

THE EQUITY COMPENSATION DESIGN AND USE MATRIX

Issues and Features Equity Types	Primary Compensation Use	Typical Plan Sponsor	Typical Recipient	Main Features	Key Accounting Issues	Key Legal Issues	Key Tax Issues	Key Communication Issues	Key Administration Issues
Incentive Stock Options (ISO)	Attract and Motivate. Retention when stock price is growing steadily	Pre-IPO and Publicly traded companies (high-tech/biotech and high growth sectors)	Execs at all sizes High-tech staff at Small to Mid-size companies	Preferential tax treatment. Limits on use. Highly Leveraged. Pays only if price increases	Complex valuation and amortization. Difficult market comparisons. Adjustments can be expensive	Limits on Grant Price, Value of Grant, Term of Grant and Term of Plan. Shareholder approval required within 12 months of BOD adoption	No tax withholding at exercise. No Ordinary income if held for qualifying period. Not applicable to int'l participants. Alternative Minimum Tax concerns	Difficult to show value if underwater. Leverage can be an issue in highly volatile stocks. Tax issues, Dispositions, AMT	Activity peaks and valleys. Grant processing. Exercise processing. Termination rules. Int'l issues. Disposition tracking
Non-Qualified Stock Options (NQSO)	Attract and Motivate. Retention when stock price is growing steadily	Pre-IPO and Publicly traded companies (all sectors)	Widely used, grant size generally based on position. Consultants and Outside BOD members	Highly Leveraged. Guaranteed corporate tax deduction when exercised. Pays only if stock price increases	Complex valuation and amortization. Difficult market comparisons. Variable Fair Value accounting for non-employee service providers	General plan documentation. Detailed documentation when used for outside BOD members. Post-termination rules and regulations	Ordinary Income and Tax withholding at Exercise. 409A Supplemental Wages eligible (\$1M threshold)	Difficult to show value if underwater. Leverage can be an issue in highly volatile stocks. Tax issues at exercise.	Activity peaks and valleys. Grant processing. Exercise processing. Termination rules. Int'l issues. Tax at Exercise
Restricted Stock Shares (RSS)	Attract and Retain. Motivation added when awarded at higher than \$0 cost to participant	Closely Held and Publicly traded companies (less volatile sectors)	Upper and Middle Management	Value if price drops. Minimally leveraged. Can be used to satisfy Executive Ownership requirements. Does not fall under IRC 409A	Simple Valuation. Value is Intrinsic value on award date. Cost essentially equivalent to paying cash. Retirement eligibility can result in accounting for expense prior to vesting completion	Private companies are subject to Blue Sky laws. Public companies are subject to SEC regulations at the time of award	No income or tax until vested. 83(b) election to be taxed at award date. Sell-to-Cover requires sufficient trade volume. Withhold-to-cover requires sufficient corporate cash. Retirement eligibility can result in income and tax prior to retirement	Event-based, forced income and taxation. Comparison to Options	Award processing. Coordination of timing with other corporate issues. Repurchases. 83(b) elections. Dividend tracking. Share issuance at time of award
Restricted Stock Units (RSU)	Attract and Retain. Motivation added when awarded at higher than \$0 cost to participant	Large Pre-IPO, Closely Held and Publicly traded companies (mature tech, less volatile sectors)	Widely used above operational staff and for late-stage employees at pre-IPO companies	Value if price drops. Minimally leveraged. Better internationally than RSS. Less dilutive than Options	Simple Valuation. Value is Intrinsic value on award date. Cost essentially equivalent to paying cash	409A considerations. Registration of shares prior to award	No income or tax until vested. Dividend Equivalents taxable unless fully restricted. Sell-to-Cover requires sufficient trade volume. Withhold-to-cover requires sufficient corporate cash. Deferral potential with sufficient notification	Time or Event-based, forced income and taxation. Comparison to Options	Award processing. Event Planning with other corporate issues. Forfeitures. Dividend Equivalent tracking. Share movement at time of vest
