



QAPITA

A CFO & FOUNDER'S GUIDE

One Company, *Two Prices*

Decoding the 409A vs. VC Valuation Gap

Why the same business is worth \$50M to its investors and a fraction of that to the IRS. And why both numbers are correct at once. A field guide to the mechanics, the market data, and the compliance stakes behind startup equity's most misunderstood number.

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A field guide to the mechanics, the market data, and the compliance stakes behind startup equity's most misunderstood number.

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THE PARADOX

Your Company Has Two Legally Correct Prices

Close a Series A at a healthy post-money valuation and, in the very same week, an independent appraiser can put your common stock at a small fraction of that per-share price. Neither number is wrong. They are answering two entirely different questions and treating them as interchangeable is the single most common valuation mistake founders and finance teams make.

THE TYPICAL GAP

25-60%

lower is the normal, expected, IRS-anticipated range for common stock fair market value versus the most recent preferred share price.

Falling far outside this band doesn't automatically mean you're wrong. It means your appraiser's report needs to explain why, an unusual cap table, a recent material event, or an atypical liquidation structure.

Why This Isn't a Bug

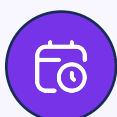
- A VC valuation price is what a sophisticated investor will pay today for a claim on tomorrow's upside i.e. negotiated, forward-looking, and attached to preferred rights like liquidation preference and board control.
- A 409A valuation price is what your common stock is worth right now, stripped of those preferred protections, strictly for IRS tax and option-pricing purposes.
- The gap between them isn't sentiment or conservatism, it's a structural, mathematically-derived consequence of exactly what sits in your cap table's preference stack.
- The two numbers even move in opposite directions at times: a round that adds protective terms for investors can push the VC valuation up while pushing the 409A-eligible residual down.

"The question isn't which number is right. It's which question you're trying to answer."



Who is reading this number?

An investor, a board member, and the IRS are asking fundamentally different questions. Match the valuation to the audience before you quote a figure.



How recently was it set?

A VC valuation is frozen at signing. A 409A can silently expire the moment a material event occurs, check the date before you rely on either.



What sits ahead of it in the stack?

Every liquidation reference, participation right and option pool between enterprise value and this number changes what it actually means

AT A GLANCE

Two Valuations, Two Jobs

	409A VALUATION	VC VALUATION
Question it answers	What is my common stock worth today, for tax purposes?	What will an investor pay today for a stake in my future?
Governed by	IRS Section 409A (Internal Revenue Code)	Negotiated contract — no statutory formula
Who performs it	Independent, qualified third-party appraiser	Investors, with company and banker input
Core method	OPM backsolve or PWERM off enterprise value	Comparables, DCF, Scorecard, VC Method
What it prices	Common stock only, after the full preference stack	Preferred stock, with rights and protections attached
Orientation	Backward-looking, conservative, defensible	Forward-looking, growth- and narrative-driven
Refresh trigger	Every 12 months, or immediately on a material event	Each new financing round
Typical cost	\$499 (AI platforms) to \$20,000+ (Big 4, pre-IPO)	No direct fee — priced into round economics
Consequence of error	20% employee tax penalty, plus interest	Down round optics or a broken narrative

How to Read This Table

Every row is a place where teams accidentally reach for the wrong number i.e. pricing options off a round valuation, or benchmarking company health off a 409A ratio. Treat the left-hand column as a checklist: before you use either number, confirm which question you're actually answering.

**Different instruments**

Preferred and common carry different rights, so a price gap between them is structurally expected, not a red flag.

**Different clocks**

A VC valuation is fixed at signing. A 409A valuation is a rolling 12-month clock that material events can reset early.

**Different consequences**

Getting the VC number wrong costs you a negotiation. Getting the 409A wrong costs your employees real IRS penalties.

Quick Reference: Terms Worth Knowing Cold

Term	What it Means
OPM Backsolve	Option Pricing Model (OPM) method that derives common stock value by working backward from a known transaction price.
PWERM	Probability-Weighted Expected Return Method (PWERM) values each likely exit scenario and weights it by probability.
DLOM	Discount for Lack of Marketability (DLOM) a value reduction applied because private stock can't trade freely.
Safe Harbor	IRS presumption that a valuation is reasonable, shifting the burden of proof to the IRS if challenged.
Cheap Stock	Risk that arises when options are later found to have been priced below fair market value at grant.
Waterfall	The order in which exit proceeds are distributed across preferred and common shareholders.

