

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 1.83-2: Election to include in gross income in year of transfer.

Rev. Proc. 2012-29

SECTION 1. PURPOSE

This revenue procedure contains sample language that may be used (but is not required to be used) for making an election under § 83(b) of the Internal Revenue Code. Additionally, this revenue procedure provides examples of the income tax consequences of making such an election.

SECTION 2. BACKGROUND

.01 Section 83(a) provides generally that if, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of the fair market value of the property (determined without regard to any restriction other than a restriction which by its terms will never lapse) as of the first time that the transferee's rights in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over the

amount (if any) paid for the property is included in the service provider's gross income for the taxable year which includes such time.

.02 Under § 1.83-3(f) of the Income Tax Regulations, property is transferred in connection with the performance of services if it is transferred to an employee or independent contractor (or beneficiary thereof) in recognition of the performance of services, or refraining from performance of services. The existence of other persons entitled to buy stock on the same terms and conditions as an employee, whether pursuant to a public or private offering may, however, indicate that in such circumstance a transfer to the employee is not in recognition of the performance of, or refraining from performance of, services. The transfer of property is subject to § 83 whether such transfer is in respect of past, present, or future services.

.03 Section 83(b) and § 1.83-2(a) permit the service provider to elect to include in gross income the excess (if any) of the fair market value of the property at the time of transfer over the amount (if any) paid for the property, as compensation for services.

.04 Under § 83(e)(3) and § 1.83-7(b), § 83 does not apply to the transfer of an option without a readily ascertainable fair market value at the time the option is granted. As a result, a § 83(b) election may only be made with respect to the transfer of an option that has a readily ascertainable fair market value (as defined in § 1.83-7(b)), at the time the option is granted and that is substantially nonvested (as defined in § 1.83-3(b)). If substantially nonvested property is received upon exercise of an option without a readily ascertainable fair market value at grant, a service provider is permitted to make a § 83(b) election with respect to the transfer of such property upon the exercise

of the option.

.05 Under § 83(b)(2), an election made under § 83(b) must be made in accordance with the regulations thereunder and must be filed with the Internal Revenue Service no later than 30 days after the date that the property is transferred to the service provider. In accordance with § 7503, if the thirtieth day following the transfer of property falls on a Saturday, Sunday or legal holiday, the election will be considered timely filed if it is postmarked by the next business day.

.06 Under § 1.83-2(c), an election under § 83(b) is made by filing a copy of a written statement with the Internal Revenue Service office with which the person who performed the service files his return. In addition, the person who performed the services is required to submit a copy of such statement with his or her income tax return for the taxable year in which such property was transferred. Section 1.83-2(d) requires that the person who performed the services also submit a copy of the § 83(b) election to the person for whom the services were performed.

.07 Under § 1.83-2(e), the statement must be signed by the person making the election and must indicate the election is being made under § 83(b). The statement must include the following information: the name, address and taxpayer identification number of the taxpayer; a description of each property with respect to which the election is being made; the date or dates on which the property was transferred and the taxable year for which such election is being made; the nature of the restriction or restrictions to which the property is subject; the fair market value at the time of transfer (determined without regard to any lapse restrictions, as defined in § 1.83-3(i)) of each property with

respect to which the election is being made; the amount, if any, paid for such property; and a statement to the effect that copies have been furnished to other persons as provided in § 1.83-2(d).

.08 Under § 1.83-2(f), an election under § 83(b) may not be revoked except with the consent of the Commissioner. The regulations also provide that such consent will only be granted where the person filing the election is under a mistake of fact as to the underlying transaction and must be requested within 60 days of the date on which the mistake of fact first became known to the person who made the election. Neither a mistake as to the value (or decline in the value) of the property for which the election was made nor the failure of anyone to perform an act that was contemplated at the time of transfer of the property constitutes a mistake of fact for this purpose. See Rev. Proc. 2006-31, 2006-2 C.B. 32, for additional guidance with respect to revoking an election under § 83(b).

SECTION 3. SCOPE

This revenue procedure applies to taxpayers who receive substantially nonvested property in connection with the performance of services and wish to file an election under § 83(b).

SECTION 4. CONSEQUENCES OF ELECTIONS UNDER § 83(b)

.01 Under § 1.83-2(a), if property is transferred in connection with the performance of services, the person performing such services may elect to include in gross income under § 83(b) the excess (if any) of the fair market value of the property at the time of transfer (determined without regard to any lapse restriction, as defined in § 1.83-3(i)) over the amount (if any) paid for such property, as compensation for services. If this election is made, the substantial vesting rules of § 83(a) and the regulations thereunder do not apply with respect to such property, and except as otherwise provided in § 83(d)(2) and the regulations thereunder (relating to the cancellation of a nonlapse restriction), any subsequent appreciation in the value of the property is not taxable as compensation to the person who performed the services. Thus, the value of property with respect to which this election is made is included in gross income as of the time of transfer, even though such property is substantially nonvested (as defined in § 1.83-3(b)) at the time of transfer, and no compensation will be includible in gross income when such property becomes substantially vested.

.02 In computing the gain or loss from a subsequent sale or exchange of property for which a § 83(b) election was filed, § 1.83-2(a) provides that the basis of such property shall be the amount paid for the property (if any) increased by the amount included in gross income under § 83(b).

.03 If property for which a § 83(b) election was filed is forfeited while substantially nonvested, § 83(b)(1) provides that no deduction shall be allowed with respect to such forfeiture. Section 1.83-2(a) further provides that such forfeiture shall be treated as a

sale or exchange upon which there is realized a loss equal to the excess (if any) of (1) the amount paid (if any) for such property, over (2) the amount realized (if any) upon such forfeiture. If such property is a capital asset in the hands of the taxpayer, such loss shall be a capital loss.

