

# Your Equity, Explained

*ISOs, NQSOs, RSUs, the 83(b) election – every type of equity compensation demystified, with the full tax math, in language a fifth grader can follow.*

ISOs

NQSOs

RSUs

83(b) Election

Tax Treatment

## 01 SETTING THE STAGE

### What Is Equity Compensation and Why Does It Exist?

I am standing in front of all of you today – leadership, engineers, sales, operations – because equity compensation is one of the most valuable things NovaSpark will ever give you, and most people who receive it do not fully understand what they have. That is not your fault. The words are confusing, the tax rules are layered, and nobody explains it plainly. That changes today.

Let me start with a simple question: why does the company give

you equity at all? The honest answer is this — **we cannot pay you as much as a large public company can**, and in return, we give you a piece of the company. If the company grows and ultimately sells or goes public, that piece becomes real money. It is deferred compensation for the risk you are taking by working here instead of somewhere safer and more established.



#### FIFTH-GRADER VERSION

*Imagine your friend is starting a lemonade stand. She cannot pay you \$10 an hour like the big grocery store would. But she says: "Help me build this stand, and I will give you 10% of everything we ever make — forever." If the stand stays small, your 10% is not much. But if it becomes the biggest lemonade chain in the country and sells for \$10 million? Your 10% is worth \$1 million. That trade — less pay now, ownership in the future — is exactly what equity compensation is.*

There are three primary forms of equity compensation you will hear about at NovaSpark and across the startup world: **Incentive Stock Options (ISOs)**, **Non-Qualified Stock Options (NQSOs)**, and **Restricted Stock Units (RSUs)**. They are all ways of giving you a stake in the company — but they work differently, vest differently, and above all, **they are taxed very differently**. Understanding the tax treatment is not optional. It is the whole game.





TYPE 01

## ISO

Incentive Stock Option. A right to buy company stock at a fixed price, with special tax treatment if you follow the rules. Only employees can receive these. The IRS rewards patience.

**Best for:** Early employees who join before big valuation jumps.



TYPE 02

## NQSO

Non-Qualified Stock Option. Also a right to buy at a fixed price, but with no special tax treatment. Available to employees, contractors, board members, and advisors.

**Best for:** Late-stage employees, advisors, and non-employees.



TYPE 03

## RSU

Restricted Stock Unit. Not an option to buy – it is an actual promise to give you shares. You do not pay anything. When they vest, you own real stock. More common at later-stage and public companies.

**Best for:** Employees at Series C and beyond, or public companies.

## Seven Words You Must Know Before We Go Any Further

I am going to define seven terms right now. Every explanation that follows depends on these. Read each one twice.

TERM	PLAIN ENGLISH	EXAMPLE	WHY IT MATTERS
Grant Date	The day the company officially gives you the option or RSU.	January 1, Year 1 – your first day at NovaSpark.	This is the starting clock for vesting and tax calculations.
Strike Price (Exercise Price)	The fixed price you pay to buy one share when you exercise. Set at the fair market value on your grant date.	\$3.00 per share – the 409A value on your grant date.	The lower this is relative to the eventual sale price, the more profit you make.
409A Valuation	An independent appraisal of the fair market value	An independent firm says one NovaSpark common	The IRS uses this number to determine your tax obligations. It

	<p>of one common share.</p> <p>Required by the IRS. Must be refreshed every 12 months or after a new funding round.</p>	<p>share is worth \$3.00 today.</p>	<p>is not the same as the preferred share price investors paid.</p>
Vesting	<p>The process of earning your options or shares over time. You do not own them all on Day 1.</p>	<p>4-year vest, 1-year cliff: you earn nothing for 12 months, then 25% vests all at once, then monthly after that.</p>	<p>If you leave before your shares vest, you lose them. Vesting keeps you building the company.</p>
Exercise (Exercising)	<p>The act of actually buying the shares by paying the strike price. You convert your option into real stock.</p>	<p>You pay \$3.00 × 10,000 shares = \$30,000 to the company and receive 10,000 shares.</p>	<p>Once you exercise, you own real shares. The tax clock starts differently depending on option type.</p>
Spread (Bargain Element)	<p>The difference between the fair market value of the share on the day you exercise and the strike price you</p>	<p>FMV = \$10.00, strike = \$3.00. Spread = \$7.00 per share.</p>	<p>This is the value you received from the company. The IRS wants to tax it. When and how depends on option type.</p>

	paid.		
Capital Gain	Profit from selling an asset. Short-term (held under 1 year) is taxed as ordinary income. Long-term (held over 1 year) is taxed at lower capital gains rates: 0%, 15%, or 20%.	You buy shares at \$3, hold for 2 years, sell at \$25. Profit of \$22 is a long-term capital gain.	Long-term capital gains rates are far lower than ordinary income rates for most people. The goal is always to qualify for long-term treatment.