“Know these six terms cold and you'll follow almost any conversation about startup valuation whether it's with a VC, an appraiser, or your own board.”

DEEP DIVE — ONE

What a 409A Valuation Actually Measures

The Mechanics, In Order

- 1 Establish Enterprise Value**

Income (DCF), Market (comparables and precedent deals), or Asset approach, whichever fits your stage and available data. Pre-revenue companies typically lean on the Asset or Market approach; growth-stage companies increasingly use DCF.
- 2 Allocate to Share Classes**

OPM (Black-Scholes-based Option Pricing Model) or PWERM (Probability-Weighted Expected Return Method) splits that enterprise value across preferred and common using the actual cap table waterfall every SAFE, note, and preference layer included.
- 3 Apply the DLOM**

A Discount for Lack of Marketability typically 12–38% depending on stage is layered on for the simple fact that private common stock can't be sold on a public exchange the way preferred often can via a secondary.
- 4 A Qualified Appraiser Signs**

A named, qualified appraiser's signature, not the price paid, is what earns IRS safe harbor, shifting the burden of proof onto the IRS rather than the company if the valuation is ever challenged.

Safe Harbor and What This Report Is Not



SAFE HARBOR

A safe-harbor 409A is presumed reasonable by the IRS unless proven “grossly unreasonable.” Without it, the burden of proof sits with the company and the IRS rarely loses that argument. Safe harbor requires a qualified, independent appraiser and expires automatically after 12 months or on any material event.

WHAT IT IS NOT

- Not a statement of what the company is worth to an acquirer or in a sale process
- Not negotiable the way a term sheet is, it's an appraisal, not a deal point
- Not a substitute for a cap table valuation used in fundraising conversations
- Not optional once you've issued your first employee option grant

What Your Appraiser Will Ask For

- A fully diluted cap table, including every SAFE, convertible note, warrant, and option grant outstanding
- The most recent financing round's term sheet & closing documents, including any preference or participation terms
- Recent financial statements and, where available, a forward-looking budget or forecast
- Board minutes covering any material events since the last valuation, new financings, major hires, or strategic shifts
- Details of any outstanding litigation, IP disputes, or regulatory matters that could affect enterprise value

DEEP DIVE — TWO

What a VC Valuation Actually Measures

A VC valuation is a negotiated price, not an appraisal. It's the point where a founder's story about the future and an investor's required return converge and unlike a 409A, it prices in rights that common stockholders never receive.

Four Ways to Arrive at a Number



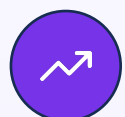
Comparables

Revenue or user multiples pulled from recently funded peers in the same category, geography, and stage the most common method at Series A and beyond.



Discounted Cash Flow

Rare pre-revenue, but increasingly common from Series B onward once growth and margins become genuinely forecastable.



Scorecard / Berkus

Qualitative scoring against team strength, market size, and early traction the default for pre-revenue seed rounds.



The VC Method

Works backward from a target exit value and the fund's required IRR to arrive at what can be paid for equity today.

How Negotiation Shapes the Final Number

- The method sets a starting range; the term sheet negotiation moves the number within it: governance asks, pro-rata rights, and pool top-ups are all levers that trade against headline price.
- Competitive dynamics matter as much as fundamentals: a multi-term-sheet process routinely prices 20–40% above a single-offer negotiation for an otherwise identical company.
- Investors price the option pool expansion into pre-money valuation, not post-money, a detail that quietly changes founder dilution more than the headline number suggests.

THE PRICE INCLUDES RIGHTS COMMON STOCK NEVER GETS

Liquidation Preference

Gets paid back first often before common sees a dollar in a sale or wind-down.

Anti-Dilution Protection

Re-prices the investor's stake if a later round comes in lower.

Board Seats & Info Rights

Direct visibility and influence over major company decisions.

