

Performance Shares: Taxes And Communications

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Tax basics of performance shares

- ▶ Like [restricted stock/RSUs](#), performance shares do not result in taxable income at grant.
- ▶ Ordinary income is recognized 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 flat withholding rate for [supplemental income](#).
- ▶ Share surrender/net share settlement. IRS tax deposit rules.
- ▶ Capital gains income for any 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 tax–return reporting

Example: 2,000 shares of performance stock vested on August 12 (company fiscal year–end June 30), 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.
- ▶ This results in \$79,500 net sales proceeds.
- ▶ Cost basis (value at vesting) is \$70,000 (*NOT \$0, though employees may think so because \$0 was paid for the stock*). Form 8949 and Schedule D show a long–term capital gain of \$9,500 ($\$79,500 - \$70,000$). For the reporting rules, see the [Tax Center](#).

Name(s) shown on return

Social security number or taxpayer identification number

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement will have the same information as Form 1099-B. Either will show what your broker and may even tell you which box to check.

Part II Long-Term. Transactions involving capital assets. For more information on long-term transactions, see page 1.

Note: You may aggregate all long-term transactions to the IRS and for which no adjustment is required under Section 8a; you aren't required to report these transactions.

You must check Box D, E, or F below. Check only one box. If you have more than one transaction, complete a separate Form 8949, page 2, for each applicable box. If you have more than one of the boxes, complete as many forms with the same box checked as you have transactions.

On Form 1099-B*

If basis is in Box 1e (even if basis is incorrect), check **Box D** here.

If no basis or "0" appears in Box 1e, check **Box E** here.

- (D) Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **note** above)
- (E) Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- (F) Long-term transactions not reported to you on Form 1099-B

1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the Note below and see Column (e) in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions.		(h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g)
						(f) Code(s) from instructions	(g) Amount of adjustment	

Company ticker/symbol and number of shares sold from stock received at vesting [Box 1a on Form 1099-B] If shares were withheld for taxes at vesting, exclude those shares from this amount.

Vesting date, or date when shares delivered or paid out [Box 1b on 1099-B] ****

Date stock sold [Box 1c on 1099-B]

Gross proceeds from stock sale [Box 1d on 1099-B]. If commissions and fees were not subtracted from proceeds, see footnote **

Basis in Box 1e of 1099-B is correct

Column (e): Basis in Box 1e of 1099-B
Column (f): I leave blank
Column (g): I leave blank

Basis in Box 1e of 1099-B is too low or blank

If **Box D** is checked:
Column (e): Basis in Box 1e of 1099-B
Column (f): Code B
Column (g): Omitted amount. Put in parentheses to indicate a negative number (as this amount reduces gain or increases loss).

If **Box E** is checked:
Column (e): Correct basis of the sold shares (income on W-2 for the year when the vested shares were delivered for meeting targets).***
Column (f): Leave blank
Column (g): Leave blank



Calculate column totals.
You report these totals on Schedule D.

Delay after end of performance cycle

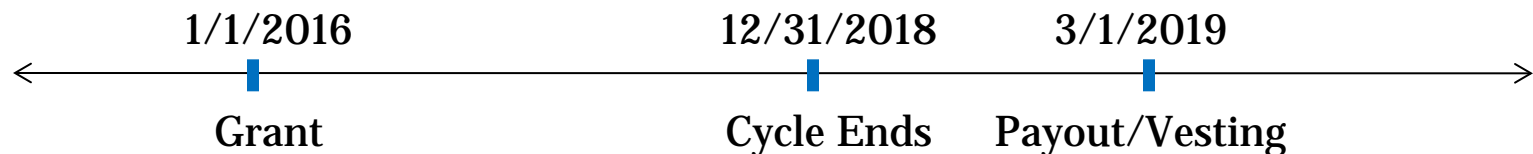
- ▶ Taxable ordinary income may not occur in the year during which the performance cycle ends.
- ▶ How long after the cycle ends does company know whether goal was reached?
- ▶ While this delay/period for official measurement is not always explicitly stated in the plan or grant agreement, companies usually 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 2½ 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)

- ▶ Can you contend that the deferral period ends before company certifies that goal is reached? While there may be some logic to this, it risks 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).

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

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.

Performance shares: communications and education

Issues to explain that 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.



- Restricted Stock
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 - ▶ **Performance Shares**
 - ▶ Taxes
 - ▶ Taxes Advanced
 - ▶ Section 83(b)

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Restricted Stock: Performance Shares

- Test your knowledge with our Restricted Stock & RSUs quiz.
- Listen to our podcast on restricted stock/RSUs, or watch our new videos on key concepts and taxes.

Articles

FAQs

- ▶ **What are the top 10 questions I should ask about my company's performance share plan?**
 You should know the answers to the following questions. Understanding the topics involved will help you make the most of your performance share grant and prevent costly mistakes...
- ▶ **Does this website's content on performance shares also apply to performance share units or performance-vesting RSUs?**
 Companies use various names for the different types of performance-based awards. Generally, this website uses "performance shares" as an umbrella term covering all grants in which the vesting or payout of company shares is contingent on meeting predetermined goals. There are, however, three small differences among the various grant types...
- ▶ **What is the difference between restricted stock and performance shares or units?** [_mso+_](#)
 Shares of restricted stock are issued up front at grant, but you do not own them outright and cannot sell or transfer the shares until the time-based restrictions lapse. With standard restricted stock units the situation is basically similar, while with performance shares your company sets goals that must be met, such as...
- ▶ **How is my performance share grant taxed, and how are taxes withheld?** [_mso+_](#)
 Performance shares do not result in any taxable income to you at grant. You do have ordinary income when the grant vests after specified targets are reached and shares (or cash) are then either delivered or paid out to you. Depending on the structure of the grant...



Test Your Knowledge: Restricted Stock & RSUs Quiz

Test your knowledge of restricted stock and restricted stock units.

Please answer the following 12 questions. This quiz is also a course of study. The answer key links to content on the topic for follow-up reading

**Available on home page:
interactive quiz on
restricted stock, RSUs, and
performance shares, along with
self-study course for CEP and
CFP continuing education credit**

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
- The stock becomes yours to hold, sell, or gift, like any other stock purchased on the open market
- The company requires you to hold it for a set period, usually three years, before selling

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Puzzled By Your Stock Compensation?

See the articles, FAQs, videos, podcasts, and more in the [Basics section](#) of the site. Our resources will help you understand core concepts, including grant terms, vesting, exercise, and taxation.



New and Updated Content

FAQ: [What are the top 10 questions I should ask about my stock grants?](#)

Article: [NEW! Ten Financial-Planning Rules You Must Know About Restricted Stock And RSUs](#)

Article: [VIDEO! Exercise Your Restricted Stock](#)

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