Starting a New Job as a Senior Professional?

Three Critical Financial Strategies to Consider

Taking on a new role as a senior professional is certainly an exciting time in one's career and can be a pivotal moment for your financial future. Transitioning into a new role will bring unique opportunities and complex challenges, particularly when it comes to financial planning and decision-making.

To earn a senior level position, a professional generally must have years of expertise in a chosen field. However, by this point most senior staff have never made financial decisions regarding many of the benefits that are now available. Without thoughtful planning, or by making an uninformed decision, a senior professional can leave a significant amount of money on the table or over-pay taxes.

The first step as you take on a new role is to carefully analyze your comprehensive compensation package. This includes not just looking at your base salary and bonus, but also stock options: Incentive Stock Options (ISOs), Non-Qualified Stock Options (NQSOs), Restricted Stock Units (RSUs), deferred compensation, and any other perks.

While each component of your compensation is worthy of exploring and optimizing individually, it is important to understand how the entire package aligns with your larger financial goals and plans. There may be new strategies and tactics available to you that are advantageous (many of which can be used together or are complementary), yet step one is to discuss with your CERTIFIED FINANCIAL PLANNER™ how your compensation package aligns with your overall financial plan.

At Osborne Partners, it is our goal to ensure an optimal and financially rewarding transition for seasoned professionals. We guide senior executives through a long list of potentially advantageous benefits when transitioning to a new position and planning for their future, yet there are three critical financial strategies that are most important.

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1. Develop a Plan for Your Stock Options that Effectively Balances Both Investment and Taxes

As a senior professional, part of your overall package will often include equity compensation and stock options. Balancing investment returns and risks with the complex set of tax implications is a pivotal challenge that senior professionals face when navigating newly awarded equity compensation, particularly stock options. These stock options, designed to reward dedication and performance, offer the potential for substantial gains, but they also come with significant tax complexities. It is often difficult to strike the right balance between maximizing investment returns and managing tax consequences. These two objectives can often conflict with each other. Therefore, it is critical to follow a thoughtful and refined process to ensure you achieve an optimal balance.

When evaluating your stock options, it is crucial to begin with a clear definition of your financial goals and risk tolerance. This lays the foundation for your personalized stock option strategy that factors in both your personal goals and the inherent volatility associated with the stock market.

Once you have these goals defined, diversification of your stock options plays a key role. Selling a portion of your concentrated stock options and investing in various asset-classes can help mitigate the impact of a downturn in a single company's stock. Diversification of your stock options can also help you achieve personal goals, such as "locking in your lifestyle" (having a sufficient amount invested in a diversified portfolio, which generates enough growth and income

to where you do not need to work or rely on other sources of income to support your lifestyle). Clients are most often best served developing a strategic plan to diversify their equity compensation into a balanced portfolio. We encourage you to consult with the Osborne Partners team to make a thoughtful diversification plan (in the meantime, please watch our video on Concentrated Stock & Option Strategies).

However, the tax implications of diversifying your stock options should not be overlooked. The decisions you make regarding when to exercise your options and whether to hold or sell the acquired stock can significantly impact your tax liability. The Internal Revenue Service (IRS) treats stock options with very specific rules, often offering preferential tax treatment if certain holding periods are met. Therefore, holding your stock options for a longer period will help reduce your tax liability.

The challenge here is that often diversification goals and tax optimization strategies conflict with each other. Diversify too much, too soon, and it will negatively impact your taxes. Waiting too long to diversify, to improve your tax pictures, risks the stock dropping significantly in value.

Therefore, it is critical to engage with a financial professional who has expertise in stock-based compensation. At Osborne Partners, we often develop multiple investment and tax scenarios, which demonstrate the potential upside and downside of holding a stock, along with the tax implications of each scenario. The objective is to provide the insights needed to make clear, data driven decisions that balance both your financial objectives and the intricacies of tax law. Working with a professional helps mitigate personal attachment to company stock and reduce the emotion tied to diversification decisions.