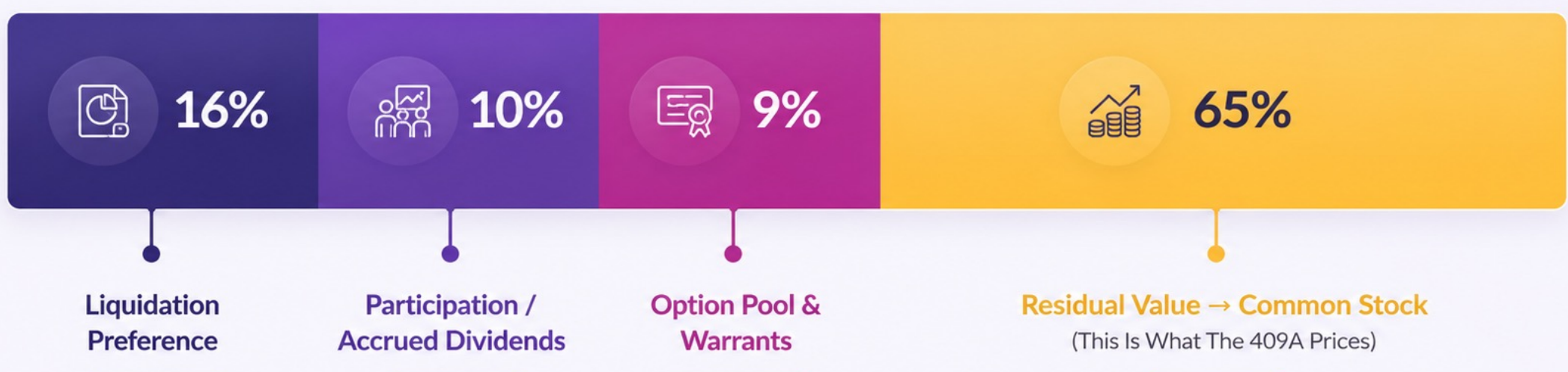
Pro-Rata & Pay-to-Play

The right to maintain ownership percentage in future rounds.

THE MECHANISM — NOT JUST THE MOOD

Where the Gap Actually Comes From

Most explanations stop at “appraisers are conservative.” The real driver is mechanical: the OPM backsolve allocates enterprise value across breakpoints defined by your cap table, and common stock only receives what's left after every preference, participation right, and option pool is satisfied.



WHY THIS MATTERS

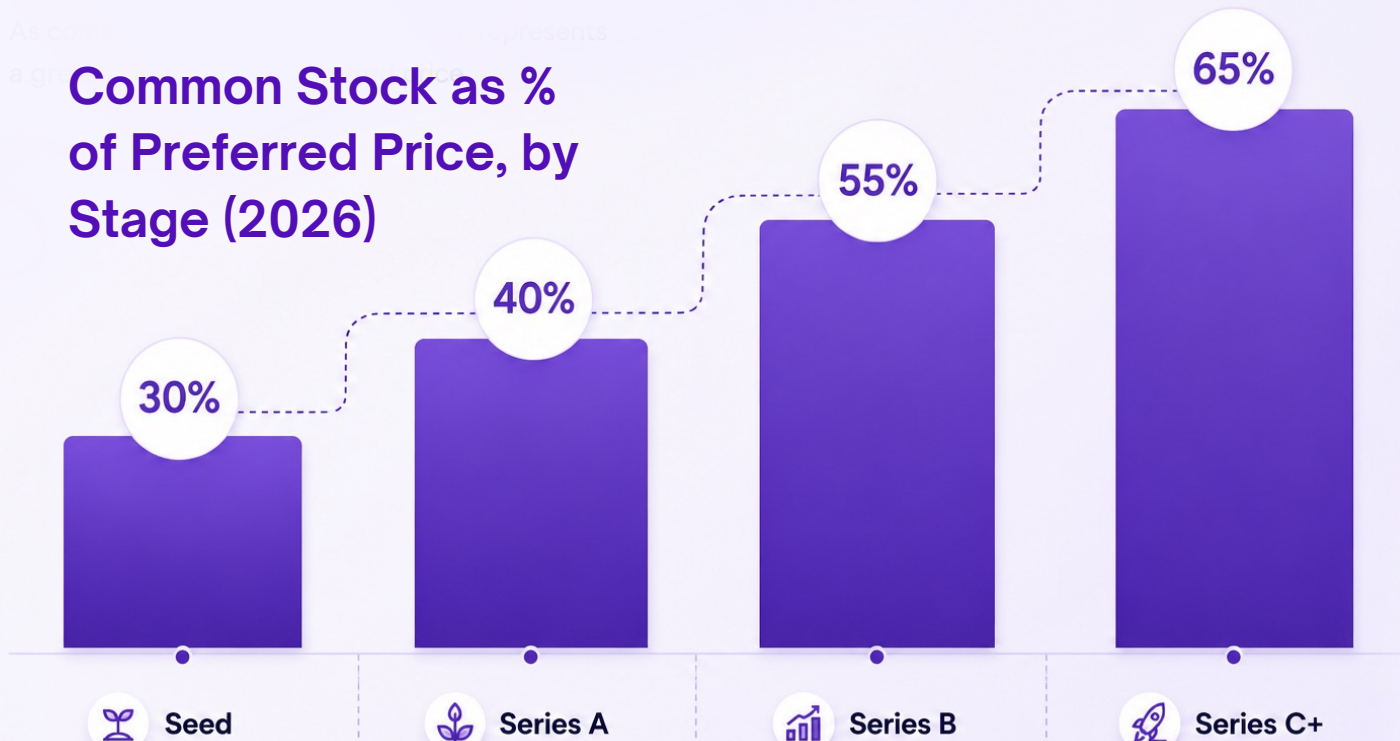
Every additional financing round stacks another layer of preference ahead of common stock. As the preference stack thickens, the residual slice available to common stock shrinks independent of whether the business is doing better or worse. This is why later-stage 409As trend toward a higher common-to-preferred ratio even when growth flattens: option pools get exercised, early preference rounds convert to common at exit, and the stack simplifies over time.

