



Best Practices for RSUs: Rewards Simplified & Understood

Jennifer Namazi, CEP, Stock & Option Solutions, Inc.
Emily Cervino, CEP, CEPI

Disclaimer

The following discussion and examples do not necessarily represent the official views of **Stock & Option Solutions, Inc. or the CEPI** with respect to any of the issues addressed. Moreover, this presentation and the views expressed by the individual presenters should not be relied on as legal, accounting, auditing, or tax advice. The outcome of any individual situation depends on the specific facts and circumstances in which the issue arises and on the interpretation of the relevant literature in effect at the time.

Anyone viewing this presentation should not act upon this information without seeking professional counsel and/or input from their advisors. Transmission of the information is not intended to create, and receipt does not constitute, an attorney-client relationship.

Materials

Available for download:

- <http://www.sos-team.com/PDFS/rsu.pdf>

Please note: URL is case-sensitive.

3



Agenda

QUICK Review of Restricted Stock Units

Best Practices

- Manage Vest Dates
- Vest During Blackout
- Fungible Share Pools
- Retirement Eligibility
- Tax Payment Methods
- Timely Payroll Deposits
- Dividend Equivalents
- Underwater RSUs?
- Depositing Shares



4



Review: Restricted Stock Units

	Restricted Stock / Restricted Stock Award (RSA)	Restricted Stock Unit (RSU)
What is it?	<u>Stock issued</u> to participant, disposition restricted until vest	<u>Promise</u> to participant to deliver stock at vest or delivery date
Cost?	Par Value Or \$0	\$0
Issuance of shares	At grant	At release/ delivery
Voting rights	Yes*	No
Dividend rights	Yes*	Sometimes (Dividend equivalents)

*In some cases may not be included, if written into agreements and participant consent acquired.

5



Review: Types of Restricted Stock

	Performance Shares (PSA or PSU)	Phantom Stock (aka Cash-settled RSUs)
What is it?	RSAs or RSUs with vesting subject to performance conditions (performance- or market-based conditions)	<ul style="list-style-type: none"> • RSUs, but settled in cash upon vesting (vs. stock) • Generally not counted against plan balances • Negative accounting consequences (liability treatment)

6



Review: US Taxation of Restricted Stock Units

	RSA	RSU
§83(b) Election	Yes	No
Income Taxation Event	Vest	Release, can be deferred
FICA Taxation Event	Vest	Vest
Deferrals Permissible	No	Yes, if plan/ agreement allows
Subject to §409A?	No	Yes

7



Review: Dividend Equivalents Taxation Summary

Form/ Timing	At Payable Date (Current)	When Underlying Stock is Paid Out (Deferred)
Cash	<ul style="list-style-type: none"> • “Cash Dividends” • Taxed as ordinary income when paid • W-2 /1099–MISC Reportable 	<ul style="list-style-type: none"> • No standard terminology • Taxed as ordinary income when paid • W-2 /1099 –MISC Reportable • Subject to 409A
Shares		<ul style="list-style-type: none"> • “Dividend Reinvestment” • Taxed as ordinary income when paid • W-2 /1099 –MISC Reportable • Subject to 409A

8



Problem: Frequent Vesting/Releases

Problem

- Frequent vesting/releases
 - Caused by:
 - Vest Date = Hire Date
 - Irregular Approval Dates
- Too many vest dates each month
- Many releases, many DWACs, more fees, more admin work, more reconciliation
- Especially “taxing” to have multiple international releases every month - tax rates difficult to obtain



9

 Stock & Option Solutions

Polling Question

How many vestings/releases does your company have each quarter?

