Restricted stock deserves attention before year end

Executives and key employees often receive stock-based compensation in addition to salaries and bonuses. If restricted stock is part of your compensation, considering the potential tax consequences well before December 31 is a good idea.

You may have decisions to make if: 1) you've recently received an award or are expecting one soon, 2) your restricted shares have vested in 2026 or will vest before the end of the year, or 3) you've sold shares this year or are considering a sale. The timing of these events and certain decisions you make can affect both the amount and type of taxable income you must report — and may provide planning opportunities that will affect your 2026 and future taxes.

Restrictions and vesting

In a typical restricted stock arrangement, you receive shares of company stock subject to one or more restrictions but at minimal or no cost to you. The most common restriction is that you must continue working for the company until a certain date. If you leave before then, you forfeit the shares.

You don't have to report any taxable income from a restricted stock award until the shares become vested — meaning when your ownership is no longer restricted. At that time, you're deemed to receive taxable compensation income equal to the difference between the fair market value (FMV) of the shares on the vesting date and the amount you paid for them, if anything. The current federal income tax rate on compensation income can be as high as 37%. Depending on your state, you may owe state income tax, too.

Any appreciation *after* the shares vest is treated as capital gain. If you later sell the shares for more than their FMV when they vested and you've held the shares for more than one year after the vesting date, the additional appreciation generally will be long-term capital gain. The federal rate on most net long-term capital gains is either 15% or 20%, but you may also owe the 3.8% net investment income tax (NIIT) and, if applicable, state income tax. Your long-term gains rate and whether the NIIT applies depend on your income.

Electing to pay tax earlier

Under Section 83(b), you can elect to recognize ordinary income when you receive the restricted stock instead of later when the shares vest. The income amount equals the difference between the FMV of the shares at the time of the restricted stock award and the amount you pay for them, if anything. The income is treated as compensation subject to federal income tax, federal employment taxes and, if applicable, state income tax.

The benefit of making the election is that any subsequent appreciation in the stock's value is treated as potentially lower-taxed capital gain rather than additional compensation income. The election also starts your capital gain holding period when the shares are transferred rather than when they vest. If you hold the shares for more than one year before selling them, any gain generally will be long-term capital gain. The election may be most beneficial if the FMV when the restricted stock is awarded is negligible or the stock is likely to appreciate significantly before income would otherwise be recognized.

The downside of making the election is that you recognize taxable income in the year you receive the restricted stock award. This means you must "prepay" tax in the current year — which not only creates tax liability for that year but also, depending on the FMV and your other income, could push you into a higher income tax bracket and trigger or increase your exposure to other taxes or income-based phaseouts of tax breaks. If you forfeit the shares back to your employer, you can claim a capital loss for the amount you paid for the shares, if anything. But you generally can't deduct the compensation income you previously recognized.

Warning: If you opt to make the election, you must notify the IRS no later than 30 days after the stock is transferred to you.

2026 planning considerations

Your considerations will depend on where you are in the restricted stock award cycle:

1. You're awarded restricted stock in 2026. If you still have time to make the Sec. 83(b) election, you need to decide whether to make it. We can run projections of various scenarios to help you assess the likelihood that making the election will save you tax in the long run.

If you *don't* make the Sec. 83(b) election for a 2026 restricted stock award, then the award will generally have no impact on your 2026 taxes. Depending on how long the vesting period is, you may want to start planning for the potential tax impact when the stock vests in the future.

If you decide to make the Sec. 83(b) election — or you already made it earlier in the year — you need to plan for how that increase to your 2026 income will affect your overall tax situation. If the FMV of the stock was low when it was awarded, the tax impact may be minimal. But if the FMV was higher, assessing whether it may push you into a higher tax bracket or trigger other taxes or tax-break phaseouts is critical so that you can plan accordingly. To help reduce any negative impact, you may, for example, want to defer other income to 2027 where possible and accelerate deductible expenses into 2026.

2. Your restricted stock vests in 2026. If you made the Sec. 83(b) election when you were awarded the stock, then there will be no 2026 tax consequences to the vesting. If you *didn't* make the election, then you need to plan for how the increase to your 2026 income from the vesting will affect your overall tax situation, similar to the planning discussed in No. 1 for a year when the Sec. 83(b) election is made.

3. You sell some or all of the shares in 2026. You need to calculate your capital gain and whether the short-term or long-term gains rate applies based on your basis and holding period, respectively, which will depend in part on whether you made the Sec. 83(b) election. If the gain will be substantial, you need to plan for the impact on your 2026 tax situation. For example, you'll want to assess whether the gain could cause you to be subject to the 3.8% NIIT or increase your NIIT liability.

If you have other investments in your portfolio that have declined in value, consider selling them to help offset your gains — a strategy known as "loss harvesting." Deferring other income and accelerating deductible expenses may also help reduce the tax impact.

Assess the tax impact

Restricted stock can affect your taxes at several points, from the initial award to vesting to an eventual sale. As year end approaches, review any restricted stock activity that has already occurred in 2026 as well as activity that will occur — and actions you're considering — before January 1, 2027. If you've recently received an award, don't overlook the 30-day deadline for making an 83(b) election.

Contact us for assistance. We can help you decide whether to make the election and, whether or not you make the election (or made it in the past), help you determine how your restricted stock should fit into your year-end tax planning.