

Lowenstein Sandler's Emerging Companies, Venture Capital Podcast: The Founder's Hour

Episode 7

Laura Cicirelli, Eric Weiner, Darren Goodman, Megan Monson

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Eric Weiner: Hi, everybody. Welcome to "The Founder's Hour." From idea to exit happy hour conversations on forming, growing and Selling a Business, a Lowenstein Sandler podcast series. I am Eric Weiner.

Laura Cicirelli: I'm Laura Cicirelli.

Eric Weiner: We're partners in Lowenstein's Emerging Companies and Venture Capital Group. Whether you're forming your first company, negotiating your first term sheet, or preparing for an exit, the decisions you make early can shape your company's future.

Laura Cicirelli: Each month, we bring the conversations happening at our New York office to the broader founder and investor community, sharing practical, legal and business insights to help you navigate every stage of your company's growth.

Eric Weiner: Hey everybody, welcome back to The Founder's Hour podcast. Thanks so much for listening to our prior episodes. If you don't mind, why don't you subscribe and become a subscriber to The Founder's Hour, we really appreciate that. Today, we're going to follow up a little bit from our last podcast, where we spoke to our partner, Julie Werner, about everything employment, hiring, firing, everything in between.

Today, we're going to pivot a little bit to equity incentives, options, restricted stock grants, ways that you're compensating your service providers. We're really lucky, again, to have guests today. We have Darren Goodman and Megan Monson of our Executive Compensation and Employee Benefits Practice, who also host their own podcast, which you should listen to called "Just Compensation."

They're going to help Laura and I, who will maybe talk a little bit more about the practicalities of these things with respect to what startup companies are doing with their service providers as far as equity

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compensation. Darren and Megan will layer in some more technical and nuanced approaches that sometimes we have to take and give us some of the “why’s” about why we have to take those steps.

Laura Cicirelli: Before we turn it over to Megan and Darren to introduce themselves, just to give them and our listeners a little bit of context as to where we've been so far in the podcast. We've formed our company. We've taken in outside financing. Now we've done a price round and we've hired some people. Right. The last thing we want to do is spend all of the money that we've raised in our price round compensating individuals.

What else can we be doing? As Eric mentioned, the option grants, restricted stock awards. How else can we incentivize individuals? This is really where we want to start the conversation. I'll turn it over to both of you to first introduce yourself. Then I think, just diving right into what is an equity incentive plan and why are we using that to issue these type of grants?

Darren Goodman: Just to start, I'm Darren Goodman. I'm the vice chair of the executive compensation practice.

Megan Monson: I'm Megan Monson. I'm a partner in the same practice group as Darren.

Laura Cicirelli: Great. Thank you both. Why? Because a lot of times we have founders, they form their company. Let's just say they have outside funding come in even through a safe or something like that. They want to hire their first employee or consultant advisor. If they just say, I want to give them equity the same way I receive my equity, why would we advise them against doing that and putting an equity incentive plan in place?

Megan Monson: I think putting an equity incentive plan in place is really the most streamlined approach. Oftentimes they're going to be hiring other employees, and by having everyone on the same set of documents that they are going to apply to, that they can rinse, cycle and repeat as they continue to grow. Their workforce just makes it a lot easier from an administrative standpoint, knowing that the terms are largely the same subject to some customization, which can be helpful as they get subsequent investors and the company is ultimately sold in the future.

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Darren Goodman: I agree, Megan, and to add to that, the equity plan will really be the backbone that has all of the key terms for all of the various types of awards that a company may want to grant in the future. It has a lot of flexibility, a lot of optionality that you might not need immediately, but you might appreciate having at some point one day together with that.

There's also standard forms of award agreement. If someone gets an option, they're going to get an option on that form. Once you have that paperwork in place and you want to grant options in the future or other types of equity awards, you say, here's who's getting the options or other awards. Here's how much they're getting.

Here's the vesting schedule. That's really it. You can simply just approve, if you've got a lot of employees, eventually you just approve batches and just say, here's the names and numbers and it's all going to be on the same form.

Megan Monson: One other point to add is it can also actually be a cost saver for companies if they are adopting this one time plan and then have these fordable world agreements that they can use on a going forward basis, versus having to customize and do something individual and bespoke every time they want to grant equity.

