



# UNDERSTANDING STOCK OPTIONS

Employee stock options can be an important part of your overall financial picture. Understanding what they are, and how and when to exercise them, can help you make the most of the benefits they provide.

## HOW DO OPTIONS WORK?

Employee stock options, once vested, give you the opportunity to purchase shares of your company's stock at a specified price, usually called the strike or exercise price. The value of a stock option depends on the price of the company's underlying shares, which fluctuates over time.

An employee stock option grant is said to be "vested" when you have the right to exercise the grant and purchase the shares at the predetermined price. The shares vest over a set schedule as described in your grant agreement. The exercise price, vesting schedule, and expiration date for each of your

option grants are displayed to you by your employer at the Portfolios sub-tab under the Employee Stock Plans tab at *etrade.com*.

As an example, say you were given a grant of 100 options at \$10 dollars each. After a vesting period of three years, the company's share price has risen to \$25. You are now entitled to buy the underlying shares for the exercise price of \$10, a full \$15 below the current market price. This process of purchasing the options' underlying shares is known as "exercise."

## THINGS TO CONSIDER BEFORE YOU EXERCISE OPTIONS

### ■ EXERCISE PRICE

Exercising vested options is typically done when the current market price of your company's stock is above the exercise price. By exercising, you can unlock the current value these options hold.

### ■ DIVERSIFICATION & COMPANY STOCK OWNERSHIP

How much of your company's stock do you ultimately want to own? Answering this question can help you decide whether to sell your shares upon exercise—or keep them. You may also want to consider issues of diversification so that the performance of your portfolio isn't overly dependent on any one investment.

### ■ TIMING

Should you exercise your options now or should you wait? If you think the underlying stock price will stay flat or decline, you may want to consider exercising. If you believe the stock price will rise significantly, you may want to exercise your options at a later time. Visit the Employee Stock Plans tab at *etrade.com* for access to charts and calculators where you can enter assumptions to help with your decision.<sup>1</sup>



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## 3 EASY STEPS FOR EXERCISING YOUR OPTIONS

Once you exercise your vested options, you can either sell the shares right away or hold onto them as part of your stock portfolio. If you sell your shares, your proceeds will be automatically deposited into your linked E\*TRADE Securities brokerage account. You can then reinvest the funds according to your own financial plan or access your proceeds through a variety of cash management tools, such as Quick Transfer.<sup>2</sup>



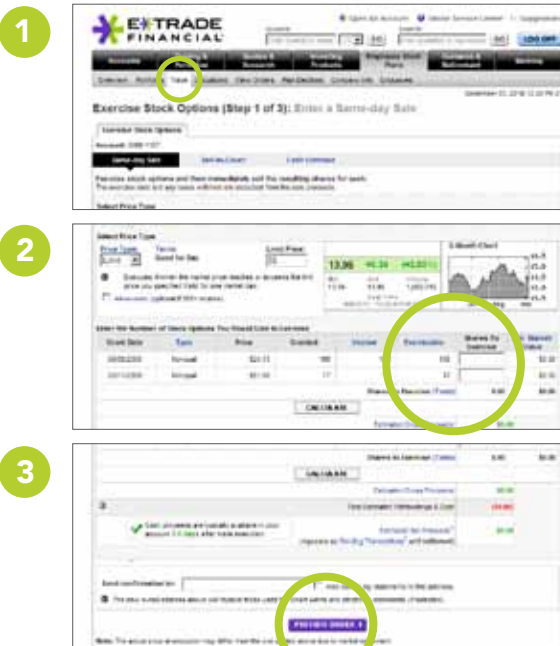
### 1. VISIT THE TRADE SUB-TAB

under the Employee Stock Plans tab in your stock plan account at [etrade.com](http://etrade.com).

### 2. CHOOSE FROM THE EXERCISE TYPE(S)

available to you as determined by your company. These determine whether your transaction will generate cash or stock, how you'll pay for the stock at exercise and any associated commissions, fees or taxes. Whether or not you need to pay taxes at the time of exercise depends on the type of option you own (see next page for details). Below is a description of each exercise type.

- Same-Day Sale/ Cashless Exercise – Exercise your options for shares of stock, and then simultaneously sell the shares. You'll end up with cash proceeds in your linked E\*TRADE Securities brokerage account, less the exercise cost of your options, along with any associated commissions, fees and taxes.



- Cash Exercise/ Exercise and Hold – Exercise your options by paying the exercise cost and any applicable taxes, along with any associated fees with your own cash funds. You'll end up with shares of stock in your stock plan account.
- Sell-to-Cover – Exercise your options by selling shares to cover the exercise cost and taxes along with any associated fees and commission. The remaining shares will end up in your stock plan account, along with any residual cash from the sale of shares.

### 3. COMPLETE YOUR ORDER

and we'll send you an alert when your order has been executed and another when settlement occurs. You can also track your order's status on the View Orders screen on [etrade.com](http://etrade.com).



