Tax implications for restricted stock

Restricted stock and restricted stock units (RSUs) are key parts of an employee's overall compensation, and as such, there are tax implications to plan for.

With restricted stock, you typically pay tax when you have satisfied the vesting requirements and are certain to receive the stock (i.e., no risk of forfeiture). With RSUs, you pay tax when the shares are delivered to you, which usually occurs at vesting (though some plans allow you to defer share delivery).

Taxes are due when your restricted stock shares vest.

How shares are taxed

The market value of the shares at vesting is taxable and, as compensation income, it's subject to federal and employment tax (Social Security and Medicare), any state and local taxes, and mandatory supplemental wage withholding. Withholding taxes (which will appear on your Form W-2) include:

- Federal income tax at the flat supplemental wage rate, unless your company uses your W-4 rate.
- Social Security (up to the yearly maximum) and Medicare.
- State and local taxes, when applicable.

Snapshot

- Restricted stock and RSUs are two ways your company can grant you shares.

Why it matters

- Both restricted stock and RSUs have tax considerations.
- Taxation is typically tied to when your shares vest.

Keep in mind

- Your company can choose to link vesting schedules to various types of performance.
- Talk to your tax professional about the tax consequences of your restricted stock and RSU grants.

Talk to an Advisor

UBS Financial Advisors understand the details of your equity compensation awards program. If you have specific questions or want to learn more about how to make your equity awards part of a complete financial plan, contact them through the Financial Advisor section of your UBS One Source home page.

Your company may offer you different ways to pay the taxes, such as:

- Surrender shares to your company and take the amount from the newly vested shares. This holds or tenders shares to cover the taxes, and company cash is used for the payroll tax deposit. (Some companies automatically do this at vesting without offering a choice, particularly for RSUs.)
- Sell-to-cover for taxes on a portion of the shares.
- Through deduction from your salary, either in one lump sum or over certain pay periods.
- Payment by check on the vesting date or within a specified period after vesting.
- Swapping already-owned company stock. (Few companies allow this method.)

Your company must withhold taxes at vesting, though it may offer you a few different ways to pay them.

When you later sell the shares, you pay capital gains tax on any appreciation over the market price of the shares on the vesting date.

Taxation for non-U.S. employees
For employees in other countries, taxation timing can differ. Income and Social Security taxes are usually based on the value of the shares at vesting for RSUs and sometimes at grant for regular restricted stock. Capital gains tax applies to the eventual sale of your shares.

Tax example
Here's an example of the entire life cycle of a restricted stock grant and the tax consequences:*

- You receive 4,000 shares of restricted stock that vest at a rate of 25% a year, and the market price at grant is $18.
- The stock price at year one is $20 (1,000 x $20 = $20,000 of ordinary income); at year two, $25 ($25,000); at year three, $30 ($30,000); and at year four, $33 ($33,000). The total is $108,000, each increment of which is taxable on its vesting date.
- You sell all the stock two years after the last shares vest, when the price is $50 ($200,000 for the 4,000 shares). Your capital gain is $92,000 ($200,000 minus $108,000), which you report on your tax return on Form 8949 and Schedule D.
- If you hold the shares for more than one year after share delivery, the sales proceeds will be taxed at the long-term capital gains rate.

