

FINANCIAL *fitness*

By RWM Wealth Advisor Sandy Carlson CFP®, CPA, CDFA™



Executive Compensation Planning

Executive compensation packages are designed to incentivize the executive team. More employers are choosing to compensate executives through these unconventional vehicles to entice them into staying with the company longer, as well as to meet performance goals, which has created an added complexity when trying to incorporate these compensation options into an individual's personalized financial plan.

Executive compensation typically includes stock options, deferred compensation, and alternative equity options. Navigating the complexity around exercising options or selecting the optimal deferred compensation payment structure has long term tax, financial planning, and estate implications if not executed correctly. The following is an overview of the more common forms of executive compensation, as well as the planning considerations surrounding this type of alternative compensation.

Nonqualified Deferred Compensation

Nonqualified deferred compensation is most commonly an unfunded obligation of the employer to pay the employee at some future date or event. Generally, there is no tax impact to the employee in the year the deferred compensation is earned; however, the deferred compensation will be taxed as ordinary income when paid out to the employee at a future date. Careful planning must be implemented to analyze the different payout options available to select the option that will maximize the total value of the nonqualified deferred compensation. Normally, this is achieved by matching the receipt of the deferred compensation to years the employee will be in a lower income tax bracket. One of the risks associated with nonqualified deferred compensation is the employer's future financial ability to honor these commitments. If the employer files for bankruptcy or goes out of business, they will not have the ability to fund the nonqualified deferred compensation obligation.

Stock Options and Restricted Stock Awards

Stock options are granted options that allow an employee to purchase company stock at a future date for a set price. Understanding what type of stock options have been granted is important to ensure that the most favorable tax treatment is selected when exercising the options. Incentive Stock Options (ISO) allow for more favorable tax treatment if a set holding period is met from the time of grant, execution, and eventual sale of the stock. Nonqualified Stock Options (NSO) have less favorable tax treatment because they are taxed as ordinary income for the full fair market value of the stock at the time the options are exercised. The employee can also choose to hold the company stock and sell at a later date to receive favorable capital gain treatment on the appreciation.


Restricted stock awards are grants of company stock that give the employee the right to purchase the stock at a discount or receive stock after a specified restriction lapses. This restriction is usually a required length of time that must be met before the employee can purchase or receive the shares of stock, commonly referred to as

vesting. Once the restricted stock is vested, the difference between the fair market value of the shares on the vesting date and the price paid for the restricted shares is taxed as ordinary income. One planning technique available for restricted stock awards is the 83(b) election, which allows the employee to receive potentially preferential capital gains tax rates if the value of the stock is taxed at the time of the grant and certain holding period requirements are met.

Other aspects of executive compensation planning to consider are how these benefits are left to heirs in the event of death and how they contribute to the gross estate, as well as the estate tax liability. Most nonqualified deferred compensation plans pass to heirs via a beneficiary designation. The appropriate beneficiary may differ depending on an individual's estate plan and the use of trusts in the estate plan.

Every company has different nuances and characteristics with their executive compensation plans and understanding the choices available and how they fit into your overall financial plan is vital to obtaining your goals. At Rinehart, we can assist in incorporating your executive compensation options effectively into your financial plan.

Sandy Carlson has over eighteen years of wealth management experience including income taxation, retirement planning, executive compensation planning, insurance, banking, trust administration and estate planning. She is a Certified Divorce Financial Analyst™ (CDFA) and also holds the QKA designation by the American Society of Pension Professionals & Actuaries. She is President-Elect of the Financial Planning Association, a Tax Instructor in the CFP Program at Queens University, and is a member of the Charlotte Estate Planning Council. Sandy values getting to know her clients and providing creative, integrated solutions for accumulating, preserving and transferring wealth.



Where will your wealth take you?

A comfortable retirement. Security for your family. Whatever your destination, Rinehart Wealth Management provides a clear direction to help you get there. The first step: Talk to our team of financial planning and investment management experts. Together, we'll create a comprehensive, customized portfolio that's designed for your personal path.

Rinehart Wealth Management
Greater Trust
521 East Morehead Street / Suite 580
Charlotte, NC 28202 / 704-374-0646
RinehartWealthManagement.com