



IPO Planning: Stock Options, RSUs, and Tax Considerations for Employees and Early Investors

An Initial Public Offering (IPO) gives early investors and employees with equity compensation a path to liquidity as shares begin trading on the public market. For example, if an employee holds stock options or restricted stock units (RSUs), this transition can convert illiquid equity into realized financial value. However, it's important for investors to approach an IPO with a clear, thoughtful plan to make informed decisions around potential gains and risks. Here is how we believe employees and early investors can make more informed decisions before a company goes public. We will cover pre- and post-IPO planning, what you need to know about your equity, tax implications, and integrating IPO gains into your **overall financial plan**.

Why IPO Planning Matters for Employees and Early Investors

From an investor's perspective, an IPO marks an important moment when a private company's shares become publicly traded, creating a potential liquidity event for employees and early investors who may have held equity in the company for

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years prior. It is often one of the first opportunities for investors to turn paper wealth into actual financial value.

When pre-IPO planning, we believe it is important to evaluate your financial goals and determine how the event will fit into your overall financial strategy. This includes identifying your short-term and long-term financial needs, understanding your risk tolerance, and reviewing your current investments. Here is why we think planning matters:

- **An IPO may result in a significant windfall** that requires decisions about selling, holding, and reinvesting.
- **Tax implications can significantly affect net proceeds**, particularly for stock options and RSUs with complex tax treatment. Planning ahead helps you better understand and manage those outcomes.
- **Overconcentration in company stock increases risk** and may leave portfolios vulnerable to volatility tied to a single company's performance.

Understanding Your Equity

Before an IPO, it is critical to understand how your equity ownership works and what it may be worth. Different types of equity come with different rules, timelines, and tax consequences, all of which can affect your outcome.

Stock Options (NSOs vs. ISOs)

Stock options give you the right to buy shares at a set exercise price, but how they are taxed depends on the type. Non-qualified stock options (NSOs) are generally taxed as ordinary income at exercise, while incentive stock options (ISOs) may offer favorable tax treatment under certain conditions. Timing matters. When you exercise and when you sell can influence both taxes owed and overall risk. Here is what to know:

- **NSO tax treatment:** Non-qualified stock options are taxed differently from ISOs and do not receive the same potential tax advantages. They are commonly included in compensation packages and give the holder the right to buy company stock at a set exercise (or strike) price. NSOs may also be granted to non-employees, such as consultants or contractors, with tax treatment varying based on the recipient's relationship to the company.
- **ISO tax treatment:** Incentive stock options may offer favorable tax benefits, but outcomes depend on factors such as how long you hold the shares after exercising, the timing of your sale, and your exposure to alternative minimum tax (AMT) based on your overall income and deductions.

Restricted Stock Units (RSUs)

RSUs are a form of equity compensation where employees receive company shares that vest over a set schedule. When RSUs vest, their value is generally treated as ordinary income based on the fair market value of the shares at that time, regardless of whether the shares are sold. Any future gains or losses when the shares are sold are treated as a capital gain or loss. After an IPO, lockup periods or company trading windows may limit when employees can sell, so it is important to factor both tax obligations and timing of any liquidity events into planning.

Pre-IPO vs. Post-IPO Value

When developing a pre-IPO strategy, it is important to understand how valuation is determined. Private company valuations are typically based on methodologies such as comparable company analysis, discounted cash flow, or precedent transactions, and may include a liquidity discount. These approaches often reflect expectations of future growth rather than current profitability. After an IPO, valuation is determined by public-market pricing, driven by supply and demand, trading activity, and company disclosures. Share prices can move with earnings, guidance, macroeconomic conditions, and sector trends, sometimes diverging from private valuations at the

time of the IPO. Understanding how valuation may change can help set realistic expectations and inform decisions about when and how much to sell.

Tax Implications of IPO Investments

Participating in an IPO or experiencing a liquidity event can introduce important tax considerations. Understanding these factors in advance can help inform decisions about timing, strategy, and coordination with your broader financial plan.

Capital Gains Considerations

The timing of a sale can significantly **affect taxes**. Shares held for more than one year generally qualify for long-term capital gains rates, which are typically lower than short-term rates applied to shares sold within one year. Planning the timing of IPO-related sales, along with your cost basis and overall income, can help improve after-tax outcomes.

Qualified Small Business Stock (QSBS)

Certain early-stage company shares may qualify as Qualified Small Business Stock (QSBS), which may allow investors to exclude a portion of gains from federal taxes, depending on eligibility. To qualify, the stock must generally be acquired from a qualified small business in exchange for money, property, or services. Additional requirements include:

- **Company qualifications, including structure, size, and business type.** A qualified small business is generally a domestic C corporation that meets specific asset thresholds at the time the stock is issued. These thresholds have changed over time, so it is important to confirm eligibility based on current rules.
- **Holding period requirements.** Qualification generally requires holding the stock for at least five years.

- **Exclusion limits.** The amount of gain that may be excluded is subject to caps per issuer and per taxpayer, based on established rules.

Because eligibility and treatment can vary, and rules may change over time, it is important to review current guidance as part of planning.

Coordinating With Other Tax Planning

IPO-related gains often occur alongside other financial events, making coordination important. Strategies such as charitable giving, trust structures, or retirement account planning may help manage taxable income and support long-term objectives. Aligning these strategies with IPO timing can help reduce unexpected tax outcomes.

IPO Selling Strategy and Liquidity Planning

Developing an IPO selling strategy and liquidity plan is an important part of overall planning. Lockup periods, commonly ranging from 90 to 180 days after an IPO, restrict when insiders can sell. These timelines directly affect flexibility and decision-making.

Deciding whether to sell shares when restrictions lift or to phase sales over time can help manage risk and reduce exposure to market changes. For example, partial sales may provide liquidity to meet tax obligations or other financial needs, while allowing some continued participation in future performance. Market conditions and price volatility may also influence the timing of decisions.

Integrating IPO Gains into Your Financial Plan

Incorporating IPO proceeds into a broader financial plan helps ensure they support long-term objectives:

- **Align proceeds** with retirement goals, estate planning, and charitable giving in a tax-aware manner.

- **Manage concentration risk** and avoid unintended tax consequences, particularly when multiple large financial events occur in the same year.
- **Evaluate your overall asset allocation** and decide how much to hold, reinvest, or diversify based on your risk tolerance and long-term strategy.

4 Steps to Prepare for an IPO



[Click here to watch video](#)

IPO Planning for Investors

KAR's **wealth advisors** have experience guiding clients through pre- and post-IPO decisions and can help you evaluate strategies that align with your financial goals, tax considerations, and risk tolerance. **Contact a KAR wealth advisor** to discuss how IPO-related decisions may fit within your broader financial plan.



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