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03 INCENTIVE STOCK OPTIONS

## ISOs — The IRS's Gift to Patient Startup Employees

An Incentive Stock Option is the most tax-advantaged form of equity compensation available. When it works correctly, you pay **zero tax at grant, zero tax at vesting, and zero tax at exercise**. You only pay tax when you sell — and at the favorable long-term capital gains rate. That is a remarkable benefit. The IRS gives it to you as a reward for bearing the risk of working at an early-stage company and holding the stock long enough to prove you believed in it.



#### FIFTH-GRADER VERSION

Imagine your school gives you a special golden ticket that says: "Anytime in the next 10 years, you can buy one scoop of our fancy new ice cream flavor for \$1.00." Today that ice cream normally costs \$1.00. Three years later it costs \$8.00. You hand in your golden ticket, pay \$1.00, get the ice cream, and immediately sell it for \$8.00. You made \$7.00 profit. With an ISO, the IRS only wants their cut when you actually sell the ice cream – not when you got the ticket, not when you used it. And if you waited long enough, their cut is smaller too. That is why ISOs are so valuable.

## The ISO Rules You Cannot Break

The IRS does not give away this benefit without conditions. There are four rules that govern ISO treatment. Break any one of them and your ISO automatically becomes a non-qualified option – and you lose all the tax advantages.

1

### Must Be an Employee

Only W-2 employees can receive ISOs. Contractors, advisors, and board members who are not also employees must receive NQSOs. The moment you terminate employment, any unvested ISOs stop accruing ISO treatment.

2

### **\$100,000 Annual Vesting Limit**

No more than \$100,000 worth of ISOs (calculated at the strike price on the grant date) can vest in any single calendar year. Any amount above \$100,000 that vests in one year automatically converts to NQSO treatment for the excess. This catches many employees at later-stage companies by surprise.

3

### **Two Holding Period Requirements**

To get favorable long-term capital gains treatment on the full gain (spread + appreciation), you must hold the shares: (a) at least **2 years from the grant date**, AND (b) at least **1 year from the exercise date**. Both conditions must be met. Selling before either deadline triggers a "disqualifying disposition" – the spread gets taxed as ordinary income.

4

### **Strike Price Must Equal Fair Market Value at Grant**

The exercise price must be at least equal to the 409A-determined fair market value on the grant date. You cannot receive a discounted ISO. If the board grants options below fair market value, the option is disqualified and may trigger additional penalties under IRC Section 409A – a separate and painful tax rule.

## **The AMT Trap — The Most Dangerous ISO Complication**

Now I must tell you something that has financially damaged many startup employees. It is called the **Alternative Minimum Tax (AMT)**. Even though ISOs produce no regular income tax at exercise, the spread IS an AMT preference item. This means if you exercise a large ISO grant and the FMV is significantly above your strike price, you may owe AMT in the year of exercise – even if you have not

sold a single share and therefore have no cash.



**THE AMT DANGER – READ THIS CAREFULLY**

You exercise 50,000 ISO shares at a strike of \$3.00. The 409A FMV is \$12.00 on exercise date. Your spread is  $\$9.00 \times 50,000 =$  **\$450,000 of AMT income**. You pay \$150,000 to exercise ( $50,000 \times \$3$ ). You owe AMT on \$450,000 even though you received no cash. At the AMT rate of 28%, that could be \$126,000 in taxes – due April 15 of next year, in cash, while you are still holding illiquid private company stock. This is not hypothetical. It destroyed many early employees during the dot-com bust of 2001. You must model your AMT exposure before exercising a large ISO block.

