Grant (Employee):	No federal income tax consequence to the optionee or the Company.	Same as ISOs.	No federal income tax consequence to the participant or the Company unless the participant timely filed an 83(b) election within 30 days from the date the RSA was granted to him or her. If instead the participant timely filed an 83(b) election, then the participant would recognize ordinary	Assuming there is a vesting schedule, no federal income tax to the participant on the date of grant.	Same as ISOs.

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			taxable income equal to the difference between the FMV of the shares on the date of grant and the price paid, if any. The Company would then have a corresponding withholding obligation and a corresponding compensation deduction.		
Date of Vesting (Employee):	No federal income tax consequence to the optionee or the Company.	Same as ISOs.	If no 83(b) election was timely filed within 30 days from the date of grant, the participant would have compensation income (taxed at ordinary rates) equal to the difference between the FMV of the shares on the date of vesting and the price paid, if any. The Company would have a corresponding withholding obligation and a corresponding	Absent a deferral arrangement, a participant holding RSUs would have compensation income (taxed at ordinary rates) equal to the difference between the FMV of the award on the date of vesting and the price paid, if any. Absent a deferral arrangement, a participant holding SARs would have compensation income (taxed at ordinary rates) equal to the difference between the FMV of the award on the date of vesting and the strike price.	Same as ISOs.

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			compensation deduction. If instead the participant timely filed an 83(b) election, then vesting would trigger no federal income tax consequence to the participant or the Company.	The Company would have a corresponding withholding obligation and a corresponding compensation deduction.	
Date of Exercise (Employee):	No federal income tax consequence to the optionee or the Company. However, the "spread" under an ISO – *i.e.*, the difference between the FMV of the shares at exercise and the exercise price – would be classified as an item of adjustment in the year of exercise for purposes of AMT. In order to avoid the application of AMT, the optionee would have to sell the underlying shares during the same	The optionee would have compensation income (taxed at ordinary rates) equal to the difference between the option's exercise price and the FMV of the underlying shares on the date of exercise. The Company would have a corresponding withholding obligation and a corresponding compensation deduction.	Not an applicable concept within most designs.	Not an applicable concept with respect to most designs.	Not an applicable concept.

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	calendar year that the ISOs were exercised. However, such a sale within the same calendar year would constitute a "disqualifying disposition" (defined below). The Company would have no withholding obligation and would not be entitled to any compensation deduction.				
Date of Sale (Employee):	The tax consequences depend upon whether the sale is a "disqualifying disposition" (*i.e.,* no disqualifying disposition if the stock is held <u>for at least</u>: (i) 2 years from the date of grant AND (ii) 1 year from the date of exercise). If the sale is <u>not</u> a disqualifying disposition, then the optionee would	Any gain or loss would be short- or long-term capital gain or loss, depending upon whether the shares were held for one year following exercise.	Any gain or loss would be short- or long-term capital gain or loss, depending upon whether the shares were held for one year from the date of vesting (if no § 83(b) election is timely made) or from the date of grant (if a § 83(b) election is timely made).	Assuming the RSU/SAR is settled in stock, the answer is the same as NSOs with respect to the one-year holding period. Not an applicable concept if the RSU/SAR is settled in cash.	All gain would be taxed at favorable capital gains rates.

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	recognize long-term capital gain (or loss) equal to the difference between the sale price of the shares and the exercise price. The Company would have no corresponding withholding obligation and would not be entitled to any corresponding deduction. If instead the sale is a disqualifying disposition, the optionee would generally have compensation income (taxed at ordinary rates) equal to the difference between the exercise price and the FMV of the underlying stock at the time of exercise (and the Company would be entitled to a corresponding deduction). Such compensation income would be added to the stock's basis to				

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	determine any capital gain (or loss) that would have to be recognized on the disqualifying disposition. The Company would have no withholding obligation, even if there was a disqualifying disposition.				
CERTAIN DESIGN FEATURES:					
Vesting Provisions:	A time-based or performance-based vesting schedule could be used, or both. In setting the vesting schedule, consideration should be given to the recognition of compensation expense pursuant to a Black Scholes formula, and whether the vesting schedule should be set to help reduce the "fair value" of the award as of the date of grant (thus reducing the amount	Same as ISOs.	Same as ISOs except that the fair value of an RSA would be equal to the FMV of the award on the date of grant and the vesting schedule would affect the period over which the compensation expense would be recognized.	SARs have similar considerations as ISOs, and RSUs have similar considerations as RSAs.	Same as ISOs and RSAs.

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	of compensation expense recognized over time). If a performance-based vesting schedule is used that contains a "market condition," then a Monte Carlo simulation (instead of a Black Scholes formula) will be used to determine the fair value of the award and any resulting compensation expense.				
Termination Provisions:	Upon a termination, all unvested equity would be immediately forfeited. Alternatively, the option could be structured so that vesting is partially or fully accelerated if: (i) the optionee's employment is terminated by the optionee for "good reason," (ii) the optionee's	Same as ISOs.	Same as ISOs, except for the exercise element.	Same as ISOs, except that no equity repurchase concept would apply if the RSU/SAR is settled in cash, however, a clawback of cash proceeds could be implemented.	Same as ISOs.

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	employment is terminated by the Company for a reason other than "cause," and/or (iii) a change in control transaction is consummated. Additionally, the acceleration of vesting upon disability and/or death is a possible design feature. Also, the option could be structured so that both unvested and vested options are forfeited for no additional consideration if the optionee is terminated for "cause." And if the option was previously exercised as of the date a termination for cause is effectuated, then the option could provide for the repurchase of the underlying stock at the lesser of: (i) the then FMV or (ii) the exercise price. Finally, the forfeiture				

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	and repurchase discussed in the above paragraph could equally be triggered if the optionee violates any non-competition or non-solicitation agreement.				
Repurchase Rights, Rights of First Refusal, Drags & Tags:	Typically these issues are addressed in the shareholders' agreement. But if no shareholders' agreement exists, or if a shareholders' agreement exists but it is desired that the optionees not participate in such agreement, then such issues are addressed in the granting documentation.	Same as ISOs.	Same as ISOs.	Same as ISOs.	Typically addressed in the operating agreement.
Change in Control:	Generally participate in the same manner as shareholders (assuming the option is exercised). To create a disqualifying disposition so that the	Same as ISOs, except there would be no automatic exercise feature.	Same as NSOs.	Same as NSOs.	Same as NSOs.

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	optionee and Company owe less in employment taxes (which in turn generally results in shareholders receiving more sale proceeds), a design feature is to require an automatic exercise prior to consummation of the change in control. As another design feature, an automatic cash-out feature could be implemented for all vested but unexercised options.				
Initial Public Offering:	Consider whether to have vesting accelerated upon the effectiveness of an S-1 Registration Statement or upon a reverse merger into a public shell corporation. Consider whether, upon the occurrence of an IPO, an optionee should have				

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	co-registration rights so that he or she can sell his or her pro rata shares in the open market to the extent other shareholders of the Company are participating in the IPO by selling shares.				

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