

# Equity Compensation Strategies 2008

## Module 2 Exam

This document provides the Module 2 exam for the *Equity Compensation Strategies 2008* course of study. The exam is based on material appearing in the 2008 edition of the book *Equity Compensation Strategies*. Further information is available at [www.fairmark.com/ecs](http://www.fairmark.com/ecs).

- **Deadline.** Answers must be submitted no later than December 31, 2009.
- **Processing fee.** A processing fee of \$60 is required for this exam. The fee can be paid online at [www.fairmark.com/ecs/exams.htm](http://www.fairmark.com/ecs/exams.htm) (preferred method). You can also pay by check or provide credit card information on the attached answer sheet.
- **Submissions.** Fax the answer sheet to (224) 535-9440 or mail it to:  
Fairmark Press Inc.  
P.O. Box 6175  
Elgin, IL 60121
- **Continuing education.** Provide your CFP number for 6 hours of continuing education credit with a score of 70% or better.
- **Questions?** Call (630) 728-3835 or email [info@fairmark.com](mailto:info@fairmark.com).

## Module 2 Evaluation Form

Please fill out this evaluation form and submit it with your answer sheet.

	Strongly disagree				Strongly agree
Content was relevant	1	2	3	4	5
Learning objectives were met	1	2	3	4	5
Content was current and accurate	1	2	3	4	5
Explanations were clear	1	2	3	4	5
I would recommend to others	1	2	3	4	5

Time required to complete this module, including reading, study and completion of the exam: \_\_\_\_\_

Comments/suggestions:

---

# Equity Compensation Strategies 2008

## Module 2 Answer Sheet

*Please Print Legibly*

Office Use

Date \_\_\_\_\_

Score \_\_\_\_\_

Name: \_\_\_\_\_

Company: \_\_\_\_\_

Address: \_\_\_\_\_

City, State, ZIP: \_\_\_\_\_

Telephone: \_\_\_\_\_ CFP # or last 4 of SSN \_\_\_\_\_

Email: \_\_\_\_\_

Notify company upon successful completion: \_\_\_\_\_

Payment:  Check enclosed  Online payment invoice # \_\_\_\_\_

Credit card # \_\_\_\_\_ Exp: \_\_\_\_\_

Name on card \_\_\_\_\_

Billing address \_\_\_\_\_

### Circle your response to each question

1. A B C D

2. A B C D

3. A B C D

4. A B C D

5. A B C D

6. A B C D

7. A B C D

8. A B C D

9. A B C D

10. A B C D

11. A B C D

12. A B C D

13. A B C D

14. A B C D

15. A B C D

16. A B C D

17. A B C D

18. A B C D

19. A B C D

20. A B C D

21. A B C D

22. A B C D

23. A B C D

24. A B C D

25. A B C D

26. A B C D

27. A B C D

28. A B C D

29. A B C D

30. A B C D

# Equity Compensation Strategies

## Module 2 Exam Questions

1. Your client plans to exercise an incentive stock option and sell the shares the same day. Assuming your client's profit is equal to the bargain element of the option, how will this income appear on Form W-2?
    - A. It will not be reported on Form W-2.
    - B. It will be reported as compensation income but not subject to withholding or social security tax.
    - C. It will be reported as compensation income and subject to social security tax but not withholding.
    - D. It will be reported as compensation income subject to social security tax and withholding.
  2. As payment for services your client receives shares of stock valued at \$50,000. The shares are vested but the stock is not publicly traded. As of the end of the year he still owns the shares and has had no opportunity to sell the stock. The shares are worth only \$10,000. What is he required to report on his tax return?
    - A. Nothing, assuming he still has had no opportunity to sell.
    - B. \$10,000 of compensation income.
    - C. \$50,000 of compensation income and \$40,000 of capital loss (subject to the \$3,000 capital loss limitation).
    - D. \$50,000 of compensation income.
  3. Your client receives shares of stock as compensation at a privately held company. The shares are vested for tax purposes but subject to certain restrictions. For the first six months after receiving the shares your client is not permitted to sell them. After that, she can sell the shares, but only at a price determined by a formula set forth in a restrictive stock transfer agreement your client signed when accepting the shares. This restriction is permanent. For tax purposes, the value of the shares takes into account:
    - A. The temporary restriction on selling and the permanent restriction on the sale price.
    - B. Only the temporary restriction on selling.
    - C. Only the permanent restriction on the sale price.
    - D. Neither of the restrictions.
  4. Your client receives a grant of restricted stock. On the grant date the company transfers the shares to an escrow account. On the vesting date the shares are released from escrow and transferred to your client's regular brokerage account. The deadline for filing the section 83b election is:
    - A. 30 days after the shares are transferred to the escrow account.
    - B. December 31 of the year the shares are transferred to the escrow account.
    - C. April 15 of the year after the shares are transferred to the escrow account.
    - D. 30 days after the shares are transferred from the escrow account to the regular brokerage account.
-