## ISO Tax Journey — Full Worked Example

Meet **Arjun**, NovaSpark's first engineer. He joins on January 1, Year 1 and receives 20,000 ISOs at a strike price of \$3.00 (the 409A value on grant date). He follows all the rules perfectly.



### Arjun

First Engineer • ISO Recipient

Grant Date	Jan 1, Year 1
Options Granted	20,000 ISOs
Strike Price	\$3.00
Vesting Schedule	4yr / 1yr cliff
Exercise Date	Jan 1, Year 3
FMV at Exercise	\$10.00

Sale Date

Feb 1, Year 4

Sale Price

\$30.00

## Arjun's ISO Tax Journey — Qualifying Disposition



### Jan 1, Year 1 — Grant Date

20,000 ISOs granted at \$3.00 strike. Tax due: **\$0**. Nothing happens at grant. The clock starts.



### Year 1 through Year 3 — Vesting

Shares vest over 4 years. Tax due each year as they vest: **\$0**. ISOs produce no tax event at vesting.



### Jan 1, Year 3 — Exercise

Arjun exercises all 20,000 vested shares. Cost:  $20,000 \times \$3.00 =$  **\$60,000 cash paid**. FMV is \$10.00. Spread =  $\$7.00 \times 20,000 =$  \$140,000. Regular income tax: \$0. BUT — AMT preference item of \$140,000. Arjun must calculate his AMT exposure and possibly pay AMT this year. He should consult a CPA before exercising.



### Feb 1, Year 4 — Sale (Qualifying Disposition ✓)

Arjun sells at \$30.00. He held more than 2 years from grant (Jan Year 1 → Feb Year 4 = 3 yrs ✓) AND more than 1 year from exercise (Jan Year 3 → Feb Year 4 = 13 months ✓). Both tests passed. The entire gain qualifies as long-term capital gain.

Sale price per share:	\$30.00
Strike price (cost basis):	\$3.00
Total gain per share:	\$27.00

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Total gain:  $20,000 \times \$27.00 =$  \$540,000  
(This is ALL long-term capital gain – no ordinary income)

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Long-term capital gains rate (assume 20%):  $\times 0.20$   
Tax owed: \$108,000  
Arjun keeps: \$432,000

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Compare to if this were ordinary income at 37% bracket:  
Tax would have been:  $\$540,000 \times 37\% =$  \$199,800  
ISO saved Arjun: \$91,800 in taxes

## Disqualifying Disposition — When the Rules Are Broken

What happens if Arjun sells too early — say he sells in December Year 3, only 11 months after exercising (failing the 1-year holding period from exercise)?

ARJUN – ISO DISQUALIFYING DISPOSITION (SOLD TOO EARLY)

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Sale in Dec Year 3: price = \$25.00. FMV at exercise was \$10.00.  
Strike = \$3.00.

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Step 1: The Spread at Exercise = Ordinary Income

FMV at exercise (\$10.00) - Strike (\$3.00) = \$7.00 ×  
20,000 = \$140,000

This \$140,000 is now W-2 ordinary income. Taxed at ~37%  
= \$51,800

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Step 2: The Remaining Gain = Short-Term Capital Gain

Sale price (\$25) - FMV at exercise (\$10) = \$15 × 20,000  
= \$300,000

This \$300,000 is short-term capital gain. Also taxed at  
~37% = \$111,000

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Total tax: \$51,800 + \$111,000 = \$162,800

Qualifying disposition tax was only: \$108,000

Cost of selling too early: \$54,800 extra in taxes

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#### 04 NON-QUALIFIED STOCK OPTIONS

## NQSOs — Simpler Rules, Higher Tax Bill

A Non-Qualified Stock Option (sometimes called an NQSO or NSO) is the workhorse of equity compensation. It is simpler than an ISO, available to a wider group of people, and does not come with the \$100,000 annual vesting cap or the complex holding period rules. The trade-off is that **the spread at exercise is taxed as ordinary income, immediately**, regardless of whether you sell the shares or

not. There is no AMT complication – but there is no preferential rate either.



#### FIFTH-GRADER VERSION

*Same golden ticket as before – you can buy ice cream for \$1.00 when everyone else pays \$8.00. The moment you use that ticket and get the ice cream, the IRS says: "You just received \$7.00 of free value. We want our cut right now – today – even if you are still holding the ice cream and have not sold it yet." With NQSOs, the government treats the act of buying the shares as if you received extra salary. They tax the spread like a paycheck. Simple, direct, and often expensive.*

## How NQSOs Work — Step by Step

**G**

### **Grant Date — No Tax**

Options are granted at fair market value (409A). No tax event. Identical to ISOs at this stage.

