Thinking It Through: Seven Questions You Should Ask About Equity Compensation

Over the past decade, there has been a surge in highly skilled and valuable employees who are compensated mostly with company stock -- stock options, restricted shares, etc. If you find yourself in this position, congratulations. These awards can be a meaningful tool to support your financial and life goals. But only if they are managed carefully.

If you take an autopilot approach to managing your equity compensation, letting it accumulate without an active strategy, it can lead to missed opportunities, hidden risks and unrealized tax savings. Instead, your equity compensation needs to be integrated into your broader financial picture and managed with a complete vision of what you want in the future.

At Laird Norton Wealth Management, we can help you be more thoughtful and intentional about your equity compensation. This paper provides an initial framework. We offer seven fundamental questions that will help you think about your equity compensation more holistically. The questions are by no means an exhaustive list. But they can help you start the planning process, so that you realize the full potential of the stock awards you've worked so hard to achieve.

Q: What do I own and when?

To manage equity compensation strategically, you must keep an eye on a moving target. Stock options have limitations on when you can exercise them. Meanwhile, other equity compensation, such as RSUs and RSAs, may have different vesting dates to keep track of. Further complicating the picture, you may have different awards vesting simultaneously, each with different terms. Each vesting date comes with tax consequences, and decisions to be made about how to come up with the cash to pay for those taxes.

Bottom line: You'll need an active plan for what's ahead, including when awards vest, and/or when you can exercise stock options.

Q: How much should I keep?

There is risk in having too much of your personal wealth tied up in a single company's stock. This is true even if it is the company you work for, and have much faith in. As a rule of thumb, individuals should not have more than 10% of their wealth invested in one company. If you are earning significant equity compensation, your wealth could quickly become more concentrated than that. You may need to diversify soon, especially if additional shares are poised to vest in the coming years.

Q: How do stock awards fit within my broader financial plan?

Equity compensation can comprise a meaningful portion of the wealth you accumulate. As such, it should be a part of the calculations for the savings you need to fund your personal goals and living expenses. However, it must be evaluated carefully.

On one hand, if you base major financial decisions on the value of restricted stock, it can put you in a bind if you leave the company and it doesn't end up vesting, or the value of the stock declines. On the other hand, some individuals ignore their equity compensation, and don't realize its full potential. For example,

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if converted to cash, that compensation can be used to repay student loans, purchase a home or vacation property, fund your children's education, or support other long-term goals.

Q: What are the tax implications?

There are several sophisticated strategies you can utilize to manage the tax implications of your equity compensation - but they require advance planning when you first receive the award. For example, with restricted stock, you can pay taxes on the award the year it is granted, as opposed to when it vests. Assuming the stock price goes up in the future, it would cost less to pay the tax at its current price.

Donating shares is another strategy for minimizing the tax impact. As one example, if you buy shares as part of your company's employee stock purchase plan, the fact that you purchased them at a discounted price to their market value means they represent a significant gain within your portfolio. Rather than selling the stock and paying the capital gains tax, some individuals prefer to donate them to a charitable organization they care about.

The key for any tax strategy is to plan ahead, with a full vision of what compensation you will receive in the future, when awards vest, when options expire and what you want to do with them.

Q: Where should I keep the stock?

Your tax situation and timetable for selling company stock determines the account you should hold it in. If, for example, you plan to hold the assets until retirement, it is best to put the stock in a tax-deferred retirement account such as a 401(k) or IRA. But those accounts have penalties for early withdrawals. So if you plan on selling some or all of the stock before retirement, it is advantageous to keep the shares in a personal investment account. Meanwhile, if you plan to transfer the shares to a charity or family member, a trust may be the most desirable vehicle to hold your stock.

Q: Do I plan to leave the company?

Typically, cessation of employment for any reason – you get sick, quit, get fired – means you forfeit your unvested shares. You need to know the policies for your individual company. If you are in the position to consider and plan an exit strategy, you should determine how much stock is unvested, how long before stock options expire, and develop a plan for how much it would cost to exercise all the stock options you could.

Q: What happens to my equity compensation if something happens to me?

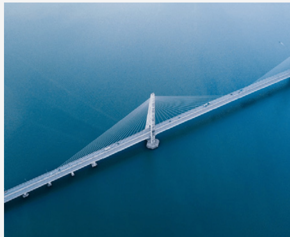
Last of all, but perhaps most important, you need to think about how to protect your family from the risk of losing unvested equity if something happens to you. In case of death, at some companies your unvested shares are forfeited, while at others the shares automatically vest and your heirs can then own them. If you are earning substantial equity compensation, it's very important to know your employer's specific policy. You can then decide if it makes sense to purchase life and/or disability insurance to cover the value of unvested stock.

You should also routinely review the beneficiaries named on your equity comp forms. Since stock grants range from three to 10 years, many things can change in your life during that time (marriage, divorce, children, etc.), and this should be reflected in the beneficiary designations you have made.

Take Control of Your Equity Compensation

Equity compensation is not just a part of your salary, to be set aside and thought of in a vacuum. It is a meaningful component of your wealth that can provide a springboard to living the life you always envisioned. But it must be managed thoughtfully to achieve those ends. Let us help you navigate the complex decisions that come with it.

At Laird Norton Wealth Management, we bring together a team of professionals to help you think about equity compensation holistically: advisors who align upcoming stock awards with the rest of your financial plan, accounting experts who deftly navigate the tax implications, and an investment team that can advise if, and how, you should diversify your portfolio so that your wealth is not too concentrated in a single company. With a team behind you, we can maximize the full potential of your equity compensation.



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Find out how

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