Maximize Your Employee Stock Purchase Plan (ESPP)

Participating in your ESPP can make a substantial difference in the amount of money you are able to accumulate over your working years. Your ESPP gives you the right to purchase company stock at a discounted price.

This is such a valuable benefit that the IRS caps the level at which you may participate. You can use up to 10% of your salary to buy stock as long as the total amount purchased does not exceed $25,000*.

Let's go through an example and see how you might use this plan to your benefit.

Assumptions

Salary:	$50,000
Contribution:	You use 10% of your pay to buy stock.
Stock price:	$50 per share
Discount at 15%:	$50 x .15 = $7.50
Your purchase price:	$50 – $7.50 = $42.50
Stock performance:	Zero - stock stays at $50 per share for 1 year

Buy Calculations

Your annual contribution	$50,000 x .10 = $5,000
Number of shares purchased:	$5,000 / $42.50 = 117.65

Sell Calculations

Selling price:	$50.00 x 117.60 = $5,882**
Taxes paid:	$882 of gain x 25%*** = $221
Net gain:	$882 – $221 = $661
Rate of return net of tax:	$661 / $5,000 = 13.2%

You buy $5,000 of stock, but you don't have to pay the current price of $50. You get a 15% discount, which means you buy the shares at $42.50 and receive 117.65 shares. You hold the shares for 1 year from the date of purchase. At the end of that year the current market value of the stock is still at $50. You sell the shares for $5,882. Of course you pay tax on the gain.

After paying taxes, the result in this example is a 13.2% return for the year. Substantially higher than you would receive in a savings or money market account. With the higher return comes a greater degree of risk. If the stock drops below $42.50 and you sell it, you lose money.

However, if the stock goes up in value, your potential return is even greater.

Because of the additional risk and return potential, the most effective way to use your ESPP plan is to commit to using it consistently. This means you are in a continuous cycle of buying stock through payroll deductions and selling the stock after you have met the required holding period (usually 2 years from purchase.)

Selling the stock soon after the required holding period significantly reduces risk and increases the odds that you will see favorable results. You will also need to develop a plan in mind as far as where you will put the money when the stock is sold.

When should you consider participating? After you have adequate cash reserves tucked away in savings, checking or money market and after you are maximizing your 401(k) contributions or at the least putting enough money in to receive the full company match.

Don't let this valuable benefit go unused.****

*The maximum dollar amount of contributions may vary from plan to plan.
** For simplicity, numbers have been rounded in the example.
*** If the 2 year holding requirement is met, some gain may be taxed as ordinary income and some gain may be taxed as long term capital gains. (see your tax or financial advisor for details) The 25% tax rate is used for example purposes (assuming a 20% federal capital gains rate and a 5% state rate) and may or may not be applicable to your situation.
****Discuss your individual circumstances with your tax and/or financial advisor when deciding if you should participate and when deciding how and when to sell your stock.

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