



# MONEY *notes*

## Variable Compensation: Managing Equity, Bonuses, and Deferred Compensation

In today's evolving workplace, more professionals are receiving compensation packages that extend beyond a simple salary, and many employers are using this type of compensation as an incentive. **Variable compensation** may rely on achieving specific goals, individual or team pay-for-performance or company profitability. While these arrangements can significantly boost your earning potential, they also introduce the need for a discussion with your BLBB advisor who understands your options and can develop a comprehensive strategy that accounts for irregular income, tax optimization, retirement planning, and long-term wealth building. Whether you're receiving stock options, Restricted Stock Units (RSU), deferred compensation, or performance-based bonuses, the decisions you make today may have profound impacts on your financial future.

### Understanding the Types of Variable Compensation

Variable compensation programs come with distinct characteristics, tax implications, and strategic considerations.

This irregular income stream requires disciplined budgeting and cash flow management to avoid the feast-or-famine cycle that derails many high earners.

Professionals who achieve the greatest long-term financial

Variable Comp Chart

TYPE	HOW IT WORKS	KEY CONSIDERATIONS	PRIMARY CHALLENGES
Annual Bonuses	Cash payment tied to company or individual performance	Subject to supplemental income withholding (typically 22% federal), which can feel higher than regular salary withholding even though ultimately taxed at your marginal rate	Managing cash flow impact of higher withholding
Commission Income	Performance-based pay that fluctuates based on sales or revenue generated	Taxed as ordinary income; requires estimated tax payments for high earners	Month-to-month income variability for sales professionals
Equity Compensation	Stock-based rewards including RSUs and stock options. RSUs are taxed as ordinary income when they vest, creating immediate tax liability even without selling shares.	RSUs: Ordinary income at vesting, capital gains on appreciation. ISOs vs NSOs have different tax treatment and AMT implications.	Managing concentrated stock positions and deciding when to sell; understanding stock options vs RSUs risk-reward profiles
Deferred Compensation	Postponed compensation that provides tax deferral benefits but typically comes with creditor risk	Tax deferral on contribution, ordinary income tax at withdrawal	Timing withdrawal decisions and managing creditor risk; often part of executive compensation strategies requiring holistic planning.

success aren't necessarily those who earn the most variable compensation—they are the ones who understand their options early and integrate them strategically into a comprehensive financial plan.

## Managing Cash Flow with Irregular Income

One of the greatest challenges for those with variable compensation packages is how to budget for the irregular income. The key is establishing a base budget built around your most conservative income estimate—typically your base salary or minimum guaranteed commission. This ensures your essential expenses remain covered during lean months.

When variable income arrives, you want to implement a strategic allocation approach. Consider, by way of example, the 50-30-20 framework adapted for irregular income:

- 50% to tax reserves and debt reduction – Build your tax buffer and eliminate high-interest obligations. Many professionals underestimate their tax burden, particularly when receiving multiple forms of variable comp throughout the year.
- 30% to investment and retirement accounts – Maximize 401(k) contributions and build taxable portfolios.
- 20% to enhanced emergency fund or discretionary spending – Create financial cushion while allowing some lifestyle enhancement.

This systematic approach can help prevent the common pitfall of lifestyle inflation that occurs when spending rises to match peak income periods.

## Tax Planning Strategies

While bonuses and salary are ultimately taxed at the same rates, bonuses face supplemental wage withholding (typically 22% federal for amounts under \$1 million).<sup>1</sup> Understanding how your employer calculates bonus tax withholding can help you plan appropriately—recognizing you may owe more at tax time if your marginal rate exceeds the withholding rate.

For non-cash equity compensation, timing becomes paramount. Understanding how RSUs are taxed starts with recognizing that vesting triggers ordinary income tax. However, the holding period for any shares you retain after vesting determines whether future gains receive long-term capital gains treatment. Strategic planning around RSU tax strategies might include selling enough shares at vesting to cover tax liability while holding a portion for potential appreciation.

When to exercise stock options depends on multiple factors: your company's prospects, Alternative Minimum Tax (AMT) considerations (for ISOs), current tax rates, and diversification need. For employees with company stock in 401(k) plans, understanding net unrealized appreciation (NUA) may unlock significant tax savings when distributed in-kind rather than rolled over.

## Integration with Retirement and Investment Planning

Variable compensation may create a unique opportunity for accelerating your retirement timeline and building wealth strategically:

- **Maximize retirement contributions:** When bonus or commission checks arrive, if possible, use them to front-load 401(k) contributions early in the year—capturing employer matches and extending your market exposure.
- **Diversify concentrated positions:** Equity compensation requires particular attention to diversification. A concentrated position in your employer's stock may represent an

investment risk. Establish rules-based selling strategies, such as selling a predetermined percentage at each vesting event.

- **Integrate with wealth-building strategy:** Variable compensation planning should align with your overall financial plan. Rather than treating bonuses and equity grants as "found money," discuss with your BLBB advisor how to use this income to accelerate debt payoff, fund tax-advantaged accounts, or build taxable investment portfolios that provide flexibility and future income streams.

## Behavioral Strategies and Timing Considerations

Success with variable compensation requires discipline and pre-commitment strategies. Consider implementing these approaches:

- **Pre-decision allocation:** Before receiving a bonus or commission check, decide how you'll allocate it. This approach prevents impulsive spending and ensures variable income serves your long-term objectives.
- **Automate transfers:** Set up automatic transfers that move predetermined percentages of variable compensation into tax reserves, investment accounts, and savings vehicles immediately upon receipt. This removes emotion from the equation and prevents the "mental accounting" trap.
- **Coordinate timing decisions:** Work with your BLBB advisor before making major decisions around equity compensation exercises or deferred compensation distributions. A seemingly small timing shift can produce dramatically different tax outcomes. For example, exercising ISOs late in the year versus early in the following year might mean the difference between triggering AMT or avoiding it entirely.

## Take Control of Your Variable Compensation Today

*How you manage variable compensation can define your financial trajectory. While the complexity of modern compensation packages might seem overwhelming, the right strategies transform these vehicles from sources of stress into powerful wealth-building tools.*

*Time is your greatest ally when it comes to variable compensation planning. Every year you delay in integrating these strategies costs you tax efficiency, compounding growth potential, and financial flexibility. Many professionals who build significant wealth through variable compensation share a common trait: they seek comprehensive financial planning guidance early, before critical decision points arise, not after.*

*The key is developing a comprehensive plan that addresses all aspects—from cash flow management with irregular income to sophisticated tax strategies around equity compensation and deferred compensation plans. Your specific situation—your income volatility, equity structure, tax bracket, and financial goals—demands customized solutions that generic advice cannot provide.*

*Don't navigate these complexities alone. Together, we can tailor a customized plan to optimize tax efficiency, manage cash flow effectively, accelerate your financial goals, and transform your variable compensation from a source of uncertainty into your greatest wealth-building asset.*

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<sup>1</sup> <https://www.experian.com/blogs/ask-experian/how-are-bonuses-taxed/>

## DISCLOSURES

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