MARKET BENCHMARKS

The Gap Narrows As You Approach Liquidity

As a company approaches liquidity, the gap between common stock and preferred price narrows.

Common Stock as % of Preferred Price, by Stage (2026)



“The appraiser isn't being conservative for its own sake it's running the same waterfall math your term sheets already dictate.”

DLOM and Cost by Stage

Stage	Typical DLOM	Typical 409A Cost
Seed	28–38%	\$499–\$2,500
Series A	22–30%	\$1,500–\$5,000
Series B	18–25%	\$3,000–\$8,000
Series C+	12–20%	\$5,000–\$20,000+

The 2026 Read

Time to liquidity not company size is the single largest driver of both ratios. As a company nears an exit or IPO, the preference stack captures a shrinking share of a much larger total equity value, so common's residual share climbs even without any change in cap table structure. These are market-observed norms, not IRS-mandated thresholds; falling outside them just means your report needs to explain why, typically citing an unusual cap table or a recent material event.

What Moves Faster Than the Benchmark

- A recapitalization or bridge note can shift your ratio out of band overnight refresh before the next grant, don't wait for the annual cycle.
- Industry matters at the margins: capital-intensive sectors (hardware, biotech) often run DLOM slightly above the software-sector benchmark shown here.
- A ratio inside the band is reassuring but not a substitute for a defensible, appraiser-documented rationale specific to your cap table.

NEW PERSPECTIVE

Why the Gap Widens When Markets Cool

The 2023–2026 funding environment rewarded structure over headline price. Flat and down rounds increasingly came with richer downside protection which pushes more of the preference stock ahead of common stock, widening the 409A gap even when the company's fundamentals haven't changed.



Stacked Preferences

Each new round adds another 1x (or greater) liquidation preference ahead of common pre-existing preferences don't disappear, they queue up behind the newest one.



Participating Preferred

A resurgence of participating structures means preferred holders can take their preference back and still share pro-rata in remaining upside, shrinking common's slice twice over.



Stacked SAFEs / Notes

Uncapped or high-cap SAFEs converting at a discount add real complexity to the waterfall an appraiser must model precisely ambiguity here tends to push valuations conservative.



Down-Round Ratchets

Full-ratchet or broad-based anti-dilution provisions re-price earlier preferred, sometimes materially increasing the effective preference claim ahead of common.



Extended Runways

Bridge financings and extension rounds common in a cooling market often carry warrant coverage or additional liquidation multiples that compound the stack further.



Insider-Led Rounds

Rounds led primarily by existing investors can carry softer headline pricing but tighter protective provisions, which shows up in the 409A model even when routine on paper.

“A wider gap in a cooling market is not a signal your company is worth less, it's a signal your cap table got more complicated.”

What This Means for Your Next Round

- Model the post-round preference stack before you sign the term sheet not after, when the 409A comes back lower than expected and surprises the board.
- Expect your appraiser to ask detailed questions about participation rights and any ratchet mechanisms; incomplete term sheet detail is the most common cause of 409A delivery delays.
- Brief your option holders proactively that a lower FMV after a protective round reflects structure, not a judgment on the business.

