

# Sample

## *Year-End ISO Planning Analysis*

For

**Mr. Isoholder**

Provided by

**Financial Advisor**

Following is a sample stock option analysis created by using output from StockOpter Pro and pasting it into a Word document. It addresses four potential year-end planning issues, but it is unlikely that all four would apply for any particular client. For more information visit [www.networthstrategies.com](http://www.networthstrategies.com) or call 877-728-5964.

# Sample Year-End Incentive Stock Option Planning Analysis

Date

Dear Mr. Isoholder;

This is your *Year-End Incentive Stock Option Planning Analysis* that was created from the assumption and grant information that you provided (see Appendices A & B).

Managing your Employee Stock Option (ESO) portfolio is part art and part science. The challenge is to carefully consider the many variables that impact your ESOs and to plot a course that will result in achieving your personal financial goals. One such variable is the effect that the transition from one tax year to the next can have on your ESO portfolio. This report identifies some of the key year-end planning issues that should be considered.

As part of this year-end planning engagement, we have reviewed the following issues:

- Exercising Incentive Stock Options (ISOs) to the Alternative Minimum Tax (AMT) Limit
- Taking Advantage of “Mature” ISO Shares
- Disqualifying Disposition Analysis
- Early Next Year Planning

Based on the assumption and grant information you provided, we have identified the following year-end planning issues and opportunities:

## **Exercising ISOs to AMT Limit**

One year-end planning opportunity is the potential exercise of ISOs tax-free. Specifically, whenever your Regular Federal Income Tax exceeds your Tentative Minimum Tax, you will be able to exercise a certain number of ISOs without triggering an AMT liability.

### **Conclusion**

Based on the information you provided, your Tentative Minimum Tax liability is projected to be \$1,934 less than your regular Federal liability this year. This would give you the opportunity to exercise 413 of your \$5 strike price ISOs without triggering an AMT liability based on a share price of \$19.80. Projecting out 15 years, this strategy (performed only in the current year) would be beneficial so long as the growth rate on the stock was greater than negative 12.19%. For a chart with the after-tax Terminal Values (amount of cash remaining after all positions within the model have been liquidated and taxed) after 15 years assuming an 8% growth rate for both strategies see Appendix C.

## **Taking Advantage of “Mature” ISO Shares**

The sale of mature shares (meeting the ISO holding period requirements) can trigger an AMT deduction equal to the AMT income recognized when you exercised the shares. This AMT

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deduction reduces your Alternative Minimum Taxable Income potential resulting in the opportunity to exercise more ISOs and/or utilize a Minimum Tax Credit Carryforward.

### Conclusion (Example)

Based on the information you provided, you have the opportunity to sell mature ISO shares at this time. If you were to liquidate your 1,000 mature shares at the current price, this would raise your regular tax liability by approximately \$10,000, but your AMT liability by only approximately \$1,000. This would allow you to exercise 1,000 of your \$5 strike price options without incurring additional taxes. Alternatively, it would allow you to utilize \$9,000 of your minimum tax credit carryforward. Projecting out 15 years, the first strategy (performed only in the current year) would be beneficial so long as the growth rate on the stock was greater than 2.50%. For a chart with the after-tax Terminal Values after 15 years assuming an 8% growth rate for both strategies (selling to exercise ISOs v. not) see Appendix X.

### Disqualifying Disposition Analysis

The impending expiration of an ISO grant can force the exercise of a significant number of ISOs in one tax period. This substantial exercise can result in a significant AMT liability. A substantial downward move in the stock price can result in a lower value in the shares than the tax liability incurred from the acquisition of the shares. This result can be mitigated or eliminated through a disqualifying disposition before the end of the year of exercise.

### Conclusion (Example)

Based on the information you provided, you have exercised a significant ISO position this year. This exercise is projected to lead to an AMT liability of approximately \$20,000. The drop in stock price subsequent to exercise has reduced the value of the shares to \$35,000, leaving you with an effective AMT tax rate at this price of 55%. If you were to sell approximately 500 of the 1,000 shares in a disqualifying disposition at the current price, you would pay approximately \$5,000 in ordinary taxes while eliminating your projected AMT liability. That would leave the remaining 500 shares to receive long-term capital gain treatment if held to maturity. Projecting out 15 years, this strategy (performed only in the current year) would be beneficial so long as the growth rate on the stock was greater than 2.50%. For a chart with the after-tax Terminal Values after 15 years assuming an 8% growth rate for both strategies see Appendix X.

### Early Next Year Planning

The impending expiration of an ISO grant can force the exercise of a significant number of ISOs in one tax period. This substantial exercise can result in a significant AMT liability. The earlier during the expiration year you exercise, the more time you can observe the stock before making a decision on whether a disqualifying disposition is prudent. Should the stock perform poorly, a disqualifying disposition can mitigate or eliminate the AMT liability. Should the stock perform well, the shares only need to be held a short time into the next tax year to garner long-term capital

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gain treatment upon sale. This sale at long-term capital gain rates can be used to fund the AMT liability from Exercise.

### Conclusion (Example)

Based on the information you provided, you have a significant ISO position expiring in the next several tax years. If you plan to hold the shares to achieve long-term capital gain treatment, you could exercise as early during the tax year as possible to limit your risk as explained above. This exercise could cause an AMT liability in the next tax year of approximately \$20,000. Should the stock price drop subsequent to exercise, this liability could be reduced or eliminated by a disqualifying disposition before year-end.

