



Equity in Startups: What it Really Means

Startups pay employees with promises as much as with paychecks. Those promises come in the form of equity (usually restricted stock, options, or RSUs). Choosing the right form of equity-based compensation depends on timing, taxes, and control over when taxes hit. Restricted stock gives you actual shares up front, typically with a four-year vesting period and a one-year “cliff.” If you leave early, the company can repurchase what hasn’t vested. Many early hires file an 83(b) election within 30 days so they’re taxed on today’s low value and treat future growth as capital gains. It’s useful when the company is brand-new and the share price is almost zero.

Options are different, you don’t own anything yet; you have the right to buy later at today’s price (the “strike price”). That strike price has to equal or exceed fair market value as of the date of grant, which is why companies get a 409A valuation. If the company’s value rises, an option lets you buy low and, one day, sell higher. Employees may receive ISOs (incentive stock options) or NSOs (non-qualified options). ISOs can be tax-friendly (i.e., no ordinary income or payroll tax at exercise) but they can trigger the alternative minimum tax (AMT). If you hold ISO shares long enough (more than one year after exercise and two years after grant), your sale can be taxed at long-term capital-gains rates. NSOs are more flexible (they can go to contractors too) but create ordinary income at exercise on the “spread” between value and strike, and employees will see withholding. Either way, exercising is what starts your capital-gains holding period, so timing really matters.

RSUs (restricted stock units) are simpler for the recipient: you don’t get stock until it’s delivered after vesting, and that’s when ordinary income tax applies. Companies withhold taxes then, which is convenient. RSUs tend to show up at later-stage private companies and post-IPO, when simpler is better and the price is high enough that buying shares (as with options) would be a burden.

A few mechanics matter more than people realize. Vesting can be purely time-based or tied to milestones (product launches, revenue targets, etc.). Some grants include acceleration if you’re terminated after a sale, often called “double-trigger” (there’s a change in control, then you’re let go). Options come with expiration dates (ISOs have a hard 10-year max, often sooner if you leave).



If you separate from the company, the “post-termination exercise window” can be short for ISOs before they convert to NSOs; some companies extend that window, but doing so may change the tax nature, so read your grant carefully. Early-exercise options (buying before vesting) can combine the best of both worlds: you exercise when the spread is near zero and file an 83(b) election within 30 days of your grant date, then shares vest over time. Not every plan allows this.

Liquidity deserves a reality check. Private-company stock is usually locked up: even if someone wants to buy it, transfer restrictions and company rights of first refusal often block the sale. When liquidity does appear, it’s typically through a tender offer arranged by the company or an IPO. And public offerings come with lock-ups that delay selling for months. Plan for taxes you might owe before there’s any easy way to turn shares into cash.

Two lesser-known tax ideas are worth mentioning. First, QSBS (Qualified Small Business Stock) can be a meaningful benefit for stock in C-corps in certain qualified industries held more than five years: up to \$10 million of gain (or more, depending on basis) may be excluded if the company and the stock meet strict rules. It’s not automatic; you’ll want a tax professional to evaluate eligibility early. Second, Section 83(i) can allow some employees at certain private companies to defer income tax on qualified stock, but it’s niche and company-driven; most startups don’t use it, though it’s good to know it exists.

Valuations change. A new financing, a big customer win, or a down quarter can lead to a fresh 409A valuation and a new strike price. That’s one reason companies refresh option pools and grant on a schedule. Dilution is normal (new hires and investors expand the pie and slice it thinner) but well-run companies try to communicate the tradeoffs (more capital for growth vs. a smaller percentage of a more valuable company).

If you’re making or evaluating a potential offer, a few practical questions help cut through the noise: What’s the vesting schedule and does it have a cliff? Are there any acceleration terms if the company sells? Is early exercise allowed? What’s the post-termination exercise window if I leave? How many total shares are outstanding (so you can translate “X options” into a percentage)? What’s the most recent 409A strike price, and how often is it updated? For RSUs, when is delivery scheduled (on vest or later), and how will withholding work?



The quick “which one fits me” still holds. If you want ownership now and can handle early taxes, restricted stock plus an 83(b) election can be smart at very low valuations. If you want upside and control over timing, options are the classic tool (ISOs if you qualify as an employee, NSOs otherwise). If you prefer clean bookkeeping and automatic withholding later, RSUs can be the simplest path at later-stage companies.

None of this is one-size-fits-all. The best choice depends on your cash situation, risk tolerance, time horizon, and confidence in the company’s trajectory. A 20-minute call with a tax professional before you file an 83(b) election or exercise options can save you from expensive surprises later.

For help in deciding which of these incentives might be best for your business, contact:

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