Eric Weiner: This should be music to founders' ears. This is a set it and forget it thing where you put the plan in place. You have these forms of agreement. Most startup companies are going to probably be on some sort of a cap table management platform, like a Carta. Exactly. Which is going to be able to, for the most part, administer the plan in a way where your board has to approve these grants.

Please don't give somebody an offer letter or an advisor agreement that says you're going to get an option grant and believe that that's the option grant because it is not. We did touch upon that last time. The board needs to approve it. Once the board approves the grant, then you can issue the grant to the recipient through Carta.

You upload the plan and the forms of agreement that Darren mentioned onto Carta. Then it's done. It's really, really easy to do. To Megan's point, it's a real cost saver. It gets things done efficiently where, many years ago, before cap table management platforms, it wasn't as much of a cost saver, though the plan was still a benefit to companies.

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Laura Cicirelli: I think just going off of that point, we spoke about this in a prior podcast, the idea of when you have this plan in place, you reserve a pool of shares underneath it to issue. Keep in mind that that pool is not unlimited, right? You can approve these things in batches. Keep in mind, once that needs to be replenished, you have to get approvals to do that.

Then you can still keep issuing under this plan. Just something else to keep in mind. Pointing out one point that Darren mentioned previously is this idea of all these different types of grants that can be issued under a plan. I know we see things or founders may hear things like ISO, NSO or, can you walk us through, I think the two biggest baskets that we should cover on this podcast really options versus restricted stock awards. Of course plans allow for other types.

Eric Weiner: I want to cut in real quickly because I want to bring in a pet peeve of mine, which I did with respect to safes. There's no such thing as safe notes and says you are not restricted stock. Restricted stock is restricted stock and says user restricted stock units they are different. Just so you know is a very common thing we hear in startup land that people call RSUs restricted stock and vice versa.

They are different. It's not a big deal. I just wanted to get that off my chest.

Laura Cicirelli: You made me nervous that I said something that was a pet peeve.

Darren Goodman: I guess to start with that, if a company grants a restricted stock award, the person who gets the award is a stockholder immediately. As soon as the award is granted, that means they are a stockholder of the company. They are on the cap table. It's restricted stock because it's subject to vesting. Vesting schedules can take a variety of different forms, but the most common one is a time-based vesting schedule.

Often, it's four years, 25% at the end of year one, so a one-year cliff and monthly thereafter over the next three years. If employment ends for any reason, normally you keep what is vested, but you'll lose anything that is unvested. The difference between that and an RSU, a restricted stock unit, is that when a restricted stock unit is granted, there's no actual shares issued.

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They're not issued until the person actually vests. Restricted stock. You're a stockholder on day one. Restricted stock unit. You are not a stockholder on day one.

Eric Weiner: We very rarely see restricted stock units. Megan, Darren, in your practice, when are you seeing clients actually issue restricted stock units, and just briefly on that?

Megan Monson: I often see them being used in later stage companies where the values gotten so high that it really doesn't make sense to issue a stock option because of the exercise price that they would have to pay to get that equity. In those situations, companies may look to do an issue restricted stock units, which are considered full value awards.

Again those are really reserved for those type of circumstances or sometimes for very senior executives as well.

Darren Goodman: I would add to that, I've seen earlier stage companies grant restricted stock units and then come to regret it. This is all or largely tax driven because when you grant the restricted stock unit you may be early stage. Your value may be really low. When the shares are issued, the person is going to have a tax bill based on the value of the stock at that time.

Eric Weiner: Right. It is important when we're talking about restricted stock or stock and options. If you're going to issue somebody stock at an early stage of the company, maybe before it's raised a dollar, the value of the company is probably going to be pretty low. If you're going to have maybe your first C-level executive that's not a founder or maybe your first couple of hires, and you want to issue them stock, if the price is really low, they can either by the stock and pay full price, in which there will be no tax liability on them, or the company can give them a restricted stock award, issue them the stock for no payment, in which case they would owe the IRS their income tax value on the stock.

It is better to issue those types of awards when the employee or service provider could afford the actual payment with options, which are not as tax efficient in the long term. Because if you get stock on day one, your long-term cap gains clock and your QSBS clock, assuming the company qualifies, starts immediately.