**V**

### **Vesting — No Tax**

Options vest over time. No tax event at vesting. Still identical to ISOs.



### Exercise — TAX EVENT (This Is the Difference)

The moment you exercise, the spread (FMV at exercise minus strike price) is treated as W-2 ordinary income for employees, or self-employment income for contractors. The company is required to withhold taxes. For employees, this shows up on your W-2. You owe income tax plus payroll taxes (Social Security and Medicare) on the spread – in the year of exercise, whether you sell or not.




### Sale — Capital Gain (But Only on the Post-Exercise Appreciation)

When you eventually sell, your cost basis is the FMV on the day you exercised (not your strike price – that was already taxed). Any additional gain above that basis is capital gain – long-term if held more than 1 year from exercise, short-term otherwise.

## NQSO Tax Example — Meet Priya's New VP of Sales

Meet **Marcus**, who joins NovaSpark as VP of Sales in Year 2 – after the Series A. He receives 15,000 NQSOs at a strike of \$8.00 (the 409A at grant time, post-Series A). He exercises two years later when the 409A is \$18.00, and sells one year after that at \$30.00.



**Marcus**

VP of Sales • NQSO Recipient

Options Granted	15,000 NQSOs
Strike Price	\$8.00

FMV at Exercise	\$18.00
Sale Price	\$30.00
Tax Bracket	37% ordinary income
Held After Exercise	13 months → LT Cap Gain

## Marcus — NQSO Tax Journey



### Grant

15,000 NQSOs at \$8.00. Tax: **\$0**.



### Exercise — ORDINARY INCOME TAX DUE NOW

FMV = \$18.00. Spread =  $\$18.00 - \$8.00 = \$10.00 \times 15,000 =$   
**\$150,000 ordinary income**. This shows on his W-2. At 37%  
 bracket: tax = \$55,500. Company withholds this from his  
 paycheck or requires a supplemental payment. He also pays  
 1.45% Medicare tax = \$2,175. Total tax at exercise:  
 approximately \$57,675. He also pays  $\$8.00 \times 15,000 =$   
**\$120,000 to buy the shares**.



### Sale — Long-Term Capital Gain

Marcus holds 13 months. Sells at \$30.00. His cost basis is **\$18.00**  
 (FMV at exercise — already taxed as income). Gain =  $\$30.00 -$   
 $\$18.00 = \$12.00 \times 15,000 =$   
**\$180,000 long-term capital gain**. At  
 20% LT rate: \$36,000 tax.

MARCUS - NQSO FULL TAX SUMMARY

Total proceeds from sale:  $15,000 \times \$30.00 =$

\$450,000

Cost to exercise:  $15,000 \times \$8.00 =$

\$120,000

Gross profit:

\$330,000

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Tax at exercise (ordinary income on \$150K spread):

\$57,675

Tax at sale (LT cap gain on \$180K additional gain):

\$36,000

Total tax paid:

\$93,675

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Marcus keeps after all taxes:  $\$330,000 - \$93,675 =$

\$236,325

Effective tax rate on total gain:  $\$93,675 \div \$330,000 = 28.4\%$

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COMPANY BENEFIT: Company gets a tax deduction equal to the spread  
NovaSpark deducts \$150,000 as compensation expense → saves  
~\$37,500 in corporate tax



#### THE COMPANY TAX DEDUCTION – AN IMPORTANT DIFFERENCE FROM ISOS

When an NQSO is exercised, the company receives a tax deduction equal to the spread — because the employee paid ordinary income tax on it. **With a qualifying ISO disposition, the company gets NO deduction.** This is one reason why CFOs at later-stage companies sometimes prefer to issue NQSOs even to employees: the company tax savings can be significant. At NovaSpark's scale, a \$150,000 spread on a single exercise saves us roughly \$37,500 in corporate tax.

