

Stock Option Issues

MAXIMIZING VALUE THROUGH KNOWLEDGE™

Many companies reward their employees with stock options or bonus shares, which are taxable on issuance or at exercise. There are two primary regulations which apply to the issuance of employee stock options, IRS Section 409A and ASC 718. The value of options must also be disclosed in proxy statements and financial statement footnotes.

IRS Section 409A states that the exercise price of an option must be greater than or equal to the fair market value of the underlying stock to qualify as deferred compensation and avoid significant tax penalties. For privately held companies, determining the fair market value of the common stock often requires an independent valuation of the company. The process can be further complicated if the company has other equity classes in addition to common stock since subtracting preferred stock as debt is no longer accepted except in very specific circumstances. Adams Capital considers and applies the Current Value Method, the Option-Pricing Allocation Method, and the Probability Weighted Expected Return Method where appropriate. However, every situation is unique, so every valuation should be treated with a fresh perspective using the latest market data. Adams Capital has the experience and credentials to make defensible assertions on the value of any type of stock option or bonus share.

For ASC 718, the fair value of any stock based compensation, including employee stock options, restricted stock, and management preferred stock, must be expensed. Outside of determining the appropriate common stock value for the issuance of employee stock options, Adams Capital can assist with the determination of fair value for any stock based compensation for ASC 718 purposes.