With options, they don't have an initial out-of-pocket cost, right? It's going to be dependent upon whether or not they want to exercise at a

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later date to get the benefit of the strike price being equal to the price on day one of the date of issuance of the grant, but they're not actually spending the money. Megan, Darren, the two types of options we always hear people talk about are ISOs and NSO's.

Everybody thinks they want ISOs. Maybe they do. I don't know, depends. Can you explain the differences of those.

Darren Goodman: The difference is purely tax driven. Whether you get an ISO or an NSO, you're not taxed on gran, and you are not taxed on vesting. The tax event doesn't occur until if and when the option is exercised. If you have a non-qualified stock option and you exercise it, you have ordinary income tax based on your gain.

Suppose your exercise price is $5. When you exercise it the stock is worth $15. You got a gain of $10. That's $10 of ordinary income. If you have an incentive stock option and you exercise it, that $10 gain, same example, is not ordinary income. However, there's a couple of big catches there. One is that that gain will count for purposes of determining whether you trigger the alternative minimum tax.

For anyone who's not aware, the alternative minimum tax is a parallel income tax regime. You don't know often. You don't know if you're going to trigger alternative minimum tax until you go and do your taxes. If your alternative minimum tax is greater than your regular income tax, you can owe additional tax. What can happen is someone exercises a lot of ISOs with a lot of gain.

They think they're not going to have tax. Then they go to do their taxes the next year. They find out they actually have a pretty significant tax bill that they weren't expecting. It's a real trap for people who aren't aware of this.

The other catch for ISOs is to get that tax benefit, you have to hold the shares for both two years from date of grant and one year from date of exercise, and that one year from date of exercise requirement can really trip people up as well, because a lot of times employees never exercise.

Eric Weiner: That is my experience. It's interesting that the market is very ISO driven with respect to employees. It makes total sense for the reasons you just described, there's potential tax benefit there, but almost no employees of startup companies end up meeting the holding period

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requirements. If the company is sold, we oftentimes see, I would say 90% of the time at least, most employers are net-exercising or something like that on a sale of the company.

If you net-exercise on the date of closing of a sale, you have not met the one year from the date of exercise prong of the holding period requirements. As a result, you have an NSO. As a result, you get taxed as ordinary income. It's interesting. Start-up companies and ECVC people live in the land of C-Corp's and options.

Options are very tax inefficient. There are things called profits interests and LLCs and stuff that are more tax efficient, but it is something that we talk to our clients about quite a bit. You may want to give everybody an ISO, but at the end of the day, most people are going to have an NSO.

We don't advise our clients to provide any advice to their service providers on what they should do, but it is something to think about. People should really understand what happens based upon their behavior with respect to these options.

Laura Cicirelli: At a very high level. I think it's also before we move on from ISOs, there's other things that we need to make sure are in existence. To even issue an ISO to someone, one, they have to be an employee, they can't be an advisor or consultant. Also, if we could just quickly talk about some of the other limitations, right, the $100,000 limit and even ownership thresholds, and we don't need to go into too much detail, but just things to be cognizant of when you're issuing these type of grants to people. Just be aware of that it may not be able to even be an ISO from the beginning.

Megan Monson: Before getting into that, I want to just touch on something that Eric said. I think a lot of companies in the startup space issue ISOs by default to the extent they can, simply because that's what common practice is and that's what employees are expecting. Not that they're actually expecting to get the tax benefit.

It's partly culturally driven. That's why companies are still following that pattern of behavior, noting that oftentimes employees aren't going to get that tax benefit again, except for outliers where people may be departing and exercise early or things like that. It also comes

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down to employee education to make sure that they really understand what they're getting and what that means.

Laura, in terms of ISO requirements, there's a couple of features that I really want to hit on. The first that you mentioned that can only be granted to employees is certainly top of mind, but there's a couple of other nuanced rules that companies and founders should be aware of. Let's talk about the 90-day post termination exercise period.

That's a pretty standard term in most option grants, but that's actually a function of the ISO rules. That's only required in order to be an ISO.

Eric Weiner: That's what we do. It's a market term. People expect options to be exercisable for 90 days post-termination. It's funny because we'll talk to our clients, “guys, it's just an ISO rule.” That's all it is. You can have an NSO, non-qualified stock option, and your post-termination exercise period can be longer. You don't end up modifying the type of option that you have.

