WHITEPAPER

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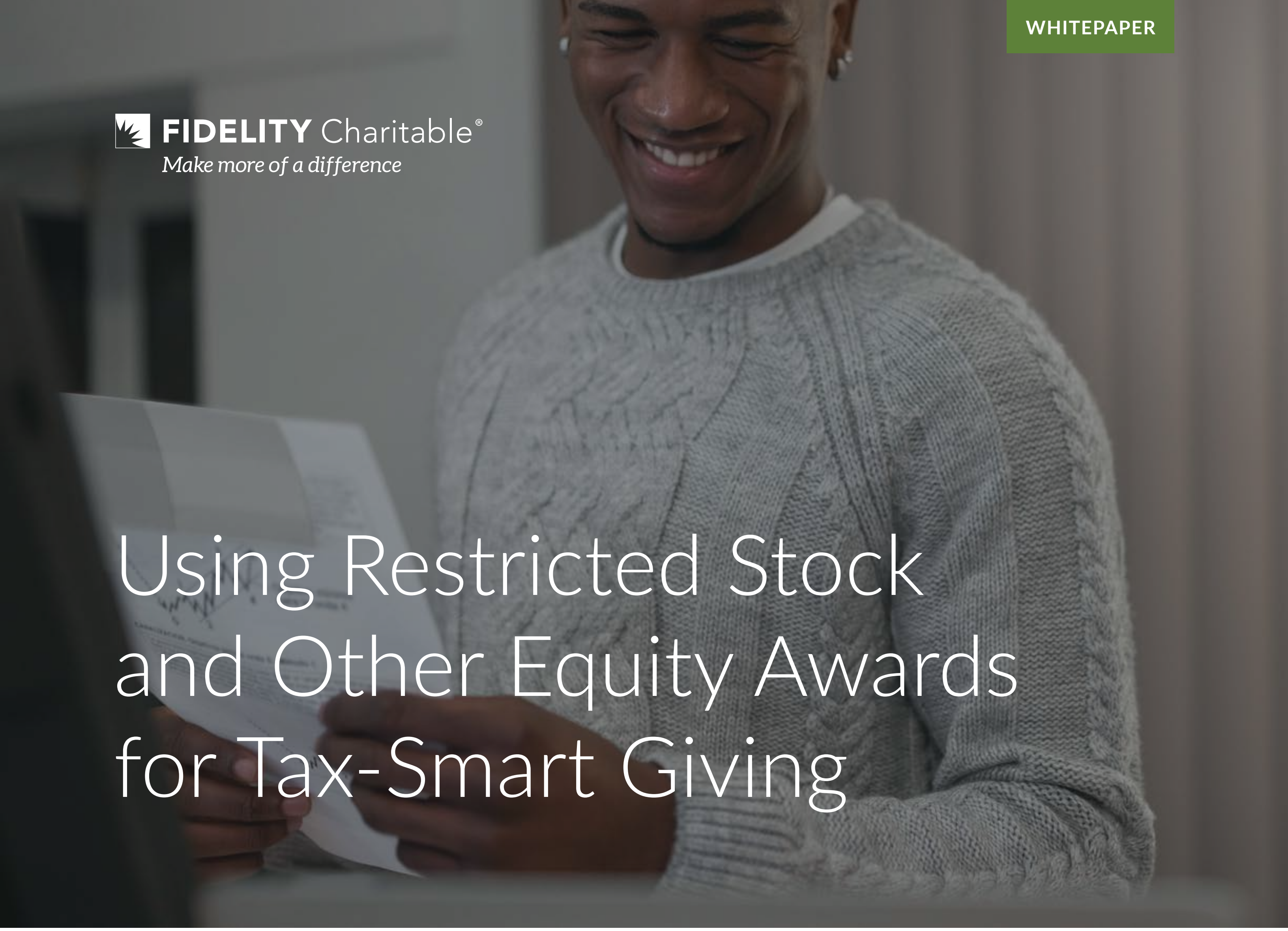


Using Restricted Stock and Other Equity Awards for Tax-Smart Giving

As the challenge of attracting and retaining employees continues, more private and public companies are adopting the use of equity compensation awards to differentiate their benefits packages. While the vesting or exercise of these awards can create substantial wealth for founders, executives, and key employees, it can also result in correspondingly large tax liabilities. Charitable-minded employees who are passionate about giving back or who want to incorporate giving into their legacy planning can use these sudden windfall events to make a meaningful difference in a more efficient way due to the potential for multiple tax benefits.