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2. Evaluate Your Deferred Compensation Options to Optimize Taxes and Generate Future Income

A goal we often discuss and aim to achieve for our clients is to pay the lowest lifetime tax bill. One of the best ways for highly compensated senior professionals to accomplish this is to take advantage of an employer offered deferred compensation plan.

Deferred compensation is a financial arrangement that offers both advantages and disadvantages, making it a complex decision for individuals seeking to balance their current financial needs with future objectives. One of the primary benefits of deferred compensation is its capacity to provide enhanced retirement security. By deferring a portion of your income, you can create a supplementary income stream in your post-career years, helping you achieve the goal of "locking in your lifestyle".

Additionally, deferred compensation plans often come with tax advantages, as the money set aside isn't immediately taxed. This is critical, as a senior professional is often in a high tax bracket. Over time, the deferred compensation can grow and compound prior to the retired professional withdrawing it (at which point it will be taxed). This can result in substantial tax savings as most individuals anticipate being in a lower tax bracket during retirement.

However, there are potential downsides to deferred compensation. Each deferred compensation plan is different (unique drawbacks), so it is critical to conduct a thorough review of the deferred compensation plan. The two most common drawbacks we see:

1. The plans are subject to the financial health of the company offering them. If the company faces financial instability or goes bankrupt, there's a risk the deferred funds could be severely diminished.

2. The plans frequently offer limited investments for the senior professionals deferred salary. For instance, if a deferred compensation plan only allows a professional to invest in US Treasuries (which historically offer a relatively low rate of return to US equities), the potential tax savings is not worth the potentially better returns generated via the equity markets.

Keeping the advantages and disadvantages of deferred compensation plans in mind, we at Osborne Partners guide clients through a thoughtful process to evaluate and balance current liquidity requirements and financial goals, current and projected future tax brackets, and the plan's specific limitations and drawbacks. Executed appropriately, deferred compensation plans can offer senior professionals significant benefits. However, overlooking a key drawback, or implementing a plan without thoughtful planning, deferring compensation can be a strategy professionals long regret.

3. Use Equity Compensation to Fund up to $66,000 in a Tax Free “Mega Backdoor Roth 401(K)”

Leveraging vesting restricted stock units (RSUs) to fund a Mega Backdoor Roth 401(k) can be a powerful strategy to enable high-income earners to contribute substantial after-tax funds to their retirement accounts and improve their overall tax position. First, ensure your employer's plan supports this option, and you structure your plan to do so.

Inexperienced senior professionals often contribute the traditional $22,500 limit (as of 2023) to their 401(k), yet still have significant liquidity remaining after these contributions. Exploring a Mega Backdoor Roth 401(k) contribution can be advantageous, as IRS limits up to $66,000 in total annual 401(k) contributions. By funding a Mega Backdoor Roth 401(k), a senior professional can effectively invest another $43,500 in a tax-free Roth every year.

How does the process work? Immediately as your RSUs vest, we recommend selling a measured amount of RSUs to contribute to a Mega Backdoor Roth 401(k). It is important to sell the RSUs immediately after they vest, as this will avoid any incremental capital gains when they are sold. Remember, RSUs are taxed as ordinary income once they vest. There is generally little you can do to manage this tax liability.

After selling the RSUs, you can proceed with contributing the after-tax proceeds to the Mega Backdoor Roth 401(k). To do this, you’ll make after-tax contributions to your traditional 401(k) account, followed by a conversion of these funds to a Roth 401(k) component. It is critical to convert your “after-tax” contribution to your traditional 401(k) immediately to a Roth 401(k) to avoid any tax liability. We often join clients in conference calls with their benefits departments to help execute this strategy.

With this strategy, you are effectively taking taxable dollars (RSUs) and shifting them to a tax-free Roth 401(k). Put differently, if this strategy is not executed, when a senior professional sells RSUs and invests the proceeds into a taxable account, any gains will be taxed at the Federal and State level. When RSU sales are used to fund a Mega Backdoor Roth 401(k), any gains or withdrawals from the 401(k) are tax-free.

At Osborne Partners, we are passionate about helping senior professionals evaluate new opportunities and execute customized strategies. New compensation packages provide new challenges; let us help analyze the best long-term plan so you can focus on your new job.

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