Darren Goodman: You can have an ISO and you can have a longer period. It's just for the first three months after their last day of employment, it'll be an ISO. After that, it automatically flips to NSO.

Eric Weiner: It's an interesting thing thinking about the discussion we have with Julie last week. We were talking about, there could be a termination of employment and there's potentially a separation agreement, and there's severance and all this other stuff. Sometimes the company doesn't have a ton of cash to give the terminated employee as severance.

You do see acceleration of the four-year vesting schedule that Darren was talking about, or here, where Megan's talking about the 90-day P-tap. You'll see people extend their post termination exercise period, which is common. There was a time maybe five, six, and seven years ago where it was really common, and companies were doing it across the board greater than 90-day P-tap... and that stopped.

Laura Cicirelli: Acceleration is way more common.

Eric Weiner: I don't mind extending P-tap on certain one-off bases. If you have a regime where everybody has five years post-termination to exercise, your option pool, your cap table stays in flux. You have to wait to

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understand if they're going to actually exercise to know what your cap table looks like and their downstream effects to that broad practice.

I do like using, if we're dealing with severing an employee or something, P-tap extensions as not maybe full consideration, but it gets you something to offer them.

Megan Monson: In that context, one thing to keep in mind is unlike the scenario where Darren mentioned that you could have something granted as an ISO that has a longer than 90-day P-tap, but it only gets a 90-day benefit for the first 90 days post-termination of employment. If you are otherwise modifying an ISO, meaning somebody who is granted an ISO now in connection with their severance of employment, extending that period to two years post-employment, that's going to automatically change that stock option to an NSO.

Again, just being mindful of there are certain procedural aspects depending upon when that term is included, how that's going to treat the option from a tax standpoint.

Laura Cicirelli: I just want to flag something to you because I think before we move on, this is a very important point for the listeners because we spoke about in our Cap Table podcast, our financing round podcast, having your cap table being flux in this way with extending the post termination window that an option holder, this person leaves the company no longer associated with the company, but they could hold, half a percentage of your company.

It's locked up now as if it's theirs, for potentially a year or longer. If you have someone come and give you a term sheet for a financing round, imagine having 5 or 6 of these people on the cap table. This is getting layered into the economics of the deal, and the price per share is getting driven down for those investors.

These people could never exercise. They fall away in a few years. You've really given away way more of your company than you should have. I just want to point that out, because it’s very important.

Eric Weiner: That's such an incredible point, because in that negotiation, the investors are going to want to have an unallocated option pool, and they're absolutely going to deem those options as outstanding. They're not going to want to take the double dilution, nor should they. I

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think for P-tap extensions, it is something we talk about a lot, like a year.

I like one year. You want to go to two years, for someone really special, one-off cases, okay. You do see people say, hey, I'm going to extend P-tap until the termination of the grant, which is like ten years. That's just too long. To Laura's point, it puts things in flux.

The other thing that I think about ISOs that's interesting, in our experience, like we said before, they almost always end up as NSOs. Then there are very technical rules, which is why we are always knocking on Darren and Megan's doors about these things with ISOs. There's $100,000 of exercise ability per year of an ISO.

What that means is if I give Darren an option grant that's worth $1 million and invest equally over four years, that means there's $250,000 of exercise ability per year, even if I call it an ISO.

Laura Cicirelli: Per grantee.

Eric Weiner: Per grantee. There's $100,000 of ISO treatment and $150,000 of NSO treatment in each year, notwithstanding the fact that we granted an ISO. That's okay. The bigger issue, I think, is, and this is more of a founder related issue, because for a top up or something, if we're in a recap scenario or even if we're not, the founder's getting a top up grant, maybe because the company is super successful.

If you own greater than 10% of the voting securities of the company and you receive an option grant that is an ISO, the strike price needs to be 110% of the fair market value. We are going to talk about 409A valuations soon. I can tell you, most people want their strike price to be as low as humanly possible.

Laura Cicirelli: It also has to be five years. The expiration date needs to be five years rather than the standard ten. There's certainly some other limitations on it that may not want.

