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Net Worth Strategies wishes you the warmest of holiday greetings and a prosperous 2002. The arrival of a new year prompts us to reflect, understand and learn from 2001 — a year much like the Chinese character for chaos. In Chinese “chaos” is made of two characters, one reading as “danger” and the other “opportunity.”



The “chaos” during 2001 for advisors arose when: clients’ portfolios lost substantial value; new employee stock options submarined; the 911 tragedies and consequences required careful damage control to retain clients; and companies, including financial services, laid off thousands.

However, in the midst of this chaos existed practice-building opportunities: more people looking to financial advisors in uncertain times; the new minimum required distribution rules providing greater potential to maximize tax-deferred wealth across generations; and option holders in non-technology sectors seeking advice for their in-the-money employee stock options.

This issue *The Planner* examines how to make hay on employee stock option “chaos.” According to a November 2001 BusinessWeek article, 75% of executive employee stock options are in-the-money. The statistic demonstrates how most executive options weather economic storms well. A proactive advisor armed with this issue’s exclusive white paper by Net Worth Strategies’ founder and CEO, Bill Briggs, can help executives understand the need for high-value stock option planning. Also look for the article by Corey Rosen, the cofounder and executive director of the National Center for Employee Ownership (NCEO), who talks about how to avoid employee stock option chaos in April 2002 with prudent year-end planning considerations.

Be sure to check out the StockOpter tip of the month on how to do a stock price override and the Determinator tip introducing the new Determinator Suite. In addition, discover what's new at Net Worth Strategies, such as our new monthly Stock Option Boot Camp here in Bend, Oregon.

Good luck in finding opportunities amidst chaos in 2002!



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*The Planner* Editor  
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## CALENDAR OF EVENTS

Date	Event	Location
1/17-18	Stock Option Boot Camp	Bend, OR
1/30	StockOpter Training Seminar	Houston
2/14-15	Stock Option Boot Camp	Bend, OR
2/27	StockOpter Training Seminar	San Francisco
3/19	StockOpter Training Seminar	White Plains, NY

For custom classes, details and to enroll call 877-728-5964.

**Planning Article of the Month:****Getting the Most From Your Employee Stock Options:**

High Value Stock Option Planning - The Value Explained To The Client

By Bill Briggs

*This article is written from the point of view of the option holder. As a financial advisor, and assuming you agree with the precepts of "High Value Stock Option Planning", you may want to forward this newsletter to your option holding clients.*

As a business executive, you are practiced at planning and execution. You are also skilled at decision-making and delegation. If your employee stock options represent a significant portion of your wealth, then you should view yourself as the CEO of your personal stock option enterprise. As with your day-to-day business activities, you will need both a strategic plan and operational capability to assure the success of this enterprise. You will also want to employ a personal CFO (financial advisor) to provide expertise, suggest alternative strategies, run analysis, and implement your decisions.

If you were starting a new business, you would spend several months developing and refining your business plan. You would likely start by defining your vision and goals. Then, you would develop a strategy for achieving your goals and develop financial projections to quantify the results. As the plan matures, you would probably tweak and tune strategies, assumptions and projections until finally you had a plan you

could confidently implement. Designing a plan for your employee stock options may not be quite as complex as developing a business plan, but it does require the same type of involvement, analysis and decision making. The pay off for this personal effort is the confidence and peace of mind you will achieve from knowing you have developed a winning plan for the financial future of you and your family.

Like any business endeavor, successful capitalization of your employee stock options has strategic and tactical elements. You, as CEO, are the final decision maker as only you have

responsibility for all facets of the strategy. Your CFO provides strategic support by defining alternative strategies and providing relevant analysis of the trade-offs.

Once the strategy has been established, tactical decisions and implementation may be delegated with the CEO stepping back to the role of review and approval. As conditions change, the CEO and CFO must monitor and adjust/redefine the strategy. This process is the essence of what we call High Value Stock Option planning (HVSOP).

