RESTRICTED STOCK UNITS

Restricted Stock Units (RSUs) are an unsecured promise by an employer to grant a set number of shares of stock to an employee upon the completion of the vesting schedule. These grants are valued in terms of company stock even though stock is not issued at the time of the grant. Once the recipient has satisfied the vesting period, the company distributes shares or the cash equivalent value of those shares. Depending on plan rules, the participant may be allowed to choose whether to settle in stock or cash. RSUs are gaining popularity among employers as an alternate form of compensation to its employees.

HOW THEY WORK

When an employer grants an employee restricted stock units, the employee must decide whether to accept or decline the grant. If the employee accepts the grant, he or she may be required to pay the employer a purchase price for the grant. The employee must wait until the grant vests and at that point, the employee will receive shares of company stock or the cash equivalent (depending on the company's plan rules).

Once RSUs vest, the employee's rights become non-forfeitable and he or she will receive an amount based on the plan's distribution schedule. In the event the employee had not elected to defer distribution, the distribution date and the vesting date are the same.

At the time of vesting, there is typically two ways an employee can use to pay for grants to meet the tax withholding amounts:

Cashless Exercise
With this option, a certain number of shares is withheld at the time of vesting to cover the estimated tax liability. The employee keeps the remaining number of shares.

Pay Cash
In this case, the employee pays for the vested shares with cash from an outside account. The employee retains all the shares.

If an employee leaves the company prior to the vesting period being satisfied, he or she may forfeit the economic interest in the plan.

INCOME TAX TREATMENT

An employee receiving RSUs is not taxed at the time of the grant. Instead, the employee is taxed when the grant is vested, unless the employee chooses to defer receipt of the cash or shares. If deferred, the employee must pay statutory minimum taxes as determined by their employer at vesting. The amount

of income subject to tax is the difference between the fair market value of the grant at the time of vesting or distribution, minus the amount paid by the employee.

For grants that pay in actual shares, the employee's tax holding period begins at the time of actual distribution, and the employee's tax basis is equal to the amount paid by the employee plus the amount included as ordinary compensation income. With RSUs, there is no capital gains treatment upon exercise so employees are taxed as ordinary income rates on the amount received on the vesting date, based on the market value of the stock.

It is important to note the Section 83(b) election is not available for recipients of RSUs as this only applies to tangible property, and no actual property is awarded at the time of grant.

COST BASIS

For grants that pay in shares, the employee's tax holding period begins once the distribution is made. As a result, the employee's cost basis is equal to the amount paid for the stock plus the amount shown as ordinary income. When the employee sells those shares, they will subject to reporting any capital gains or losses.

BENEFITS TO THE EMPLOYEES

- Automatic share withholding (or "surrender") for the taxes at vesting can be easier because no shares were issued and there are no transfer-agent records to be changed.
- Some plans may allow for an employee to defer acceptance of the shares, which results in have more control of one's tax liability.
- If the grant has a provision that accelerates vesting at retirement, the employee is not subject to ordinary income when he or she is eligible to retire but is still working.

WHY COMPANIES ARE FAVORING RSUs

In addition to reducing their administrative costs, here are other reasons why several employers have decided to provide this form of compensation to their employees:

- When vesting is performance-based, no shares are issued up front and they can be canceled if an employee's performance-vesting goal is not satisfied.
- For employees working overseas, these prevent hassles in areas where restricted stock is taxed at grant and the taxation may not be delayed until vesting.

This material is for informational purposes only. The information expressed in this document is as of the date of its publication and is subject to change. Please contact your financial advisor regarding the application of these issues to your business and individual circumstances.

Clarity WEALTH ADVISORS

WWW.CLARITYWEALTHADVISORS.COM