Fix My Portfolio

Opinion: 'I was given 90 days to decide, but no one knows the answer': Should you buy stock in the company that just laid you off or let your options expire worthless?

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By Beth Pinsker Follow

A reader is worried about paying a huge tax bill for shares that may fall in value in the future

It can be hard to leave money on the table when you leave a job, but there's a cost to exercising stock options.
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AMZN -2.29% CRM -2.22% META -1.35% LYFT -2.81% COIN -7.56% HOOD -4.08%

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Dear Fix My Portfolio,

I was laid off from a tech company recently, just before the latest big wave. I was given 90 days to decide what to do about my stock options, so I have just a short time to decide. I've been hunting for a job. I still have three months' runway in the bank, and I've got freelance income that will come in soon, so I'm not panicking.

My options are priced at almost $1 per share, and the company is now valued at around $9, but it's a private company so I'd have to wait until it goes public to make any money. The company seems like a good bet, but I'm worried about taking on a tax burden by exercising my options.

I've spoken to other folks at similar companies who had stock, went public, tanked hard, and they got screwed. I've spoken with a tax attorney, and two financial advisers, and still no one knows the answer. What should I do?

Signed,

B2B Seeker

Dear B2B Seeker,

You've joined a growing crowd of those laid off from big tech, along with thousands from Twitter, Amazon **AMZN,** **-2.29%**, Salesforce **CRM,** **-2.22%**, Meta **META,** **-1.35%**, Lyft **LYFT,** **-2.81%**, Coinbase **COIN,** **-7.56%** and Robinhood **HOOD,** **-4.08%** — to name just a few. This sector heavily favors using stock options as deferred compensation for highly paid employees. While you're working at the company, it's a great tax benefit because you can delay giving the IRS its cut until you cash out, but when you leave, the shares evaporate if you don't buy them in the window you're given. It can be hard to leave money on the table.

In a layoff situation, you also have to figure out whether it's worth it to you to put the money up to buy the stock and any potential taxes due, in order to potentially make money down the road.

"The first thing that's important to understand is there is a cost to exercise and there's potentially a tax liability," says David Snider, founder of Harness Wealth, based in New York.

If you leave a public company, it's a lot easier to get straight answers. You'd know the amount of shares you have vested, the discounted strike price to buy and the current market value to sell. You'd likely do what's called a cashless exercise — buying and selling your shares in the same transaction. You could have the tax withheld immediately, and invest the profit any way you wish.

It probably goes without saying that if there isn't any profit because your discounted price is more than the current price, you wouldn't do the exercise, and your options would just expire untouched. I've been in this situation myself during the dot-com bust in 2000, and ended up with a lot of scratch paper for my kids to scribble on.

The difficulties of a private company

With a private company, it's harder to figure out. Your company provided you the cost of the shares and the amount you have vested, so you can figure out the transaction price easily enough at $1 times the number of shares. The company's valuation at $9 — done by an independent company (known as the 409a valuation) — will change over time, but not likely in the 90 days you have to decide.

That 90 days is typical, by the way, and gives you some sense of the tax implications. That is, if your shares are designated as qualified incentive stock options (ISOs), which the company should be able to tell you.

Some companies are giving laid off employees longer to decide, which changes the tax picture.

"Some say end-of-year, some even say five years," says Vieje Piauwasdy, senior director of equity strategy at Secfi, a wealth management company that specializes in employee stock options.

The IRS gives you 90 days to exercise ISOs after leaving a company before they lose their tax advantage, meaning you can buy the stock options and delay paying the tax until you cash them out and potentially treat the future profit as a long-term capital gain. But after 90 days, the options turn into nonqualified stock options (NSOs), and the spread between your strike price and the fair market value when you exercise will be treated as ordinary income.

There's also the alternative minimum tax (AMT) to consider, which is why you may have trouble getting a definitive answer from a casual consultation. You actually have to run your own real numbers on this, using your full tax situation to see if the exercise would tip you over into owing this extra tax.

Personal situation

There are some free calculators available to estimate, such as this one offered by Harness, but to get a clear picture of the exercise cost and the taxes from a professional, it will cost you. Harness charges $250 for a one-hour consultation with a tax professional, for starters. SecFi charges $1,800 for a three-month engagement and $4,200 for a one-year IPO liquidity plan. Given that some executives have millions tied up in options, the price may be worth it.

Looking closely at your overall financial situation will also help you decide if you can afford to lay out the money for the exercise right now. Some companies, like SecFi, offer financing options to borrow against your future gain in order to complete the purchase. With a private company, however, there's no way of knowing when it might go public, or at what price.

"It can be 20 years you're stuck with this illiquid thing," says Snider. "You could potentially lose money."

There are sometimes secondary markets for private company stock options, says Piauwasdy, but mostly for late-stage startups that are expected to be highly valued when they go public.

