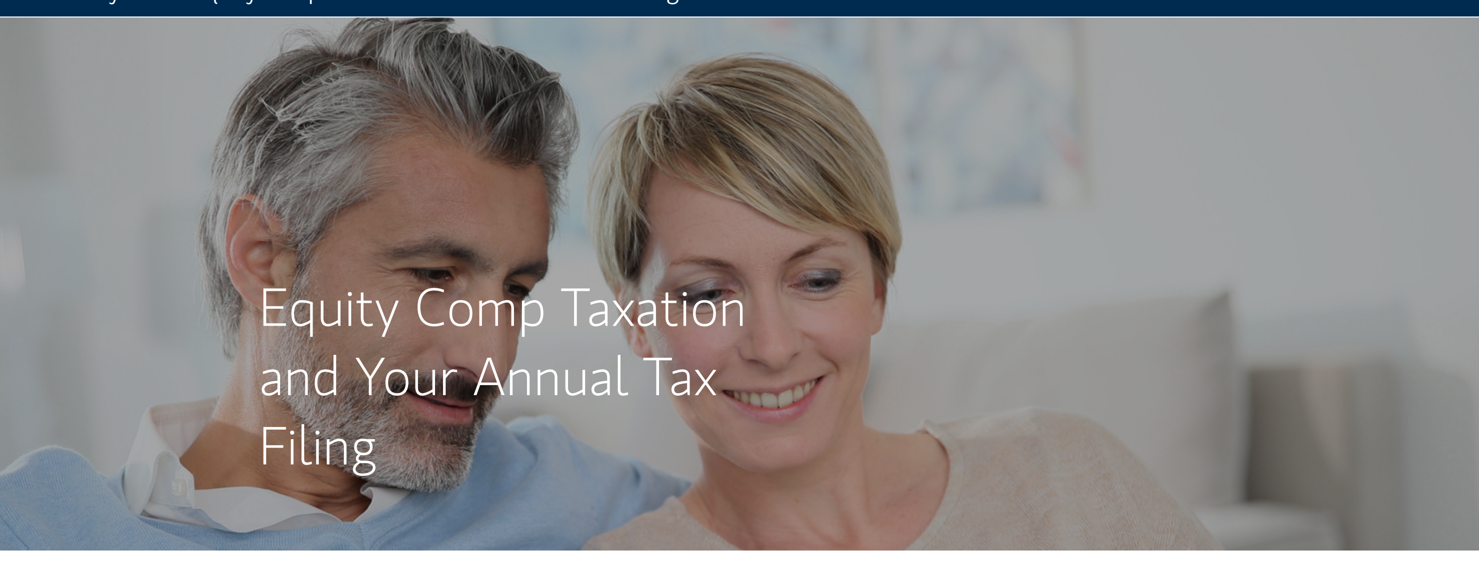

Equity Comp Taxation and Your Annual Tax Filing

Equity compensation can be one of the most valuable benefits offered by your company, but it's important to understand how they work—and how they're taxed. For example, one type of equity award may trigger certain federal taxes depending on the circumstances—federal ordinary income tax, the alternative minimum tax, and federal short- or long-term capital gains tax. Here's what you need to know.

Any sports fan can tell you, to be successful, you have to understand the value of having a winning game plan.

The value of having and executing a successful plan, of course, extends far beyond the field. In personal finance, it requires making sure that you're taking advantage of every opportunity to increase your wealth and strengthen your financial security. One often-overlooked way to do this is to consider the tax impact of your financial decisions. Equity compensation can be one of the most valuable benefits offered by your company, yet one of the more complex, especially when it comes to how your equity compensation is taxed. The type of equity compensation, and the length of time you hold the actual shares underlying your equity award, will impact the tax treatment of your equity compensation.

As tax season approaches, having a plan helps. A tax advisor can help you determine the best way to manage your tax obligations, but here's what you need to know about the tax treatment of your specific type of equity compensation and which tax forms you'll need to collect for your annual federal tax filing:

For all equity types:

How long you hold your shares that you acquired through exercise, vesting or purchase (as applicable) matters. If you hold shares in your portfolio for more than one year after the date of exercise, vesting or purchase before selling, any change in value from the date of grant, exercise, vesting or purchase (as applicable) may be treated as a long-term capital gain (or loss) which is taxed at a lower rate than a short-term capital gain (or loss) (i.e., if you hold the shares for one year or less after the applicable date).[1] If you are planning to sell shares, be sure to have a plan on exactly which shares you wish to sell based on when you acquired them—it can have a significant impact on how much you owe in taxes. Also, keep in mind that, depending on the circumstances, you may owe additional taxes, such as state and local income taxes and employment taxes.