- a. 1
- b. 2-4
- c. 5 – 15
- d. More than 15
- e. Not applicable

10

 Stock & Option Solutions

Problem: Frequent Vesting/Releases

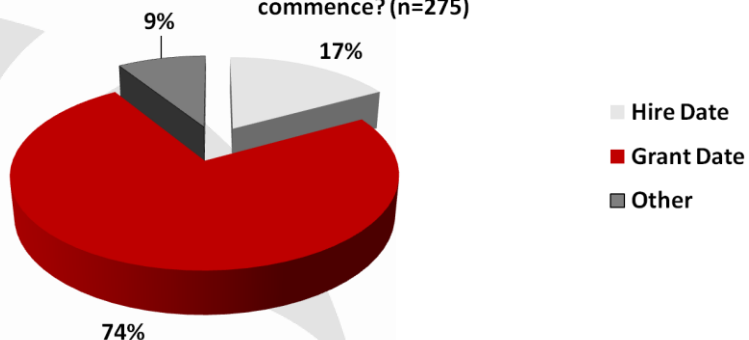
Problem Solved

- Grant / Approval Date = once per month
- OR Release Dates less frequent – Quarterly?
- Allows you to sync up with international locations
 - Ensure all still employed before releasing shares to terminated employees
- But...multiple releases: same participant, same day
 - May violate de minimis rules for rounding
 - Some audit firms / partners assert: > 1 share = not de minimis
 - Consider staggering vestings – still same day, but 3.5 years of vesting and 3.75 years

11

Problem Solved: Frequent Vesting/Releases

For grants to newly hired employees, when does vesting commence? (n=275)



*2007 NASPP/Deloitte Survey Data

12

Problem: Vesting During Blackout

Problem

- Shares to be Sold to Cover Taxes
 - Especially for international
- Participants not allowed to sell during blackout

Problem Solved

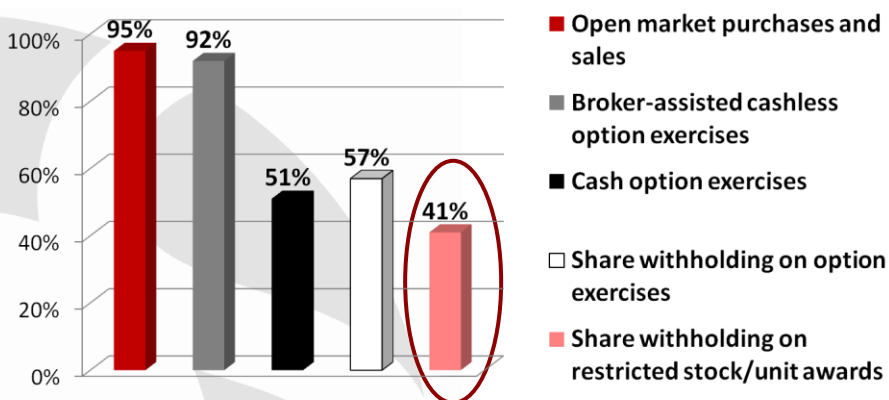
- 10b(5)-1 plan written into grant agreement?
 - May not work since other 10b5-1 plans say "no sales may be made outside this agreement"
- Do not allow sales by those subject to blackout
- Do not allow choice by those subject to blackout
 - **Mandate tax payment election**
- Avoid vesting within blackouts!
 - Fewer vest dates every year

13



Problem: Vesting During Blackout

What transactions are prohibited during blackout periods?
(Check all that apply.) (n=303)



*2007 NASPP/Deloitte Survey Data

14



Problem: Fungible Share Pools

Problem

- Counting shares differently (different ratio) based on type of grant
 - Options: 1 for 1
 - RSU: 2 for 1, 3 for 1, etc.

Problem Solved

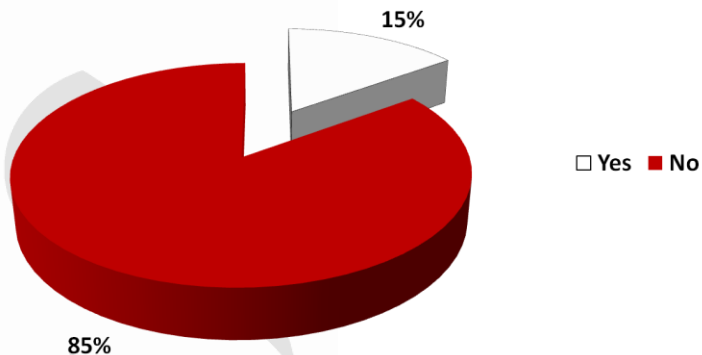
- Softwares / providers beginning to be able to support
 - Upgrade to newer version
- Workarounds
 - Tracking in spreadsheet
 - Workaround:
 - Subplan in admin system– anything granted out of it are 2 for 1
 - At end of every quarter, adjust available balance of parent plan

15



Problem: Fungible Share Pools

Do any of your company's stock plan include a flexible share reserve? (7) (n=393)



*2007 NASPP/Deloitte Survey Data

16



Polling Question

Does your company have any plans that included a “fungible share pool”?