**Strategy development**

In order to develop a successful strategy, you need to start with a clear goal or vision. The central question is how much wealth are you trying to create, and for what purpose/s? As an example, assume that financial independence was a key goal for you and your family and that you decided that you need \$5 million to fund it. In this case, securing the last \$2 million required to fund your goal would probably be more important to you than accumulating \$2 million in excess of your goal. As illustrated in **Appendix A**,

holding a significant portion of ones wealth in options or shares in a single company is a risky proposition. Imagine how you would feel if you had your objective within your grasp, only to see it slip away due to business

downturns or market declines outside of your control. Over the past couple of years this occurred all too frequently. Therefore, your strategy should establish a plan for exercising, selling, and/or hedging the options over time in order to secure your goal.

*(Continued on page 5)*

*"Like any business endeavor, successful capitalization of your employee stock options has strategic and tactical elements."*

## Building Your Practice Through Employee Stock Option Planning: Year-end Planning Considerations For Employee Stock Options

By Corey Rosen, PhD

As the year draws to close, it's time again to think about employee stock options and tax planning. For holders of nonqualified options (NQSOs), taxes come into play mainly in deciding when to exercise an option. For holders of incentive stock options (ISOs), tax-planning issues are much more complicated.

Nonqualified options present a straightforward scenario. By not exercising an option, option holders defer the requirement to pay the ordinary income tax they must pay when they exercise. That means that whatever that tax would be is still invested and, if the stock goes up, making money. If the options are exercised, then the tax is paid and the remaining amounts can be invested. So that remaining amount will have to earn a much higher rate of return than the stock of the employer to produce equivalent yields. On the other hand, by exercising sooner, the option holder reduces risk substantially.

With ISOs, the situation is much more complicated. If shares are held for one year after exercise and two years after grant, the optionee pays capital gains taxes, not ordinary income tax. However, the spread on the options is subject to the alternative minimum tax (AMT). In the more pleasant scenario, the employee exercises the ISOs and decides to hold the shares for one year or more. The stock

price holds steady or rises. The optionee pays no tax on exercise, and capital gains taxes on sale. The spread may be subject to AMT, but most or all will be recovered in future years.

Life has not been like that in 2001, however, with most option holders facing declining stock values. In the worst-case scenario, optionees have exercised ISOs and realized a large spread. That amount is subject to AMT the next April. But between the time the options are exercised and the time taxes are due, the share price plummets. The stock value is now less than the AMT that is due.

Avoiding this AMT trap is unquestionably the most important tax planning issue an optionee faces. There are some things the optionee can do to avoid getting caught:

1. If optionees have a lot of nonqualified options, or gains on other stock, they can exercise the options or sell the shares before the end of the year. This may increase ordinary tax to a point it is higher than the AMT. Of course, either exercising options or selling existing shares might be imprudent now for other investment reasons. Paying the AMT might be a better choice.
2. Sell some or all of the shares acquired by the option by December 31 of the tax year in

which the option was exercised. This will be a disqualifying disposition, of course, and ordinary income taxes will be due. But there will be no AMT next April. Waiting until after December 31, and still selling before

*"Avoiding the AMT trap is unquestionably the most important tax planning issue an optionee faces."*

holding the options for a year, means there is both a disqualifying disposition and AMT obligations. Alternatively, only enough shares could be sold to cover the AMT.

In this approach, an employee would buy and sell enough shares to cover the purchase price, plus any taxes that would be due, and then keep the remaining shares as ISOs. For instance, an employee might buy 5,000 shares on which he or she has options and keep 5,000. If the shares were worth \$30, with an exercise price of \$10, this would generate a net before taxes of 5,000 x the \$20 spread, or \$100,000. After taxes, this would leave about \$50,000, counting payroll, state, and federal taxes all at the highest levels. In the following year, the employee has to pay AMT on the remaining \$100,000 spread for shares that were not sold, which could be as much as \$28,000. But the employee will have more than

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## Year-end Planning Considerations for Employee Stock Options

(Continued from page 3)

enough cash left over to deal with this.

