

# Money Matters

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## Skloff Financial Group Question of the Month: Employee Restricted Stock Units

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**Q:** We read the article ‘Employee Incentive Stock Options – Use Them or Lose Them’ and ‘Employee Nonqualified Stock Options – Use Them or Lose Them’. Our employer has awarded us restricted stock units. When do we own them and what are the tax ramifications?

**A:** **The Problem.** Many employers award restricted stock units to attract and retain employees. Unfortunately, many employees do not truly understand the mechanics of restricted stock units, their tax ramifications and how their terms can change.

**The Solution – Restricted Stock Units.** Employers can grant employees restricted stock units (RSUs). If utilized correctly, RSUs can benefit both the employers and employees. Key to utilizing them in the right manner is understanding their key characteristics, described below.

**Grant Agreement.** This agreement defines the number and vesting schedule of your restricted stock units.

**Grant Date.** This is the day you are issued (granted) the restricted stock units.

**Vesting Schedule.** The grant is “restricted” since you do not own the shares until they vest. Vesting is when you own the shares. Vesting schedules can be based on a period of time, over multiple periods of time, and/or performance, but generally require you remain employed with the company. For example, your vesting schedule may be 20% per year for five years. As another example, your vesting schedule may be 100% at the end of four years. The latter is often referred to as “cliff” vesting. Vesting is valuable to employers, as it creates an incentive to attract and retain employees. Vesting is valuable to employees, as provides a clear path to receiving additional compensation at set points in time.

**Taxes.** You generally do not owe taxes when you are granted RSUs. You owe taxes when your RSUs vest and are delivered to you. You are generally subject to federal and (if applicable) state and local income taxes, Social Security taxes and Medicare taxes. Some companies allow you to surrender back some of the vested shares back to company to pay the taxes. Importantly, you do not have voting rights or receive dividends on unvested RSUs.

**RSUs Examples.** On June 1, 2016, when the stock price is \$10 per share, you receive 100 RSUs that vest on June 1, 2019. On June 1, 2019 (three years later), you receive 100 shares when the stock price is \$15 per share. Your \$1,500 ( $\$15 \times 100$  shares) of compensation is taxed as income, subject to the 10%, 12%, 22%, 24%, 32% 35% or 37% federal income tax rate based on your total income, plus (if applicable) state and local income taxes, plus Social Security and Medicare taxes. On July 2, 2020, you sell your 100 shares for \$18 per share – or a total of \$1,800. Your profit of \$300 [ $(\$18 - \$15) \times 100$ ] is a long term capital gain because you owned the shares for 366 days or longer, subjecting it to the 0%, 15% or 20% capital gains tax rate and (if applicable) an additional 3.8% Net Investment Income Tax based on your modified adjusted gross income instead of the 37% maximum income tax rate (sorry I.R.S.).

On June 1, 2016, when the stock price is \$10 per share, you receive 100 RSUs that vest on June 1, 2020. On June 1, 2020 (four years later), you receive 100 shares when the stock price is \$18 per share. Your \$1,800 ( $\$18 \times 100$  shares) of compensation is taxed as income, subject to the 10%, 12%, 22%, 24%, 32% 35% or 37% federal income tax rate based on your total income, plus (if applicable) state and local income taxes, plus Social Security and Medicare taxes. On December 2, 2020, you sell your 100 shares for \$20 per share – or a total of \$2,000. Your profit of \$200 [ $(\$20 - \$18) \times 100$ ] is a short term capital gain because you owned the shares for less than 366 days, subject to your income tax rate (making the I.R.S. happy).

**Often Overlooked.** Many restricted stock unit plans have clear language defining your rights upon termination from the company. For example, upon termination (other than by reason of death or disability) RSUs are forfeited. RSUs have value even if the stock price is below the per share grant date. A job transitions can be emotional time when you may overlook a material part of your wealth – your employee restricted stock units. So, understand your ‘options’ on your RSUs.

### Action Step – Understand Your Restricted Stock Units

Work closely with a Registered Investment Adviser (RIA) to make the best financial decisions with your employee restricted stock units.

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