

# A Tiered Approach to Equity Design with Multiple Equity Compensation Vehicles

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As the popularity of stock options declines in response to the changing economic, legislative, and regulatory environment, companies are revisiting the design of their equity compensation programs. However, it is becoming increasingly clear that no single equity vehicle will emerge as the “right answer” for all companies. Instead, companies must step back and revisit their own unique objectives in granting equity to their employees. Different companies will have different and likely multiple, objectives for their equity programs. To achieve these objectives, companies in both the public and private sector can employ multiple equity vehicles, structured in a tiered design, to balance the strengths and limitations of individual equity vehicles and to address equity plan objectives at different levels of their organizations.

In the 1990s, stock options became the leading form of equity compensation for countless companies across the U.S. and abroad. Now, however, in the aftermath of the spring 2000 dot-com crash and high-profile corporate scandals such as WorldCom, and with the near-certainty that options will soon have to be expensed on corporate financial statements, companies are looking to alternatives. Though options still have many virtues, the rapid change in the economy over the past three years, plus the accounting changes looming on the horizon, has brought some of their limitations sharply into focus. In place of options, many companies are looking at restricted stock as they begin a new quest for the “one true answer” to equity compensation design for the 21st century. When Microsoft, one of the earliest and most successful users of stock options in the 1990s, announced in July 2003 that it was abandoning its stock option program in favor of restricted stock units, the passionate analysis and debate that it generated revealed the extent to which companies are seeking direction—any direction—as to what might be the cure for their stock option woes.

However, those waiting for “the” answer are likely to be sorely disappointed. An undeniable truth emerging in this post-dot-com era is that there will be no “next big thing” in equity compensation—no single, universally embraced approach of the “one size fits all” variety. More likely, the picture that will emerge as the business cycle moves through a new round of growth will have two notable features. First, companies will no longer act in lockstep, all using essentially the same approach, as they did during the dot-com era. Instead, each company will be called upon to evaluate for itself its own unique needs and circumstances to fashion an equity program that may be quite different from the one being implemented by its competitors down the street. Second, companies will be less likely to find the perfect and complete answer in a single equity compensation vehicle; as outlined in table 8-1 below, there is a range of vehicles that companies can draw on in fashioning their equity plans that extends far beyond options and restricted stock. Instead of relying upon just one equity compensation vehicle, a well-tailored program will likely consist of a combination of vehicles, uniquely blended at each company to achieve a range of business objectives, and with each element offsetting the potential vulnerabilities of the others.

There is nothing new about restricted stock. What is new is the trend to use it broadly in place of stock options or other equity vehicles instead of reserving it for the executive suite or for special attraction or retention awards. Likewise, there is nothing new per se in having multiple equity compensation plans. Public companies especially have frequently employed a mix of equity vehicles, typically including stock options, ESPPs, 401(k) matches, and more.

However, aside from integrating an ESOP with a 401(k) plan, companies both public and private often lack a well-developed strategy for coordinating their multiple equity plans and integrating those diverse vehicles into a comprehensive employee ownership program.

We present here just such a strategy, which we call a “tiered” approach to equity program design. This approach can help a company harness the advantages of multiple equity vehicles with an eye toward the big picture to achieve coordinated, comprehensive results. For companies that have only a single equity plan, this article will show the benefit of using multiple equity plans. For companies that already have multiple equity plans, this article will discuss how they may be organized to work more effectively together. Also included are examples of how individual companies are applying the tiered approach to equity compensation design. Finally, we illustrate how a company can use an ESOP to make a market for shares that employees acquire through the other equity vehicles in the company’s tiered program—an important consideration for private companies where there is no existing market for the shares.