3. Exercise the options early in the year. This may be too late for 2001, but worth considering in future years. This gives the optionee a better chance of seeing how the stock is doing. If it looks like it is going down below where a comfortable price, there is time to sell by December 31.

For instance, assume John exercises his ISOs in January at \$10 per share at a time when the shares are worth \$30. There is no immediate tax, but the \$20 spread is subject to the AMT, to be calculated in the next tax year. John holds on to the shares, but watches the price closely. By December, they are only worth \$17. John is a higher-income taxpayer. His accountant advises him that all of the \$20 spread will be subject to a 26% AMT tax, meaning John will owe tax of about \$5.20 per share. This is getting uncomfortably close to the \$7 profit John now has on the shares. In the worst-case scenario, they fall to under \$10 next year, meaning John has to pay \$5.20 per share tax on shares

where he has actually lost money! If, however, John sells before December 31, he can protect his gains. In exchange, he'll pay ordinary income tax on the \$20 per share spread (about \$8 per share). He'll end up about

even, but that's better than ending up behind. On the other hand, if in December the stock price still looks strong, John can hold on for another month and qualify for capital gains treatment. By exercising early in the year, he has minimized the period after December 31 he must hold the shares before making a decision to sell. The later in the year he exercises, the greater the risk that in the following tax year the price of the stock will fall precipitously. If John waits until after December 31 to sell his shares, but sells them before a one-year holding period is up, then things are really bleak. He is still subject to the AMT *and* has to pay ordinary income tax on the spread as well. Fortunately, almost in every case, this will push his ordinary income tax above the AMT calculation and he won't have to pay taxes twice.

### About the Author & NCEO

Corey Rosen is the executive director and cofounder of the National Center for Employee Ownership (NCEO). The NCEO is a private, nonprofit membership and research organization that serves as the leading source of accurate, unbiased information on

employee stock ownership plans (ESOPs), broadly granted employee stock options and related programs, and ownership culture. The NCEO is the main publisher and research source in the field, holds dozens of workshops and conferences annually, and provides services to thousands of members. To learn more about the NCEO, visit [www.nceo.org](http://www.nceo.org).

Mr. Rosen cofounded the NCEO in 1981. He has coauthored five books on employee ownership and written over 100 articles on the subject for business, professional, and trade publications. He can be contacted at [crosen@nceo.org](mailto:crosen@nceo.org).

### StockOpter Tip of the Month:

*Transaction stock price override*

Do you have a client who exercised ISOs earlier this year? Was the stock price considerably higher? If so, consider this scenario:

- You have a client who works for Juniper Networks.
- Your client has an ISO grant for 1,000 shares.
- He or she exercised in February when the price was around \$100/share
- You want to demonstrate to your client the results if the shares were sold in December as a disqualifying versus selling in February of next year when the shares have matured.

StockOpter can help to quantify why your client should consider making a disqualifying disposition before the end of the year.

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### BACK-OFFICE EXPERTISE

Whether you're a current StockOpter user and need client-specific assistance, or an advisor who has yet to master the art of option planning, let Net Worth Strategies' stock options experts be your back-office support team.

BASIC OPTION PLANNING  
STOCKOPTER USER PLANNING ASSISTANCE  
COMPREHENSIVE OPTION PLANNING

See our web site for details or call 877-728-5964

### StockOpter Tip of the Month

(Continued from page 4)

Here's how:

In the Base Case, enter the number of ISOs exercised in the row titled, **# of qualified options to exercise**. Then, enter the fair market value at the time the options were exercised in the row titled, **Transaction stock price override**. Sell the shares the following year by entering the appropriate number in the row titled, **# of shares to sell (qualified)**. Then, enter a projected stock price at the time the options are going to be sold in the row titled, **Transaction stock price override**.

