

**EMPLOYEE STOCK  
OPTION FINANCING**



**EXECUTIVE SERVICES GROUP**

*As an employee of a publicly traded company, you may have been granted stock options as part of your employee benefit plan. The stock option grant gives you the ability to purchase shares of your company's stock at a predetermined price ("exercise" price) for a specified period of time ("grant life"). There are two types of option grants: Non-Qualified Stock Options and Incentive Stock Options. The primary difference between these two option grants is the tax consequences involved upon the exercise of the option and the subsequent sale of the underlying shares.*

### **NON-QUALIFIED STOCK OPTIONS**

If you have been granted non-qualified stock options, generally you will be taxed at ordinary income rates on the difference (the "spread") between the exercise price and the fair market value of the stock on the date that you exercise your stock options. Your company is required to withhold this tax upon exercise. If you do not sell the underlying stock the day you exercise; typically, the fair market value of the stock on the date of exercise will become your cost basis of the stock.

#### **EXAMPLE:**

You are granted 1000 non-qualified stock options at an exercise price of \$10 per share. You exercise your options on a day that your company stock is trading at \$40 per share and sell the same day. You will have to pay ordinary income tax on the spread of \$30 per share ( $\$40$  fair market value -  $\$10$  exercise price =  $\$30$ ). Now suppose you do not sell the same day you exercise; rather, you sell a couple of months later when your company stock is trading at \$50 per share. You will pay capital gains tax on the \$10 gain you received ( $\$50$  fair market value -  $\$40$  cost basis =  $\$10$ ).

### **INCENTIVE STOCK OPTIONS**

If you have been granted incentive stock options, generally, you will not be taxed upon the exercise of your stock options. You will only be taxed when you sell the underlying shares. Tax will be on the difference between the exercise price and sale price at the federal long-term capital gains rate of 15% provided that you have held the option two years from the date of grant and the stock one year from the date of exercise. If these holding periods are not met you will be taxed at ordinary income rates when you sell the underlying shares. The exercise of an incentive stock option may subject you to the Alternative Minimum Tax (AMT).

#### **EXAMPLE:**

You were granted 1000 incentive stock options with an exercise price of \$10 per share on January 1, 2001. You exercised these options on January 1, 2002. On February 1, 2003 you decided to sell the shares you received upon the exercise of your incentive stock option when your company stock was trading at \$50 per share. Since the holding periods were met, you will be taxed at the federal long-term capital gains rate of 15% on the \$40 per share spread ( $\$50$  sale price -  $\$10$  exercise price =  $\$40$ ).

## HOW CAN OPPENHEIMER & CO. INC. HELP?

In addition to guiding you through the tax consequences associated with the exercise and/or sale of your stock options, we can assist you in financing the exercise of your stock options. We understand that you may not have sufficient funds readily available to pay for the exercise of your stock options and any applicable taxes, or you may not want to disrupt your savings. In that regard, the Executive Services Group at Oppenheimer has developed the following lending programs which allows you to exercise your stock options, usually without any outlay of cash. As long as your company guarantees the delivery of shares, Oppenheimer can finance the exercise of the stock options before the shares are received.

### EXERCISE AND SELL

The exercise and sell program allows you to exercise your options and sell the underlying shares the same day. Oppenheimer can lend you up to 100% of the fair market value of the stock to be received upon exercise to pay for the cost of exercise and any applicable taxes. The costs associated with this program will be commissions on the sale of the shares underlying your stock options and margin interest. Margin interest is charged\* from the day the funds are sent to the company to pay for the option until the shares are received into your account at Oppenheimer or settlement date, whichever is later.

