Stock Options

and Charitable Planning at the University of Florida

When considering a charitable contribution of stock options to the University of Florida, you must determine what type of options you own and how long you have held the options. There are two types of Stock Options, Incentive and Non-Statutory:

Incentive Stock Options (ISO)

- Also referred to as “statutory options,” which meet requirements for favorable federal income tax treatment.
- You cannot directly donate ISOs during your lifetime. However, you may exercise the ISOs and give the actual shares as a gift, just like any other shares.
- If you have held the shares for the mandatory holding period and exercises the ISO, you can claim a fair market value deduction and avoid recognition of any capital gain.
- Neither the granting nor the exercise of an ISO will trigger income tax if you hold the shares for a minimum holding period and do not exercise more than three months after leaving employment.
- To achieve the best tax outcome, you must hold the shares:
    1. For at least two years from the date the option was granted.
    2. One year from the date the option was exercised. Then, the shares can be gifted to charity as “long-term gain” property.

Example: Mr. Smith is a Vice President of Good Food Inc. and was able to purchase company stock for $100 per share. They are qualified as ISOs and the granting of the options does not trigger a taxable event.

When the stock is valued at $500 per share, Mr. Smith exercises his option and pays $100 per share. This does not trigger any income tax consequence, but if Mr. Smith is subject to Alternative Minimum Tax (AMT), he will have $400 of ordinary income per share. With ISOs, AMT concerns may arise upon exercise, and a donor should assess his or her individual tax situation to determine whether the AMT will apply.

If Mr. Smith holds the shares for more than a year, his stock becomes long-term capital gain property. He then sells the shares for $900 each. As a result, he realizes $800 of long-term capital gain ($900 - $100). If he donates any of his shares to UF he avoids the capital gains taxes and is able to deduct the gift valued at $900 per share. Thus, the “cost” of making this gift for Mr. Smith is low.

Non-Statutory Stock Options (NSO)

- NSO's, also called "non-qualified" options are generally more flexible than ISOs, however their tax treatment is less favorable.
- NSOs are considered compensation received in exchange for services and are includable in your gross income. They are subject to taxation as income upon either:
    1. The initial grant to the employee if the option has a readily ascertainable value.
    2. When the NSO is exercised.
- When you realize ordinary income, equal to the difference between the exercise price and the current fair market value of the stock, it is taxed immediately, there is no minimum holding requirement.
- If you donate the shares received from exercising an NSO, you will receive a charitable deduction that can be used to offset the income recognized at exercise.

NSOs do not offer the possibility of avoiding tax on the gain inherent in the options. Therefore, gifting the NSOs to UF during your lifetime has a less favorable tax treatment. You will recognize tax as ordinary income when UF exercises the NSO and you may not have a charitable deduction to offset the ordinary income.

☛ ***Note:*** *It is often a better strategy to use a different asset (such as highly appreciated stock or real estate) to make a gift that will create a significant deduction to offset the income generated from exercising the NSOs.*

Bequest of ISOs, ISO Shares and NSOs

If the ISO plan allows, the same tax treatment is applicable to the exercise of an ISO and is not lost upon your death. The ISO plan may allow your estate to exercise the ISO which it acquires by bequest. Thus, bequeathing an ISO to UF will generate a charitable deduction for the estate/heirs.

A lifetime gift of NSOs is not particularly advantageous, however a testamentary transfer of NSOs to UF may provide some real benefits. Like retirement plan assets, stock options do not receive a stepped-up basis at death. All gains recognized upon the subsequent exercise of the NSOs will be deemed "income in respect of a decedent" (IRD) and included in the gross income of the person or entity that receives and exercises the option. Since a qualified charity is tax exempt, it does not owe IRD.

In summary, you need to review the terms of the stock option plan or agreement to determine whether a transfer of the option is possible.

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