



**CITY OF PHILADELPHIA  
DEPARTMENT OF REVENUE**

February 6, 2009

XXXXXX XXXXXXXXX  
XXXXXXXXXXXXXX, LLP  
XXXXXXXXXXXXXX, Suite xxxxx  
XXXX XXXXXX Street  
Philadelphia, PA 191XX-XXXX

**Re: XXXXXX Corporation – Restricted Stock Units - Wage Tax - Request for  
Letter Ruling**

Dear Mr. XXXXXXX:

This letter is in response to your request for a Philadelphia Wage Tax ruling on the granting of Restricted Stock Units (RSUs) to select employees of the XXXXXX (XXX).

**Facts**

This ruling is based upon the following facts as detailed in your letter of October 28, 2008.

- Xxx currently maintains its corporate headquarters and commercial domicile in Xxx, Pennsylvania but has determined it is doing business within the City Philadelphia.
- Xxx grants RSUs to select employees to ensure that these employees have a continuing stake in the long-term success of the company. These RSUs are also used to attract, retain and motivate those employees responsible for the company's long-term success.
- RSUs are not actual shares of Xxx stock but rather a promise from Xxx to deliver shares of common stock at a future date when the applicable restrictions have been lifted. As part of the RSU agreement between Xxx and each of its selected employees, no actual shares of stock are issued unless and until the restrictions have lapsed. Therefore, RSU

recipients do not have any share-ownership rights, including voting, assignment and transfer rights during the period of restriction.

- The value of the shares to the individual employee is not certain until the restrictions have lapsed and the shares actually vest with the employee.
- Xxx grants two types of RSUs, time-based and performance-based. If the employee terminates his or her employment on or before the vesting date or if certain performance goals are not met, the RSUs are forfeited.

### **Questions Presented**

1. Are the RSUs granted to the employees subject to the Philadelphia Wage Tax?
2. If the RSUs are determined to be subject to the Wage Tax, at what date should they be considered taxable *Salaries, Wages, Commissions and Other Compensation* to the employee?
3. If the RSUs are determined to be taxable for the Philadelphia Wage Tax, how should Xxx calculate the taxable amount for the nonresident employees working both inside and outside the City of Philadelphia?

### **Conclusion**

Pursuant to City of Philadelphia *Income Tax Regulation § 203(k)*, property received by an employee from his or her employer is generally subject to the Philadelphia Wage Tax based upon the fair market valuation (FMV) of the property at the time of receipt. However, if the property received (i.e. RSUs) is subject to a substantial risk of forfeiture (is restricted) and cannot be transferred free of that restriction/risk then the recognition of the compensation by the employee is deferred until the date the interest in the property is no longer subject to the risk of forfeiture or becomes transferrable free of the risk or whichever occurs earlier (i.e. the vesting date). The amount of compensation is the FMV of the stock received by the employee on the vesting date less any amount paid for the stock by the employee.

The Philadelphia Code imposes the Wage Tax on the compensation earned by non-residents of Philadelphia for work done or services performed or rendered in Philadelphia. (§ 19-1502(1)(b)) Therefore, the RSUs granted to nonresidents of Philadelphia for the time they were assigned to work within Philadelphia will be subject to the Wage Tax on the FMV of the stock received on the vesting date. This is true even in instances where the nonresident employee is subsequently relocated to another office (or no longer in Philadelphia work status) prior to the vesting date. The nonresident Wage Tax allocation percentage is the same percentage used for the employee's other non stock based compensation for the time they worked within Philadelphia or i.e. days worked in Philadelphia versus the total number of days worked everywhere. Conversely, nonresident employees granted RSUs for time that they did not work within Philadelphia or were assigned to other offices/locations will not have to report

compensation for Wage Tax purposes ó even if the vesting date occurs while the employee is assigned to work within Philadelphia.

A Philadelphia resident would be taxed on 100% of the FMV of the stock received on the vesting date regardless of what office they were assigned or where the services were rendered.

### **Discussion**

The exemption from the definition of *Salaries, Wages, Commissions and Other Compensation* provided to stock options under *Philadelphia Code § 19-1501(10)(f)* is not applicable to RSUs. Though an argument can be made that the granting of RSUs are *similar to* the granting of stock options they are not identical stock-based methods of compensation. The only similarity between the two methods is that on the date of grant no transfer of property has occurred. Interesting, the term *Similarity to option* as explained by *26 CFR 1.83-3(a) (4)* is defined as *(a)n indication that no transfer has occurred is the extent to which the conditions relating to a transfer are similar to an option.* If they were identical methods, there would have been no need to seek clarification of the tax status of RSUs from this Department. Therefore, any statute providing for the exemption from the Wage tax for stock options will be strictly construed and limited to the plain reading of the language.

RSUs not being exempt from the statutory definition of *Salaries, Wages, Commissions and Other Compensation* are therefore construed to be taxable compensation. *Income Tax Regulation § 203(k)*, though not specifically addressing RSUs is the controlling regulatory authority. The problem not addressed by the regulations is that the date the RSUs are granted the amount of compensation to the employee cannot be calculated or measured with certainty due to the restrictions/substantial risk of forfeiture that is present. In this instance, the Department will look to the Federal income tax treatment of RSUs (i.e. *26 CFR 1.83-1*) to fill in the regulatory gaps. That is, the transfer of property (i.e. stock) on the vesting date will subject the employee to the Wage Tax based on the FMV on that date and would require Xxx under Philadelphia Code § 19-1507 to withhold the proper tax.

Another issue is that these RSUs are awarded only to *select* employees. *Income Tax Regulation § 203(m) Fringe Benefits* provides that ò(a)ny payment which is discriminatory in nature or not uniformly given to each employee (except by equivalent substitute) is taxable at actual, imputed or fair market value.ö Therefore, to the extent that the non-select employees do not receive RSUs or some functional equivalent, those that do will be subject to the tax.

The proper Wage tax for a nonresident of Philadelphia is calculated on the ratio of days/time worked in Philadelphia to the days/time worked everywhere. This methodology (as explained in *Income Tax Regulation § 209*) applies to all components of compensation (including RSUs). Since the Wage Tax statute imposes the tax on a nonresident for compensation earned for service performed in Philadelphia, Xxx will need to track the granting of RSUs to the subsequent vesting. That is, the granting of RSUs to nonresidents for the time spent working in Philadelphia will be subject to the tax even in instances where the employee is subsequently reassigned to non Philadelphia duties before the vesting date. Conversely, the earning of RSUs for non Philadelphia time will not subject the nonresident to Wage Tax even if the vesting date occurs when the nonresident employee is in a Philadelphia *status*. In other words, with respect to

nonresident employees, the grant date as opposed to the vesting date will control the determination of the taxable event.

Philadelphia residents, regardless of where their services are rendered will be subject to the tax at 100% of the FMV received on the vesting date.

This ruling was prepared based upon the facts presented and can only be relied upon by Xxx. If the facts should change, the Revenue Department can be contacted for an updated ruling.

Sincerely yours,

Joseph F. Procopio Jr., CPA  
Tax and Revenue Conferee

JFP

cc: K. Richardson  
T. Afessa