Stock Plan Services

Employee Stock Purchase Plans (ESPP): qualifying and disqualifying dispositions

The shares you purchase through a Qualified ESPP can be eligible for preferential tax treatment. Your shares can "qualify" for this special tax treatment or be considered "disqualified" depending on when you sell and if certain holding periods have been met. This special treatment will determine whether the income from your sale is taxed at ordinary income rates or at the more favorable capital gains rates.

What is a qualifying or a disqualifying disposition?

Disposition is just another way of saying that you have sold, gifted, or transferred ownership of your shares.

- **Qualifying dispositions** occur when shares **are held** for the required holding periods—which means they'll receive a more preferential tax treatment.
- **Disqualifying dispositions** occur when the shares **are not held** for the required holding periods—which means they won't receive preferential tax treatment.

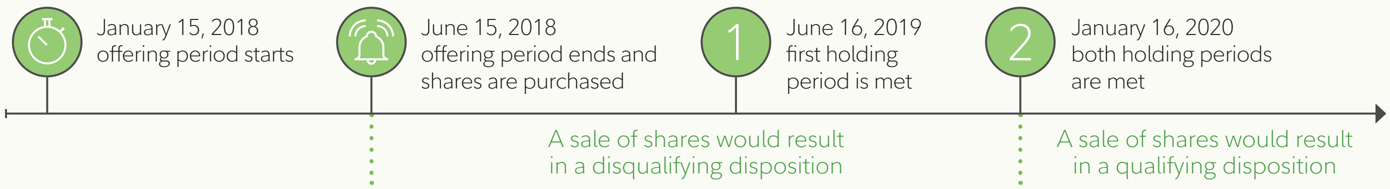
What are the holding periods?

To receive preferential tax treatment, the shares must meet both of these two holding periods when they're sold:

1. At least one year from the purchase date

2. At least two years from the offering date (the date the offering period begins)

This example shows when a disqualifying and qualifying disposition would occur in an ESPP with a six-month offering period.



What is the difference in tax treatment and why is it important?

When you sell your stock, the sale triggers ordinary income. Although no withholding applies, a qualifying or disqualifying disposition will determine the tax amount you owe on this income.

This example shows the ordinary income calculation for both qualifying and disqualifying dispositions for an ESPP with a 15% discount, when the stock price has increased since the start of the offering period. The "spread" is the difference between the purchase price and the market value on the purchase date. The plan does not have a lookback for the purchase price calculation.

- > Fair market value at the start of the offering period .... $28.00 per share
- > Fair market value at purchase .... $30.00 per share
- > Price you pay with a 15% discount (no lookback)...................................... $25.50 per share
- > Spread on purchase date $4.50

Total shares
20 shares

With a **qualifying disposition**, you have held your shares for the required holding periods. When you sell, your ordinary income is calculated from the price at the start of the offering period. Capital gains rates, which are generally more favorable than ordinary income rates, apply to the remainder of your sale proceeds.

- > Total shares purchased 20
- > Ordinary income per share ($28 x 15% discount) $4.20

Ordinary income for taxes (20 x $4.20)... $84.00

In the event of a **disqualifying disposition**, you have sold your shares before the end of the holding periods and all of your income (the spread on the purchase date) will be taxed at ordinary income rates.

- > Total shares purchased 20
- > Ordinary income per share ($30 – $25.50) $4.50

Ordinary income for taxes (20 x $4.50)... $90.00

You may still owe additional taxes on any gains that have occurred since you purchased your shares. These are called capital gain or loss taxes. To learn more about how this is calculated for Qualified ESPP plans, please see the **Qualified ESPP Guide**.

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