COMPLIANCE & RISK

The Cost of Treating Both Numbers as One

The “Cheap Stock” Trap

“Cheap stock” risk arises when a company grants options at a strike price a later reviewer, an auditor ahead of an IPO, or an acquirer's diligence team, concludes that it was unreasonably below fair market value at the time of grant. It is one of the most common findings in pre-IPO and M&A due diligence.

- Options priced off a stale or informal “rule of thumb” discount instead of a documented, qualified appraisal
- A 409A not refreshed after a material event like a new round, active M&A talks, or a major revenue shift
- Grants issued in the gap window between a funding close and the delivery of the updated 409A report
- Cap table complexity, stacked SAFEs, multiple preferred series, warrants not fully reflected in the last valuation model

If challenged, restated option pricing can trigger retroactive taxable income for every affected employee, not just recent hires and requires refiling prior-year tax forms for both the company and its employees.

What a Violation Actually Costs an Employee

1

Immediate taxation

The entire vested, previously-untaxed deferred amount becomes taxable income in the year of the violation not the year of actual payout.

2

+20% federal penalty

A flat additional tax on top of ordinary income tax, paid personally by the employee, not the company.

3

+ Premium interest

The federal underpayment rate plus one percentage point, calculated back to the year compensation was first deferred.

4

+ State penalties

High-tax states add further burden California alone adds a 5% state penalty, and combined liability can exceed 50% of the spread value.

A REAL-WORLD CAUTIONARY TALE

A well-documented enforcement case involved a semiconductor company executive whose option grant was priced in one month but not formally approved until the next, by which point the stock had appreciated. The IRS determined the options were granted below fair market value and assessed a 409A violation; the executive challenged the assessment and lost, ultimately paying several million dollars in penalties. The lesson: timing discipline between board approval and grant date is not a formality it's the difference between compliant and non-compliant equity.

The Correction Window

The IRS does maintain a correction program that can minimize or even eliminate 409A penalties but only if the error is identified and corrected within two calendar years of when it occurred. The longer a violation goes unnoticed, the more likely an audit finds it first, and the less relief is available.

Who Actually Bears the Risk



Employees

Bear the direct tax consequence immediate income inclusion, the 20% penalty, and premium interest all land on their personal return, not the company's.



The Company

Bears reputational and diligence risk a cheap-stock finding can delay or reprice an acquisition, or complicate an IPO registration process.



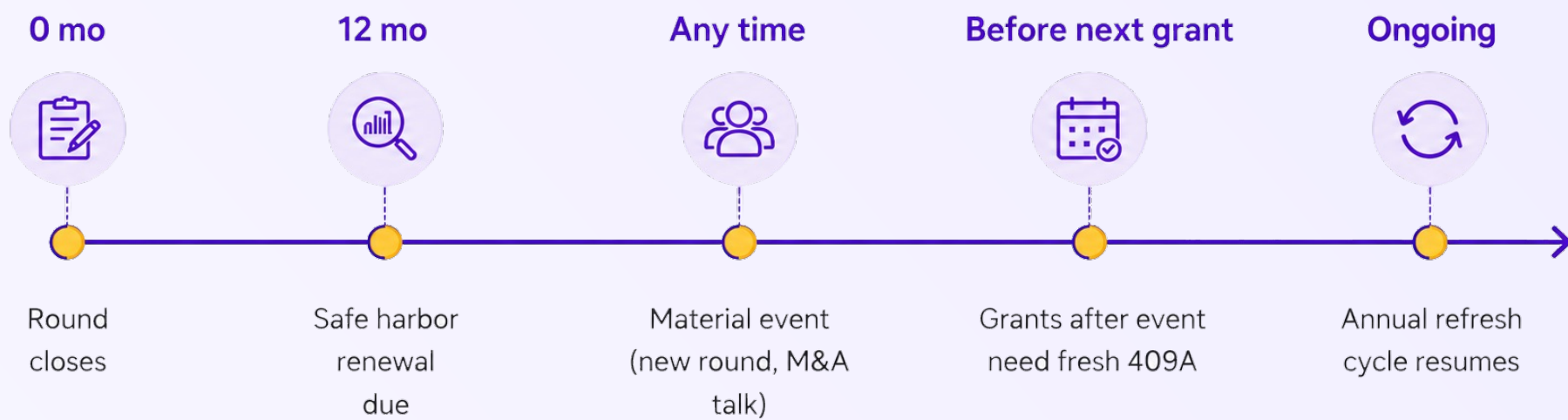
The Board

Bears governance risk directors who approved grants without a current valuation can face scrutiny for failing a basic compliance duty.

