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In this article, Galek examines California’s grant-to-vest workday allocation formula for restricted stock units, arguing that it is not necessarily the most reasonable allocation called for by California regulation.

California generally applies a grant-to-vest workday allocation formula for restricted stock units (RSUs) received by a California employee who later relocates to another state before all units have vested to determine the California-source portion of the resulting income. The grant-to-vest workday allocation formula is a pro rata method that determines the California-source portion of equity compensation income by dividing the number of California workdays between the grant date and the vesting date by the total workdays during that same period. The formula is familiar, administrable, and supported by precedential authority. Less frequently examined is whether the formula remains reasonable in every application, as California’s own regulations require.[1]

Regulation

Although the grant-to-vest allocation formula is generally supported and reasonable on a particular set of facts, it is not necessarily the most reasonable allocation required by the regulation. The California Franchise Tax Board’s administrative practice has largely disregarded this distinction, treating the grant-to-vest method not as one permissible approach among others but as the standard itself. The regulation says otherwise.

The California Code of Regulations provides the operative standard for allocating multistate compensation income, requiring that this compensation be apportioned “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” (emphasis added).[2] The regulation does not prescribe a single formula. It does not reference the grant-to-vest method or any specific approach. Instead, it establishes a standard — reasonable attribution — and empowers practitioners to select methods that align with it.

The regulatory language is deliberately open-ended, saying “in such a manner” rather than “pursuant to the formula prescribed by the Franchise Tax Board” and saying “reasonably attributable” rather than “calculated by reference to the ratio of California workdays during the grant-to-vest period.”[3] The drafters could have codified a specific formula. They did not. Instead, they chose language that imposes an obligation of reasonableness on whatever method is applied, which necessarily implies that more than one

[1] Cal. Rev. & Tax. Code section 17041(i)(1)(B).

[2] Cal. Code Regs. tit. 18, section 17951-5(b).

[3] *Id.*

method may be permissible and that the permissibility of any method depends on the result it produces in context.

This is a critical structural point. The grant-to-vest formula is not the regulatory standard. It is one method of satisfying the regulatory standard. The standard is *reasonableness*. The formula is an instrument, and like any instrument, its adequacy must be measured against the standard it is supposed to serve, not assumed by virtue of its widespread use.

Foundation and Reinforcement

The statutory framework reinforces this reading. The Revenue and Taxation Code imposes a jurisdictional limit on California's taxation of nonresidents to income derived from California sources.[4] This limit is not an administrative preference. Once a taxpayer becomes a nonresident, California may tax compensation income only to the extent the income is attributable to services actually performed within California. Any allocation method that systematically overattributes income to California by injecting pre-move service days into post-move sourcing calculations is in tension with the statute's jurisdictional boundary.

California conforms to Internal Revenue Code section 83, under which RSU income is recognized at vesting, not at grant.[5] Each vesting date is a discrete recognition event when the taxpayer realizes a specific economic benefit. This is consistent with analyzing each tranche on its own terms for sourcing purposes. Recognition timing does not, by itself, dictate sourcing, but the fact that the code treats each vesting event as independent cuts against treating the entire grant-to-vest period as an undifferentiated block for allocation purposes.

The Board of Equalization's decision in *Appeal of Pesiri* is foundational.[6] *Pesiri* established that what constitutes a reasonable allocation method under California's regulations is not determined in the abstract; rather, the allocation is determined by reference to the facts and circumstances of the case. That holding is significant not merely as a general principle but also as a direct constraint on the FTB's position in RSU sourcing disputes. If reasonableness is case-specific, the FTB cannot satisfy the regulatory standard simply by pointing to a formula that has been approved in other cases involving different facts. It must demonstrate that the formula produces a reasonable result on the facts presented. *Pesiri* does not permit the FTB to treat any allocation method, however well-supported in the general case, as categorically reasonable regardless of the outcome it produces in a specific application.

The FTB's own chief counsel guidance reinforces and extends this principle. Chief Counsel Ruling 2013-02 and 2014-01 both describe the grant-to-vest formula as the FTB's standard approach to allocating stock option and RSU income.[7] But the rulings do not stop there. Both rulings say identically, "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."[8] Both rulings also say identically, "Any reasonable allocation must be based on the facts and circumstances of each case."

This principle is further reflected in the FTB's public-facing guidance. FTB Publication 1004, which provides instructions for nonresidents and part-year residents, describes the grant-to-vest workday allocation as "*one* reasonable method" for sourcing stock option income (emphasis added).[9] Similarly, the FTB's "Residency and Sourcing Technical Manual," an internal guide for its audit staff, uses identical language, saying that this formula is "*one* reasonable method" for

[4] Cal. Rev. & Tax. Code section 17041(i)(1)(B).

[5] IRC section 83(a); Cal. Rev. & Tax. Code section 17081.

[6] *Appeal of Pesiri*, No. 89-SBE-027 (Cal. BOE Sept. 26, 1989).

