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Q: What is an incentive stock option?

A: A right given to an employee to purchase company shares at a discounted price. Unlike nonqualified stock options, ISOs may result in favorable tax treatment (long-term capital gain).

Q: What is the "incentive", and how is this beneficial to me?

A: As opposed to nonqualified stock options, incentive stock options are taxable when sold, not exercised. Additionally, provided a holding period is met, the gain (the excess of proceeds above cost, *not* market value which is the case for nonqualified options) qualifies for long-term capital gain treatment.

Q: What is the holding period to qualify for long-term capital gain treatment?

A: ISOs must be held two years after the grant date and one year after the exercise date to qualify for long-term capital gain treatment.

Q: What if I sell prior to satisfying the holding requirements?

A: This is called a disqualifying disposition, and the result is the discount on the purchase (the difference between the cost and market value at date of exercise) being taxed as ordinary income and included in an employee's W2.

Q: Are there any other tax items to be taken into consideration?

A: Yes - although the discount is not reported as income in the year of exercise (unless sold), it is income for alternative minimum tax purposes.