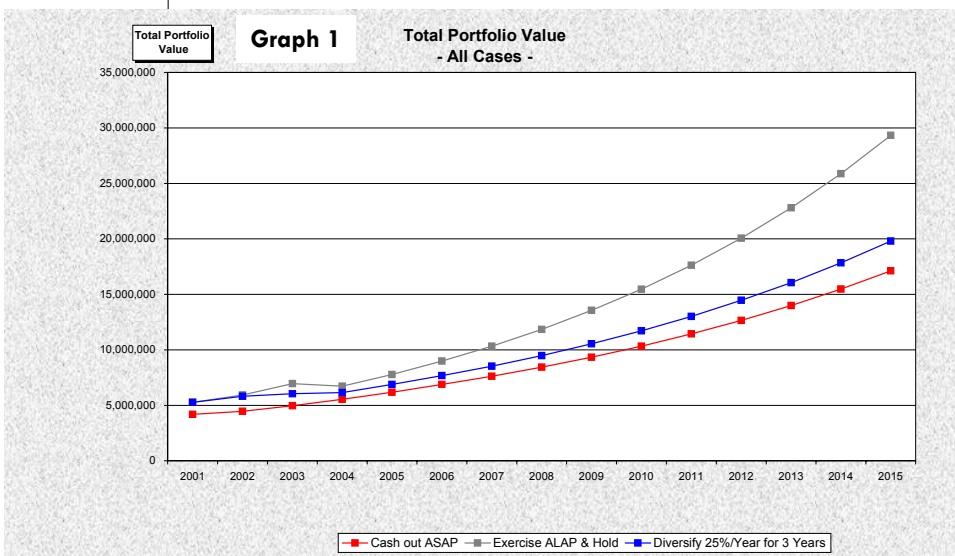
Add a case sheet using, **Blank values**. Enter the same number of shares exercised at a fair market value of \$100/share earlier in the year in the row titled, **Disqualifying disposition**. Then, enter a projected stock price at the time the options are going to be sold in the row titled, **Transaction stock price override**. (Consider using the same price as the first case sheet to illustrate the results assuming no additional appreciation/depreciation of the stock price from current levels.)

Compare the results on the Case Summary sheet. For the example above, if the shares are sold as a disqualifying disposition at \$25/share in December versus selling them qualified at \$25/share next February, the results are as follows:

Case Sheet:			Case Sheet:		
Hold ISO for Qualified Sale			Disqualifying disposition at year end		
Year	After Tax Cash Flow	Total Portfolio Value	Year	After Tax Cash Flow	Total Portfolio Value
2001	-17,338	12,902	2001	14,844	14,844
2002	30,471	13,133	2002	524	16,408

### Getting the Most From Your Employee Stock Options (Continued from page 2)

The challenge of stock option planning is that there are an unlimited number of possible strategies, and the best strategy is a function of personal goals, assumptions, risk tolerance, plan requirements, and SEC regulations. Your goals will need to be achieved within the context of such things as insider trading rules, company imposed equity holding requirements, and your desire to hold shares in your company's stock. **Graph 1** below is a sample illustration for three different strategies. For each strategy, it shows the value of the unexercised and exercised options plus reinvested cash proceeds from the sale of shares (Total Portfolio Value or TPV). Remember, these are three of an unlimited number of



strategies.

In **Graph 1**, we assumed that the option stock would appreciate by 12% per year. But, note the dramatic change in results in **Graph 2** (on the following page) for these same three strategies if we assume the option stock performs over the next 15 years as Apple stock has performed (year to year change in price) over the past 15 years.

As **Graph 2** graphically illustrates, the uncertainty of future returns make a hold-until-expiration approach very risky. Further, this demonstrates the importance of planning around your goals and expectations and, through an interactive, iterative process establishing a

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plan with an acceptable balance between risk and reward.

