



Performance Shares: Taxes & Communications

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Taxes: core principles

- Similar to taxes on restricted stock/RSUs: performance shares do not result in any taxable income at grant.
- Ordinary income when specified targets are reached *and* shares (or cash) are then either released or delivered. Depending on the structure of the grant, this may be in the tax year (e.g., in the first quarter) *after* the end of the performance period.
- Compensation amount is the fair market value (FMV) of the stock at vesting or payout multiplied by the number of shares received.
- Reported on W-2. Standard supplemental income withholding of 25% (35% for amounts over \$1 million).
- Share surrender/net share settlement. IRS tax deposit rules.
- Capital gains income for amount over W-2 income (tax basis).
- The tax reporting for performance share units is identical when the shares are delivered at vesting.



Example of individual tax return reporting

Example: 2,000 shares of performance stock that vested on August 12 (company has June 30 year-end), when the company certified that it reached specified targets and the shares were released. The market price was \$35 per share (\$70,000 total). More than one year later, the stock is sold at \$40 per share, minus commissions and fees of \$500 (\$79,500 net sales proceeds). Tax basis (value at vesting) is \$70,000 (*NOT \$0, though employees may think so because \$0 was paid for the stock*), and **Schedule D** shows a long-term capital gain of \$9,500 (\$79,500 – \$70,000).

EXAMPLE: Performance shares: hold at vesting/sell after 12 months

SCHEDULE D (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Capital Gains and Losses

▶ Attach to Form 1040 or Form 1040NR. ▶ See Instructions for Schedule D (Form 1040).
▶ Use Schedule D-1 to list additional transactions for lines 1 and 8.

OMB No. 1545-0074

2008

Attachment
Sequence No. 12

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-7 of the instructions)	(e) Cost or other basis (see page D-7 of the instructions)	(f) Gain or (loss) Subtract (e) from (d)
8	2,000 sh. comp. stock	8-12-07	10-12-08	\$79,500 00	\$70,000 00	\$9,500 00
9	Enter your long-term totals, if any, from Schedule D-1, line 9					9
10	Total long-term sales price amounts. Add lines 8 and 9 in column (d)					10
11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824					11
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1					12

Number of vested performance shares you are selling

Vesting or payout date

Date stock sold

Value of shares at vesting. This is part of your W-2 income in the year the shares vested for meeting the performance targets.

Gross proceeds on your 1099-B after commissions and fees *

* If commissions and fees are not subtracted from the proceeds on your 1099-B, add them to your cost basis in column (e).

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Schedule D illustrations in Tax Center on public site and in Knowledge Center (licensing clients)

http://www.mystockoptions.com/articles/index.cfm/catid/AB6E12DA-295D-42B9-BA7D1

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- Tax Cuts 2003-2009
- NQSO Basics
- NQSO Withholding
- NQSOs: W-2s & Tax Returns
- ISO Basics
- ISO Withholding
- ISOs: W-2s & Tax Returns
- ESPP Basics
- ESPP Withholding
- ESPPs: W-2s & Tax Returns
- Restricted Stock Basics
- Restricted Stock Withholding
- Restricted Stock: W-2s & Tax Returns
- Section 83(b)
- SARs: W-2s & Tax Returns

Tax Center: Reporting Company Stock Sales **UPDATED!**

- Test your knowledge with our [Taxes](#) quiz.
- Listen to our new [podcast on tax return tips & avoiding reporting mistakes!](#)

FAQ Table of Contents:

- [NQSO Stock](#)
- [ISO Stock](#)
- [Restricted Stock and RSUs](#)
- [SARs Stock](#)
- [ESPP Stock](#)

NQSO Stock

- Schedule D diagram! How are capital gains taxed when I sell my NQSO stock?** [mso+](#)
If you hold stock acquired from the exercise of an NQSO for more than one year, the appreciation is...
- Schedule D diagram! How do I report a sale of nonqualified stock options on my federal income-tax return?** [mso+](#)
You need to complete a Schedule D, Capital Gains and Losses, for the year of the sale of your stock and...
- Schedule D diagram! I did a cashless exercise with my nonqualified stock options last year. Do I need to show the transaction on Schedule D of my Form 1040**



Understand withholding, W-2s, and tax returns.

