

Key Differences Between ISOs and NSOs

Eligible Recipients	Employees of the issuing corporation or a qualifying corporate parent or subsidiary only	Employees, directors and qualifying consultants or advisors
Exercise Price	At least FMV on the grant date (110% for holders of more than 10% of voting power)	At least FMV on the grant date to stay outside Section 409A. A discount can trigger significant adverse Section 409A tax consequences.
Maximum Term	10 years (five years for holders of more than 10% of voting power)	Set by the plan and award agreement, but typically 10 years
Annual Limit	\$100,000 limit, measured using grant-date value, on shares that first become exercisable in a year. Any excess is treated as an NSO.	None
Treatment After Termination of Employment/Service	Exercise after three-month post-termination window (if allowed) loses preferential ISO tax treatment.	Exercise period is set by the plan and award agreement, but typically three months.
Tax at Exercise	Generally, no regular federal income tax or withholding, but the spread may be an alternative minimum tax (AMT) adjustment.	Ordinary income equal to the spread. For employees, the spread is wages subject to withholding and employment taxes.
Tax on Sale of Shares	Long-term capital gain on a qualifying sale (shares held more than two years after option grant and more than one year after exercise); less favorable tax treatment if ISO holding periods are not met	Post-exercise appreciation or loss is generally capital gain or loss.