



State of California
Franchise Tax Board

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07.31.13

CHIEF COUNSEL RULING 2013-02

Dear M*. *****,

You requested a Chief Counsel Ruling regarding how to properly source income received from a Restricted Stock Unit plan when a taxpayer lived in California on the date of grant, but became a nonresident of California prior to the vesting date.

FACTS

Taxpayer has been an employee of ***** since ***** **, *****. Taxpayer received a grant of restricted stock units (RSUs) on ***** **, *****. The RSU plan provided for a two-part vesting requirement. First, the plan required the occurrence of an "Initial Vest Event," which was defined as the earlier of:

1. Six months after the effective date of an initial public offering (IPO); or
2. A change of control.

Additionally, the RSUs vested incrementally over a period of 48 months of continuous service with the company.

The employee, a California resident on the date of the grant of the RSUs, terminated his California residency on *** **, *****. He continued his employment with ***** and periodically travelled to California for business purposes.

The ***** IPO occurred on *** **, ***** and, pursuant to the vesting provisions of the RSU plan, the Initial Vest Event occurred on ***** **, *****.

ISSUE

What is the proper method of determining the portion of California source income received by an employee who was granted RSUs as a California resident, but did not recognize income on them until he became a nonresident?

HOLDING

The Taxpayer must use a reasonable apportionment method to determine the portion of California source income received. The most reasonable apportionment method to determine the portion of California source income received is to multiply the compensation received by a ratio of California working days from the grant date to the vest date over the total working days anywhere during the same period.

DISCUSSION

California residents are taxed upon their entire net income regardless of source, while nonresidents are taxed only on income from a California source.¹ Thus, part-year residents are taxed on their entire taxable income during the period they were residents and on the income derived from California sources during the period they were nonresidents.²

The taxation of restricted stock such as that here is governed by Internal Revenue Code (IRC) section 83(a), to which California tax law conforms under California Revenue and Taxation Code section 17081.³ IRC section 83(a) provides that a taxpayer does not recognize any gain when restricted stock is granted. Instead, a taxpayer recognizes taxable compensation to the extent the fair market value of the stock exceeds the option price when the restricted stock is vested or, in the words of the statute, at "the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier. . . ."⁴ It is well-established that gain from the vesting of the restricted stock is characterized as compensation for personal services.⁵

An RSU plan awards an employee the right to receive a fixed payment equal to the value of a specified number of shares of employer stock.⁶ Unlike restricted stock options, an RSU plan allows an employee to receive an amount based on the full value of a share, rather than only an amount equal to the increase in value from the date of grant through the vest date.⁷ The IRS treats RSUs like other forms of nonqualified stock options subject to a

¹ Rev. & Tax. Code §§ 17041, 17951.

² Rev. & Tax. Code § 17041(b), (i).

³ Incorporated by reference in Revenue and Taxation Code section 17081.

⁴ Treas. Reg. § 1.83-7(a).

⁵ *Commissioner v. LoBue* (1956) 351 U.S. 243; *Appeal of Charles W. and Mary D. Perelle*, 58-SBE-057, Dec. 17, 1958.

⁶ BNA 385 T.M. II. E.

⁷ *Ibid.*

substantial risk of forfeiture, most specifically like restricted stock.⁸ The ***** RSUs are comparable to grants of restricted stock in a number of ways that are significant to this analysis. Like restricted stock, these RSUs have a clear grant date and a period of vesting. Also similar to restricted stock, their value is not recognizable on the grant date, but rather on the date the RSUs are vested.

Here, the RSUs were subject to a two-part vesting period. The Taxpayer remained in the continuous service of ***** for 48 months from ***** **, ****, so the RSUs met this portion of the vesting requirements as of ***** **, ****. The vesting of the RSUs remained contingent upon this requirement until six months after the ***** IPO on ***** **, ****.

When an employee performs services in California during the grant to vest period of the restricted stock and during this period becomes a nonresident, a portion of the compensation from the vesting of the restricted stock is California source income.⁹ Revenue and Taxation Code section 17041 provides that the California taxable income of a California nonresident includes gross income and deductions derived from sources within California, as determined in accordance with Revenue and Taxation Code section 17951 and the applicable regulations. Regulation section 17951-5, subsection (b), provides:

If nonresident employees are employed in this State at intervals throughout the year, as would be the case if employed in operating trains, boats, planes, motor buses, trucks, etc., between this State and other states and foreign countries, and are paid on a daily, weekly or monthly basis, the gross income from sources within this State includes that portion of the total compensation for personal services which the total number of working days employed within the State bears to the total number of working days both within and without the State. If the employees are paid on a mileage basis, the gross income from sources within this State includes that portion of the total compensation for personal services which the number of miles traversed in California bears to the total number of miles traversed within and without the State. *If the employees are paid on some other basis, the total compensation for personal services must be apportioned between this State and other States and foreign countries in such a manner as to allocate to California that portion of the total compensation which is reasonably attributable to personal services performed in this State.* Gross income from sources within this State does not include qualified retirement income, as defined in Section 17952.5 of the Revenue and Taxation Code received by a nonresident. . . . [Emphasis added.]

⁸ See Treas. Reg. § 1.409A-1(d)(1) ("Compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned on the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial."); Notice 2009-8 (1/26/2009); Notice 2009-85 (11/9/2009).

⁹ *Appeal of Robert C. and Marian Thomas*, 55-SBE-006, Apr. 20, 1955; *Appeal of Janice Rule*, 76-SBE-099, Oct. 6, 1976; *Appeal of Karl Bernhardt*, 84-SBE-153, Nov. 14, 1984.

Any reasonable allocation must be based on the facts and circumstances of each case.¹⁰ The most reasonable method here appears to be to multiply the compensation by a ratio of California working days from the grant date to the vest date over the total working days anywhere during the same period.¹¹

Taxpayer was granted the RSUs while he was a California resident on ***** **, ****. He performed services for his employer from the grant date of ***** **, **** through the vesting date of ***** **, ****. Thus, a portion of the RSUs is compensation for the performance of personal services in California and must be allocated accordingly.

The allocation method used must reflect the extent to which the income is compensation for the performance of personal services in California. The most reasonable method of determining the portion of the California source income from the RSUs here appears to be to calculate a ratio of the portion of days the Taxpayer performed services in California: The numerator of the ratio would contain the number of days Taxpayer performed services for ***** in California from ***** **, **** through ***** **, ****; the denominator would contain the total number of days Taxpayer performed services for ***** worldwide from ***** **, **** through the date the RSUs vested, ***** **, ****. This ratio would then be multiplied by the total amount of compensation recognized on the vesting date to determine the total amount of California source income. Although Taxpayer in this matter is not limited to using this method of calculating his California source income, this method has been determined to be a reasonable manner of allocation and appears to be the most reasonable method that can be used under this taxpayer's facts and circumstances.¹²

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayer and are based upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of section 21012 of the Revenue and Taxation Code. Please attach a copy of this letter and your request to the appropriate return(s) (if any) when

¹⁰ *Appeal of James B. and Linda Pesiri*, 89-SBE-027, Sept. 26, 1989.

¹¹ See Cal. Code Regs., tit. 18 § 17951-5(b).

¹² Publication 1004; see Cal. Code Regs., tit. 18 § 17951-5(b).

filed or in response to any notices or inquiries which might be issued.

Very truly yours,

Maria Brosterhous
Tax Counsel