

Know What You Don't Know: Tips, Traps in Representing Executives - Before, During and After Employment



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THE EMPLOYMENT CONTRACT

- **The Definition of “Good Cause”**
- **Difference between a “Good Cause” and “Without Cause” Termination**
- **Discretion Granted in Compensation Decisions**

COMPENSATION TERMS

- **DEFERRED COMPENSATION**
- **STOCK OPTIONS**
- **RESTRICTED STOCK**
- **RSU**
- **PHANTOM STOCK**
- **SAR**
- **LTIP**
- **CHANGE IN CONTROL AGREEMENT**
- **409A**

DEFERRED COMPENSATION

- **A deferred compensation plan withholds a portion of an employee's pay until a specified date, usually retirement**
- **Examples – pensions, retirement plans, stock options, SAR's, severance agreements**
- **Deferred compensation plans can be qualifying or non-qualifying**

STOCK OPTIONS

I. MORE TERMS

- **Grant**
- **Exercise**
- **Sale**
- **“In the Money”**
- **“Under water”**
- **“Black-Scholes”**

STOCK OPTIONS CONTINUED

II. INCENTIVE STOCK OPTIONS (ISO)

- **No tax on exercise or grant options**
- **Capital Gains Tax upon sale of stock (2 year – 1 year rule)**
- **AMT issue**
- **Limit to how many an employer can issue**
- **No income tax deduction for employer**
- **Must be granted with exercise price at FMV**
- **Option term is limited to 10 years**
- **Plan must be approved by shareholders within 12 months**

STOCK OPTIONS CONTINUED

III. NON-QUALIFIED STOCK OPTIONS (NSO)

- **No tax on grant**
- **Ordinary income or exercise**
- **Capital grant tax on sale**
- **Company Loan**

RESTRICTED STOCK

- **Unregistered shares of ownership**
- **Restricted stock is nontransferable**
- **Must be traded in compliance with special SEC regulations**
- **Typically subject to forfeiture**

RSU

- **A restricted stock unit is a form of company stock**
- **The executive receives it according to a vesting plan and distribution schedule after achieving certain criteria (performance or service requirement)**
- **The restricted stock units (RSU) are assigned a fair market value when they vest**
- **Upon vesting, they are considered income, and a portion of the shares are withheld to pay income taxes**
- **The employee receives the remaining shares and can sell them at any time**

PHANTOM STOCK

- **A type of long-term incentive plan used to award employees with potential value without stock dilution**
- **It is tied to the appreciation in the equity or market value of the company**

SAR

- **Stock Appreciation Rights (SAR) is a method for companies to give their management or employees a bonus if the company performs well financially**
- **SAR's resemble employee stock options in that the executive benefits from an increase in stock price**
- **However, the executive does not have to purchase anything to receive the proceeds**
- **No dilution of company stock**

LTIP

- **A long-term incentive plan (LTIP) provides benefits that may not be tied to the company's share price**
- **In a typical LTIP, the executive, must fulfill various conditions or requirements to prove that he has contributed to increasing shareholder value**

I AM NOT A TAX ATTORNEY



DEFERRED COMPENSATION – 409A

(a) RULES RELATING TO CONSTRUCTIVE RECEIPT

(1) Plan failures

(A) Gross income inclusion

(i) In general If at any time during a taxable year a nonqualified deferred compensation plan—

(I) fails to meet the requirements of paragraphs (2), (3), and (4), or

(II) is not operated in accordance with such requirements,

all compensation deferred under the plan for the taxable year and all preceding taxable years shall be includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income

(ii) Application only to affected participants

Clause (i) shall only apply with respect to all compensation deferred under the plan for participants with respect to whom the failure relates

409A CONTINUED

(B) Interest and additional tax payable with respect to previously deferred compensation

(i) In general If compensation is required to be included in gross income under subparagraph (A) for a taxable year, the tax imposed by this chapter for the taxable year shall be increased by the sum of—

(I) the amount of interest determined under clause (ii), and

409A CONTINUED

(II) an amount equal to 20 percent of the compensation which is required to be included in the gross income

CHANGE OF CONTROL

A) CHANGE IN OWNERSHIP

B) CHANGE IN EMPLOYMENT

A) Reduction in Duties

B) Reduction in Pay

C) Change in Location

C) NOTICE