

The Stock Bonus Plan

Like any other bonus, owners can base a Stock Bonus on a performance standard. (If business makes \$X or does "X," employee gets a predetermined amount of ownership.)

Alternatively, they can simply assign whatever bonus amounts they feel are appropriate. The stock can be unrestricted or subject to *substantial risk of forfeiture*.

In the world of Exit Planning, the concept of forfeiture (employees forfeit all or parts of the bonus if they leave the company) is crucial. Forfeiture means that if an employee leaves before a certain date, he or she forfeits all or a portion of the bonus. In Exit Planning, forfeiture provisions are designed to support the owner's exit timeframe objectives. For example, if an owner plans on leaving his or her business in five years, the forfeiture period should cover at least five years (and perhaps longer) unless there are other incentives (such as buying the rest of the company) in place.

It was this concept of forfeiture that gave Stan Bartholomew some peace of mind. Stan was a 50-year old sole owner who wanted to pass his company to his top-flight management team. As his advisors, we had suggested several equity-based bonus plans because:

1. Stan was open to having co-owners—even before his departure.
2. Stan wanted his Key Employee Group (KEG) to succeed him.
3. Stan needed to handcuff his KEG to his company, but he didn't want to take any cash from cash flow to do it.

But Stan was not yet satisfied. Stan did not want to worry about statutory requirements so he ruled out the Incentive Stock Option Plan. He also was not happy with the tax consequences to his employees under the Non-Qualified Stock Option Plan. He did, however, like the idea of "jump starting" the transfer of ownership to his key employees.

At this point, we talked to Stan about using a Stock Bonus Plan. Under that plan, Stan's employees would initially receive S distributions with respect to the stock (rather than receiving an option or buying stock over time), thus motivating them to stay with the company.



**Michael Wildeveld, CEPA, M&AMI,
CM&AP, CM&AA, CBI, CBB**
michaelw@veldma.com

Veld Mergers & Acquisitions
www.veldma.com
1 Park Plaza, 600
Irvine, CA 92614
[310-652-8066](tel:310-652-8066)

We suggested that Stan include a substantial risk of forfeiture to achieve two goals. First, forfeiture meant that he wasn't giving stock to employees who could walk out the door and cash out their stock. The great Exit Planning benefit of a "substantial risk of forfeiture" is that the risk can lapse incrementally over a period of years, thus "handcuffing" employees to the business by creating financial benefits if they stay. Second, by doing so, there is no income tax consequence to the employee or tax deduction allowed to the business, until, or as, the forfeitures lapse.

As forfeitures lapse, ordinary income equal to the value of the unrestricted portion of the ownership interest is recognized by the employee and the company receives a corresponding deduction. Normally, the employee makes an "83(b) election" to recognize the income tax consequence at the time of the bonus or when a non-qualified stock option is exercised even though the stock may be subject to a full risk of forfeiture.

Our next question to Stan had to do with tax liabilities. Stan had already told us that he did not want to "help" employees pay the tax on their bonuses.

If, for example, the Fair Market Value (FMV) of Stan's contemplated stock bonus is \$40,000, Stan's company receives a \$40,000 tax deduction, and the employee has taxable income of \$40,000 and pays taxes of about \$12,000 (assuming a 30 percent tax rate).

Before allowing Stan to dismiss the "gross up" strategy, we explained that we could also include another design element: the 83(b) election.

The information contained in this article is general in nature and is not legal, tax or financial advice. For information regarding your particular situation, contact an attorney or a tax or financial professional. The information in this newsletter is provided with the understanding that it does not render legal, accounting, tax or financial advice. In specific cases, clients should consult their legal, accounting, tax or financial professional. This article is not intended to give advice or to represent our firm as being qualified to give advice in all areas of professional services. Exit Planning is a discipline that typically requires the collaboration of multiple professional advisors. To the extent that our firm does not have the expertise required on a particular matter, we will always work closely with you to help you gain access to the resources and professional advice that you need.

This is an opt-in newsletter published by Business Enterprise Institute, Inc., and presented to you by our firm. We appreciate your interest.

Any examples provided are hypothetical and for illustrative purposes only. Examples include fictitious names and do not represent any particular person or entity.