- a. Yes
- b. No
- c. Not applicable

17

Problem: Retirement Eligibility

	RSA	RSU
FICA due at Retirement Eligible Date ¹	Yes	Yes
Income Tax due at Retirement Eligible Date ²	Yes	No



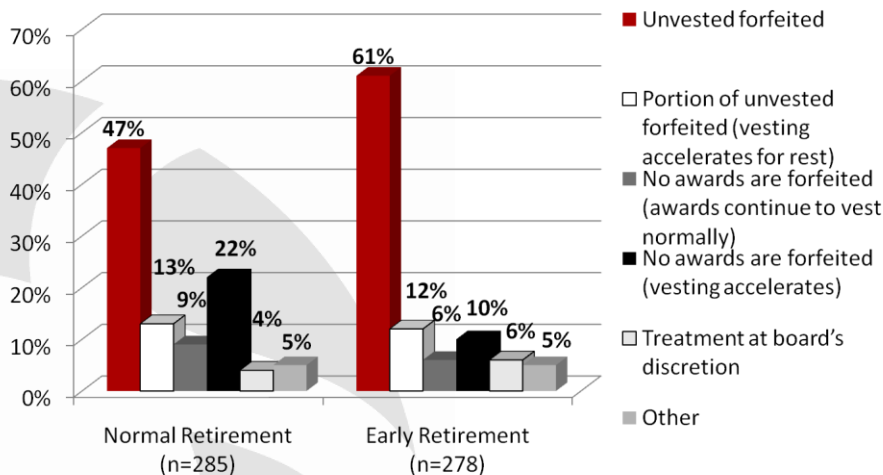
¹ Rule of administrative convenience allows FICA to be collected at any date (after vesting) during the calendar year.

Many companies “deem” FICA collected on 12/31 when often SS limit has already been met.

² Most systems do not support taxation at retirement eligibility.

18

Problem: Retirement Eligibility



*2007 NASPP/Deloitte Survey Data

19

Stock & Option Solutions

Polling Question

What happens to your company's unvested RSUs at retirement?

- Unvested forfeited
- Portion forfeited, rest accelerated
- None forfeited, all accelerated
- None forfeited, vesting continues
- Other
- Not applicable

20

Stock & Option Solutions

Problem: Retirement Eligibility

Problem Solved:

- Forfeit shares at retirement
 - If this is really a “retention vehicle”?
 - But... is acceleration at retirement part of the culture?
- Collect FICA on 12/31
 - Hopefully many have met Social Security cap
 - Only Medicare remains – much lower % to collect
 - Educate employees in advance about liability
 - Collect via payroll deduction?
 - » Last payroll run of the year?

21

 Stock & Option Solutions

Problem: Retirement Eligibility

Problem

- If plan/agreement accelerates (or continues) vesting at retirement
 - Participant “earns” shares once retirement eligible
 - FICA tax event at retirement eligible date OR grant date

Problem Solved?

- Some companies try to avoid with clause in agreement
 - Acceleration / continuation of vesting “at board discretion”
 - Receipt not “guaranteed”?
 - No taxation event at retirement eligible date?
- IRS representatives assert (off the record) they would consider “facts & circumstances”
 - Has anyone ever forfeited?
 - Is it just a “rubber stamp”?



22

 Stock & Option Solutions

Best Practices: Sell-to-Cover Tax Payment Method

Advantages

Provides cash for payment of payroll tax

Avoids issues of over-withholding where flat rate not available

- Very important internationally



Disadvantages

Challenge: estimating shares to sell

Is employee authorization required to sell shares?

- If default method, include in grant agreement?
- Get acceptance!

If vests during closed window, can employee sell?