Not all awards present the same charitable opportunities. Most often, equity compensation takes the form of grants of stock options, restricted stock awards (RSAs), restricted stock units (RSUs), phantom stock, or stock appreciation rights (SARs).

This whitepaper will focus on outright, lifetime gifts of shares acquired from the most common sources: RSUs, RSAs, non-qualified stock options (NSOs), and incentive stock options (ISOs). Once these awards are vested and/or exercised and the underlying stock has been held for greater than one year, it can simply be referred to, for purposes of this whitepaper, as "Appreciated Stock."

It is important to note that under federal securities laws, if the company is private and the shares have not been registered, the stock is considered "Restricted Stock." However, if the underlying shares have been registered, which generally applies to public companies, and are held by an "Affiliate," the stock is technically not restricted and is referred to as "Control Stock." Both Restricted Stock and Control Stock must be sold in accordance with the Rule 144 resale restrictions,[1] and as we will see, both forms are prime assets for gifting to charity because of the advantageous tax benefits.

[1] *According to the U.S. Securities and Exchange Commission, "Rule 144 provides an exemption and permits the public resale of restricted or control securities if a number of conditions are met, including how long the securities are held, the way in which they are sold, and the amount that can be sold at any one time." This generally impacts senior officers, directors, and greater-than-10% shareholders.*

Choosing the best awards for a giving strategy

Prime assets to consider

Once vested and held for greater than one year, the shares acquired upon the vesting of RSAs and RSUs can be ideal assets to give to charity, as the donor receives a twofold tax benefit. First, if contributed directly to a public charity, including sponsors of donor-advised funds, the donor can qualify for an income tax deduction for the full fair market value (FMV) of the securities in an amount up to 30% of the donor's adjusted gross income, with a five-year carryforward for any excess not deductible in the year of the contribution.[2] Second, rather than donating the after-tax proceeds from selling the stock, the charity receives the full value of the Appreciated Stock and the donor recognizes no taxable gain on the appreciation in the stock. This can be a valuable strategy even for donors who take the standard deduction. Employees who receive these types of awards often can start to align their philanthropic intent with the vesting of future awards for a comprehensive tax planning play.

Rules for short-term shares

If the underlying stock has been held for less than one year, the donor is entitled to deduct from his or her income only the cost basis (the FMV of the stock received at vesting) or the FMV on the date of the charitable contribution, whichever is lower. As partial compensation for the basis-only deduction, the donor can use the deduction to offset up to 50% of his or her Adjusted Gross Income (AGI), with the same five-year carryforward. In short, the vesting of the RSA or RSU, followed by a gift of the shares within a 12-month period, will result in a financial "push" to the donor for income tax purposes and generally yields the same tax benefit as selling the stock and donating the after-tax proceeds.

Reviewing other awards

Most company plans do not permit transfers of NSOs to charity, as they result in taxation to the holder/donor on exercise, even though the individual no longer owns the contributed options.[3] ISOs, by their terms, cannot be transferred during the holder's lifetime, thereby preventing the possibility of a lifetime transfer of these options to any transferee, including a charity.[4] For these reasons, neither ISOs nor NSOs are viable assets for contributing to charity. However, the shares acquired upon exercise can be suitable for donating. Most tax professionals take the position that unvested RSUs and RSAs are not completed gifts for tax purposes and advise that the underlying unvested shares can likewise not be gifted.

Potential IPO? Plan ahead.

There are some planning techniques the donor/employee may wish to consider. Under Section 83(b) of the Internal Revenue Code, an employee can accelerate tax treatment of his or her RSAs to the grant date, even if the stock is unvested and subject to a substantial risk of forfeiture.[5]

An employee would make this election if he or she expects the stock to appreciate. Any future appreciation is taxed at the lower capital gains rate, and, if held for more than one year after the 83(b) election is made, the award could receive long-term capital gains tax treatment, rather than ordinary income tax treatment.

The risk to this strategy is if the stock price declines or if the shares are forfeited (because the vesting requirements were not met), the employee would have paid taxes and cannot take a loss. This strategy is mostly used with early-stage non-publicly traded companies, as the value of the stock award when granted can be dramatically lower than at later vesting.