## RSUs — No Check to Write, No Complexity, Just Shares

A Restricted Stock Unit is the simplest form of equity compensation to understand. You do not buy anything. You do not pay a strike price. The company simply **promises to give you shares** when you meet certain conditions — usually a time-based vesting schedule. When the RSU vests, you receive actual shares. The fair market value of those shares on the vesting date is ordinary income. Period. No elections, no AMT (with rare exceptions), no two-year holding periods. Simple, predictable, and increasingly common at Series C and beyond.



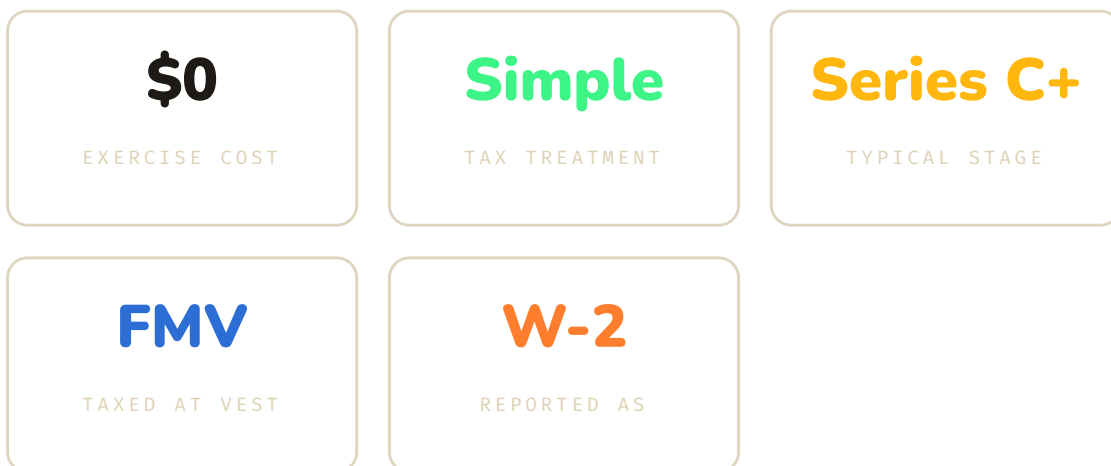
### FIFTH-GRADER VERSION

*Your school gives you a promise: "Stay with us for four years, and every year on your anniversary we will give you a \$1,000 gift card." You do not pay anything. You just show up, do your work, and on each anniversary, you receive the gift card. The moment you receive it, you owe income tax on it — just like if the school had given you cash. That is an RSU. It is a compensation promise that turns into real stock on a schedule. Simple as a gift card, taxed like*

a paycheck.

## Why RSUs Exist — and When Companies Use Them

RSUs are most common at companies where the stock already has significant value and liquidity is foreseeable. Here is the logic: with options, an employee needs to *believe* the stock will be worth more than the strike price to benefit at all. With RSUs, even if the stock price stays flat, the employee receives the full value — because there is no strike price. RSUs are a promise of value, not a bet on appreciation.



## RSU Tax Journey — Meet Sofia

Meet **Sofia**, who joins NovaSpark as Head of Engineering post-Series B at a 409A value of \$12.00 per share. She receives 10,000 RSUs vesting quarterly over 4 years (625 shares per quarter).



## Sofia

Head of Engineering · RSU Recipient

RSUs Granted	10,000 shares
Vesting Schedule	Quarterly / 4 years
Per Quarter	625 shares
FMV at Grant	\$12.00
FMV at Q1 Vest	\$14.00
FMV at Q8 Vest (Yr 2)	\$22.00
Sale Price (Post-IPO)	\$45.00

## Sofia — RSU Tax Journey



### Grant Date

10,000 RSUs granted. Tax: **\$0**. RSUs have no tax event at grant. (This is why the 83(b) election generally does not apply to RSUs — more on this below.)



### Q1 Vesting — ORDINARY INCOME TAX ON EACH VEST

625 shares vest. FMV = \$14.00. Income recognized:  $625 \times \$14.00 = \mathbf{\$8,750}$  ordinary income. This is included in Sofia's W-2 for the quarter. At 37%: \$3,237.50 in tax. The company will typically withhold shares to cover taxes — often selling 30–40% of the vested shares automatically, leaving Sofia with the net shares. She can elect to pay cash instead if she wants to keep all shares.