Eric Weiner: This is a very technical portion of the podcast, but we usually say, and it's hard for founders to believe us sometimes, that options are some of the most technical things we deal with on any given day. They're hyper technical. There's many different rules. Thankfully, we have Darren and Megan and members of their team because there are a lot

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of nuanced issues that arise. These are the basics, but there's so many more. It's a really technical part of your business.

Laura Cicirelli: I think the takeaway from this, too, is that, you can certainly say things are ISOs and you're approving ISOs, but it may very well be that the default is going to be treated as an NSO at the end of the day.

Darren Goodman: Under the Internal Revenue Code rules, it doesn't matter what you label it, if you get this stuff wrong, it's an NSO. I just want to add for the for the 10% scenario where someone is a founder, I usually see people wanting to have NSOs because the five year deadline in particular, that can be a real problem because usually that's a hard deadline and you can't extend it or you'll run into some tax issues.

Five years is not that long a period of time. You could easily see a scenario where you're a founder, you have options that potentially have a lot of value, but for one reason or another, it might be impractical to exercise them, like alternative minimum tax, for example. You're in a position where it's use it or lose it and you're stuck. You can't afford to exercise, but you can't also extend it for tax reasons.

Eric Weiner: I think that is an incredible point because one may think that those options expire. Issue me more options in the fifth year, but at that time, the company's value may be ten times what it was. Maybe the option strike price was $1 when you got the option five years ago and now it's $13.25.

That's a material difference. By the way. Congratulations to the company if that's happened. Not to the founder because he or she will have been put in a pretty negative position. We do talk to founders about that. Typically, we will say definitely talk to your financial planner or your tax advisor because this is a numbers game.

You want to make sure that you know what the impacts of these things are going to be. I thought that was a great point.

Laura Cicirelli: We've been talking about options for a little bit. I want to go into details for the listeners. What happens when someone wants to exercise an option, both on their end, how do they exercise? Then on the company's end, what should the company be doing, considering with its accountants, when they have these type of exercise notices that they receive?

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Megan Monson: To start off, I'll preface this by saying look at what the terms of your plan documents and the word agreement say with respect to the exercise process. However, typically it's going to involve setting some sort of exercise notice, submitting that to the company, whether it's through an online platform like Carta or, if they don't use some sort of record keeping tool, submitting it to the company.

Again, your plan and option documents will tell you that and at a minimum, paying the exercise price. To the extent that you have an ISO, again, from the company side, there's no tax withholding. You would pay the exercise price and then the exercise would be processed on the back end. Following the end of the year that the exercise occurred, the company would then issue the individual a form 3921 with respect to the ISO exercise.

Darren Goodman: That has the information the person needs to do their taxes and figure out if they have any AMT.

Megan Monson: Exactly.

Eric Weiner: Don't forget to do this stuff. A lot of companies don't do it.

Megan Monson: The process is similar but shifts a little bit if someone's exercising an NSO. They would still do the same. They would submit their exercise notice, they would pay the exercise price. On the company side, there would also be a tax withholding obligation on the exercise. This goes back to the point that Darren made earlier.

It's really important to know what the tax status is of an option, even again, if you intended for it to be an ISO. If it's factually not an ISO, there's unfortunately the opportunity to mess up the tax withholding piece of it. Then that would also run into some incorrect tax reporting. Those type of things can ultimately be costly and a problem to fix.

We often see these things come up again, maybe when companies are being sold or investors are coming in and they're like, why didn't we know about this sooner? It's just really important to understand the logistical pieces that happen at the time of exercise.

Eric Weiner: Can I compliment you on another great point? That's a great point. It's something that we've been talking about on this podcast a little bit: there are certain things where it's not just the myopic view of the thing

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you're doing right this second. There's downstream effects. In diligence, if you're going to be sold, you want your options to be clean.

You don't want to have tax issues that are going to maybe have the buyer have their outside accountants dig in under. They're going to do that diligence. It's better to be clean than dirty. These are things that are easy to do right but easy to do wrong. This is why you want to follow all the steps that Megan was outlining.

Megan Monson: I guess a related point to be aware of is, when you're filling out either the 3921 or you're having to process what the tax withholding is going to be, you need to know what the company's value is at the time of exercise. A question that often comes to us is how do we know what that value is.

