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"Tip of the Month"

Rewarding Valuable Employees with Incentives

Many companies realize that their employees are their most important assets. Many use several forms of incentives to attract, retain and reward employees for their participation and commitment to the success of the company. These forms of incentives may include bonuses, outright gifts of stock, specialized restricted stock purchase agreements, phantom stock plans, stock appreciation rights, and stock options, or any combination of these incentives.

Stock options are one such form of incentive. When granted a stock option, an individual receives a contract right to purchase shares in the company for a fixed term at a fixed price. In most cases, the fixed price is the fair market value of the stock on the date the option is granted.

There are two basic kinds of stock options, qualified stock options and nonqualified stock options. Qualified stock options are specific creatures of the Internal Revenue Code. All other stock options are nonqualified stock options. Companies generally adopt stock option plans that permit grants of both incentive stock options (qualified) and nonqualified stock options. The key difference between the two types of stock options is that nonqualified stock options do not receive any preferential tax treatment under the Internal Revenue Code.

To receive preferential tax treatment, incentive stock options must meet certain requirements. Before granting any incentive stock options, the company must have a written option plan. The plan must set forth the maximum number of shares that may be issued under the plan as well as the class of employees eligible to receive options. Further, the plan must receive shareholder approval within 12 months of adoption by the company's board of directors. In addition, the option must conform to various restrictions. In contrast, the grant of a nonqualified stock option is not limited by the federal income tax laws as to the number of shares, price per share, length of term, or identity of the recipient. The tax consequences of the nonqualified stock option, however, are generally less advantageous to the employee than are the tax consequences of a qualified stock option.

Phantom stock plans or stock appreciation rights are contracts under which a company provides an employee with one or more of the benefits of stock ownership without actually making the employee a stockholder. Phantom stock is not real stock. It is a form of deferred compensation where the company promises to make payments in the nature of a bonus to an employee based on the increase in value of the company stock or on the dividend performance of the company's stock, or both.

If you would like to discuss how your company could use these types of incentives to reward your valuable employees, please call (603) 668-1971 to schedule an appointment.

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