Like developing a business plan,

goals, they also change as the economy changes and your knowledge and awareness of the issues change. Changes in any of these variables can have a

*business plan, the assumptions evolve through an iterative process of thought and analysis.*

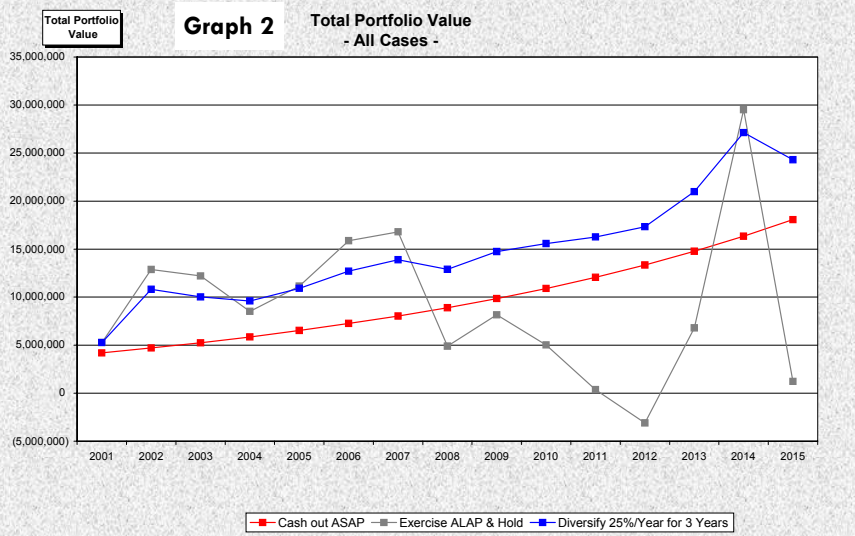
## 2. You and your family are taking the risks, and will be the ones to reap the rewards.

Only through interactive consideration of alternative strategies based on your assumptions that you have judiciously established, can you confidently decide on the strategy that will best serve your goals. Again, you can delegate the detailed task of developing the alternatives to be considered. But as CEO of your personal wealth enterprise, you cannot delegate the final decision.

## Tactical Decision Making and Implementation

Once your strategy is established, tactical decisions need to be made regarding actions to be taken contemporarily. These actions should achieve the following partial list of potential objectives:

1. Generate the cash flow for consumption or diversification called for in your strategy.
2. Minimize the current and long term tax burden.
3. Capitalize on opportunities permitted under your company's stock plan such a swap and reload provisions.
4. Comply with SEC rules and company policy regarding insider trading.
5. Consider the opportunities for insiders to diversify



stock option planning is a dynamic four-step process of:

1. Defining assumptions.
2. Postulating strategies.
3. Evaluating the projected financial results.
4. Refining assumptions and strategies.

You can, and probably should, employ others to run the numbers, suggest alternative strategies, and provide expert opinion. But, only you can decide on the final set of assumptions and strategies. This is true for two reasons:

**1. Assumptions are a function of your personal views, desires and goals.** While assumptions are inherently tied to your personal views, desires, and

profound impact on the strategies you choose to optimize your stock option wealth. Such changes give rise to a requirement for frequent review and update of the plan. Following is a partial list of assumptions that illustrates this point.

- Projected price of option stock
- Projected return on reinvested cash proceeds from option liquidation
- Projected growth of non-option income (earnings, rents, dividends, etc.)
- Retirement date
- Unusual income or taxation events
- Desired lifestyle funding or other cash requirements
- Likelihood of voluntary or involuntary separation

*Most of us do not walk around with these assumptions in our heads. As with developing a*

afforded by SEC rule 10b5-1.  
 6. Comply with company policy regarding share holding requirements.  
 7. Reduce the risk of concentrated stock positions.

You will probably lean heavily on your CFO in formulating and implementing these tactical decisions as he or she has the expertise, experience, and analytical tools to produce optimum results. As illustrated by the following examples, the opportunities for short-term savings and long-term wealth building are substantial.

As you can see in **Table 1**, by following a tax efficient plan, a significant cash flow savings is achieved in the initial years. This in turn generates a significant increase in Total Portfolio Value over time.