### Disclaimer

You agree to indemnify and hold harmless Financial Advisory Firm to the fullest extent lawful, against any and all losses, judgments, awards, claims, damages or liabilities (“claims”), together with all costs related hereto (including reasonable attorney fees), arising out of this engagement including, without limitation, claims arising as a result of any information that you provide to Financial Advisory Firm either in written or oral form relating to this engagement, except for any claim resulting primarily from the willful misconduct or gross negligence of Financial Advisory Firm.

We have taken the information regarding your financial situation and modeled various strategies, which could be implemented toward achieving your goals. The assumed rates of change utilized in the analysis do not represent a guarantee or even a prediction of future results.

Please don't hesitate to call or email if you have questions or would like a more detailed analysis.

Sincerely,

Financial Advisor  
Financial Advisory Firm

# Sample Year-End Incentive Stock Option Planning Analysis

## Appendix A: Summary of Assumptions

Assumptions	2003	2004	2005
<b>Names</b>			
Client Name	Joe Isoholder		
Initial year for StockOpter model	2003		
<b>Current / Future Year Information</b>			
Filing status*	2	2	2
Number of exemptions	2	2	2
<b>Income:</b>			
Salaries and wages (client)	80,000	80,000	80,000
Salaries and wages (spouse)	80,000	80,000	80,000
Self-employment income (client)	0	0	0
Self-employment income (spouse)	0	0	0
Investment income	1,000	1,000	1,000
Dividend income	500	500	500
Long-term capital gain (loss)	1,000	1,000	1,000
Other income	1,500	1,500	1,500
Adjustments to gross income	0	0	0
<b>Itemized deductions:</b>			
Deductible taxes, excluding state income tax	4,000	4,000	4,000
Interest paid on home equity loans (see Help file)	0	0	0
Investment interest expense	0	0	0
Other investment expense, excluding investment interest	0	0	0
Other itemized deductions, excluding state income tax	15,000	15,000	15,000
<b>AMT adjustments &amp; preferences (not listed above):</b>			
Exclusion items	0	0	0
Deferral items	0	0	0
* 1 = Single; 2 = Married Filing Jointly; 3 = Married Filing Separately; 4 = Head of Household; 5 = Qualifying widow(er)			
<b>Issuing Corporations</b>			
Ticker symbol of corporation issuing options	ACME		
Initial stock price (1/1 of the first year of model)	\$18.00		
Estimated annual appreciation of stock price	10.00%		
Per share dividend (1/1 of first year of model)	\$0.32		
Estimated annual appreciation of dividend	0.00%		
<b>Prior Year Information</b>			
Minimum tax credit carryforward	0		
Capital loss carryforward	0		
Investment interest carryforward	0		
Capital loss carryforward - AMT basis	0		
Investment interest carryforward - AMT basis	0		
<b>Estimated Tax Rates</b>			
Capital gains rate (override)			
Average state income tax rate	9.00%	9.00%	9.00%
State taxable income adjustment	0	0	0
Estimated inflation/escalation rate for tax-related values	0.00%		
<b>Investment Account</b>			
Annual dividends	2.00%		
Capital gains distributions	2.00%		
Appreciation	6.00%		
Interest (loan) rate for negative balances	10.00%		

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## Appendix B: Grant Inventory

Initial Inventory					
Plan Label	ISO #1	ISO #2	ISO #3	ISO #4	ISO #5
<b>Plan Name</b>	1999 ISO \$5	2000 ISO \$7	2001 ISO \$9	2002 ISO \$11	2003 ISO \$14
<b>Owner</b>	Client	Client	Client	Client	Client
<b>Issuing Company</b>	ACME	ACME	ACME	ACME	ACME
<b>Owner relationship to company</b>	Employee	Employee	Employee	Employee	Employee
<b>Grant date</b>	1/1/99	1/1/00	1/1/01	1/1/02	1/21/03
<b>Expiration date</b>	1/1/09	1/1/10	1/1/11	1/1/12	1/21/13
<b>Exercise Price</b>	\$5.00	\$7.00	\$9.00	\$11.00	\$14.00
<b>Per Share AMT Adj / Cost Basis*</b>	0.00	0.00	0.00	0.00	0.00
<b># Unvested options</b>	0	1,000	2,500	4,500	7,000
<b># Vested options</b>	5,000	3,000	2,500	1,500	0
<b># of Exercised and unsold shares</b>	0	0	0	0	0
<b>Vesting Schedule</b>					
2003	0	1,000	1,250	1,500	1,750
2004	0	0	1,250	1,500	1,750
2005	0	0	0	1,500	1,750
2006	0	0	0	0	1,750
2007	0	0	0	0	0
2008	0	0	0	0	0
2009	0	0	0	0	0
2010	0	0	0	0	0
2011	0	0	0	0	0
2012	0	0	0	0	0
2013	0	0	0	0	0
2014	0	0	0	0	0
2015	0	0	0	0	0
2016	0	0	0	0	0
2017	0	0	0	0	0

\* For ISOs, this is 'Average per share AMT adjustment before sale', for NQSOs and RSPs this is 'Average per share cost basis before sale'

# Sample Year-End Incentive Stock Option Planning Analysis

## Appendix C: Terminal Value of Exercising ISOs to AMT Limit v. Not