FEATURED FAQs

- Schedule D diagram! How do I report a sale of performance shares on my federal income-tax return?** [mso+](#)
You need to complete a Schedule D, Capital Gains and Losses, for the year of the sale of your stock and file it with your Form 1040 federal income-tax return. You do this even if you are only...
- Schedule D diagram! How do I report a sale of shares from restricted stock units (RSUs) on my federal** [mso+](#)



Delay after end of performance cycle

- Taxable ordinary income may not occur in the year during which the performance cycle ends.
- How long after the cycle ends does company know whether goal was reached?
- While this delay/period for official measurement is not always explicitly stated in the plan or grant agreement, companies usually require a brief interval.
- Need to determine whether the goal was met *and* then to handle administrative details in the delivery or vesting of shares.
- Look at your plan documents for language related to this delay between the end of the performance cycle and the time of measurement. You may need to add provision in future grants or discuss this timing with individuals receiving grants.



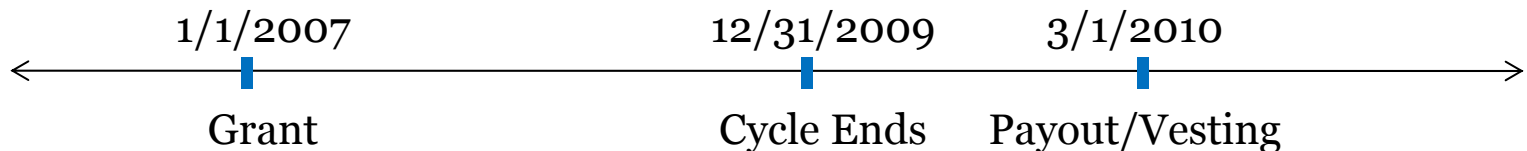
Samples of grant agreement language

- 1: The shares are payable 60 days after the end of the performance period, based on the Compensation Committee's assessment of the extent to which the performance goals were achieved."
- 2: the Units will vest (if at all) on each Vesting Date (as defined below) beginning in the _____ quarter of _____ and ending on the Vesting Date for the _____ quarter of _____ provided some or all of the below performance measures ("Performance Measures") are achieved. For purposes of this Agreement, the term "Vesting Date" means the date the Company files its Form 10-Q or 10-K during each fiscal quarter, subject to the achievement of relevant Performance Measures.



Short-term deferral rule

- Want to avoid tax problems (20% penalty and interest) under the tax code's [Section 409A](#) on deferred compensation. Issues triggered when any difference between the year income is earned and the year it is paid.
- Up to 2 1/2 months after the end of the company's taxable year (usually also end of performance cycle when 12/31), company can deliver shares to fit into this rule.
- An allowable "short-term deferral" up until March 15 to minimize risk of 409A problems.





Exception to short-term deferral end date (going beyond March 15)

- Contend that it does not run until company certifies that goal is reached. Some logic to this, but risk triggering 409A penalties.
- “substantial risk of forfeiture” still applies by adding provision that must be employed through the pay out/vest date
- Unforeseeably became “administratively impractical” for company.
- Grant is subject to the \$1 million deduction limit under Code Section 162(m) (and company did not reasonably anticipate the application of Section 162(m) when the bonus award was originally made)

For more on this topic, see a memo issued by Latham & Watkins

http://www.lathamwatkins.com/upload/pubContent/_pdf/pub2576_1.pdf



Deferral election

- When executive makes proper timely election, the 409A rules allow deferred delivery of the shares and the income until a future year.
- Income for purposes of employment taxes (e.g., Social Security and Medicare) when the shares are considered to have been earned or vested (when amounts “reasonably ascertainable” and not subject for forfeiture), but ordinary income when the shares are delivered in the future.
- Companies can collect and report the FICA taxes once per year for everyone under the rule of administrative convenience. See IRS Announcement 85-113 (on reporting and withholding for taxable noncash fringe benefits). Since shares cannot be sold, need method to collect FICA taxes.



