

RSU Awards to U.S. Taxpayers Require Careful Review Before Grant

April 13, 2017 – Cross-Border Counselor
by Marianne O'Bara

Recently we blogged about pitfalls and potential adverse tax consequences for U.S. taxpayers with respect to deferred share unit awards that pay out following the participant's termination of services. Read that blog entry [here](#). But what about restricted share units (RSUs) that are subject to vesting based on continued service and that are settled/paid out immediately after the scheduled vesting date(s)?

If you only have a handful of employees in the U.S. who would receive RSUs under your existing RSU Plan, you may wonder whether review by U.S. tax counsel really is necessary. Common sense would suggest that there is no way such RSUs could run afoul of the U.S. tax rules related to deferred compensation (otherwise known as "Section 409A" of the U.S. Internal Revenue Code) because the intent is to pay out as soon as the RSUs vest and hence there is no "deferral" of compensation. Forget common sense. Given the significant adverse tax consequences (20% penalty tax) for the recipient if the RSU is neither exempt from, nor compliant with, Section 409A, the answer is yes, have the terms of the RSU Plan and RSU agreement reviewed by U.S. tax counsel before granting RSUs to U.S. taxpayers.

A common problem with respect to RSUs awarded to U.S. taxpayers has to do with the "retirement" provisions in the RSU award. A company may believe that the RSUs will not be deferred compensation that is subject to Section 409A because the RSUs are subject to vesting based on continued service through stated "vesting" dates and they are paid out shortly after the scheduled vesting dates. The company believes the RSUs are exempt under the "short term deferral" exemption, and thus there is no risk of Section 409A penalties for noncompliance. However, many RSU awards have "retirement" provisions which state that upon a participant's Retirement (as defined in the RSU Plan or RSU agreement), the RSUs will "continue to vest" as though the participant had continued employment or services with the company through the scheduled vesting dates. For U.S. tax purposes the substantial risk of forfeiture lapses once an individual becomes eligible to retire, even if the individual does not in fact retire. Thus, such an RSU awarded to an individual who is retirement eligible, or who will become retirement

Related Capabilities

- Canada Cross-Border Transactions

eligible during the vesting period, will not be subject to a substantial risk of forfeiture as soon as the individual is retirement eligible because the settlement/payout which will occur immediately following the scheduled vesting dates will be outside of the short term deferral period (*i.e.*, the RSUs won't be settled/paid out in all cases by March 15 of the year following the year in which the RSUs no longer are subject to a substantial risk of forfeiture). Since such RSUs will not be exempt from Section 409A, they must instead meet all of the 409A rules for documentary and operational compliance; hence the need to review the documents before grant in order to structure them to comply with Section 409A.

Fortunately, through careful drafting and plan administration, RSU awards can be designed and administered to avoid these and other potential problems. We work regularly with Canadian tax counsel to ensure compliance.

Tip: In thinking about whether any recipients of RSUs are U.S. taxpayers, remember that U.S. taxpayers are taxed on worldwide income, regardless of where they reside. U.S. taxpayers are: (i) U.S. citizens regardless of residency; (ii) non-resident aliens ("green card" holders); and (iii) non-citizens, non-green card holders who have a "substantial presence" in the U.S. under the U.S. income tax laws (but exceptions to this category apply – careful analysis of the facts and applicable tax treaties required).