**Table 8-1. Tax and Accounting Impacts of Different Equity Vehicles**

Vehicle	Tax		Accounting	
	Company <sup>1</sup>	Employee	Current	Proposed
<b>Stock Options</b>	Spread deductible at exercise	Spread taxable at exercise	No expense	Fair value of options expensed
<b>Performance-Based Stock Options/Shares</b>	Spread deductible at exercise/full value deductible when earned	Spread deductible at exercise/full value deductible when earned	Variable over performance period	Full value of option shares earned expensed over performance period
<b>SARs</b>	Spread deductible at exercise	Spread taxable at exercise	Variable until exercise	Treated as a liability (unless settled only in stock, then treated like a stock option)
<b>Stock Grants</b>	Full value deductible at grant	Full value taxed at grant	Full value expensed	Full value expensed
<b>Restricted Stock/Delayed Issuance Awards</b>	Full value deductible at vesting/issuance	Full shares taxable at vesting/ issuance	Full value expensed over vesting period	Full value expensed over vesting period
<b>ESOPs</b>	Contributions and dividends deductible when made	Taxed when benefits are received	Interest and cost of allocated shares expensed	—
<b>Qualified (423) stock purchase plans</b>	No deduction	Taxed at sale (ordinary income/capital gain)	No income statement expense	Fair value expensed if discount is greater than 5%
<b>Nonqualified stock purchase plans</b>	Spread and discount deductible at exercise	Spread and discount taxable at exercise	Discount is expensed	Fair value is expensed
<b>401(k)</b>	Pretax contributions deductible when made	Taxed when benefits are received	Contributions expensed	—
<b>Qualified and Nonqualified Deferred</b>	Deductible when benefits paid	Taxed when benefits are received	Expensed and carried as a liability	—

<sup>1</sup>Subject to section 162(m) or applicable tax qualification rules, as the case may be.

## **Preliminary Considerations**

When companies restructure their equity compensation programs, whether to attract and retain talent, motivate individuals to achieve key goals, build a team-oriented culture, or achieve something else, they will be required to address a host of critical issues that relate to the continuing appropriateness of their equity compensation designs. The following four considerations will serve as guideposts when going through this process.

### **Get a Clear Picture of How Sharing Your Company's Equity with Employees Will Contribute to Your Business's Success**

As wise heads have long pointed out, “If you don’t know where you’re going, any road will get you there.” And indeed, in their rush to “benchmark” and match what everyone else was doing during the overheated dot-com era, too many companies plunged into equity compensation without a carefully developed idea of what they were trying to achieve. Few companies pondered such questions as, “How exactly can employee stock ownership help our company generate improved business results?” or “What is it about stock ownership that can lead to performance gains?”

From a strategic viewpoint, approaches to employee stock ownership tend to fall into two camps:

- The “incentive” camp sees employees as hired hands that have no inherent desire for, or interest in, their employer’s success—the business is, after all, run by and for those who put up the capital. Adherents to this perspective use equity as an addition to the array of incentives that are available to management to foster effective performance by employees.
- The “ownership” camp seeks to redefine traditional employee and management roles, using shared equity as the foundation for a different approach in which the company recognizes that those doing the work are not simply hired hands but central stakeholders who should have a financial stake in the overall success of the business venture. While traditional companies in the incentive camp feature an “us” and “them” culture and a mentality that separates the employees from the management acting on behalf of the “real” owners, adherents in the ownership camp seek to create a team concept in which there is only “us” and everyone is a part of it.

Fundamental to a company’s re-examination of equity compensation strategies and programs, then, is an assessment of where it wants to be along the spectrum of organizational models—whether it wants to “incent” employees who are otherwise seen as lacking an intrinsic reason to perform, or whether it wants to build an organizational culture in which employees are “co-owners” and central stakeholders in their own right.

### **Look More Broadly than Stock Options**

Stock options are not a company’s only available equity vehicle: there are a variety of other equity compensation vehicles that companies can employ to share ownership and create long-term incentives. These include grants of stock (usually “restricted” by a vesting requirement), stock purchase programs, qualified retirement programs such as 401(k) plans and ESOPs, deferred compensation, and exotic and not-so-exotic variations on these approaches.

Determining which of these many choices may be right for a given company will involve an assessment of that company's business situation. Selecting the right equity vehicle(s) for a given company will be influenced by:

- The current growth stage of the business (i.e., start-up, growth, or maturing).
- The long-term strategic goals (i.e., is the goal to push for maximum short-term growth and then sell the company, or is the goal to create a company that is “built to last?”).
- The specific purposes that the plan is intended to achieve (e.g., attraction and retention of good employees, motivating employees to improve performance, building a nest egg for retirement, or repositioning employees as central stakeholders).
- The accounting impact (see table 8-1) and economic impact—i.e., what is affordable for the company in terms of impact on cash flow, dilution, and unwanted turnover.

### **Do Not Assume a Single Vehicle Will Emerge as the Clear Choice for Every Company**

It was, and remains, too much to expect any single equity vehicle to be “all things to all companies.” Bottom line, the vehicles that work for one company may not be appropriate for another company or even for the same company at a later stage in its development. For example, many commentators have suggested that Microsoft chose to move from stock options to restricted stock units in recognition of its transition from a company experiencing rapid growth to one that is more mature and focused upon longer-range goals. The creation of an effective equity compensation program, therefore, requires that it be designed to fit the company's present situation with an understanding that its elements will likely change with the company's circumstances.

