LIFE SPANS

THE BRIDGE DIVORCE STRATEGIES NEWSLETTER

INTERESTING INFO YOU CAN READ OVER A SINGLE CUP OF COFFEE!

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STOCK OPTIONS 101

I like to say that there are three parties in any divorce: The husband, the wife, and Uncle Sam. Because everyone agrees that the less we can give to that greedy uncle, the more that's left for the remaining two parties.

I don't think they taught you much about things like stock options, restricted stock units, or Black-Scholes valuation models when you were in law school. Why would they? They're complex subjects, even for a CPA like me.

But they all show up in divorce, whenever one party - often, the husband - works for a big company. Figuring out what this stuff is worth, and what qualifies as community property vs. individual parties' property, can be really tricky. But the dollar amounts at stake are often in the six-, and even seven-digit, range. And it all gets back to leaving more for the parties, and less for that greedy "uncle."

THE CARROT

In this article, I'd like to give you a little primer on just what stock options are. I'll try to answer some of the questions you might've been reluctant to ask. And I'm going to start with the real basics. I'm going to assume that this is new to you.

(If you already know this stuff, 1. Congratulations, and 2. Stay tuned for my next newsletter, in which I'll dive into the asset-dividing calculus of all this stuff.)

So. Let's say Husband works for a big, publicly-traded company. His employer may "grant" (*i.e., give*) him stock options as part of his compensation. These are purposely-overpriced shares of the company's stock, that he would have the "option to exercise" (dumbed down: "have the choice to kind-of cash in") at a specified date in the future.

Some quick definitions. A "non-qualified stock option" is so named because the employer doesn't qualify for a deduction until the option is actually exercised. And, germane to our discussion here, is the "strike price." Remember I said that the stock price was purposely overpriced? That's what this is all about. Example: Let's say the stock is trading at eight dollars a share. The stock options would include a strike price of, say, *ten* dollars a share.

What does this mean? And why does the employer do this?

BANKING ON THE FUTURE

There are two reasons an employer would offer an employee (such as an executive) a stock option, structured like this. First, it's an incentive for the employee to stay with the company, since they can't exercise the stock options until some time in the future. Second, it's an incentive to help the employee to *grow* the company, and boost its stock price, through lots of hard work.

So if the employee is issued the stock options with a strike price of ten dollars a share, when it's trading at just eight dollars a share, it doesn't do the employee much good. But, in the future, when that employee is finally able to exercise his option, and, say, that stock is now trading at *12* dollars a share, he benefits from that locked-in strike price, and gets to pocket the difference. See?

This incentivization around "future service" shouldn't be confused with "reward for prior service," but I see parties do this all the time. Community property is at stake!

I mentioned that this gets complicated, especially when it comes to dividing assets, and here's one reason why. The options are usually granted on a rolling schedule. A common scenario spans four years, with 25 percent of the options vesting at the end of Year One, the next 25 percent after Year Two, and so on. Each tranche has a different strike price. The market goes up and down. Getting dizzy yet?

Oh it gets much more involved. Let's bring in our old friend Uncle Sam. If the employee conducts a "cashless exercise," in which the shares are purchased and sold concurrently, the difference is taxable, and treated as W-2 income. If he held it for another year, that would be a capital gain, but that would be unwise, as the market price is available to anyone.

OTHER FLAVORS

There are also "incentive stock options." They're not as common, and they've evolved with the tax laws recently. But income from them is treated as a capital gain, although you must hold them for one year from the exercise - and two years from the date they were granted - to qualify for the capital-gains treatment.

Then there's "restricted stock," which you shouldn't confuse with "restricted stock *units*." Restricted stock *units* represent common stock that will be delivered at a future date; but with restricted stock, the employee owns the stock, but is restricted from selling it because it hasn't vested yet.

Question: *Are your eyes glazing over?* Have you even made it to this sentence? On the one hand, I do hope I've given you a little taste for the basics of executive compensation; on the other, I'd like you to appreciate just how specialized, detailed, and arcane this can get... and why you don't want to touch this stuff with a ten-foot pole. Call me instead.

A RED-FLAG REVIEW™

For a limited time, I'd like to offer you, absolutely free and with zero obligation, 30 minutes of my expertise in which I will look at any proposed settlement you may have, and give it my professional sniff-test. I can see this stuff real fast. And if I find red flags, as I often do, you can return to your client and say, "I ran this past my financial expert and she saw some issues with this." So you go from hero to super-hero, and your client can get better negotiating leverage.

And *then*, if you and your client think you'd like to actually engage me for my services, we can talk. I earn my reputation on ROI, and I think that this little loss-leader of mine will show you just how important timing can be.

So contact my office to book your Red-Flag Review™. You send your docs, I'll take a look at them, and give you up to 30 minutes of my time, gratis, on the phone. If you'd like me to sign your NDA in advance, I'd be happy to. What are you waiting for?

THERE REALLY IS A FREE LUNCH

Given today's Covid-19 environment, we are now offering online CLE, and will order lunch for the attorneys in your office who would like to participate from their remote locations. What a tasty way to learn things about the financial side of divorce that fly under your radar—and help you earn from one to three hours of CLE credit in the process!

Simply give us a call at (480) 378-2383 (or send an email to carma.hall@bridgefinancialstrategies.com) and say, "Hey! We'd love to take you up on that ingenious remote lunch-and-learn opportunity!" There's no obligation. Call us today!

WHAT?? CHEAT ON YOUR CLIENTS' TAXES??

Okay, I was purposely being cute here. Of *course* I'm not advocating that anyone cheat on anyone's taxes. But I would like to offer you a taxes-in-divorce *cheat sheet*, absolutely free. It's our latest 2021 edition, a handy little card you can keep in your desk drawer to help you with some quick, basic info about all kinds of important financial facts that pertain to divorce.

Want a copy? I'll be happy to send you one. Simply give us a call at (480) 378-2383 (or send an email to carma.hall@bridgefinancialstrategies.com). Go for it!

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