



Cardinal Wealth Management LLC

Making Sense of Your Equity Compensation

A plain-English guide to RSUs, ESPPs, stock options, and ESOPs

Your employer pays you in more than a paycheck. Stock grants, purchase plans, options, and ownership plans can build real wealth, and they can also create tax surprises and concentration risk that most people discover too late. This guide covers the four most common types of equity compensation, how each one is taxed, and the mistakes worth avoiding.

Restricted Stock Units (RSUs)

Your company promises you shares. On each vesting date, a portion of those shares becomes yours, and their full value counts as ordinary income that year, the same as salary.

What trips people up: Employers often withhold taxes on vested RSUs at a flat supplemental rate that may be lower than your actual marginal bracket. If your income is high, the withholding can fall short and leave you with a surprise bill in April.

The other decision: Once shares vest, holding them is the same decision as buying your company's stock with cash that day. Would you do that with a bonus check? For some people, yes. For many, the honest answer is no.

Employee Stock Purchase Plans (ESPPs)

An ESPP lets you buy company stock through payroll deductions, often at a discount of up to 15%. Many plans add a "lookback" that applies the discount to the lower of two prices, which can make the effective discount larger.

What trips people up: The tax treatment of your discount and gains depends on how long you hold the shares after purchase. Selling early (a "disqualifying disposition") is not wrong, but it

changes what gets taxed as ordinary income versus capital gain. Know which one you are choosing.

Worth knowing: Federal rules cap qualified ESPP purchases at \$25,000 of stock value per calendar year, so this is a supplement to your savings plan, not a replacement for it.

Stock Options (ISOs and NSOs)

An option is the right to buy shares at a fixed “strike” price for a set number of years. If the stock rises above your strike, the spread is your potential gain. The two types follow different tax rules:

- **Non-qualified stock options (NSOs):** The spread between strike price and market value is taxed as ordinary income when you exercise.
- **Incentive stock options (ISOs):** No regular tax at exercise, and gains can qualify for long-term capital gains rates if you meet two holding-period tests. The catch: a large ISO exercise can trigger the alternative minimum tax (AMT) in the year you exercise, even though you sold nothing.

What trips people up: Exercising a big ISO block without modeling the AMT first or sitting on options so long they expire worthless. Both are avoidable with a plan.

Employee Stock Ownership Plans (ESOPs)

An ESOP is a retirement plan your employer funds with company stock, at no cost to you. Shares accumulate in your account as you work, and you receive the value when you leave or retire, based on the plan’s vesting and distribution rules.

What trips people up: ESOP distribution rules differ from 401(k) rules. Timing, form of payment (cash versus shares), and rollover options vary by plan, and the tax treatment depends on those details. If your ESOP distributes cash rather than shares, certain tax strategies you may have read about, like net unrealized appreciation, generally will not apply. Read your plan document before you make any election, and get help interpreting it if the language is unclear.

The Risk That Cuts Across All Four

Concentration. Equity compensation ties your paycheck, your benefits, and a chunk of your net worth to one company. If that company struggles, you can face a falling portfolio and a threatened job at the same time. Employees of Enron and Lehman Brothers lived exactly that.

A useful gut check: if any single stock, including your employer’s, makes up more than 10–15% of your investable assets, it deserves a deliberate plan, whether that plan is to diversify on a schedule or to hold with your eyes open.

The Four Types at a Glance

	RSUs	ESPP	ISOs / NSOs	ESOP
What it is	Company shares granted to you that become yours on a vesting schedule	A program letting you buy company stock through payroll, usually at a discount	The right to buy shares at a fixed price for a set window of time	A retirement plan funded with company stock, at no cost to you
You pay to get it?	No	Yes, through payroll deductions	Yes, when you exercise	No
Taxed when?	At vesting, as ordinary income	Discount taxed at sale; treatment depends on holding period	Depends on type and holding periods; ISOs can trigger AMT	At distribution, usually after leaving the company
Biggest pitfall	Under-withholding at vest; holding every vested share	Selling rules and holding periods misunderstood	Exercising without a tax plan; letting options expire	Assuming the payout works like a 401(k)

Five Questions to Ask About Your Own Equity Comp

- What do I actually have, and what is the vesting schedule?
- What happens to each grant if I leave, get laid off, or the company is sold?
- How much tax will I owe this year from vesting, purchases, or exercises, and is enough being withheld?
- What percentage of my net worth is tied to my employer?
- Do I have a written plan for when to sell, or am I deciding by feel?

Let's Talk

Cardinal Wealth Management specializes in planning for professionals with equity compensation. If you want a second set of eyes on your grants, your tax picture, or your

concentration risk, we offer a no-obligation introductory conversation.

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Cardinal Wealth Management LLC

1013 Royal Oaks Dr. McKinney, TX 75072

Phone: 503-864-7505

Email: chris@cardinalwealthmanagement.org