### **Employ a Combination of Vehicles for Maximum Impact**

Each equity vehicle has both strong points and weak points. When a company attempts to rely on just one vehicle, the danger is that the weaknesses inherent in that particular vehicle cripple the program and result in its falling short of ideal effectiveness. As an alternative, companies may find that if they assemble an equity-sharing program that employs more than one equity vehicle, the weaknesses inherent in any one vehicle may be offset to some degree by strengths in one or more other vehicles. Like investors who diversify their investments among several different stocks so that weak performance by one can be offset by strengths in others, companies are likely to find that they will create the most effective equity compensation program by combining several equity compensation vehicles into a multi-tiered program.

### **Building Effective Equity Programs by Combining Vehicles: A Tiered Approach to Equity Design**

The choices on the equity compensation menu are many: stock options, restricted stock, ESPPs, ESOPs, 401(k) plans, synthetic equity such as phantom stock, and more. How does one go about selecting from these diverse choices to produce an effective employee ownership program? Do you just throw them at the wall to see what sticks? Or can there be a method to this madness?

To get a handle on the design of equity plan solutions for the 21st century, it may be effective to think about a company's plans in three tiers (as illustrated in table 8-2). Each tier is focused on achieving different objectives for the business:

- A *base tier* is used to create widespread, long-term employee ownership, ensuring that every employee has a stake in the company's success. In most large organizations, this would likely be in the form of a highly tax-efficient vehicle such as an employee stock ownership plan (ESOP) or 401(k) employer-matching contributions.
- The *performance tier* is designed to offer additional ownership to incent and reward those employees who make special contributions to the growth of the company. This will typically be done through such vehicles as stock options or restricted stock awards. In this tier, awards are tied to individual performance, and payouts should be clearly linked to the creation of shareholder value.
- The *investment tier* allows employees who are committed to the company to invest their own money in the business. Public companies can take advantage of the ESPP vehicle for this purpose, while private companies can offer direct share purchase opportunities.

This tiered approach to equity compensation design allows a company to use equity in various ways to motivate and reward behaviors of different groups of employees that are required to drive the company's success. While most companies will have elements relevant to each tier, different emphasis may be placed on different tiers and different designs may be used to accomplish objectives in the three tiers. These differences might depend upon whether the company is public or private.

**Table 8-2. A Tiered Approach to Multiple Equity Vehicle Programs**

Tier	Purpose	Example Equity Vehicles
Investment Tier	<ul style="list-style-type: none"> <li>• Encourages employees who are committed to the company to invest their own money in the business</li> <li>• At a private company especially, this can be a special privilege that outsiders don't have</li> </ul>	<ul style="list-style-type: none"> <li>• Nonqualified compensation deferral</li> <li>• 401(k) employee investment</li> </ul>
Performance Tier	<ul style="list-style-type: none"> <li>• Awards more ownership to individuals who contribute more to the growth of the company</li> </ul>	<ul style="list-style-type: none"> <li>• Stock options</li> <li>• Restricted stock</li> </ul>
Base Tier	<ul style="list-style-type: none"> <li>• Assures that every employee will have at least a basic financial stake in the future success of the company</li> </ul>	<ul style="list-style-type: none"> <li>• ESOP</li> <li>• 401(k) employer match</li> </ul>

## Six Benefits of Using Multiple Equity Vehicles in a Tiered Approach

Companies may find a number of appealing advantages to using multiple equity vehicles in a tiered approach to equity design, including:

1. *Achieves multiple objectives:* Using more than one equity vehicle can allow a company to achieve multiple objectives. For example, a company may wish to build an organizational culture that focuses company-wide attention on business performance and encourages conscientious job performance through a base tier that is built on a longer-term focused vehicle (such as an ESOP, stock purchase plan, or even equity grants at hire). At the same time, the company may want to focus top management and other key contributors on building intermediate and longer-term shareholder wealth through a tier of performance-based restricted stock, stock options, or annual incentives that pay out in stock or restricted stock.

Selected individuals could also have the opportunity to invest further in the company through a nonqualified deferred compensation plan with company stock as an investment alternative. In this way, the company uses multiple equity vehicles to achieve multiple objectives, where one vehicle standing alone may end up “just missing” on all objectives.