[7] Chief counsel rulings are nonprecedential and may not be cited as authority. However, the rulings' analytical framework reflects the FTB's own interpretive understanding of the regulatory standard and is significant precisely because it acknowledges the standard's flexibility. *See Appeal of Southern Minnesota Beet Sugar Cooperative*, 2023-OTA-342P (Cal. OTA Mar. 17, 2023).

[8] FTB Chief Counsel Ruling 2013-02 (July 31, 2013) and FTB Chief Counsel Ruling 2014-01 (May 13, 2014).

[9] FTB Publication 1004, "Equity-Based Compensation Guidelines," at "section E. Restricted Stock" (2015).

sourcing such compensation (emphasis added).[10] The use of "one reasonable method" in official guidance underscores that the grant-to-vest formula is permissible but not the sole approach.

Those authorities strongly support that (1) the grant-to-vest formula is not the exclusive method, (2) taxpayers may use alternative approaches, and (3) the governing criterion is reasonableness measured against specific facts. If the FTB's position were that the grant-to-vest formula is the regulatory standard itself, rather than one method of satisfying the regulatory standard, the language used in those authorities would be extraneous and inaccurate. The chief counsel twice affirmed the availability of alternative methods, grounded in a facts and circumstances inquiry, confirming methodological flexibility. The FTB treats the grant-to-vest formula as the default by convenience, not by mandate.

The regulatory text, *Pesiri*, and the FTB's chief counsel rulings demonstrate that reasonableness is the standard; the grant-to-vest formula is one permissible method of meeting that standard. The permissibility of any method, including the grant-to-vest formula, depends on whether it produces the most reasonable result on the facts of the case. The question in any given dispute is not whether the FTB's formula is generally defensible but whether it is reasonable on each taxpayer's specific facts and circumstances.

OTA Agreement

The precedential decisions by the California Office of Tax Appeals (OTA) in *Appeal of Stabile*[11] and *Appeals of Cremel and Koeppel*[12] are consistent with this framework, though the FTB frequently cites those decisions as if they foreclose it. The grant-to-vest formula was a reasonable method of allocating stock compensation income on the facts in each case. The formula satisfied the regulatory standard in those cases, but neither decision held that the formula is the regulatory standard, that it is reasonable in all cases, or that alternative methods are impermissible. Neither decision addressed a situation in which the taxpayer presented a fact-specific alternative allocation and argued that the grant-to-vest formula produced an unreasonable result on multi-tranche facts (that is, RSU grants that vest in multiple installments over time) spanning a residency change. Neither decision held that the FTB's formula is the only reasonable method, a holding that would have been inconsistent with the regulatory text and the chief counsel's own guidance.

A decision that a method is reasonable on specified facts does not establish that the method is reasonable on all facts. *Stabile* and *Cremel and Koeppel* both answered the question they were asked: Was the grant-to-vest formula reasonable on the factual record in each case? They do not answer the question presented by multi-tranche RSU grants that straddle a change in residency, because that question was not before the OTA.

The OTA's nonprecedential decision in *Appeal of Hall* comes closest to the multi-tranche, mid-residency-change fact pattern this article examines.[13] The OTA held that the taxpayer's relocation was "immaterial" to the sourcing analysis because the RSU income was compensation for services performed in California during the residency period. The conclusion that pre-move California services do not lose their sourcing character merely because the taxpayer later becomes a nonresident is unobjectionable. Services performed in California remain California-source services regardless of the taxpayer's residence when the income is recognized.

But *Hall* does not resolve whether the grant-to-vest formula remains reasonable when applied mechanically across multiple tranches that vest after a residency change. There is no doubt that pre-move services retain their California-source character. However, it is also not reasonable to include, based on the facts and circumstances, the same pre-move service days in the allocation numerator for every subsequent vesting tranche, which would compound with each vesting event and inflate the California ratio for tranches that vest long after the taxpayer has left the state.

[10] FTB, "Residency and Sourcing Technical Manual," at section 3275 (last updated 2025).

[11] *Appeal of Stabile*, 2020-OTA-198P (Cal. OTA Apr. 28, 2020).

[12] *Appeals of Cremel and Koeppel*, 2021-OTA-222P (Cal. OTA May 18, 2021).

[13] *Appeal of Hall*, 2025-OTA-113 (Cal. OTA Dec. 13, 2024) (nonprecedential).

Whether the grant-to-vest formula remains reasonable when its mechanical application across multiple tranches produces a compounding attribution effect was not before the OTA in that case. Because *Hall* is nonprecedential, it does not bind future panels, even on the narrower question whether pre-move California services retain their sourcing character after a residency change.

Counting the Days

Beyond *Hall*, the structural problem with applying the grant-to-vest formula across multi-tranche RSUs that straddle a residency change is the compounding distortion it produces. Structurally, applying the grant-to-vest formula across multi-tranche RSUs that straddle a residency change compounds the distortion. The same block of pre-move California workdays appears in the numerator for every subsequent vesting tranche, which was already captured during the taxpayer's resident period. To count them again in the nonresident sourcing formula inflates the California-source portion of income that vests after the taxpayer has left the state. For a four-year RSU with quarterly vesting, the final tranches may carry a California allocation ratio that bears little relationship to the taxpayer's actual post-move connection to the state. This is precisely the kind of outcome the "reasonably attributable" standard exists to prevent.

