

How Are Restricted Stock Units Taxed?

By: Exchange Capital Management

June 13th, 2023



Uncle Sam always wants his cut, even when it comes to your Restricted Stock Units (RSUs). Whether you're a seasoned C-suite executive or just starting out in your career, the tax implications of RSUs can be confusing. Knowing how and when your RSUs will be taxed can help you avoid lofty tax surprises come tax season.

When Will I Be Taxed on My RSUs?

While looking through your benefits package, keep an eye out for the word “vesting.” Some restricted stocks have a vesting schedule, meaning they’re not fully yours until you meet certain requirements. Companies may require you to work with them for a few years until the stock is completely vested, while others may base their vesting schedule on performance-based benchmarks. Regardless of how your company’s vesting schedule is outlined, the tax liability for RSUs does not begin until the day they vest.

How Are RSUs Taxed?

Federal Ordinary Income Tax: The day the stock vests, the Fair Market Value (FMV) of the stock will be added to your income for that tax year, and you will be expected to pay ordinary income tax by the tax deadline. Your ordinary income tax is how most of your income is taxed and your exact rate is based on your annual income and filing status.

State Income Tax: Once the FMV of the stock is added to your income, you may also be subject to state income tax. Each state has different rules, so it's crucial to research how your state handles the taxation of restricted stock.

Federal Insurance Contributions Act Tax (FICA): This is a type of payroll tax that is levied on both employees and employers to fund Social Security and Medicare programs. At the time of vesting, the value of the restricted stock is added to an employee's regular income, and both the employer and employee are required to pay FICA tax on the amount. The tax rate for Social Security is currently 6.2% for employees and 6.2% for employers, up to a certain annual limit, and the Medicare tax rate is 1.45% for both employees and employers, with no annual limit.

Capital Gains Tax: If you choose to keep the restricted stock you received after it has vested, and the stock price increases from its value on the vesting day, you will be required to pay a tax on the difference between the stock's value when you sell it and the price it was worth on the day it vested.

For example, if the restricted stock vests at \$100 and you sell it later for \$150, you have a capital gain of \$50. The rate at which you will be taxed depends on how long you held the stock.

Short-term Capital Gains: If you sell the stock within a year of vesting and make a profit, it is treated as short-term capital gains, taxed at ordinary income rates.

Long-term Capital Gains: Any investment held for over a year and sold at a profit will be subject to a more favorable tax rate.

How Do I Calculate My Tax Liability?

To illustrate all the tax implications we've discussed, imagine you're a Michigan resident in the 22% federal ordinary income tax bracket. Let's assume the FMV of the RSUs at vesting is \$10,000.

Federal Ordinary Income Tax: $\$10,000 \times 22\% = \$2,200$

State Tax: Michigan has a flat income tax rate of 4.25%. Knowing this information, we can calculate your state tax liability: $\$10,000 \times 4.25\% = \425

FICA Tax: $\$10,000 \times 7.65\% = \765

Total Tax Liability: $\$2,200 + \$425 + \$765 = \$3,390$

After accounting for your total tax liability, you're only receiving \$6,610 instead of the entire \$10,000. Don't forget that you may be subject to capital gains tax if you hold onto the stock rather than sell it.

For example, imagine you hold your stock for at least a year instead of selling. After the one-year holding period, the stock value increased to \$11,000, meaning you had \$1,000 of capital gains. At the 15% long-term capital gains tax bracket, you would need to multiply \$1,000 by

15% to find your tax liability of \$150. You may also be subject to state tax if you sell the investment with a capital gain since the gain would be added to your income for that year.

The Bottom Line

Although RSUs can incentivize employees to remain with a company for the long haul, the intricacies of this benefit can be overwhelming. When talking about taxes on restricted stock, many focus solely on federal income tax and capital gains. However, that isn't the only type of tax you will be subject to. It's critical to understand how restricted stock can affect the entirety of your taxes, not just specific rates.