Oftentimes you'll look to what's the 409A a value is. We'll get into what a 409A valuation is in a minute. That will often be the price that's used for purposes of determining the value of the company at the time of exercise. It can get a little bit complicated if you're in a scenario where that 409A may no longer be reliable.

Again, we'll get into a minute of what those scenarios may be. As a company, you'll have to make an educated judgment call. Does your plan allow you to freeze exercises? If not, what does it mean if your valuation is wrong and you either in particular for NSO's over under withhold. There's a whole bunch of things to be thinking about when someone's going to exercise their options, beyond just the procedural steps, if you will.

Laura Cicirelli: I think we should definitely take a minute on 409A because we hear about it all of the time from, when do I need a 409A, and a do I need a 409A? What happens if I don't get one? Let's spend some time talking about that.

Darren Goodman: When you're setting your exercise price, 99% plus times out of 100, in order to comply with the tax rules, you need to set the exercise price at least at fair market value on the date of ground.

Eric Weiner: Offline we could talk about the 0.1%.

Laura Cicirelli: The fair market value of a share of common stock, because that's what the option is going to be for.

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Darren Goodman: That's a whole other story. It should absolutely be common. The trouble if you're a private company is how do you determine the value? It's not something where you just look at the market price each day.

In order to make things easier for companies, the IRS rules say that if you get an independent valuation, which is a 409A valuation, you get a presumption that you set the exercise price properly.

This is the norm throughout the industry. It's the gold standard. Go and get a 409A valuation. That will give you a number that you can rely on for setting the exercise price for up to 12 months. It's 12 months from the valuation date, not 12 months from the date you get the report. If you got it today, but it's as of January 1st of 2026, it's only good through 2026.

Eric Weiner: It can be a shorter period than 12 months.

Darren Goodman: Absolutely. If there is a material event before 12 months, then it can cause your 409A to no longer be reliable. This is something where we do get a lot of questions, because the term sheet example is a great one. I think that one's clear. You often have companies where they're in a scenario where it's more gray. They've been talking to investors, but they don't have a term sheet.

They have outperformed their projections. There are any number of situations where companies at least want to think about before they make the grants, “do we have a valid foreign and a still, or have events caused our 409A to become unreliable?”

Eric Weiner: I think when we know that a company is going to start fundraising, before they're talking to investors, before they get a potential price in writing. Even if it's not in a term sheet, they're going to start fundraising and talking about different valuations of the business. Yes, you're going to be talking about a preferred stock value, but that would be a material event.

If you know you're going to go out and start doing this and you have pending grants, prove the grants. There's no reason to wait. Sometimes companies will say, I only issue my option grants, or I approve my option grants quarterly at every board meeting, but I don't do anything on the in between.

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You don't have to wait. The board can be in a meeting and approve in the interim. You can do something by a written consent in the interim. If you know you're going to go out and start fundraising, you got ten employees been waiting for the grants. I promise you, they're not going to be happy if you end up telling them, I was going to issue a grant at $0.10. Then I got a term sheet. We did our series A round and now it's $0.22 and I didn't approve it at the right time. Not going to be happy. You want to be bored thinking about this stuff.

Megan Monson: A couple of other things that I see often come up on the 409A valuations, one being companies that have a 409A valuation in place, it's expired, meaning it's beyond the 12-month presumption of reasonableness. They're still using it to grant options. That's something that I see come up often. Again, to the point I made earlier, it's something that I see on the other side gets scrutinized by investors if there's a later deal.

Another thing that sometimes comes up, especially for early-stage companies, is “we haven't really raised money, do we need a 409A valuation?” A good rule of thumb is you should always have one, because it's going to be something that somebody's going to be expecting to see, even if the value is very low.

Oftentimes if you are using a record keeping platform like Carta, a 409A valuation is part of the package in terms of signing up.

Laura Cicirelli: The one thing I will say is when we form company, sometimes they know right away. “I have these three advisors that I'm working with. I'm going to give them stuff right at the same time. I'm getting my equity.” If we know the founder just paid par value for the share, I think there's a very strong argument that these advisors, that is fair market value. You just had someone purchase a shares for that amount. It's that area in between where it's been six months. It's been a year since formation, haven't done too much. That's when it's back to the 409A.