Cautionary tale

If you're reading this and you're still employed in the tech industry or you're in another sector that also offers stock options as deferred compensation, you should see this as a cautionary tale. Ryan Losi, a CPA and executive vice president at PIASCIK, based in Glen Allen, Virginia, is already starting to see executives leaving startups for companies that can offer higher base salaries.

"My first call Monday was with a fintech executive who was willing to give up options because she thought it would be a long time before the company would ever recover," says Losi. "In super hot markets, when equity is rising, everyone wants equity. When things are down, everyone wants cash."

Got a question about the mechanics of investing, how it fits into your overall financial plan and what strategies can help you make the most out of your money? You can write me at beth.pinsker@marketwatch.com.

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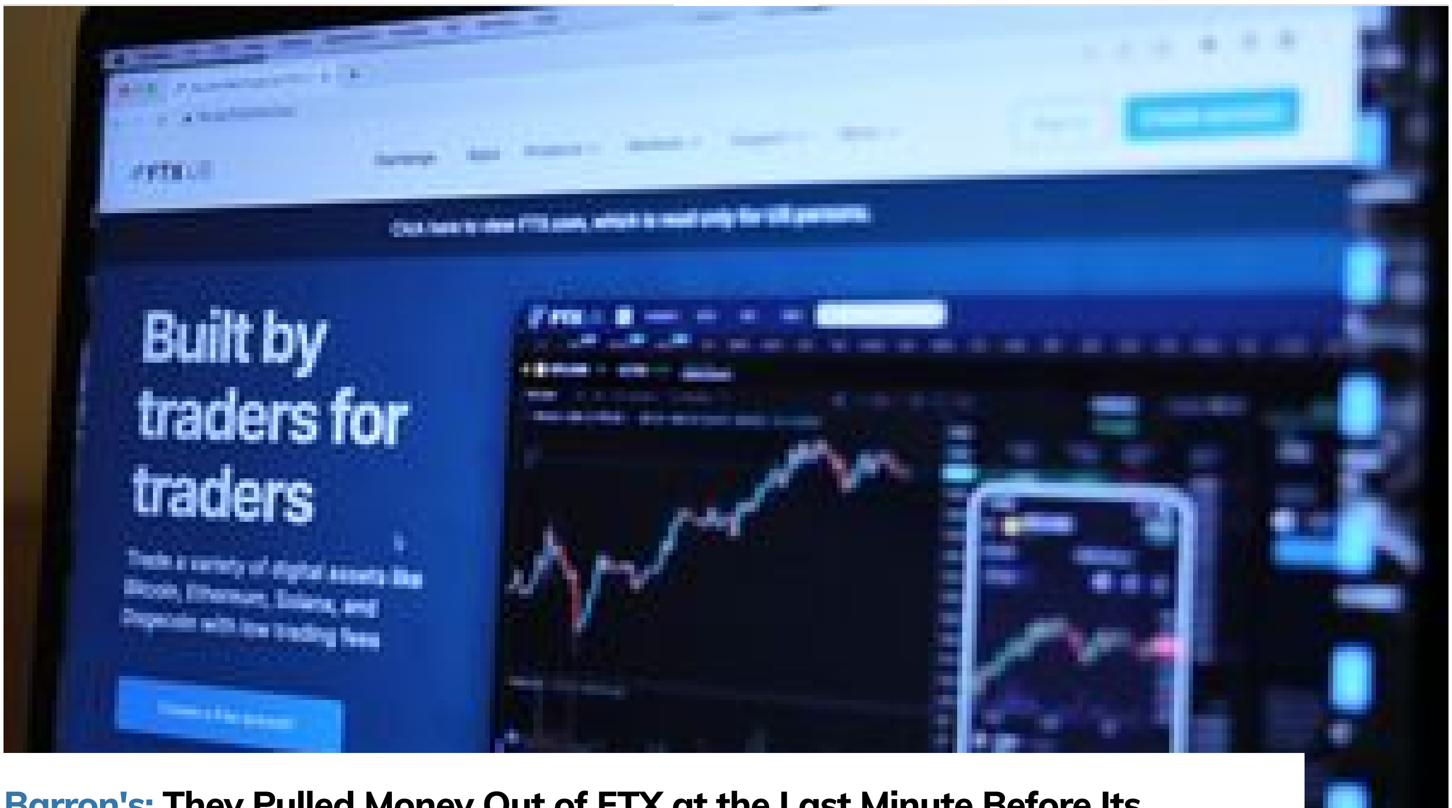

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Beth Pinsker is an investing columnist at MarketWatch. She has been a certified financial planner (CFP®) since 2018. Previously, she was a personal finance columnist and editor at Reuters, an editorial director at Fidelity and editor-in-chief of Walletpop.com. Prior to covering personal finance, she was a film critic and entertainment business reporter, writing for Entertainment Weekly, The Dallas Morning News and many more publications. You can follow her on Twitter @bethpinsker.