[2] *In the case of non-publicly traded stock, the donor's deduction is the FMV of the stock as determined by a qualified independent appraisal in compliance with IRS rules and regulations.*

[3] *IRC Section 422 (b)(5)*

[4] *PLRs 9737015 (June 13, 1997) and 9737016 (June 13, 1997)*

[5] *An 83(b) election is generally irrevocable and must be made within 30 days of the grant of the RSA. The election must be made in writing and filed with the IRS office where the employee regularly files his or her tax returns. The employee must also send a copy of the election to the employer.*

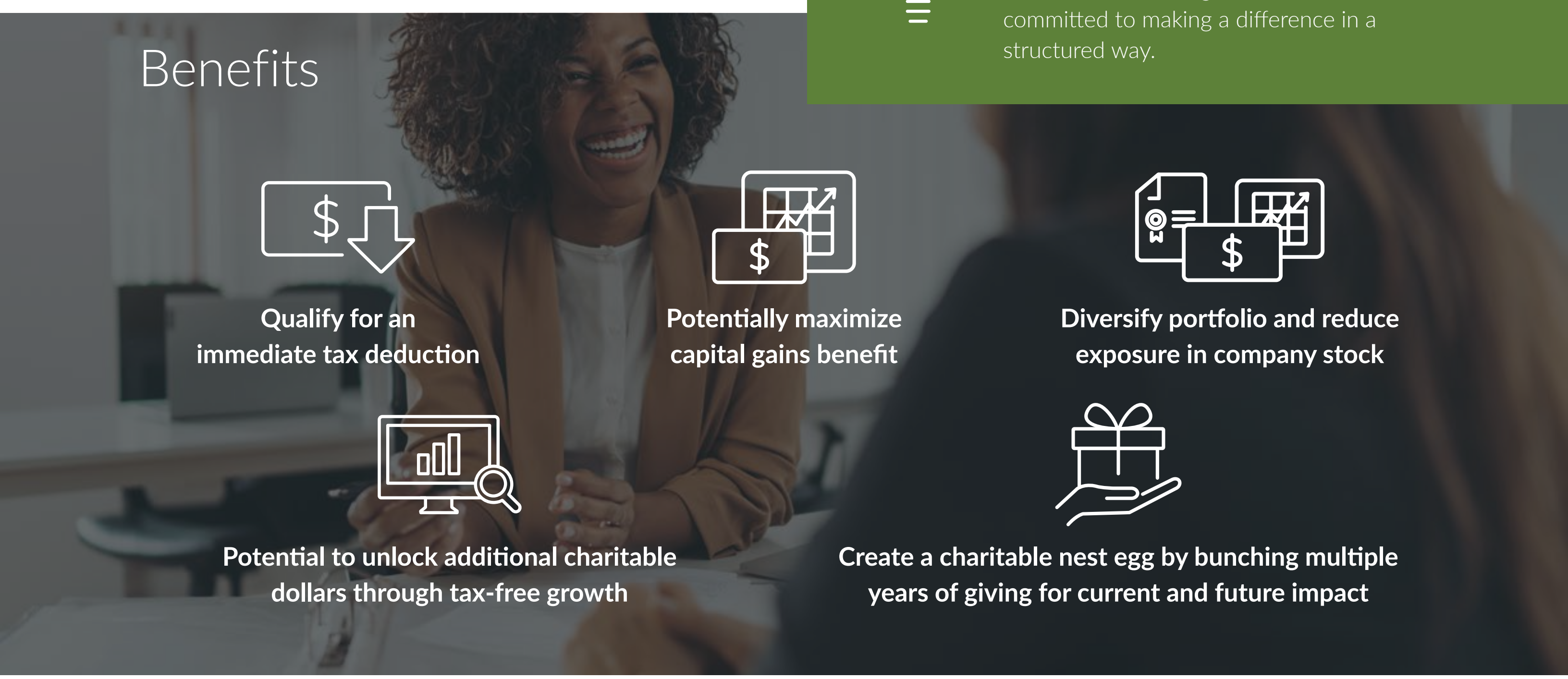
Putting it all together: A good giving strategy can help you give more and maximize tax benefits

Jane is the founder and CEO of a tech company that recently went public. She has accumulated $5 million of Restricted Stock as a result of early stock option exercises and Section 83(b) elections on RSAs, with a relatively low cost basis of $50,000. She has held this underlying stock for longer than one year. In this year of the IPO, Jane has an unusually high income of $13 million due to RSUs vesting and is interested in minimizing tax exposure. Also, as a senior executive, she is concerned about the optics and impact of selling a large number of shares relatively soon after the IPO.