*2. Maximizes tax efficiency while retaining flexibility:* While ESOPs and 401(k) plans offer tremendous tax benefits—giving the company a deduction for the full value of any equity contributed to the plan while imposing no current tax liability on the employees who receive that equity—these tax-qualified vehicles come with rules that significantly limit the company’s ability to determine which employees will get how much of the total equity pie. By using a tax-qualified plan as the base tier while “topping off as needed” with a second vehicle that is not restricted by federal income tax nondiscrimination rules (but at the cost of the favorable tax treatment), a company can capture most of the tax benefits that could be obtained by relying exclusively on a qualified plan while gaining the flexibility to create incentives and rewards for those who earn them.

*3. Protects against unintended consequences within a tier:* Multiple equity vehicles within a tier can be structured to complement each other to achieve the right objectives in the right way. For example, stock options alone allow holders to realize gains based on absolute stock price appreciation. However, complementing stock options with restricted stock that vests based on relative total shareholder return can create a powerful combination that sends the message that the real focus is sustained above-average wealth creation for shareholders.

*4. Provides a balance between long-term and short-term equity interests:* Another advantage of combining vehicles is that it enables a company to provide part of its equity awards in a form that gives the employee-shareholder the freedom to control when he or she will liquidate the equity while providing other equity that must be held for the long term. If employees cannot cash in their equity except at retirement, many will see a very limited value in that equity. At the same time, if employees can, and do, sell off their equity within a short time after receiving it, the linkage between company performance and the employee’s financial well-being will come to an end. ESOPs and 401(k) plans, for example, are retirement programs that pay out only after the employee leaves the company (except for certain exceptions such as dividends on ESOP-held stock paid directly to employees), while gains on vested stock options and the value of restricted stock (once vested) may be realized whenever the employee chooses. Providing a balance of long-term and short-term equity interests will likely produce the optimal outcome.

*5. Manages dilution:* Companies also need to be cognizant of the fact that different vehicles tend to lead to different levels of dilution. By using vehicles with different dilutive impacts, companies can manage dilution. For example, a company that has in the past relied solely on stock options (a highly dilutive vehicle) could reduce dilution by substituting another, less dilutive, vehicle (such as performance-restricted stock) in place of at least some of the erstwhile option awards. A number of companies have already begun to take this path.

*6. Manages predictability of payout:* Different equity vehicles also provide distinct future gain opportunities. While future stock option gains may be difficult to predict, restricted stock values operate within a more certain range. Therefore, companies can gauge the level of predictability required for their equity compensation program by adjusting grant patterns of different vehicles to balance near-term pay delivery needs with longer-term opportunities.

## Risks to Be Managed When Combining Multiple Vehicles

Despite the advantages that companies might realize by combining equity vehicles, a number of risks exist that also need to be managed when designing a multi-vehicle equity compensation program. These risks include:

1. *Too many vehicles can become too complex:* From a practical design perspective, the idea is not to use multiple vehicles for multiple vehicles' sake, but to use multiple vehicles in pursuit of a stronger program than would exist using one vehicle. This means every vehicle needs to have a specific role to play, and to the extent the design of the vehicle can make its purpose transparent, all the better. Well-designed communications can also ease concerns about complexity and greatly enhance the effectiveness of a given design.
2. *The performance tier has inadequate leverage:* In many cases, companies are responding to the backlash against stock options by replacing some, or all, of their performance tier stock option opportunity with another equity vehicle. These companies must be mindful that replacing stock options with a vehicle that has less potential upside for employees could dampen the entrepreneurial drive that the tier of the equity program is intended to foster.
3. *The equity design becomes all about pay delivery:* A multi-tiered design would be misused if it was seen solely as a way of delivering immediate pay to employees. Companies must make sure that the overarching focus of its equity program is not so much on what the equity is worth at grant but on what the employees, through their performance, can make it worth in the future. If a grant of \$10,000 of equity is seen simply as \$10,000 of pay, it loses its power to incent employees to build shareholder value or to promote a culture in which employees are seen, and behave, as owners themselves.

## ESPPs and the Effect of Option Expensing

As companies consider the design of a multi-tiered equity ownership program, they will need to take into account the impact of current and proposed accounting rules, particularly as they relate to stock option plans and employee stock purchase plans.