### EXERCISE AND HOLD

The Exercise and Hold program allows you to exercise your stock options and hold the underlying shares in your Oppenheimer account. Oppenheimer can lend you up to 50% of the fair market value of the shares to be received upon exercise provided your company stock is eligible for margin. If 50% of the fair market value does not cover the entire cost of exercise and any applicable taxes, you will be required to deposit cash, other marginable securities, or sell a sufficient number of shares to cover the shortfall. You will pledge the shares received upon exercise for the loan created when Oppenheimer advances the cost of exercise and any applicable taxes to the company. Your shares are then held on margin until the loan is paid in full or the shares are sold. The costs associated with this program include margin interest on the loan.\* If and when you decide to sell these shares you will also be charged a commission.

## EXERCISE AND SELL TO COVER

This program combines both the Exercise and Sell and the Exercise and Hold programs. It is designed for those who wish to hold the stock they receive upon exercise; but, do not have the cash available to pay for the exercise and any applicable taxes nor want to incur a margin debit. In this program Oppenheimer will per your direction sell a sufficient number of shares to cover the cost of exercise and any applicable taxes; the remaining shares will be held in your account at Oppenheimer. The costs associated with this program include commissions on the sale of the stock and interest on the funds forwarded to the company to pay for the cost of exercise and any applicable taxes. Margin interest is charged\* from the day the funds are sent to the company until the shares are received into your account at Oppenheimer or settlement date, whichever is later.

Whether you decide to sell or hold the stock that you receive from the exercise of your options, your Oppenheimer Financial Advisor, in conjunction with the Executive Services Group, is prepared to assist you with each step of the transaction.

## PROCEDURES FOR EXERCISING YOUR EMPLOYEE STOCK OPTIONS

### DAY 1

- Open a margin account\*\* with Oppenheimer (if you do not already have one) and sign a stock power.
- Sign a Third Party Authorization Letter – this allows Oppenheimer to pay the company for your option exercise from your account.
- Choose Exercise and Sell, Exercise and Hold or Exercise and Sell to Cover.
- Affiliates who wish to Exercise and Sell or Exercise and Sell to Cover must complete Rule 144 documentation.
- Oppenheimer receives a Corporate Letter of Intent from your stock plan administrator guaranteeing delivery of shares within 3 business days.
- Oppenheimer will sell your shares according to your instructions if you chose to Exercise and Sell or Exercise and Sell to Cover (We can accept market orders and limit orders).
- Oppenheimer will use the sale proceeds to send a check or wire to your company to pay for the cost of exercise and any applicable taxes if you chose to Exercise and Sell or Exercise and Sell to Cover.
- If you chose to Exercise and Hold your stock options, Oppenheimer will send a check or wire to your company to pay for the entire cost of exercise and any applicable taxes thus creating a margin debit balance in your Oppenheimer account.

#### DAY 4

- Oppenheimer receives the shares from your company.
- If you chose the Exercise and Sell program, proceeds of the sale less the cost of exercise and any applicable taxes are made available to you. The proceeds can either be invested or paid to you via check or wire transfer.
- If you chose the Exercise and Hold program, your shares are held on margin until the shares are sold or the margin loan is paid in full.
- If you chose to Exercise and Sell to Cover, your shares that were not sold will be held in your account until further instruction from you.

*For more information regarding the exercise of your stock options, AMT or the financing programs available through Oppenheimer, please contact your Oppenheimer Financial Advisor.*

*The information contained herein is based on our understanding of current tax laws which are subject to change without notice, but it should not be construed as providing tax advice. Oppenheimer & Co. Inc. does not offer tax or legal advice. Clients should evaluate carefully the financial, market, regulatory, credit and tax consequences of any transaction independently of Oppenheimer.*

\* Margin interest is based on the broker call rate. The broker call rate is determined by prevailing market interest rates that change periodically. Oppenheimer & Co. Inc. can provide you with the interest rate you will be charged when you decide to exercise your option.

\*\* Establishing a margin account requires the signing of a Customer Agreement which will be accompanied by a Margin Disclosure Document. The Margin Disclosure Document details risks specific to margin loans which could entail the potential loss of the entire investment. Please read all documents thoroughly before signing.

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