Your Equity Comp, Explained

ISOs • NQSOs • Restricted Stock • RSUs — key federal points with California notes

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Incentive Stock Options (ISO)

Statutory option — potential for full capital gains, but AMT-driven

Grant	No tax.
Exercise	No *regular* tax. The bargain element (FMV − strike) is an **AMT preference item** — may trigger alternative minimum tax. Creates a minimum tax credit (Form 8801) usable in later years.
Sale	**Qualifying disposition** (>2 yrs from grant & >1 yr from exercise): entire gain over strike is long-term capital gain. **Disqualifying disposition**: bargain element becomes ordinary income (W-2), remainder capital.
Dual basis	Regular-tax basis = strike; AMT basis = FMV at exercise. Track separately — drives AMT gain/loss and credit recovery.
Forms	Form 3921, Form 6251 (AMT), Form 8801 (credit), CA Sch. P (540) / Form 3510.

Ex. Strike $10, FMV $60, 1,000 sh, exercise & hold. Regular tax: $0. AMT preference: $50,000 — may owe AMT. Sell 25 mo. later at $90 (qualifying): $80,000 LTCG, and MTC begins unwinding.

Non-Qualified Stock Options (NQSO)

Ordinary income at exercise — no AMT, no qualifying-disposition rules

Grant	No tax (assuming no readily ascertainable FMV).
Exercise	Bargain element (FMV − strike) is **ordinary income** — W-2 for employees (income + FICA withholding) or 1099-NEC. Flat 22% supplemental withholding (37% over $1M) is often short for high earners.
Sale	Gain/loss beyond basis is capital. Basis = strike + bargain element already taxed. >1 yr from exercise = long-term.
Watch	**1099-B basis trap:** broker often reports strike only — adjust basis to full FMV on Form 8949 or you pay tax twice on the spread.
Forms	W-2 / 1099-NEC, Form 8949 + Sch. D.

Ex. Strike $10, FMV $50, 1,000 sh. At exercise: $40,000 ordinary income; basis $50. Sell 18 mo. later at $80: $30,000 LTCG.

Restricted Stock (actual shares)

Section 83(b) election available — the timing lever

Grant	No tax if subject to substantial risk of forfeiture (unvested), *unless* an 83(b) election is made.
Vesting	**Default:** FMV at each vest date is ordinary income (W-2) as shares vest. Basis = FMV taxed.
83(b) election	File within **30 days of grant**: pay ordinary tax on FMV *at grant* (often near $0 for founders/early stock). Future appreciation is all capital gain; holding period starts at grant. Risk: no refund if shares forfeited or value drops.
Sale	Gain over basis is capital; long-term if >1 yr from the taxable event (vest, or grant if 83(b)).
Forms	83(b) statement to IRS, W-2, Form 8949 + Sch. D.

Ex. 100,000 sh at $0.01 FMV, 4-yr vest. **With 83(b):** $1,000 ordinary income now; sell at $5 later → ~$500K LTCG. **Without:** ordinary income on FMV at each vest — potentially huge if value climbs.

Restricted Stock Units (RSU)

A promise of shares — no purchase, no 83(b), no timing choice

Grant	No tax. 83(b) **not available** (units, not stock).
Vesting	FMV at vest is **ordinary income** (W-2). Automatic — no election. Basis = vest-date FMV.
Withholding	Usually sell-to-cover at flat 22% (37% over $1M). **Badly short** for 32–37% earners + CA 9.3–13.3% — the #1 RSU filing surprise. Plan estimates.
Sale	Gain/loss beyond vest-date basis is capital; clock starts at vest, not grant.
Watch	**1099-B basis trap:** broker may report $0 basis — adjust to vest FMV on Form 8949 to avoid double tax. (§409A/§83(i) deferral rare, private-co only.)

Ex. 500 units vest at $80: $40,000 ordinary income; basis $80. Sell 14 mo. later at $110: $15,000 LTCG.

Side-by-Side

	ISO	NQSO	Restricted Stock	RSU
Tax at grant	None	None	None (or 83(b))	None
Ordinary income event	None for regular tax (AMT only)	At exercise	At vest (or grant w/ 83(b))	At vest
AMT exposure	Yes — spread is preference	No	No	No
83(b) available	N/A	N/A (early exercise stock only)	Yes — 30 days	No
Capital gains potential	Full spread if qualifying	Appreciation after exercise	Appreciation after taxable event	Appreciation after vest
Holding period starts	At exercise	At exercise	At vest (grant if 83(b))	At vest
FICA	No	Yes (employees)	At vest (grant if 83(b))	Yes, at vest
Key trap	AMT & dual-basis tracking	1099-B basis double-count	Forfeiture risk after 83(b)	22% withholding gap
Key forms	3921, 6251, 8801	W-2/1099, 8949	83(b), W-2, 8949	W-2, 8949

California notes: *CA conforms broadly to federal equity taxation but has its own AMT (Sch. P / Form 3510 for ISO credit) and taxes equity income sourced to CA workdays — relevant for clients moving in or out of state during a grant's vesting period. CA has no preferential capital gains rate; all gains taxed at ordinary rates up to 13.3%.* |