### Q8 Vesting (Year 2) — Same Mechanics, Higher FMV

625 shares vest. FMV = \$22.00. Income:  $625 \times \$22.00 = \mathbf{\$13,750}$  ordinary income. Tax at 37% = \$5,087.50. Each vesting event is

a separate tax event, each at the current 409A value.



### Post-IPO Sale at \$45.00

Sofia sells all remaining shares. Her cost basis for each lot equals the FMV on the day that lot vested (already taxed as income). Any gain above that basis is capital gain – long-term if held more than 1 year from vest date, short-term otherwise.

SOFIA – RSU EXAMPLE: Q1 VEST THROUGH SALE (625  
SHARES FROM Q1)

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Shares in this lot:	625
FMV at vesting (Q1):	\$14.00
Ordinary income recognized at vest:	\$8,750
Tax at 37% (ordinary income):	\$3,237

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She holds these 625 shares for 15 months after vest, then sells

Sale price:	\$45.00
Cost basis (FMV at vest):	\$14.00
Long-term capital gain per share:	\$31.00
Total LT capital gain (625 × \$31):	\$19,375
Tax at 20% LT rate:	\$3,875

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Total tax (ordinary + capital): \$7,112

Sofia keeps on this lot: \$28,125 - \$7,112 = \$21,013

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## The 83(b) Election — The Most Important Tax Move a Founder or Early Employee Can Make

I saved this for its own chapter because it deserves it. The **83(b) election** is a one-page letter you file with the IRS within 30 days of receiving restricted stock or exercising certain options. It is one of the highest-value tax planning tools in all of startup compensation. And it is almost never explained to people until it is too late to use it.

Here is the core idea. When you receive stock that is subject to a vesting schedule (meaning you could forfeit it if you leave), the default IRS rule is: **you owe income tax on each tranche as it vests, at the fair market value on each vest date.** But what if the value is going to go way up between now and when the shares vest? You would be paying ordinary income tax on a much higher value later. The 83(b) election says: *"I elect to recognize income today, at the current (low) value, and pay taxes now – so that all future appreciation is taxed as capital gain, not ordinary income."*



### FIFTH-GRADER VERSION

*You receive a puppy today. The puppy is worth \$50. But you earn ownership of it gradually – 25% per year. If you do nothing, you pay income tax each year on whatever the dog is worth that year.*

By year 4, the dog might be worth \$2,000 (it won an agility competition). You owe income tax on \$2,000 instead of \$50. The 83(b) election says: "I choose to pay the income tax right now, today, on the \$50 value." Then, when you eventually sell the dog for \$2,000, the entire \$1,950 gain is a capital gain – taxed at the lower rate. You paid a little tax early, on a tiny amount, to avoid a huge tax bill later. That is the 83(b) in a single sentence: **pay a small tax now to avoid a big tax later.**

## When Can You File an 83(b)?

The 83(b) election applies to **property** received for services that is subject to a substantial risk of forfeiture (vesting). In practice at startups, this means:



83(B) APPLIES

### Founder Shares

Founders who receive restricted stock subject to vesting should almost always file an 83(b). The stock is worth very little at incorporation. Filing now means minimal tax today and all appreciation treated as long-term capital gain.



83(B) APPLIES

## Early Exercise of Options

Some companies allow employees to exercise unvested options (called "early exercise"). If you do, you receive restricted shares subject to vesting. Filing an 83(b) on these early-exercised shares can be extremely valuable for early employees when the 409A is still low.



83(B) DOES NOT APPLY

## Standard RSUs

RSUs are not "property" under the tax code until they actually vest — so there is nothing to elect on before that. The 83(b) election is generally not applicable to standard RSUs. (There is a variant called the 83(b) for RSUs in certain structures, but it is rare.)

## The 83(b) for Founders — The Ultimate Example

Let us look at you, the CEO of NovaSpark, on Day Zero. You receive 5,000,000 founder shares at \$0.001 per share (the par value). They vest over 4 years. The total value today is \$5,000. In 5 years, those shares are worth \$15.00 each at exit — \$75,000,000 total. What happens with and without the 83(b)?

WITHOUT 83(B) — DEFAULT TAX TREATMENT FOR FOUNDERS

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Year 1 cliff vest: 1,250,000 shares vest. 409A at time = \$0.50.