If you have stock options:

There are two types of stock options: Incentive stock options and non-qualified stock options. Here's how they differ:

	Incentive Stock Options (ISO)	**Non-qualified stock options (NQSO)**
When you may be subject to taxation	When you sell the shares acquired by exercising your options (also, you may owe the alternative minimum tax when you exercise your options (purchase the shares) in certain instances).	When you exercise your options (purchase the shares) and when you sell the shares acquired by exercising your options.
Potential federal income taxes	**Alternative minimum tax (AMT):** If you choose to exercise your options and hold onto all or a portion of the underlying shares (i.e. don't sell them in the same tax year as exercise), you may owe AMT for that year's tax filing. **Federal ordinary income tax:** If you sell your shares at the time of exercise or sell shares in two years or less from grant or one year or less from exercise, you may owe federal ordinary income tax as a result of the sale. **Federal capital gains tax:** Depending on the length of the period of time between the date of grant and exercise, the date you sell your shares, and the fair market value (FMV) of the shares when you sell them, you may owe federal short-term or long-term capital gains tax as a result of the sale. If you sell your shares in one year or less after the date of exercise, you will generally owe short-term capital gains tax; if you sell your shares more than one year after the date of exercise, you will generally owe long-term capital gains tax.	**Federal ordinary income tax:** You will owe federal ordinary income tax at exercise. **Federal capital gains tax:** Depending on how long you've held your shares after exercise and the FMV of the shares at the time of sale, you may owe federal short-term or long-term capital gains tax when you sell your shares. If you sell your shares in one year or less from the date of exercise, you will generally owe short-term capital gains tax; if you sell your shares more than one year after the date of exercise, you will generally owe long-term capital gains tax.
Forms to look out for	**Form 3921**: You will receive this document if you exercised any ISOs during the year. **Form W-2:** You may receive a Form W-2 if you recognize ordinary income as a result of certain ISO dispositions. **Form 1099-B:** You will receive this document if you sold any shares during the year. **Form 8949 and Schedule D (Form 1040)**: You will complete these forms to report all capital gain and loss transactions.	**Form W-2:** You will receive a Form W-2 to reflect the income you receive from the exercise of your NQSOs. **Form 1099-B:** You will receive this document if you sold any shares during the year. **Form 8949 and Schedule D (Form 1040)**: You will complete these forms to report all capital gain and loss transactions.

If you have Restricted Stock Units (RSUs):

When you could owe taxes	At vest when shares are delivered to you and when you sell your shares.
Potential federal income taxes	**Federal ordinary Income tax:** You will owe federal ordinary income tax on the FMV of the RSUs that vest that year. Typically, your company will withhold taxes on vested RSUs at the supplemental wage withholding rates, however the withholding rates could be less than your effective tax rate, so you may owe additional federal, state and local taxes when you file. **Federal capital gains tax:** You will owe federal capital gains tax on the positive difference between the FMV of the shares at vest/delivery and the FMV of the shares at sale. If you hold your shares for one year or less, you will generally owe short-term capital gains tax; if you hold them for more than one year, you will generally owe long-term capital gains tax.
Forms to look out for	**Form W-2:** The FMV of the shares at vest/delivery will be reported on your Form W-2 as part of your ordinary income. **Form 1099-B:** You will receive this document if you sold any shares during the year. **Form 8949 and Schedule D (Form 1040)**: You will complete these forms to report all capital gain and loss transactions.

If you participate in a qualified employee stock purchase plan (ESPP):

When you could owe taxes	When you sell shares purchased via an ESPP. (You are not taxed when shares are purchased)
Potential federal income taxes	**Federal ordinary Income tax:** You may owe federal ordinary income tax on a portion of the proceeds from the sale of shares purchased via an ESPP. **Federal capital Gains taxes:** Depending on when you sell your shares and the FMV of the shares at the time of sale, you may owe federal short-term or long-term capital gains tax. If you sell your shares in one year or less from the date the shares were purchased, you will generally owe short-term capital gains tax; if you sell your shares more than one year after the shares were purchased, you will generally owe long-term capital gains tax.
Forms to look out for	**Form 1099-B:** You will receive this document if you sold any shares during the year that were purchased via an ESPP. **Form 3922:** This form will indicate whether you purchased shares through your company's ESPP. **Form 8949 and Schedule D (Form 1040)**: You will complete these forms to report all capital gain and loss transactions.

Note: if your company offers a non-qualified ESPP, your tax obligations will differ from above. You should speak to a tax advisor to understand the tax treatment of non-qualified ESPPs

The bottom line

No matter what type of equity you receive, it's highly recommended that you work with a professional tax advisor and financial advisor to understand how your equity impacts your tax obligations. It's important to understand the types of taxes you may owe when you receive equity compensation, that you provide the right documents to your tax preparer to submit an accurate annual tax filing, and how you can use equity value gains (and losses) as part of your winning financial game plan.

Learn more about equity compensation and how Morgan Stanley can help you achieve your goals.

[1] If you have incentive stock options or shares acquired through an employee stock purchase plan, you may receive long-term capital gains tax treatment if you do not sell the shares for more than one year from the date of exercise or date of purchase, as applicable.

> Disclosures