Performance Awards (PSU)	Motivate	Publicly traded companies (especially if subject to Say on Pay voting)	Executives, Scientists, Finance staff	Preferred by shareholders, especially for Say on Pay considerations. Payout earned, modified or accelerated if goals are met. Complex design issues	Very complex accounting and valuation. Value of market-based goals cannot be reversed if missed. Non-market-based goals require probability calculations	Possible challenges from shareholders and recipients regarding meeting and issuing of performance goals	Income and taxes due at vesting. Due to unpredictable nature of performance it can be difficult to plan for the tax event. Deferral potential with sufficient notification	Understanding and management of performance-criteria. Event-based income and taxation	Monitoring goals against awards. Processing with limited pre-notification. Standard RSU issues
Stock Appreciation Rights (SAR)	Attract and Motivate	Privately held companies	Upper and Middle Management	Can be settled in cash or stock. Provides option-like features	Stock-settled treated like options (fixed, Fair Value accounting). Cash-settled require variable accounting (quarterly adjustment of Fair Value)	Possible ERISA issues with long-term holding period on broad-based plans. Generally not deemed "stock" for S Corps	Taxed at time of exercise. Ordinary Income and Taxes must be withheld	Comparison to options (stock value no/no stock). Delivery of only the appreciation rather than whole grant	Limited support from brokers at exercise (unlike options). Limited overall software capabilities
IRC 423 Employee Stock Purchase Plan (ESPP)	Retain, Motivate and create ownership	Publicly traded companies and those in the process of IPO	Broad-based (required by law)	Preferential tax treatment. Very flexible. Requires "skin in the game" from participants. Excellent communication tool	Features drive valuation. Discount of 5% or less, and no look-back = no expense. Option-like element (look back) or discount of greater than 5% requires option valuation and expense under ASC 718	Limits on participant inclusion/exclusion. Limits on Discount, Term of Offering. Value of share purchased in each calendar year. Shareholder approval is required within 12 months of BOD adoption	No Ordinary Income or Capital Gain/loss until first transfer. Grant Date Discount is minimum amount of Ordinary Income. Must hold shares for 2 yrs from grant and 1 yr from purchase to receive preferential treatment	Comparison to 401K. Enrollment and contributions. Dispositions and tax consequences. Great tool to support communication from executives	Coordinating HR and Payroll systems and staff. Quick turnaround at purchase date. Surveys until all shares are transferred, even for ex-employees
Non-Qualified Stock Purchase Plan (NQ-ESPP)	Retain and create ownership	Mature publicly traded companies (non tech sector)	Management-only or broad-based	Ease of purchase and admin. Low cost. Limited shareholder impact	Expense only if purchase is made at a discount	Possible 409A issues if shares are restricted after purchase	Ordinary Income and tax withholding at Purchase for any discount amount	Comparison to purchases on open market. Understanding company role	Coordinating HR and Payroll systems and staff. Quick turnaround at purchase date. If discounted, taxation at purchase
Deferred Stock Units (DSU)	Retain and create ownership. Retirement	Mature publicly traded companies (non tech sector)	Executives (C-Suite)	Income and Tax deferral. Flattens volatile pay cycles. Creates retirement income	Simple Valuation. Value is Intrinsic value on award date. Cost essentially equivalent to paying cash	Deferral Election must be made within strictly defined period. Payout restrictions must be clearly defined to meet tax rules. 162(m) considerations	Employment Tax (FICA/FUTA) due at orig. vest date. Ordinary Income and tax withholding at end of deferral period. Complex 409A issues	Complex tax issues. Complex release timing rules. Dividend income	Separating Employment Income from Ordinary Income. Limited software support. Long-term tracking issues
Phantom Stock Awards (PSA)	Attract and Retain (may replace stock settled RSS an RSU)	Privately held and mature publicly traded companies	Upper and Middle Management	Can be settled in cash or stock. Provides restricted stock unit-like features	If award can be settled in cash, then variable accounting is required (quarterly adjustment of Intrinsic Value)	Possible ERISA issues with long-term holding periods on broad-based plans. Generally not deemed "stock" for S Corps	No income or tax until vested. Taxes generally withheld from final cash payment	Comparison to RSS/RSU (stock value but no stock). Delivery of full value but generally in cash	Limited software support. Coordination with Payroll and treasury at payout. Standard RSU issues

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