Income = \$625,000

Tax at 37%: \$231,250 — DUE IN CASH THIS YEAR

Year 2 monthly vests: shares vest when 409A = \$1.00 → income = \$1,250,000

Tax at 37%: \$462,500

Year 3 monthly vests: shares vest when 409A = \$2.00 → income = \$2,500,000

Tax at 37%: \$925,000

Year 4 monthly vests: shares vest when 409A = \$4.00 → income = \$5,000,000

Tax at 37%: \$1,850,000

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Total ordinary income tax paid on vesting: ~\$3,468,750

Then at exit (\$15/share): basis = \$4/share → \$11 × 5,000,000 = \$55M capital gain

Capital gains tax at 20%: \$11,000,000

TOTAL TAX WITHOUT 83(b): approximately \$14,468,750

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WITH 83(B) – FILED WITHIN 30 DAYS OF FOUNDING

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Grant date: 5,000,000 shares × \$0.001 = \$5,000 total value

Ordinary income tax on \$5,000 (at 37%): \$1,850 – ONE TIME, PAID NOW

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No tax as shares vest each month – already paid ordinary income on grant

At exit: sale price \$15.00, basis \$0.001. Gain = \$14.999 × 5,000,000 = \$74,994,500

Held 5+ years = long-term capital gain

Capital gains tax at 20%: \$14,998,900

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TOTAL TAX WITH 83(b): approximately \$15,000,750

(nearly the same? wait – look at what CHANGED)

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WITHOUT 83(b): \$3.4M in ORDINARY INCOME TAX during vesting years (cash due)

WITH 83(b): \$1,850 in ORDINARY INCOME TAX at grant (trivial)

SAVINGS ON ORDINARY INCOME TREATMENT: \$3,466,900

And all appreciation is capital gain (lower rate) instead of partly ordinary income

Net benefit of 83(b): eliminates \$3.4M in high-rate taxes during vesting years



#### THE 30-DAY DEADLINE IS ABSOLUTE

You have exactly **30 calendar days** from the date you receive the restricted property (the stock grant date) to file the 83(b) election with the IRS. There are no extensions. There are no exceptions. The IRS will not accept a late filing. If you miss this window, it is gone forever. Every founder and early employee who receives unvested restricted stock should file this letter within the first week of receiving their shares — not on Day 29. Have your attorney prepare it the same day you sign your stock purchase agreement.

## How to Actually File an 83(b)

1

### Prepare the Election Letter

Your attorney or equity platform (Carta, Pulley) will have a template. The letter states: your name and address, a description of the property (number of shares, grant date, company name), the fair market value at grant, the amount you paid, and your election to include the value in gross income in the year of receipt.

2

### **Send to the IRS — Certified Mail, Return Receipt**

File the letter with the IRS service center where you file your tax return. Send it via certified mail with return receipt requested. Keep the postmarked receipt. This is your proof the letter was filed within 30 days.

3

### **Send a Copy to the Company**

File a copy with the company (your CFO and/or legal counsel should receive it). This is required. Keep a copy for your own records.

4

### **Attach a Copy to Your Tax Return**

Attach a copy of the 83(b) election to your federal income tax return for the year in which you received the property. This ensures the IRS sees it when processing your return.

## **When 83(b) Is a Bad Idea**

The 83(b) is not always the right choice. There are two situations where you should think carefully before filing.



**DO NOT FILE 83(B) IF ...**

**Situation 1 – The stock has already appreciated significantly and you paid fair market value.** If you exercise options at FMV (e.g., the 409A is \$10 and you pay \$10), there is no spread and therefore no benefit to an 83(b). The income recognized is zero regardless.

**Situation 2 – You believe the company will fail.** If you file an 83(b) and the stock becomes worthless, you paid income tax on value you will never receive – and a capital loss on worthless stock is harder to use than not having recognized the income at all. If you have serious doubts about the company's viability, consult a CPA before filing.

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07 THE MASTER COMPARISON

## ISO vs. NQSO vs. RSU — Everything Side by Side

Here is the table I want every single person in this room to save, print, and put next to their grant agreement.