TIMING & TRIGGERS

Two Clocks, Running at Different Speeds

A VC valuation is a single point in time, set at a term sheet's signature. A 409A valuation is a rolling clock that must stay current and the trigger that resets it is rarely the one founders expect.



The 12-Month Rule

Safe harbor from a valuation expires automatically after 12 months, even if nothing else about the company has changed. Grants issued on an expired valuation lose safe harbor protection immediately, regardless of how conservative the original number was.

Best practice: calendar the renewal 60 days before expiry, not on the expiry date itself, to leave time for the appraiser's full turnaround.

The Material Event Rule

This is the one that catches teams off guard: a new financing round, an acquisition offer, or a significant swing in revenue can void safe harbor immediately regardless of how recently the last 409A was completed.

Best practice: loop your 409A provider in the moment a term sheet is signed, not after the round closes, so the refresh is ready before the first post-round grant.

Who Owns This Calendar?

Finance / CFO

Owns the refresh calendar and material-event monitoring; the single point of accountability.

General Counsel

Flags material events from a legal read of new agreements like term sheets, LOIs, board consents.

409A Provider

Executes the refresh within the safe-harbor window once notified of a trigger.

People / HR

Freezes new equity grants until the finance team confirms the refreshed valuation is in hand.

“The 12-month rule is the clock you can plan around. The material-event rule is the one that actually catches people.”

A Sample Annual Refresh Calendar

Quarter	Finance & Legal Action
Q1	Confirm safe-harbor expiry date; notify 409A provider if renewal falls this year
Q2	Review cap table for any undocumented material events from the prior two quarters
Q3	If a round is in progress, loop in the 409A provider ahead of the anticipated close
Q4	Complete the annual refresh if no material event has already triggered one earlier

MYTHBUSTING

Seven Things Founders Get Wrong



MYTH

“Our 409A should match what investors just paid.”

TRUTH

Preferred and common are different instruments with different rights, a 25–60% gap is expected, not a red flag.



MYTH

“A cheaper 409A provider means a weaker report.”

TRUTH

Price doesn't determine safe harbor eligibility, a qualified appraiser's signature does, at any price point from \$499 up.



MYTH

“We can reuse last year's 409A after this round.”

TRUTH

A new financing round is a material event that voids safe harbor immediately, independent of the 12-month clock.



**MYTH**

"VC valuation is the 'real' value of the company."

TRUTH

It's the price for preferred shares under specific negotiated terms, not a blanket valuation of the whole cap table.

**MYTH**

"A lower common-to-preferred ratio means we're struggling."

TRUTH

It's usually a function of stage and preference stack thickness, not company health always read it in context.

**MYTH**

"The 409A only matters for accounting purposes."

TRUTH

It sets the legal minimum strike price for every option grant. Get it wrong and the tax exposure lands on employees personally.

**MYTH**

"Once we're profitable, the gap should close."

TRUTH

Profitability helps, but the gap is driven primarily by the preference stack and time-to-liquidity, not top-line performance alone.



Still Not Sure Which Number Applies?

- If the conversation is with an investor, a board member, or the market, use the VC valuation.
- If the conversation is about an option grant, a strike price, or anything the IRS might ask about, use the 409A.
- If you genuinely don't know which one applies, that's the signal to ask your finance lead or 409A provider before quoting either number externally.

"Most of these myths survive because the two numbers sound like they should agree. They were never trying to."

WORKED EXAMPLE

Same Company, Two Numbers: Northstar Robotics

Illustrative Series A close, for teaching purposes only — not a real company.

THE VC VALUATION

\$50M

post-money valuation, Series A

- \$12M raised for 24% of the company
- 1x non-participating liquidation preference
- Preferred share price: \$4.35 / share
- Priced on comparable ARR multiples plus team strength
- 15% option pool refresh negotiated pre-money

THE 409A VALUATION

\$1.52

common stock fair market value per share

- OPM backsolve off the \$50M enterprise value
- Preference stack plus option pool allocated first
- 35% DLOM applied for illiquidity
- Ratio to preferred price: 35% inside the Series A benchmark band
- Signed by a qualified independent appraiser; safe-harbor eligible

A Second Scenario: The Bridge Round

Six months later, Northstar raises a \$4M insider-led bridge at a flat \$50M cap, but with a 1.5x participating preference to compensate investors for the flat price. The VC-facing headline number hasn't moved but the 409A backsolve tells a different story.