The widely studied proposal to alter the accounting treatment of stock options may also affect employee stock purchase plans (ESPPs). As of this writing, accounting rules provide that certain ESPPs, in particular those that qualify under Section 423 of the Internal Revenue Code, are treated similarly to stock options. Stock options may or may not be granted at a discount from market value. If options are granted at full market value, the companies offering them are not required to recognize a charge to earnings. However, since the key feature of ESPPs is the opportunity for employees to purchase company stock at a discount, companies that offer such ESPPs are not required to recognize a charge to earnings, even for the discount that is provided to employees under such plans. If a company opts to expense its options under FAS 123, however, its ESPP must also be expensed, unless the ESPP meets a limited set of exceptions, most notably that there is not greater than a 5% discount on the current share price at the time of purchase.

In April 2003, FASB decided that all stock-based compensation should be recognized as an expense in financial statements. This new, mandatory standard, which will become effective in 2005, requires recognition as a compensation cost not only for stock options but also for

ESPPs whenever the ESPP’s terms are more favourable than those offered to shareholders generally. As a result, no purchase discounts will be permitted without an accounting cost. A few companies that have opted to voluntarily expense their stock options have pared back their ESPPs in some fashion, either eliminating the plan altogether, reducing the maximum amount employees can invest, cutting the employee purchase discount, or eliminating the “look-back” feature of such plans. Such actions, however, may be an overreaction because the accounting impact of such plans will generally be much less than options, due to a smaller spread on ESPP options than on stock options with multi-year terms.

## Public Companies: Emerging Practices

Most activity among public companies appears to be in the performance tier, where “early adopters” are beginning to diversify the vehicles they are using to address the current environment and stock options’ shortfalls. While a few companies are sticking steadfastly with stock options as their vehicle of choice in the performance tier, they are likely to be in the minority. These tend to be companies that have historically exceeded peer group performance levels and have strong communication to help employees understand how their jobs impact stock price performance.

However, the desire on the part of investors that senior executives in particular have some “skin in the game” is as strong as ever, given the recent environment of corporate scandals that fuelled regulatory and legislative changes. This has raised interest at some companies in new investment tier alternatives. In many cases, the vehicles now fulfilling the objectives of the investment tier are simpler than their earlier counterparts but no less powerful in the messages that they send. One of the more popular methods currently in practice is to mandate executives to defer a portion of their bonuses into company stock, often with ownership requirements attached. An interesting variation on this from Richard Breeden, who has been charged with reforming MCI’s governance systems as it emerges from bankruptcy, is to encourage executives to go out onto the market and use some of their cash pay to purchase company stock themselves. While this gets them to the same ownership as deferring their bonuses into stock, the act of writing out a check themselves is a powerful psychological reminder that they are investing their own money into their company, even if the approach is less tax-efficient than a straight deferral. While care must be taken to ensure these transactions do not violate insider trading laws, from an executive/shareholder alignment perspective, this is a very strong, yet simple, design.

Tables 8-3 and 8-4 illustrate what two public companies are doing at this time with multi-tier equity programs.

**Table 8-3. Public Company Example A: Multi-Billion Dollar Pharmaceutical Company**

Investment Tier	A nonqualified bonus deferral program allows a select group of senior management to defer portions of their salaries and bonuses, with company stock as one investment option.
Performance tier	Stock options combined with performance shares earned based on financial performance focus executives on intermediate drivers of business value in addition to longer-term stock price appreciation.
Base Tier	A 401(k) employer match in stock and company-wide stock option grants every two years provide lots of opportunity for all employees to build ownership in their company.

**Table 8-4. Public Company Example B: Multi-Billion Dollar Hospital Management Company**

Investment Tier	A nonqualified stock purchase plan allows members of the executive team to defer their bonuses to purchase restricted stock at a 25% discount to fair market value. The restricted stock cliff-vests after three years and is coupled with stringent ownership expectations to ensure significant long-term ownership levels.
Performance tier	Stock options, combined with earned annual equity, reinforce short- and longer-term performance achievement. Earned annual equity is restricted stock that is earned based on achievement of annual performance objectives within individuals' control. Once earned, the restricted stock vests over two years. This approach reinforces employee ownership and complements stock options by providing a vehicle with higher "line-of-sight" because the basis for earning awards is within employees' control.
Base Tier	A 401(k) match and ESOP ensure all employees have some stake in the company.

