

## INCENTIVE STOCK OPTIONS (ISOS)

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**RYAN McCARTHY,**  
CPA®, CFP®  
Financial Planner  
650 610-9540  
[ryan@mamportfolios.com](mailto:ryan@mamportfolios.com)

***“While the tax treatment of ISOs can be complex, understanding the implications and key features provides significant benefits to the employee.”***

McCarthy Asset Management, Inc. is an independent, fee-only investment advisory firm that has been helping people invest wisely for over fifteen years. Our mission is to help you better understand and improve your financial situation. We specialize in Retirement Planning, Portfolio Management and Tax Planning.



### Features:

- ISOs qualify for special tax treatment under the tax code and are not subject to Social Security, Medicare or withholding taxes.
- ISOs can be granted only to employees, not to consultants or contractors.
- An ISO must be exercised within three months after date of termination from employment to retain its special tax treatment.
- \$100,000 limit on the aggregate grant value of ISOs that may first become exercisable (vested) in any calendar year.
- To meet the requirements of a qualifying disposition once the ISOs are sold, you must hold the acquired shares for at least two years from the date of grant and one year from the date of exercise. If you sell your shares before meeting this holding period requirement, then it is treated as a disqualifying disposition for tax purposes.
- The spread is the difference between exercise price and Fair Market Value (FMV).



### Tax Treatment:

- Grant
  - ◊ The granting of ISOs is not a taxable event.
- Vesting
  - ◊ The vesting of ISOs is not a taxable event.
- Exercise
  - ◊ For ISOs, the spread at exercise is not a taxable event for regular tax purposes. However, the spread is a positive alternative minimum tax (AMT) preference income adjustment. Once the shares are subsequently sold, the employee receives a negative AMT preference income adjustment. This AMT preference income is a temporary/timing difference.
  - ◊ Unlike NSOs, there is not any withholding required from the company for ISOs.

## Our Services

### Investment Management Services:

- MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.

### Financial Planning Services:

- The Net Worth Analysis (NWA) tracks the accumulation of Invested Assets for pre-retirees and the retention of Invested Assets for retirees. Updated annually.
- "Retirement Analysis" a comprehensive analysis of your retirement goals, which produces easy-to-read, interactive working plan, stored in the cloud. Updated as needed for life events.

### Tax Services:

- Clients have the option of utilizing the income tax services provided through the firm Stephen P. McCarthy, CPA. These services are offered at an hourly rate and may include:
  - Tax Return Preparation
  - Income Tax Projections
  - Tax Minimization Ideas
  - Tax Authority Representation

### Other Services:

- MAM has retained several outside experts, whose services are available at no cost to our clients:
  - Medicare Planning— Eileen Hamm of Superior LTC Planning Services, Inc.
  - Long Term Care Planning— Allen Hamm of Superior LTC Planning Services, Inc.

- Sale in a disqualifying disposition
  - ◇ Lesser of exercise date spread or actual gain on sale is taxed as ordinary income. Excess gain is taxed as capital gain.
  - ◇ Disqualifying dispositions get complex in that the treatment varies depending on how the sale price compares to the FMV on the exercise date. The important thing to note is that if you hold ISOs, you want to ensure that you meet the holding period requirements to qualify as a qualifying disposition.
- Sale in a qualifying disposition
  - ◇ Excess of sale proceeds over exercise price is long-term capital gain.

### ISO Taxation Example Qualifying Disposition:

- Receive ISO with exercise price of \$15. Exercise when FMV is \$20. Hold more than 1 year from exercise & 2 years from grant. Sell when price is \$25.
  - ◇ At time of exercise, you have a positive AMT preference income adjustment of \$5 (\$20 - \$15). A taxpayer only pays AMT tax when it's higher than regular tax.
  - ◇ At time of sale, you have \$10 (\$25 - \$15) in capital gains and no W-2 income. Full gain of \$10 over exercise price taxed at long-term capital gains tax rates. Once you sell your ISOs, you also receive a \$5 negative AMT preference income adjustment, which offsets the positive AMT preference income incurred when ISOs were exercised.

One important thing to remember is that you may be eligible to make a Section 83(b) election on your ISOs, which can have significant tax benefits. We recommend consulting with your employer to determine if you're eligible to make this election.