The Taxation of Restricted Stock Units

Is your employer awarding you restricted stock units (RSUs)? RSUs differ from other long-term incentives in both form and taxation. Here we will discuss some of the important details that are unique to RSUs.

What are RSUs and How Do They Work?

RSUs are a form of compensation paid to key employees based on job performance and loyalty. They are not yet shares of stock; rather potential shares conditionally promised by your employer. The promise is this: at some point in the future the company will deliver one share of stock to you for every RSU awarded. The vesting of RSUs and remittance of shares usually occurs in phases over two to five years.

RSUs vs Stock Options: Understanding the Difference

With RSUs, you don't have to buy the shares, but you also don't own them until the company delivers the stock. In contrast, stock options are contracts that let employees buy company shares at a set price within a set timeframe. Naturally, this fundamental difference translates to how RSUs and stock options are taxed to the recipient.

Taxation of RSUs: What You Need to Know

RSUs are considered a form of compensation and are included in your taxable income when they vest. Because RSU income is considered supplemental, the withholding rate can vary between 22% and 37%. Usually, your employer will liquidate a percentage of the shares to cover the withholding requirement. In addition to federal income tax, RSU income may be subject to state and local income taxes.

After RSUs Vest: Tax Implications and Strategies

Once your RSUs vest, they are treated like normal shares of stock. Your tax basis in the shares will be their market value when they vest – the same amount that was previously taxed as income. When you sell the shares, the resulting gain or loss will be included in your tax filing as a capital gain. To qualify for preferential long-term capital gains treatment (max of 20%), the shares must be held for one year following the vesting date. Otherwise, the capital gain will be short-term and taxed at your ordinary income rate in the year sold.

Incorporating RSUs into Your Financial Plan

RSUs can make up a substantial portion of your total compensation. There are many considerations when including them in your overall financial plans, and their taxation is only one. It is critical to work with a financial planning professional to ensure your RSU and other long-term incentives are properly integrated into your financial plan.

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