

Incentive Stock Option Basics

For U.S. Employees

A stock option is not the same as a share of common stock. A stock option is a right to buy a set number of shares of the company's common stock at a set price (the "exercise price").

The Lifecycle of an Incentive Stock Option (ISO)



1

GRANT

Stock options awarded at Exercise Price (can also be called Strike Price or Grant Price).



2

VESTING

Vesting is the process by which you earn the right to exercise (that is, purchase) shares of your company stock. As long as you continue to be employed by your company or any of its subsidiaries, the options may continue to vest. The vesting schedule is determined by your company and should be outlined in your grant documents.



3

EXERCISE

A stock option is exercised when you pay the Exercise Price and receive shares of company stock in return. A stock option may be worth exercising if the current stock price (also known as the fair market value or FMV*) is higher than the exercise price.



4

TAXATION

The federal income tax treatment of your stock option will depend on the timing and manner in which they are exercised (see below for more details).



5

TRACKING

You can keep track of your options and shares from previously exercised options on the Shareworks platform.

*When private, a company's FMV is based on the 409A valuation; when public, it is based on the stock price.

Choices for Exercising Your Stock Options

1	2	3												
EXERCISE AND HOLD (CASH EXERCISE)	EXERCISE AND SELL* (SAME DAY SALE OR CASHLESS EXERCISE)	SELL TO COVER*												
When you exercise your options with cash and receive the full number of shares from the exercise of your options, so you may benefit from any potential future increases in stock value.	When you exercise your options and immediately sell your shares. You will receive the net proceeds in cash once all option exercise costs, including commissions, fees and taxes have been satisfied. You may use the proceeds from the stock sale to cover the purchase price and additional fees.	When you exercise your stock options and sell enough shares to cover your option exercise costs, including, commissions, fees and applicable taxes, you then receive the remaining shares.												
<table border="1"> <thead> <tr> <th>PAY IN</th> <th>RECEIVE</th> </tr> </thead> <tbody> <tr> <td>Cash</td> <td>Shares</td> </tr> </tbody> </table>	PAY IN	RECEIVE	Cash	Shares	<table border="1"> <thead> <tr> <th>PAY IN</th> <th>RECEIVE</th> </tr> </thead> <tbody> <tr> <td>Cash from stock sale proceeds</td> <td>Cash</td> </tr> </tbody> </table>	PAY IN	RECEIVE	Cash from stock sale proceeds	Cash	<table border="1"> <thead> <tr> <th>PAY IN</th> <th>RECEIVE</th> </tr> </thead> <tbody> <tr> <td>Cash from stock sale proceeds</td> <td>Shares</td> </tr> </tbody> </table>	PAY IN	RECEIVE	Cash from stock sale proceeds	Shares
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*This option is only possible if the company is publicly traded or if there is a secondary market for company stock.

ISO Taxation Table

	At Exercise	Sell in Same Calendar Year (Disqualifying Disposition)	Sell Next Calendar Year or Later (Qualifying Disposition)
Exercise and Hold	Difference between the exercise price and FMV at exercise is included for purposes of calculating Alternative Minimum Tax.	Difference between the strike price and the lesser of (1) FMV at exercise or (2) the sale price is taxed as ordinary income and subject to federal, state and local income taxes. Any additional income is taxed as a short-term capital gain.	Difference between the strike price and sale price is taxed as a long-term capital gain (or loss) if the shares are held for at least two years from grant and one year from exercise.

Calculating Potential Value of Stock Options

The potential value of your grant depends on the value of the shares, the strike price and the number of shares you were granted.

$$\begin{aligned} &\text{Number of Shares} \\ &\times (\text{Company Share Price} - \text{Exercise Price}) \\ &= \text{Net Value of Option} \end{aligned}$$

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