5. Your client received a stock grant subject to two rules that apply if employment terminates within two years. One rule says your client will forfeit the shares if termination is for cause. The other says your client will be required to sell the shares to the company for an amount equal to their fair market value if termination is not for cause. Which of these restrictions would be considered a substantial risk of forfeiture for income tax purposes?
- A. Neither.
  - B. Forfeiture upon termination for cause.
  - C. Forced sale at fair market value.
  - D. Both.
6. As compensation your client receives shares of stock, subject to a restriction that prevents a transfer of the shares to another person or entity and also subject to a condition that creates a substantial risk of forfeiture. At what point will the shares be considered vested for tax purposes?
- A. When the transfer restriction or substantial risk of forfeiture terminates, whichever happens sooner.
  - B. When the transfer restriction terminates.
  - C. When the substantial risk of forfeiture terminates.
  - D. When the transfer restriction or substantial risk of forfeiture terminates, whichever happens later.
7. Your client received a stock grant in December. The grant occurred during a blackout period when the company prohibits sales. Your client's first opportunity to sell the shares came in January, when the value of the shares was substantially lower. What are the tax consequences?
- A. Your client must report income in the year he received the shares based on the value on the date of grant.
  - B. Your client must report income in the year he received the shares based on the value on the first date he could sell the shares.
  - C. Your client must report income in the year he had a first opportunity to sell the shares based on the value on the date of grant.
  - D. Your client must report income in the year he had a first opportunity to sell the shares based on the value on the first date he could sell the shares.
8. Your client received a grant of shares of stock. The shares will be vested one year from now, but restrictions on sale will remain in place for a period of time after vesting. Your client did not file a section 83b election. What are the tax consequences?
- A. Your client must report income when the stock is received even if it is not vested.
  - B. Your client does not have to report income until the shares are vested.
  - C. Your client does not have to report income until he is able to sell the shares.
  - D. Your client does not have to report income until he actually sells the shares.