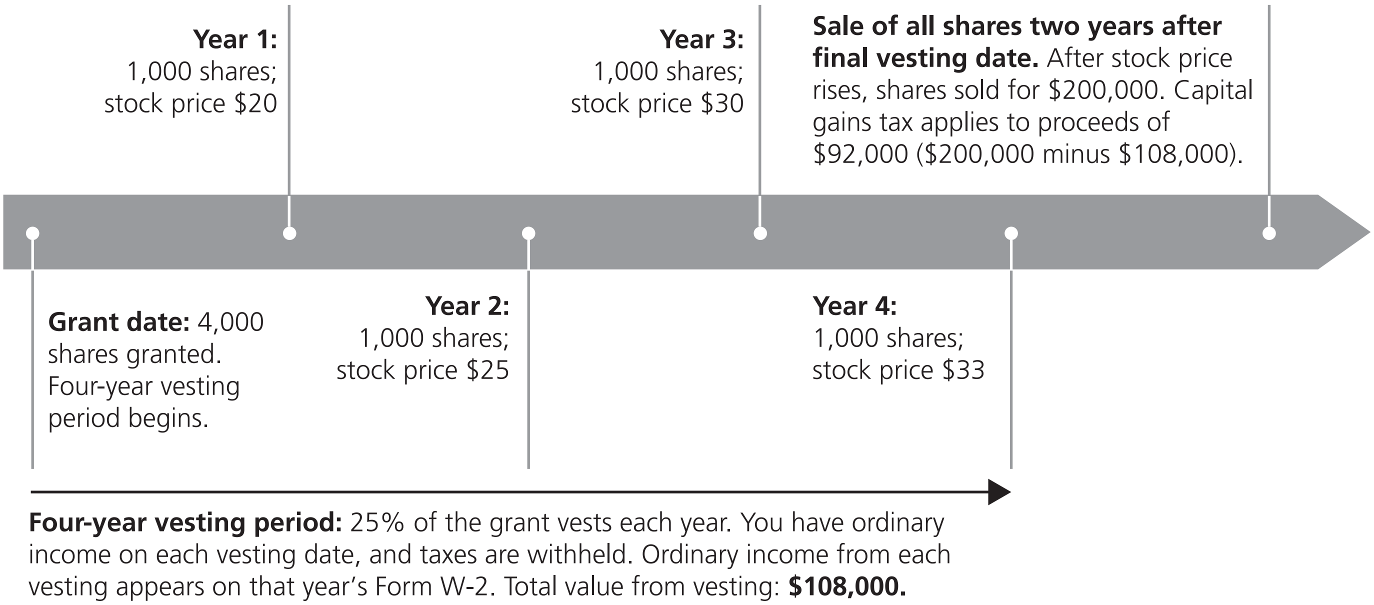
*Please refer timeline chart on next page.

The section 83(b) election
With restricted stock (but not RSUs), you can make a Section 83(b) election with the IRS during the 30 days after the grant date. With an 83(b) election, you pay taxes on the value of the stock at grant instead of vesting. This carries risks, as you cannot recover the taxes you paid if you later forfeit the grant by, for example, leaving your job before the vesting date. However, the 83(b) election can be a good bet if you are confident you will meet the vesting requirement and if you have good reason to believe the stock price will be significantly higher on the vesting date than it is on the grant date—which means you'll pay less tax at grant. Also, moving the time of taxation to the grant date starts the capital gains holding period earlier, which can make a difference at the eventual sale of your shares.

Section 83(b) election example
Using the data from the previous example, let's say you make a timely 83(b) election at grant.

- At that point, you have ordinary income of $72,000 (4,000 x $18) and, when you later sell, a capital gain of $128,000 ($200,000 minus $72,000).
- In contrast to the earlier example, this type of election allows you to convert $36,000 of ordinary income to the lower-taxed capital gains ($128,000 = $92,000 of capital gain in the prior example plus $36,000 that was ordinary income without the 83(b) election).

Timeline: sample key dates for restricted stock and RSUs*



*For restricted stock, this example assumes no Section 83(b) election to be taxed at grant. (The election is unavailable for RSUs.)

With RSUs, you cannot make the Section 83(b) election, but some RSU plans have a tax-deferral feature that allows you to delay delivery of the shares until a specific point in the future (e.g., retirement) or some other time you choose.

Know your company's vesting practice so you can plan for the taxation implications.

Tied to performance goals?
A company can grant restricted stock and RSUs so they vest not according to length of employment after the grant date, but after the achievement of stated performance goals—such as total shareholder return or earnings per share—during the stipulated performance period. While technical differences exist, these restricted stock/RSU grant types are functionally very similar to grants of performance shares or units and, in fact, companies often blur the line between the grant types.

These grants can have highly customized goals, and are sometimes based on internal milestones in product development and sales. For example, the vesting of restricted stock at a pharmaceutical company may accelerate upon the achievement of goals linked to market approval for a new drug or the start of clinical trials for another drug.

Since vesting is linked with taxation, it's a good idea to determine if the performance goal practice is in place at your company for your shares.

Further reading
If you found this article helpful, the Knowledge Center on your UBS one Source website includes many other resources to help you understand your equity awards. For more details specifically on restricted stock and RSUs, see the articles in the "Awards plain and simple" section of the site.

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