409A deferral election rules

- May see more plans with this feature as top two tax rates go up to 36% and 39.6% in 2011.
- *General rule:* The deferral election for new grants must be made within 30 days of the grant and cannot vest for at least 12 months after the election.

Special election rules for performance-based compensation:

- In general, "performance-based" means compensation that is paid only after you reach established "organizational or individual performance criteria" that are not "substantially certain" to be met when the criteria are made. Must be set within 90 days after the start of your performance period.
- Performance-based compensation can be grants/bonuses that vest/pay out solely from hitting price targets.



409A deferral rules

- Election for performance award must be made no later than six months before the scheduled payout if the work takes place over at least 12 months.
Example: June 30 for award with cycle ending Dec. 31. Might be even full year ahead of time if making election at same time as deferring bonus or salary under NQ deferred comp plan.
- The compensation at the time of the election cannot be "readily ascertainable" (i.e., the amount must be unknown and not yet earned), even when the election is made six or more months before the payout.
- A redeferral election for any scheduled payout needs to be made at least 12 months before that date, and the payout must be deferred for at least five years (can change only an election in 2009 that relates to payments owed in 2010).



Performance shares: communications and education

Issues to explain/participants need to understand:

- Goal(s) that trigger the vesting or payout of the award.
- How many shares will be received if the goal is reached. Target number of shares and any sliding scale that provides a minimum and maximum number of shares to be paid out according to the actual performance relative to the goal.
- What employee/executive can do to reach this goal. **How they can impact reaching the target.**
- Period for measuring whether the goal is reached and the closing date of this period
- Method for monitoring performance towards this goal during the performance period. Any sharing of internal monitoring and accounting.



Performance shares: communications and education

Issues to explain:

- When vesting/share delivery will occur (i.e., how long after end of cycle). Any delay between certification and issue/vesting.
- Whether there is any additional time-based vesting.
- Whether there is any election to defer delivery of the shares.
- The timing and methods for making the deferral.
- What happens if the performance period is cut short for some reason, whether through termination of employment, retirement, death, or acquisition of the company.
- How taxes are withheld and paid.



Test Your Knowledge: Restricted Stock & Restricted Stock Units Quiz

Test your knowledge of restricted stock and restricted stock units. Please answer the following 10 questions. This quiz is also a course of study. The answer key links to content on the topic for follow-up reading.

1. **What is restricted stock?**

- A type of stock option
- The collective term for a grant of stock units
- A grant of company stock you must register with the SEC
- A grant of company stock that you cannot sell until vesting

2. **How long after grant does restricted stock usually expire?**

- It never expires, unless your employment ends before vesting
- 10 years, unless your employment ends before vesting
- 10 years, regardless of whether your employment ends before vesting
- When you retire

3. **What happens to vested restricted stock?**

- 50% of the stock is rolled into another company benefit, usually a 401(k)
- The stock becomes yours to hold or sell after a lockup period of 180 days

**Available on home page:
interactive quiz on
restricted stock, RSUs, and
performance shares, along
with self-study course for
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FEATURED FAQs

Q: **UPDATED!** How long do I have to exercise my vested stock options after my employment ends?

A: The period for exercise depends on both your employer's plan design and the reason for your termination...

Q: **UPDATED!** With restricted stock units, can I defer delivery of the shares at vesting?

A: RSUs that let you delay the delivery of shares at vesting depend...

RECENT QUESTIONS

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Become smarter about employee stock options, ESPPs, restricted stock/RSUs, and SARs. Our Knowledge Center provided by the experts at myStockOptions.com will help you make educated decisions.



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NEW & UPDATED CONTENT

FAQ: UPDATED! [When I file an extension to complete my tax return after April 17, are there any mistakes I should avoid that involve stock grant income?](#) [_mso+](#)

FAQ: UPDATED! [If I exercise NQSOs, will I need to make estimated tax payments?](#) [_mso+](#)

FAQ: UPDATED! [When my restricted stock vests, will I need to make estimated tax payments?](#) [_mso+](#)

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