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# IMPORTANT TAX CONSIDERATIONS<sup>1</sup>

Before you exercise your options and/or sell shares, you'll want to carefully consider the tax consequences of the transactions. Tax treatment for each transaction depends on the type of stock option you own. For advice on your personal financial situation, please consult a tax advisor.<sup>1</sup>

## KNOW THE TYPES OF OPTIONS

The two types of employee stock options, shown below, are primarily differentiated by how taxes are triggered and determined. The type of Options you have will be listed in the Portfolios sub-tab under Employee Stock Plans on [etrade.com](http://etrade.com).

- **INCENTIVE STOCK OPTIONS (ISOs)**

A type of employee stock option that qualifies for special tax treatment by the IRS. Taxes generally do not have to be paid when these options are exercised, and the resulting shares may qualify as long-term capital gains or loss if held longer than a year.

- **NONQUALIFIED OPTIONS**

These options can result in ordinary taxable income when exercised. The tax is based on the difference between the exercise price and fair market value (FMV) at the time of exercise. Subsequent sale of shares may result in a capital gain or loss, which will be short or long term depending on the duration held.

## A CLOSER LOOK AT POTENTIAL TAX SCENARIOS<sup>1</sup>

There are typically two points in the life cycle of an employee stock option at which you may be required to pay taxes—upon exercise of the option (for a nonqualified option) and at the time you sell the resulting shares.

- **FOR NONQUALIFIED OPTIONS AT EXERCISE**

Taxes are based on the difference between the value of the underlying shares at the current market price and the exercise price

- **FOR ALL OPTIONS UPON SALE OF STOCK**

At the time of sale, you will typically incur either a capital gain or loss, which is dependent upon the cost basis of the shares acquired. The amount of time that the shares were held will further dictate whether the gain or loss is long-term or short-term. Shares must be held at least one year in order to qualify for long-term treatment.

- **NON-QUALIFIED (NQ)**

The subsequent sale of shares from a non-qualified option will typically result in a capital gain or loss. This will be determined by the difference between the sale price and the FMV at exercise. Further, the duration of which the shares were held after exercise will determine whether the gain or loss is considered short or long term.

- **QUALIFIED (ISO)**

Generally, taxes are not paid at the time of exercise of an ISO, since they receive preferential tax treatment. Shares must meet the following minimum holding requirements to continue receiving such tax treatment: two years from Grant Date AND one year from exercise. Shares that are sold before these holding requirements have been met may incur ordinary income tax, along with a capital gain or loss. Shares that meet both holding requirements should only be subject to long term capital gain or loss, since they were held at least one year from exercise.



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## POTENTIAL TAX CONSEQUENCES FOR EACH OPTION TYPE<sup>1</sup>

This hypothetical example assumes a \$10 exercise price on a grant of 100 options.

| OPTION TYPE            | TAXES AT EXERCISE                                                                       |  | TAXES ON SALE OF SHARES*                                                                                                                                                                                                                                                                                                                                                                                              |  |
|------------------------|-----------------------------------------------------------------------------------------|--|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|
|                        | MARKET PRICE = \$25                                                                     |  | SALE PRICE = \$45                                                                                                                                                                                                                                                                                                                                                                                                     |  |
| Incentive Stock Option | Not Applicable                                                                          |  | Qualified Disposition:<br>$\$45 - \$10 = \$35$<br><br>100 shares X \$35 = <b>\$3,500 taxed as capital gains (long-term)</b><br><br>Disqualified Disposition:<br>$\$45 - \$25 = \$20$<br><br>100 shares X \$20 = <b>\$2,000 taxed as capital gains (long-term or short-term dependent on duration shares were held)</b><br><br>$\$25 - \$10 = \$15$<br><br>100 shares X \$15 = <b>\$1,500 taxed as Ordinary Income</b> |  |
| Nonqualified Option    | $\$25 - \$10 = \$15$<br><br>100 shares X \$15 = <b>\$1,500 taxed as ordinary income</b> |  | $\$45 - \$25 = \$20$<br><br>100 shares X \$20 = <b>\$2,000 taxed as capital gains (short or long term dependent on duration held).</b>                                                                                                                                                                                                                                                                                |  |

\* Tax treatment for each transaction depends on the type of stock option you own. Please keep in mind that these examples are based on hypothetical conditions. For advice on your personal financial situation, please consult a tax advisor.<sup>1</sup>



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## CONSIDER YOUR OPTIONS WITH HELP FROM E\*TRADE

At E\*TRADE, you'll find the tools, calculators, and the personalized guidance that can help you to make important decisions about your employee stock options. We give you an array of investment choices and resources from E\*TRADE Securities to help you make the most of your proceeds.



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Estimate the value of your holdings, compare the impact of different transaction types, assess various tax scenarios, and more.<sup>2</sup>



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