Eric Weiner: It would be impractical, I think, to do it differently than that. I think that in the interim period, you now have eight customers that are paying you money, you're probably worth something different. It's funny, we do as lawyers get asked, “what should my strike price be?”

We are not outside valuation firms. You should get a 409A valuation when you're asking that question.

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Darren Goodman: Just to circle back to that example, where you have a company that's newly formed and they want to give advisors awards, I think that relates to what we talked about at the outset, which is “should we be giving options, should we be giving restricted stock?” Because I think that's a great situation where you give restricted stock because, as Eric mentioned at the beginning, you have the potential for capital gains there.

Just to add to what Eric had said, I'm going to assume those advisor awards are going to be subject to vesting. In that scenario, to start the long-term capital gain clock, when you have restricted stock awards, you have to file an 83 B election with the IRS in order to start the capital gain clock on the date of grant.

It's a one-page form. It's not complicated. The trap there is that there are 30 days to file that form after the stock is granted, and on day 31, it's too late. That is a hard file. Look, people get this right all the time, but it's not that unusual for it to slip through, especially if you're giving a lot of restricted stock awards. People delay and then they just missed the deadline without realizing it.

Laura Cicirelli: This will be diligenced for sure in a future priced round. Investors want to see this stuff to make sure you've done it properly.

Eric Weiner: It's diligence 101. To Darren's point, it's so easy to get it right, but people still get it wrong. We usually say startup companies break eggs. We've talked about breaking eggs on this podcast before. Usually, we can make a nice tasting omelet out of the egg.

With 83B, it's not fixable without some pain. You can do things to accelerate the tax and all this other stuff. It's not. It is something that is going to require likely some out of pocket expense on the person who made the mistake. Hopefully that mistake is caught very early.

It really is important if someone is getting stock that vests. Stock, not an option. Stock that reverse vests, you got 30 days to file your 83B Lowenstein I promise you, if we are helping you with that, we are going to remind you that you have X amount of time to file that 83B to an unbelievable degree, because we were going to want to make sure you don't make that mistake.

Just because we're talking about reverse vesting and 83Bs, I just want to pivot to. We were talking about 409A. A lot of times you also get

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asked about early exercise ability. Someone has an option grant. They say, “I know my option grant vest over four years. We want to give Laura an early exercisable option.”

This is interesting in a couple of ways. Number one, you could do that. Really what it means is, if Laura has an option to vest over four years, it's early exercisable, she can exercise all of them today. It would start reverse vesting under that schedule. If you exercise an early exercisable option that reverse vests, you have 30 days to file the 83B.

The other thing that we were talking about, about the $100,000 limitation, this is something that Darren, I believe I learned from you on many an occasion, is that if you have that million dollar option example I was talking about at the beginning of the podcast, where for years, it's $250,000 in exercise ability per year, 100,150 if you make that grant fully early exercisable in year one.

You have $100,000 in ISO and $900,000 in NSO. You're going to go from having $400,000 of ISO treatment to $100,000, and you can go from $600,000 NSO $900,000.

Darren Goodman: That's a great example for a number of reasons. Early exercise NSOs may make more sense, but if there's one takeaway from this, it's you need to be thinking about all of this stuff, and you need to think about it before you grant the awards, because it's the planning. A little bit of planning up front could save you from much larger headaches in the future.

Laura Cicirelli: I think really the takeaway from this podcast are these things are so nuanced, and a lot of times our clients say, I just want to issue these options, like, what's the problem? That should be super simple.

There's a lot of questions and stuff that needs to go into it, and we need to make sure we're doing things right, because just like you said, Darren, you want to make sure that from the onset these things are done properly.

Thank you, guys, so much for helping us today. If anyone has questions on these things, obviously you can reach out to Eric and myself, but also Megan and Darren and their team are here. Where can the listeners also subscribe to your podcast in addition to ours?

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Megan Monson: If you want to listen to "**Just Compensation**," you can check it out on the Lowenstein website, Apple, Spotify, audible, or really wherever you listen to your podcasts.

Laura Cicirelli: Thanks, guys.

Eric Weiner: Thank you so much for joining us for "**The Founder's Hour**." If you enjoyed this episode, be sure to subscribe on Apple Podcasts, Spotify, YouTube, or wherever you listen so you don't miss future conversations.

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