

GRANT
9/1/01
"Thanks for working here!
You can buy 100 shares
at \$2 a share through 9/1/05"
Stock presently trading at
\$2 a share

NO TAX CONSEQUENCES EXERCISE 9/1/02 Employee buys 100 shares

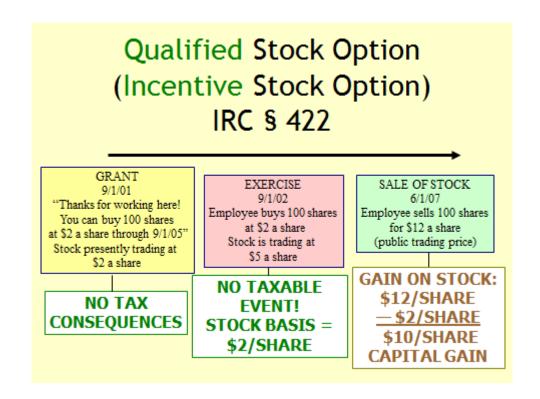
at \$2 a share Stock is trading at \$5 a share

TAXABLE EVENT! \$3/SHARE "SPREAD" IS COMPENSATION INCOME

ORDINARY INCOME SALE OF STOCK 6/1/07 mployee sells 100 shares

Employee sells 100 shares for \$12 a share (public trading price)

GAIN ON STOCK: \$12/SHARE -- \$5/SHARE \$7/SHARE CAPITAL GAIN



ISOs – Section 422

- Employee must retain stock for specified periods
- Option price cannot be less than FMV at grant
- Limit on value of stock covered by ISOs (\$100K per employee per exercise year)
- Potential problems with alternative minimum tax (AMT) IRC § 56(b)(3)