9. Your client received a stock grant on September 1 valued at \$40,000. The shares were not vested for tax purposes and your client did not file a section 83b election. On December 15 your client received a \$2,000 dividend on these shares, paid in cash without restriction. The stock became vested on March 1 of the following year. For the year your client received the shares, your client must report:
- A. \$40,000 of compensation income and \$2,000 of dividend income.
  - B. \$2,000 of compensation income.
  - C. \$2,000 of dividend income.
  - D. Nothing.
10. Your client received a stock grant that was not vested and made a timely section 83b election. Which of the following is a true statement about the subsequent vesting date?
- A. Compensation income is reported as of this date.
  - B. Your client's capital gains holding period begins as of this date.
  - C. Dividends received before this date do not qualify for the 15% rate.
  - D. The date has practical significance but no tax significance.
11. Your client made the section 83b election, but then decided it was a bad idea. As a general rule, will the IRS permit him to revoke the election?
- A. Yes, if he acts before April 15 of the following year.
  - B. Yes, if he acts before December 31 of the same year.
  - C. Yes, if he acts before the 30-day period for making the election expires.
  - D. No, regardless of when he acts.
12. Your client has received a restricted stock unit that will vest over the next four years. She wants to know whether it makes sense to make the section 83b election. Which of the following would be an accurate response?
- A. She should definitely make the election.
  - B. The decision depends on circumstances, such as the likelihood of remaining with this employer throughout the four-year period.
  - C. The election is unlikely to be a wise choice in this situation, although it could provide a benefit.
  - D. The election is not available in this situation.
13. Your client is considering participating in her employer's employee stock purchase plan. Which of the following is an accurate statement of the tax consequences of buying shares through such a plan?
- A. The purchase is made with after-tax dollars, regardless of whether the plan is qualified.
  - B. The purchase is made with pre-tax dollars only if the plan is qualified.
  - C. The plan is made with pre-tax dollars, regardless of whether the plan is qualified.
  - D. If the plan is qualified, the money used to purchase the shares is subject to income tax but not social security tax.

14. Your client bought shares through a nonqualified employee stock purchase plan, paying \$9,000 for shares that had a value of \$10,000 on the purchase date. Which of the following is an accurate statement about the tax consequences?
- A. Your client reports \$1,000 of compensation income upon purchase of the shares.
  - B. Your client does not have to report compensation income when shares are purchased through a nonqualified ESPP.
  - C. Your client reports \$1,000 of compensation income if he makes a disqualifying disposition.
  - D. Your client reports \$1,000 of compensation income upon selling the shares without regard to whether the sale is a disqualifying disposition.
15. Your client participates in a qualified employee stock purchase plan in which the offering period is six months. To avoid a disqualifying disposition, how long must your client hold shares after the date of purchase?
- A. More than 6 months.
  - B. More than 12 months.
  - C. More than 18 months.
  - D. More than 24 months.
16. Your client participates in a qualified employee stock purchase plan that permits him to buy shares at a 15% discount. In which of the following situations can your client end up reporting compensation income and a capital loss as a result of selling the shares?
- A. A sale that is a disqualifying disposition.
  - B. A sale that is not a disqualifying disposition.
  - C. Both of these.
  - D. Neither of these.
17. If the stock value rises above the exercise price of an option, how is the value of the option affected?
- A. Time value and intrinsic value both go up.
  - B. Time value goes up but intrinsic value goes down.
  - C. Intrinsic value goes up but time value goes down.
  - D. Time value and intrinsic value both go down.
18. Your client has held stock options for several years. Information provided by your client's company indicates her stock options now have a Black-Scholes value of \$200,000. For planning purposes, you would like to know the time value of the options. Which of the following is an accurate statement?
- A. Time value and Black-Scholes value are the same.
  - B. Time value is Black-Scholes value minus intrinsic value.
  - C. Time value is Black-Scholes value plus intrinsic value.
  - D. There is no easy formula that relates time value and Black-Scholes value.
19. Which of the following is an accurate statement about the range of possible numbers for the overall value of a stock option?
- A. It must lie somewhere between the intrinsic value and the time value.
  - B. It must lie somewhere between the intrinsic value and the stock value.
  - C. It must not exceed the stock value by an amount greater than the time value.
  - D. It must not exceed the stock value by an amount greater than the intrinsic value.