- Mandate into agreement? No investment choice!

More dilution – more shares released



Best Practices: Withhold-to-Cover Tax Payment Method

Advantages

Employee-friendly

May preserve share pool

Reduces dilution

- Fewer shares released,
- More shares may be returned to plan
- RMG / ISS considerations

Easier to administer

Minimizes involvement of Treasury since no cash transfers from vendor

Disadvantages

Company funds employees' tax

- Plan for cash outlay to IRS
- Forecasts to treasury / payroll
- Special payroll run?

Risk: PR doesn't do special run?

Communications challenging

Perception: liberal share counting?

Accounting implications of rounding

- Over-withholding?
- IFRS



Problem: Timely Payroll Deposit

Problem

- Next-day deposit when cumulative amount exceeds \$100,000
- March 14, 2003 Field Directive
 - Guidance regarding deposits of employment tax relating ONLY to exercise of nonqualified stock options
 - Some may argue can be applied to any transaction with a settlement (sell-to-cover, etc.)
 - Others will argue only NQ options, same-day sale



Problem Solved

- Limit of number of releases, work with payroll to do special payroll run
- Estimate amount, remit based on estimate

25

Stock & Option Solutions

Polling Question

Do you feel that your company is generally in compliance with the IRS requirements for timely payroll deposits (around RSUs)?

- Yes
- Mostly
- No
- Not applicable

26

Stock & Option Solutions

Problem: Dividend Equivalents

Problem

- Administratively challenging
- Two-class method EPS for cash
- Negative perception if underlying shares forfeited?

Problem Solved

- Don't pay them!
- If you must pay them (and why must you?):
 - Cash are easiest to administer, but frowned upon if underlying shares/units are forfeited
 - Expense must be reclassified to comp expense on forfeiture if originally booked to retained expense
 - Beware equivalents on vested & deferred RSUs (FICA due at dividend date!)

27

 Stock & Option Solutions

Problem: RSU Cash Dividend Equivalents: International Treatment

Problem

- Beware of paying cash dividends on unvested RSUs
 - Can trigger taxation at grant treatment in some jurisdictions

Problem Solved

- Don't pay cash dividend equivalents on RSUs
- Don't pay cash dividend equivalents on RSUs to international participants
- Do dividend reinvestment instead of cash dividends (though will make them subject to 409A)

28

 Stock & Option Solutions

Problem: Underwater RSUs

Problem

- Employee paid “bonus” of \$10,000 in RSUs when stock price = \$10
- One year later, when first (of four) tranches vests, stock price = \$6
- Employee's bonus is now worth \$6,000 – only \$1,500 of which is vested
- Could create legal issues? “Promise” unfulfilled?

Problem Solved

- Consider avoiding assigning a \$ value at the time of grant – keep discussion in terms of shares
- Educate employees on the “always in the money” nature of RSUs vs. options

29

 Stock & Option Solutions

Polling Question

Do you communicate RSU grants to participants in terms of dollar values at the time of grant?

- No, we use share amounts only
- Yes, we use share amounts and dollar amounts
- Yes, we use dollar amounts only
- Not applicable

30

 Stock & Option Solutions

Problem: Depositing Shares

Problem:

- Participant fails to “activate” brokerage account OR
- W-8 Ben expires, account “suspended”
- Shares can’t be deposited at vest/release!



Problem Solved:

- **Communicate, communicate, communicate!**
- Consider language to allow cancel if shares can’t be deposited
 - At least one company deemed this “too risky” ...
- Work with your vendor
 - Not all require account activation / suspend accounts w/ expired W-8Ben
- Consider *options instead* for some populations – there if/when they want to deal with it OR expire unexercised...

Contact Information



Jennifer Namazi, CEP
 Manager, People Solutions
 6399 San Ignacio Avenue, Suite 100
 San Jose, CA 95119 USA
 Bus: (408) 754-4644
 E-mail: jnamazi@sos-team.com
www.sos-team.com



Emily Cervino, CEP
 Director
 500 El Camino Real
 Santa Clara, CA 95053 USA
 Bus: (408) 551-1833
 E-mail: ecervino@scu.edu
www.scu.edu/business/cepi/