**Summary**

To get the most from your options you need to employ the same executive skills that earned you this high leverage component of your compensation package.

Specifically,

- Recruitment of an advisor who has the expertise, experience and tools to support our decision process.
- Periodic involvement in establishing assumptions and reviewing alternative strategies.

Table 1			Diversify 20%/YR @ 10% - Optimized			Diversify 20%/YR @ 10% - Not Optimized		
Case Sheet:			Case Sheet:			Case Sheet:		
Year	After Tax Cash Flow	Total Portfolio Value	Year	After Tax Cash Flow	Total Portfolio Value	Year	After Tax Cash Flow	Total Portfolio Value
2001	2,256,096	11,280,161	2001	1,805,997	9,032,173	2001	1,805,997	9,032,173
2002	2,180,357	11,428,497	2002	1,706,658	9,052,559	2002	1,706,658	9,052,559
2003	2,603,307	12,414,925	2003	1,684,325	9,202,538	2003	1,684,325	9,202,538
2004	1,624,989	11,900,969	2004	2,203,628	10,072,695	2004	2,203,628	10,072,695
2005	295,060	13,005,331	2005	251,061	11,008,774	2005	251,061	11,008,774
2006	325,437	14,215,731	2006	275,355	12,033,271	2006	275,355	12,033,271
2007	352,847	15,537,179	2007	299,762	13,152,972	2007	299,762	13,152,972
2008	385,476	16,981,170	2008	326,376	14,375,468	2008	326,376	14,375,468
2009	418,020	18,557,544	2009	355,214	15,711,330	2009	355,214	15,711,330
2010	456,457	20,280,635	2010	387,034	17,170,764	2010	387,034	17,170,764
2011	470,914	22,137,441	2011	400,138	18,744,308	2011	400,138	18,744,308
2012	510,521	24,161,839	2012	433,710	20,459,875	2012	433,710	20,459,875
2013	553,599	26,369,091	2013	470,224	22,330,397	2013	470,224	22,330,397
2014	600,450	28,776,031	2014	509,936	24,370,140	2014	509,936	24,370,140
2015	651,406	31,400,543	2015	553,127	26,594,257	2015	553,127	26,594,257

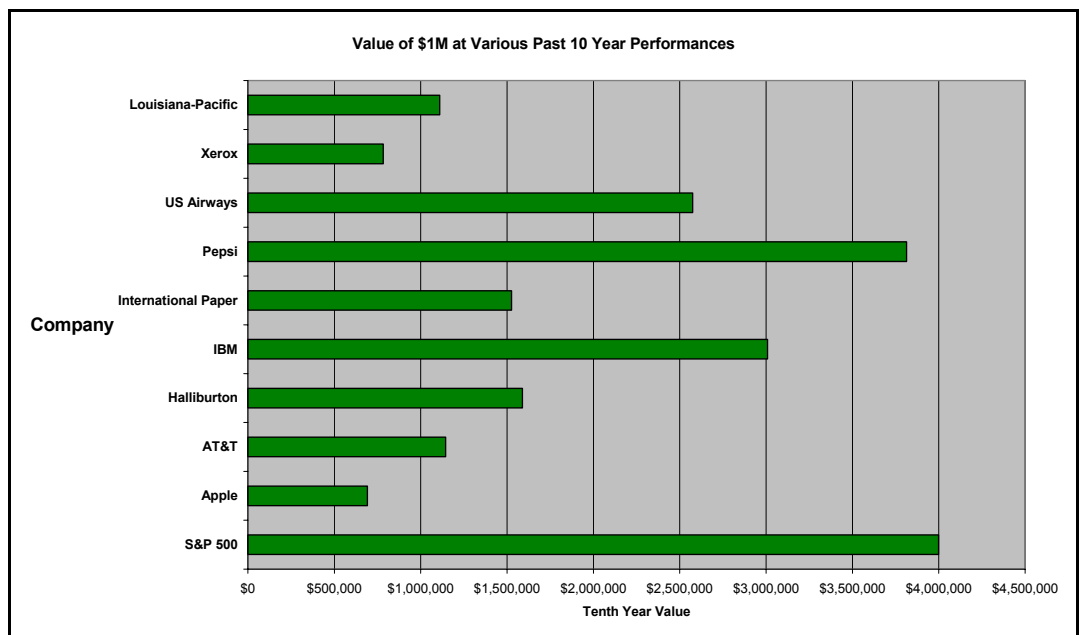
- Decision making based on the analysis but in the context of your goals and beliefs and ultimately based upon wise decision making.