20. Which of the following happens when your client harvests a stock option?
- A. He secures the time value but abandons the intrinsic value.
  - B. He secures the intrinsic value but abandons the time value.
  - C. He secures the intrinsic value and the time value.
  - D. He abandons the intrinsic value and the time value.
21. Which of the following would indicate an option is ripe for harvesting?
- A. Time value is large and intrinsic value is small.
  - B. Time value is small and intrinsic value is large.
  - C. Time value and intrinsic value are both large.
  - D. Time value and intrinsic value are both small.
22. Your client is wealthy and reasonably well diversified, even when taking into account the wealth represented by her stock options. How do these factors affect a determination of when to cash in a stock option?
- A. These factors tend to favor continued holding of the option.
  - B. These factors tend to favor early exercise of the option.
  - C. These factors make it irrelevant when your client exercises the option.
  - D. These factors should be disregarded in deciding when to exercise the option.
23. Your client exercised a nonqualified stock option, paying \$10,000 for shares that had a current value of \$50,000. She sold the shares immediately for \$50,000. The following January she received a Form W-2 that included \$40,000 of compensation income from exercising the stock option. She also received Form 1099-B showing sale proceeds of \$50,000. How should she respond?
- A. She should request a corrected Form W-2.
  - B. She should request a corrected Form 1099-B.
  - C. She should report \$40,000 of compensation income and also report a capital gain.
  - D. She should report \$40,000 of compensation income and also report a sale of stock with no gain.
24. Your client has received a nonqualified stock option. The exercise price is equal to the current value of the stock. Your client is not permitted to exercise the option during the first two years after the grant date. After that, your client can exercise the option if he is still employed by the company that granted the stock option. Shares of stock will be vested when your client receives them. When will your client report compensation income?
- A. When the option is received.
  - B. When the option becomes exercisable.
  - C. When the option is exercised.
  - D. Never, because the income is capital gain.

25. Your client has received a grant of stock options under an early exercise stock option plan. He can exercise the option now, but the shares will vest over a four-year period. The current value of the shares is the same as the exercise price of the stock option. The company is planning an initial public offering (IPO). Which of the following is an accurate statement about planning considerations in this situation?
- A. Your client should definitely exercise the stock option before the IPO.
  - B. Your client should definitely wait until after the IPO to exercise the stock option.
  - C. Your client should definitely file the section 83b election if he exercises the stock option now.
  - D. Your client should definitely file the section 83b election if he exercises the stock option after the IPO.
26. Your client uses shares that have a basis of \$5 per share to pay the exercise price on a nonqualified stock option. The exercise price is \$12 per share and the value of the shares at the time of exercise is \$20 per share. What is your client required to report in connection with the exercise of the option?
- A. No capital gain or compensation income.
  - B. Capital gain but no compensation income.
  - C. Compensation income but no capital gain.
  - D. Capital gain and compensation income.
27. The economics of a stock appreciation right are similar to the economics of which of the following?
- A. A retirement plan.
  - B. A nonqualified stock option.
  - C. An employee stock purchase plan.
  - D. A stock grant.
28. Your client has received a stock appreciation right, permitting him to receive cash equal to the growth in value of the stock above \$20 per share, the value on the date the stock appreciation right was granted. What is your client required to report for federal income tax purposes?
- A. Nothing until the year of exercise, when your client reports compensation income equal to his profit.
  - B. Nothing until the year of exercise, when your client reports capital gain equal to his profit.
  - C. Each year until the year of exercise he reports compensation income equal to the growth in value of the shares.
  - D. Upon receipt of the stock appreciation right he reports compensation income equal to the value of the stock appreciation right.
29. Your client holds a nonqualified stock option that will not expire for several years. He is considering exercising the option now and holding the stock so that future appreciation will be taxed as long-term capital gain. In which of the following situations is this strategy likely to make sense?
- A. Only if the company is publicly traded.
  - B. Only if the company is privately held.
  - C. Both of the above.
  - D. Neither of the above.

30. Your client holds a stock option that is ripe for harvesting from an economic perspective, but is considering continuing to hold the stock option for the purpose of tax deferral. She expects the tax rate that applies to the option profit to be the same regardless of when she exercises the option. Which of the following correctly describes the benefit of tax deferral in this situation?
- A. Deferral in this situation produces a detriment, not a benefit.
  - B. Deferral produces neither a benefit nor a detriment in this situation.
  - C. Deferral produces a benefit, but the benefit is not large enough to justify a high level of risk.
  - D. Deferral produces a benefit that is large enough to justify a high level of risk.