## Private Companies: Emerging Practices

Private companies may have more latitude, especially in the investment tier, because their stock will generally be unavailable for purchase unless specially offered by the company. Our first example is one of the growing legends in the world of employee stock ownership, Springfield ReManufacturing Corporation (SRC) and its remarkable CEO, Jack Stack (author of "The Great Game of Business" and "A Stake in the Outcome"). From its beginnings in the mid-1980s as a management buyout of a grimy little diesel engine rebuilding plant from an old and dying International Harvester, SRC has used its employee stock ownership programs as the foundation for an operation philosophy that has seen its stock price climb from \$1 a share at the time of the buyout to more than \$870 a share currently.

SRC's employee stock ownership system consists of three tiers. At its base is an ESOP, which assures a solid, long-term ownership stake for all employees on highly tax-advantaged terms (for both the company and the employees). The ESOP holds about one-third of the equity in the SRC employee stock ownership system. To combat any tendency toward complacency, the company also issues stock options to anyone in the organization who is in a position to be a key driver of growth for the organization. The outstanding stock options represent another one-third of the equity in the program. The final third of the employee-owned stock is represented by shares of stock that employees have purchased for their own investment.

Table 8-5 and 8-6 illustrate how two other private firms—an engineering firm and a management consulting firm respectively—have structured their multi-tier equity programs.

**Table 8-5. Private Company Example B: 150-Employee Engineering Firm**

Investment Tier	Annual cash profit-sharing bonuses may be invested in company stock, with employee-investors receiving a "free" stock option for every two shares purchased.
Performance tier	Stock options granted to reward actions that are anticipated to produce revenue in the future. Restricted stock granted to reward current revenue production.
Base Tier	Employee stock ownership plan (ESOP) that purchases shares from founding shareholders to hold for all permanent, full-time employees.

**Table 8-6. Private Company Example C: 100-Employee Management Consulting Firm**

Investment Tier	Purchase opportunities granted to newly hired consultants to give them the ability to increase their ownership stake early on.
Performance tier	Restricted stock granted to reward current revenue production.
Base Tier	Employee stock ownership plan (ESOP) that purchases shares from founding partners and from employees who acquire shares through the other tiers of the equity program.

### **The ESOP as a Market for Shares Owned by Employees in Private Companies**

Note that in example C, the company is using the ESOP not only as the base tier of its equity ownership program *but also as a market for stock that employees acquire through the other tiers*. This creative method of gaining multiple benefits from diverse equity vehicles offers tremendous power to private companies, who otherwise inevitably struggle with the difficulty of providing liquidity to employees who acquire company equity.

Generally, money that a company spends on redeeming stock from a shareholder is not deductible; it is an after-tax expenditure. A company with an ESOP, however, can channel the money that it has earmarked for stock redemptions through the ESOP, making every penny of that money deductible from its corporate income taxes. With companies in most states paying a combined federal and state tax bill in excess of 40%, a company that provides liquidity to employee-shareholders via its ESOP is in effect getting the IRS and the state to provide 40% of the funding for such redemptions. These redemptions by the ESOP in turn provide a continuing source of shares to feed into the “base tier” so that new employees can participate and all employees can build their equity interests over time as they remain with the company. The result is a dynamic system of employee stock ownership in which equity can be acquired by employees through multiple, flexible vehicles while providing a financially efficient mechanism for shareholder liquidity and a continuous renewal of the program.

Note that an employee-shareholder who sells stock to the company’s ESOP will in most cases not be able to take advantage of the provisions of Internal Revenue Code Section 1042 to defer the capital gains tax that may be due on the sale. While Section 1042 generally permits a qualifying shareholder to defer indefinitely the recognition of tax liability on the gain from a sale of stock to an C corporation ESOP, one of the qualifying restrictions contained in that section is that the stock being sold was not obtained via “a transfer pursuant to an option or other right to acquire stock to which section 83, 422, or 423 applied” (Internal Revenue Code Section 1042(c)(i)(B)). Despite this limitation, the tax advantages associated with the use of an ESOP as a market for the shares owned by employee-shareholders are clearly substantial.

### **Conclusion**

Many companies are reconsidering their use of stock options. That does not mean that they will abandon employee stock ownership. A truly effective equity plan starts with a soul-searching evaluation of what the company wants to get out of it. By fashioning a set of complementary equity vehicles into a multi-tiered program, a company can tailor its equity program to fit its individual needs. Don’t be disheartened by the end of the glory days for stock options. There are plenty of other equity vehicles out there, and more than one is likely to be suitable as an adjunct to, or substitute for, stock options.