	BEFORE BRIDGE	AFTER BRIDGE
Headline VC valuation	Ratio to preferred price	\$50M (unchanged)
Liquidation preference stack	Ratio to preferred price	+1.5x participating \$6M
Common stock FMV / share	\$1.52	\$1.14 (-25%)
Ratio to preferred price	35%	26%

“The headline number told investors nothing changed. The 409A told the real story: the preference stack got 25% more expensive for common stock.”

How Northstar's CFO Explained It to the Board

Rather than let the lower post-bridge FMV read as a surprise, Northstar's CFO circulated a short pre-read before the board meeting: the headline valuation was unchanged, the new participating preference was the sole driver of the lower common stock price, and the ratio remained defensible within the Series A benchmark band. No board member raised it as a concern in the meeting itself because there was nothing left to explain reactively.

DECISION FRAMEWORK

A Coordination Checklist for Finance Teams



Calendar Both Clocks Together

Track the 409A's 12-month expiry and every material event on the same calendar as your fundraising timeline not two separate systems.



Loop In Your 409A Provider Pre-Close

Give your appraiser visibility into a round in progress so the refreshed valuation is ready the moment the round closes.



Brief the Board on the Gap, Proactively

A board that understands why the 409A is lower than the round price won't mistake it for a governance problem.



Model the Full Preference Stack

Before your next round, model how a new liquidation preference layer will compress the residual value available to common stock.



Separate the Narratives

Use the VC valuation to talk to investors. Use the 409A only for option pricing and IRS compliance never blend the two.



Freeze Grants in the Gap Window

Avoid issuing new option grants between a funding close and the delivery of the refreshed 409A report.



Document Every Judgment Call

When something arguably isn't a material event, write down why, that memo protects you if a later reviewer disagrees.



Review the Ratio in Context Every Cycle

Compare your common-to-preferred ratio against the current-stage benchmark each refresh cycle.

Red Flags That Signal You're Overdue for a Refresh

- It's been close to 12 months since your last valuation, or you can't immediately recall the exact expiry date
- You've closed a round, taken a bridge, or had serious M&A conversations since the last report was signed
- New hires are waiting on option grants and no one has confirmed the current 409A is still within its safe-harbor window
- Your common-to-preferred ratio hasn't been checked against the current-stage benchmark in over a year

The One-Sentence Version

"If you only remember one thing: never let a funding round close without your 409A provider already in the loop."

WHERE QAPITA FITS

One Platform, Both Clocks in Sync

Qapita's cap table sits at the center of both valuations, it's the single source of truth an appraiser needs for the 409A backsolve, and the same data room investors diligence before a term sheet. Coordinating both from one platform closes the gap-window risk described earlier in this guide.

What This Looks Like in Practice



Live, audit-ready cap table across every SAFE, note, and preferred series the exact source data an appraiser needs for the OPM backsolve.



Automated 409A refresh alerts tied to material-event triggers, so both clocks are tracked in one place.



Waterfall modeling to see preference-stack impact on common stock before you sign a term sheet, not after.



Coordination workflows with valuation providers so grants are never issued in a gap window.

160+ countries. One cap table.

- Multi-jurisdiction tax and compliance built in (Tapestry)
- Configurable investor dashboards for real-time diligence
- Form 3921 and advanced reporting out of the box
- White-glove onboarding from your existing cap table
- Transparent in-house 409A valuations from certified CFAs

The tool that answers “what does my cap table say” shouldn't be different from the one that answers “what's the fair market value.”

How Coordination Works, Step by Step

1

Cap table stays current by default

Every SAFE, note, and preferred series is entered as it closes, so the data an appraiser needs is always ready — no year-end scramble to reconstruct history.

2

Material events trigger a flag automatically

The moment a new round, conversion, or major cap table change is logged, Qapita surfaces it as a candidate material event for the finance team to review.

3

The 409A provider gets a clean handoff

Instead of a manual data pull, we work from the same live source investors diligence cutting the typical turnaround time.

See Your *Valuation Gap, Modeled Live*

Bring your cap table. Leave with a clear picture of your preference stack, your likely 409A report, and where the next round could move it.

[Book a Demo](#)

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