The compounding effect of applying the grant-to-vest formula across multiple tranches is best illustrated by a simple example. Assume an employee is granted RSUs on January 1, 2020, while working full-time in California. The RSUs vest quarterly over four years with continued employment required through each vesting date. The employee relocates permanently to another state on January 1, 2022, after two years of service in California and thereafter performs no further services in California.

Under the grant-to-vest method, each vesting tranche is allocated based on the ratio of California workdays to total workdays during the period from the grant to the relevant vesting date. For the first eight tranches (those vesting before the move), 100 percent of the income is allocated to California, consistent with California's worldwide taxation of residents. This result is not in dispute.

For the ninth tranche, vesting on April 1, 2022, the formula divides two years of California workdays by approximately 2.25 years of total workdays, producing a California allocation of approximately 89 percent, even though the employee performed no services in California during the quarter immediately preceding vesting. As additional tranches vest in later quarters, the same two-year block of pre-move California workdays continues to appear in the numerator while the denominator grows; the California ratio remains substantial: about 67 percent for the tranche vesting on January 1, 2023, a full year after the employee's departure. By the final tranche, vesting on January 1, 2024, the California allocation ratio remains 50 percent, allocating half the income to a state in which the employee has not worked for two years.

This result does not stem from the employee's compensation arrangement. It arises from the repeated reuse of the same pre-move service period in the allocation numerator for each successive tranche. Any multi-tranche RSU grant spanning a residency change will produce the same escalating divergence between the allocation ratio and actual California activity. The grant-to-vest formula compounds pre-move California services into later tranches when applied across multiple vesting events after a taxpayer's change in residency, increasingly distorting the allocation from actual in-state activity.

What Is Reasonable?

The FTB's likely response to the compounding-distortion argument (that residence-based taxation and source-based taxation are distinct exercises of jurisdictional authority, not double-counting) is doctrinally coherent. But it answers the wrong question. The regulation does not ask whether California has a valid jurisdictional basis for taxing the income; it asks whether the allocation is "reasonably attributable" to services performed in California. A formula can rest on a valid exercise of tax authority and still fail the reasonableness standard if it produces a result that systematically overattributes income to California. The FTB may argue that resident and nonresident taxation represent separate exercises of jurisdictional authority. But that distinction, although it establishes California's power to tax, does not establish that any particular measure of that tax is reasonable.

A proportional allocation approach better aligns with the regulation's text and purpose in multi-tranche, mid-residency-change cases. Under this approach, RSUs vesting during California residency are allocated entirely to California, consistent with the state's worldwide taxation of residents. For RSUs vesting after the taxpayer becomes a nonresident, the allocation formula counts only California workdays occurring after the residency change, divided by total workdays during the relevant vesting period, with each tranche calculated independently. This method ties the allocation to actual post-move California services, respects the structural bifurcation between resident and nonresident taxation for taxpayers who change residency status midyear, and satisfies the "reasonably attributable" standard by producing a result that reflects the taxpayer's actual connection to California during the period in which each tranche of income was earned.[14]

Constitutional doctrine establishes the outer limits on state taxation rather than optimal sourcing rules.[15] Courts grant states significant leeway in designing apportionment formulas, and a taxpayer would face a difficult burden in demonstrating that a time-based allocation is constitutionally infirm. But the constitutional framework reinforces the broader point that the due process and commerce clauses of the U.S. Constitution require a state's tax to bear a rational relationship to in-state activity. The "reasonably attributable" standard in section 17951-5(b) operates in the same manner. When the grant-to-vest formula produces a California allocation ratio for late-vesting tranches that reflects years of pre-move residency rather than post-move California services, the statutory standard and the constitutional principle both require a more fact-specific allocation.

The grant-to-vest formula remains a reasonable default and an appropriate starting point for sourcing RSU income. Although it is well supported and administrable — and in many circumstances produces a result that satisfies the regulatory standard — California law does not elevate that default into an irrebuttable rule. The governing regulation asks whether the allocation is "reasonably attributable" to California services, which must be asked anew in every case. The FTB's chief counsel guidance expressly recognizes that taxpayers are not limited to the grant-to-vest method and that reasonableness depends on the facts and circumstances of each individual case. When the facts include multi-tranche vesting, a mid-period change in residency, and a formula that compounds pre-move workdays into every subsequent tranche, the standard demands more than the mechanical application of a default; it demands an evaluation of whether the result is reasonable, because reasonableness, not the formula, is the standard the regulation provides. ■

[14] *See* FTB Legal Ruling 2003-1.

[15] *See, e.g.*, *South Dakota v. Wayfair Inc.*, 585 U.S. 162 (2018).