

# Non-Qualified 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 a Non-Qualified Stock Option (NQSO)



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												
<b>EXERCISE AND HOLD (CASH EXERCISE)</b>	<b>EXERCISE AND SELL* (SAME DAY SALE OR CASHLESS EXERCISE)</b>	<b>SELL TO COVER*</b>												
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
PAY IN	RECEIVE													
Cash	Shares													
PAY IN	RECEIVE													
Cash from stock sale proceeds	Cash													
PAY IN	RECEIVE													
Cash from stock sale proceeds	Shares													

\*This option is only possible if the company is publicly traded or if there is a secondary market for company stock.

## NQSO Taxation Table

	At Exercise	Sell After Holding Shares for One Year or Less	Sell After Holding Shares for One Year or More
<b>Exercise and Hold</b>	Difference between the FMV at exercise and the exercise price is taxed as ordinary income and subject to federal, state and local income taxes in addition to payroll taxes.	Difference between the FMV at exercise and the sale price is taxed as a short-term capital gain (or loss).	Difference between the FMV at exercise and the sale price is taxed as a long-term capital gain (or loss).
<b>Exercise and Sell</b> (same day sale or cashless exercise)	Difference between the FMV at exercise and the exercise price is taxed as ordinary income and subject to federal, state and local income taxes in addition to payroll taxes.		Not applicable.
<b>Sell-to-Cover</b>	Difference between the FMV at exercise and the exercise price is taxed as ordinary income and subject to federal, state and local income taxes in addition to payroll taxes.		Difference between the FMV at exercise and the sale price is taxed as a long-term capital gain (or loss).

## 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.

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

### Disclosures:

Morgan Stanley Smith Barney LLC ("Morgan Stanley"), its affiliates and Morgan Stanley Financial Advisors do not provide tax or legal advice. Individuals should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving legal matters.

Tax laws are complex and subject to change. The information contained herein is based on the tax laws in effect as of 1/3/20. Morgan Stanley assumes no responsibility to update this information in the event of such change(s) in tax law. You should speak with your tax advisor about whether there have been any changes to these laws.