FACTOR	ISO	NQSO	RSU
Who Can Receive	Employees only	Employees, contractors, advisors, directors	Employees contractor directors

Tax at Grant	None	None	None
Tax at Vesting	None	None (unless early exercise)	Yes — ordinary income on FMV
Tax at Exercise	None (regular) / AMT preference item	Yes — spread is ordinary income + payroll tax	N/A — no exercise
Tax at Sale	All LT cap gain if qualifying disposition	Cap gain on post-exercise appreciation only	Cap gain on post-vest appreciation
Company Tax Deduction	None (qualifying disposition)	Yes — equal to spread at exercise	Yes — equal to FMV at vest
\$100K Annual Vesting Cap	Yes — excess converts to NQSO	No cap	No cap
AMT Risk	Yes — spread is AMT preference item	No	No
Employee Must Pay to Exercise	Yes — strike price × shares	Yes — strike price × shares	No — shares delivered free
Best For ...	Early employees at low 409A	All employees, later-stage,	Series C+ employees public

	valuations	advisors	company employees
83(b) Election Available?	Yes, on early exercise of unvested shares	Yes, on early exercise of unvested shares	Generally No
Complexity	High (holding periods, AMT, ISO limit)	Moderate	Low
Best Tax Outcome Possible	All LT cap gain on full gain – 20%	Ordinary income on spread; LT cap on rest	Ordinary income on vest value; LT cap on rest

## The Six Questions Every Employee Should Ask — and Answer

Before I close, I want to leave you with six practical questions. These are the questions I would ask if I were sitting in your seat right now, receiving an equity grant for the first time. Get answers to all six. Write them down. Keep them somewhere safe.

Q1

### **What type of equity am I receiving — ISO, NQSO, or RSU?**

Ask HR or your equity administrator to confirm in writing. This determines your entire tax strategy. Do not assume. Check your grant agreement. It will say "Incentive Stock Option" or "Non-Statutory Stock Option" or "Restricted Stock Unit."

Q2

### **What is my strike price and what is the current 409A value?**

The gap between these two numbers is your current "spread" — the value you are sitting on right now. Ask for the most recent 409A report date. If the 409A was done 14 months ago, it is likely stale and the company should commission a new one before issuing options.

Q3

### **Does the company allow early exercise?**

If yes, consider whether an early exercise plus 83(b) election makes sense — especially if the 409A value is low and you believe it will rise significantly. Talk to a CPA before doing this. The cost of early exercise plus the 83(b) tax can be very low when 409A values are still early-stage.

Q4

### **What happens to my options if I leave the company?**

The standard post-termination exercise window is 90 days. If you leave after vesting, you have 90 days to exercise your vested ISOs before they expire (or convert to NQSOs). Some companies have extended this to 1–5 years. Know your window. Getting laid off with vested options and missing the exercise window is one of the most painful things that happens to startup employees.

Q5

### How many total fully-diluted shares are outstanding?

This is the denominator for your ownership percentage. If you have 10,000 options and there are 30,000,000 fully-diluted shares, you own 0.033% of the company. That number combined with a realistic exit valuation estimate tells you what your equity could actually be worth. Do not accept a grant without knowing the fully-diluted share count.

Q6

### Is there a liquidity preference stack above me?

We covered this in Part 2. If investors have \$70M in liquidation preferences and the company sells for \$80M, common stockholders split \$10M – not \$80M. Your equity is worth a fraction of the headline number. Ask what the total liquidation preference is across all preferred stock classes. This is the number that determines whether your options have real value at any given exit price.



#### THE CFO'S CLOSING MESSAGE TO EVERY EMPLOYEE

Equity compensation is not a lottery ticket and it is not free money. It is a structured bet that requires you to understand what you own, when you own it, and what you owe the government when you realize it. The people who get this right – who file the 83(b) on Day 1, who understand their holding periods, who model their AMT exposure before exercising – walk away with significantly more money than those who do not. This is not difficult information to master. You just did it in one session. Now put it to work.

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→ COMING NEXT



PART 4

## The Exit Waterfall

NovaSpark sells for \$200M. Who gets paid what, in what order? The liquidation waterfall, participating preferred, conversion decisions, and the final reckoning for founders and employees. Every dollar accounted for.

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## Part 3 of 4: ISOs • NQSOs • RSUs • 83(b) Election • Tax Treatment

Equity Compensation • Strike Price • 409A • AMT • Qualifying Disposition •

Ordinary Income vs. Capital Gain