As we all learned in grade school, “you will get out of it what you put into it”. Best wishes for your success in this important venture.

**Appendix A**

The chart below shows the returns of several companies that have under-performed the S&P 500 over the past ten years. It demonstrates the fundamental value of diversifying. Certainly, another consideration is the opportunity cost of early liquidation. This may be another important component in your considerations.

*(Continued on page 8)*



## Getting the Most From Your Options

(Continued from page 7)

### About the Author

Bill Briggs is the chairman and CEO of Net Worth Strategies, Inc. After receiving a degree in business administration from UCLA, Bill joined the IBM Corporation. During his 26-year career with IBM, Bill held key management positions in sales, marketing, business development, product development, financial planning and strategic planning. After leaving IBM, Bill developed early versions of Net Worth Strategies' *StratPlan*, which he used in his personal financial planning practice during the mid-1990s. To contact Bill email: [bbriggs@networthstrategies.com](mailto:bbriggs@networthstrategies.com)

### Determinator Tip of the Month: Dispelling the Myth & Deploying the Suite

In the last issue *The Planner* introduced the "Retirement Plan Distributions: The Simplification Myth" — a research report by seven of the nation's leading retirement distribution planning experts. The report demonstrated how the new proposed IRS rules for minimum required distributions increased rather than diminished the need for planning.

The Simplification Myth stirred up quite an industry buzz. The report was covered in several industry trade publications, including *Journal of Financial Planning*, *Journal of Retirement Planning*, *MorningStar Advisor*, *Horseshmouth*, and *Inside Information*. Thousands of financial

advisors have downloaded the research report via our web site. If you haven't grabbed your free copy yet, point your browser towards:

[www.NetWorthStrategies.com](http://www.NetWorthStrategies.com)

In addition to fueling a frenzy of interest, the report became the foundation of a development effort by Net Worth Strategies, Inc. A team of researchers conducted interviews with several experts, leading trade publication editors, and more than 100 financial advisors. Nearly two months later, the team discovered that a retirement distribution planning solution needed the following:

- Provide an efficient process for doing retirement plan reviews
- Illustrate and maximize the wealth effects of a "Stretch IRA."
- Monitor required minimum distributions compliance across multiple retirement accounts.
- Model premature distribution strategies/72(t).

Based on this research, Determinator Suite was developed. The Suite is four retirement distribution planning tools packaged as one turnkey solution: software for both the new and old minimum required distribution rules; software for

premature distributions; and materials to market and perform retirement plan reviews.

Now that the Determinator Suite is available, Net Worth Strategies is allowing financial advisors the opportunity to test drive it for 30 days for free. The 30-day trial program is risk free and takes a minute to sign up. If you're interested call us at 877-728-5964.



### WHAT'S NEW AT NET WORTH STRATEGIES?

Net Worth Strategies is now offering the Stock Option Boot Camp — a more comprehensive

*Net Worth Strategies is now offering the Stock Option Boot Camp to help financial advisors increase their productivity and planning expertise.*

option training program. This two-day class combines our basic option planning course with a second day of advanced case studies and assistance in developing your own client case.

The Boot Camp is appropriate for first time students while returning students can choose to attend both days or just the second to build on previous knowledge.

Sign up for an upcoming camp:

- January 17th and 18th
- February 14th and 15th

**For more information and to enroll call 877-728-5964.**