Jane is philanthropically minded but doesn't have a long-term charitable plan. She has previously contributed cash to support several different charities. After speaking with her financial advisor, Jane decides that it is better for her to donate her most-appreciated asset, which in this case would be her Restricted Stock.[6] After learning about the benefits and flexibility of donating to a donor-advised fund (DAF) sponsor, she decides to contribute $1 million of Restricted Stock. She can fully deduct the $1 million in the current year to offset some of the income from her RSUs vesting, and she does not have to pay capital gains on the appreciation of $950,000. In addition, by contributing the $1 million to a DAF sponsor, she is able to front-load or bunch five years' worth of her customary charitable giving, while allowing the assets in the DAF to potentially grow tax-free.

As Jane grows her company, she can start to integrate charitable benefits and programs that can also help her employees give back more efficiently—including by offering a charitable match that can supercharge their impact by pairing donations of Appreciated Stock into a DAF.

If you are considered a company insider and have a 10b5-1, your plan may allow you to incorporate an annual charitable giving strategy paired with a donor-advised fund, making it even easier to be committed to making a difference in a structured way.



Benefits

Qualify for an immediate tax deduction

Potentially maximize capital gains benefit

Diversify portfolio and reduce exposure in company stock

Potential to unlock additional charitable dollars through tax-free growth

Create a charitable nest egg by bunching multiple years of giving for current and future impact

[6] Corporate insiders are required to file a Form 5 for gifts of company stock on or before the 45th day after the end of the issuer's fiscal year, or they can file a voluntary Form 4 no later than two business days after the gift.

The chart below provides a snapshot of the charitable opportunities for equity compensation awards.

Charitable Opportunities for Equity Compensation Awards

	Participant Tax Treatment Upon Exercise/Vesting	Charitable Opportunity	Income Tax Deduction
Vested Restricted Stock Awards (RSAs) & Restricted Stock Units (RSUs) held >1 year*	Ordinary income on difference between fair market value (FMV) at vesting and amount paid for such stock (if any)	Ideal Elimination of capital gain recognition on difference between FMV at vesting and FMV at date of gift	FMV Up to 30% of Adjusted Gross Income (AGI) with a 5-year carryforward
Stock received upon NSO exercise held >1 year	Ordinary income on difference between exercise price and FMV at exercise	Ideal Elimination of capital gain recognition on difference between FMV at exercise and FMV at date of gift	FMV if held for > 1 year of exercise Up to 30% AGI with 5-year carryforward
Stock received upon ISO exercise	No ordinary income if held > 1 year of exercise + 2 years from grant (although spread between FMV of stock upon exercise price is an Alternative Minimum Tax (AMT) preference item and included in participant's AMT calculation). The sale price, less the exercise price, is taxed as long-term capital gain.	Good If holding periods are met, elimination of capital gains on difference between FMV at exercise and FMV on date of gift (Potential AMT concerns: participant loses the benefit of higher AMT basis, and AMT preference may be lost)	FMV if held for > 1 year of exercise + 2 years from grant Up to 30% AGI with 5-year carryforward
Vested RSAs held <1 year	Ordinary income on difference between FMV at vesting and amount paid for such stock (if any)	Neutral No advantage over donating after sales proceeds	Lesser of cost basis (market value of stock received at vesting) or FMV Up to 50% AGI with 5-year carryforward
Unvested RSUs	Ordinary income at vesting unless plan provides for deferral upon predetermined delivery date	*None*	*N/A* Unvested RSUs are not transferrable
ISOs	No ordinary income if held > 1 year of exercise + 2 years from grant (although spread between FMV of stock upon exercise price is an Alternative Minimum Tax (AMT) preference item and included in participant's AMT calculation). The sale price, less the exercise price, is taxed as long-term capital gain.	*None*	*N/A* Non-transferrable during participant's lifetime
NSOs	Ordinary income on difference between exercise price and FMV at exercise	*None* Donor recognizes ordinary income upon exercise by charity	Generally, company plans do not permit the transfer of NSOs to charity

** Stock acquired upon the vesting of an RSA/RSU*

About the Author

Amy M. Grossman, J.D., is vice president of the Complex Asset Group at Fidelity Charitable®, an independent public charity that has helped donors support more than 433,000 nonprofit organizations with over $100 billion in grants since its inception in 1991. Ms. Grossman works directly with donors, their advisors, and corporate and business lawyers to facilitate charitable contributions of these assets to achieve the most favorable tax treatment with the greatest charitable impact. Ms. Grossman's strength is providing strategic advice on the full spectrum of monetization, hedging, and diversification strategies, as well as estate and gift tax planning for pre- and post-liquidity events.

Fidelity Charitable® has years of experience in accepting equity awards and helping advisors and donors navigate these types of donations.

We invite you to contact our team of experts to discuss your opportunity today at **800-262-6039**.

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