SECTION 5. EXAMPLES

The following examples illustrate the tax results that may occur depending on whether or not a § 83(b) election is made following the transfer of substantially nonvested stock in connection with the performance of services. The tax results in the examples do not depend on whether or not the stock transferred to the employee is traded on an established securities market.

Example 1. Company A is a privately held corporation and no stock in Company A is traded on an established securities market. On April 1, 2012, in connection with the performance of services, Company A transfers to E, its employee, 25,000 shares of substantially nonvested stock in Company A. In exchange for the stock, E pays Company A \$25,000, representing the fair market value of the shares at the time of the transfer. The restricted stock agreement provides that if E ceases to provide services to Company A as an employee prior to April 1, 2014, Company A will repurchase the stock from E for the lesser of the then current fair market value or the original purchase price of \$25,000. E's ownership of the 25,000 shares of stock will not be treated as substantially vested until April 1, 2014 and will only be treated as substantially vested if E continues to provide services to Company A as an employee until April 1, 2014. On April 1, 2012, E makes a valid election under § 83(b) with respect to the 25,000 shares of Company A stock. Because the excess of the fair market value of the property (\$25,000) over the amount E paid for the property (\$25,000) is \$0, E includes \$0 in gross income for 2012 as a result of the stock transfer and related § 83(b) election. The 25,000 shares of stock become substantially vested on April 1, 2014 when the fair market value of the shares is \$40,000. No compensation is includible in E's gross income when the shares become substantially vested on April 1, 2014. In 2015, E sells the stock for \$60,000. As a result of the sale, E realizes \$35,000 (\$60,000 sale price - \$25,000 basis) of gain, which is a capital gain.

Example 2. The facts are the same as in *Example 1* above, except that E does not make an election under § 83(b). Under § 83(a), E includes \$0 in gross income in 2012 as a result of the transfer of stock from Company A because the stock is not substantially vested. When the shares become substantially vested on April 1, 2014, E includes \$15,000 (\$40,000 fair market value less \$25,000 purchase price) of compensation in gross income. E's basis in the stock as of April 1, 2014 is \$40,000

(\$25,000 paid for the stock and \$15,000 included in income under § 83(a)). As a result of the 2015 sale of the stock for \$60,000, E realizes \$20,000 (\$60,000 sale price - \$40,000 basis) of gain, which is a capital gain.

Example 3. The facts are the same as in *Example 1* above, except that E terminates employment with Company A on August 1, 2013 before the shares become substantially vested. Because the excess of the fair market value of the property (\$25,000) over the amount E paid for the property (\$25,000) is \$0, E includes \$0 in gross income for 2012 as a result of the stock transfer and related § 83(b) election. When E terminates employment on August 1, 2013, the fair market value of the stock is \$30,000 but Company A purchases the stock from E for \$25,000 pursuant to the terms of the restricted stock agreement. As a result of the 2013 sale of the stock for \$25,000, E realizes \$0 in gain (\$25,000 sale price - \$25,000 basis).

Example 4. Company B is a publicly held corporation and Company B stock is traded on an established securities market. On April 1, 2012, in connection with the performance of services, Company B transfers to F, its employee, 25,000 shares of substantially nonvested stock in Company B. At the time of the transfer, the shares have an aggregate fair market value of \$25,000. F is not required to pay Company B any consideration in exchange for the stock. The restricted stock agreement provides that if F ceases to provide services to Company B as an employee prior to April 1, 2014, F will forfeit the stock back to Company B. F's ownership of the 25,000 shares of stock will not be treated as substantially vested until April 1, 2014 and will only be treated as substantially vested if F continues to provide services to Company B as an employee until April 1, 2014. On April 1, 2012, F makes a valid election under § 83(b) with respect to the 25,000 shares of Company B stock. Because the excess of the fair market value of the property (\$25,000) over the amount F paid for the property (\$0) is \$25,000, F includes \$25,000 of compensation in gross income for 2012 as a result of the stock transfer and related § 83(b) election. The 25,000 shares of stock become substantially vested on April 1, 2014 when the fair market value of the shares is \$40,000. No compensation is includible in F's gross income when the shares become substantially vested on April 1, 2014. In 2015, F sells the stock for \$60,000. As a result of the sale, F realizes \$35,000 (\$60,000 sale price - \$25,000 basis) in gain, which is a capital gain.

Example 5. The facts are the same as in *Example 4* above, except that F does not make an election under § 83(b). Under § 83(a), F includes \$0 in gross income in 2012 as a result of the transfer of stock from Company B because the stock is not substantially vested. When the shares become substantially vested on April 1, 2014, F includes \$40,000 (\$40,000 fair market value less \$0 purchase price) of compensation in gross income. F's basis in the stock as of April 1, 2014 is \$40,000 (\$0 paid for the stock and \$40,000 included in income under § 83(a)). As a result of the 2015 sale of the stock for \$60,000, F realizes \$20,000 (\$60,000 sale price - \$40,000 basis) of gain, which is a capital gain.

Example 6. The facts are the same as in *Example 4* above, except that F terminates employment with Company B on August 1, 2013 and forfeits the shares before the shares become substantially vested. Because the excess of the fair market value of the property (\$25,000) over the amount F paid for the property (\$0) is \$25,000, F includes \$25,000 of compensation in gross income for 2012 as a result of the stock transfer and related § 83(b) election. In the year F terminates employment, F forfeits the 25,000 shares back to Company B and such forfeiture is treated as a sale of the shares in exchange for no consideration. Pursuant to § 1.83-2(a), F realizes no loss as the result of such sale. F is not entitled to a deduction or credit for taxes paid as the result of filing the § 83(b) election or the subsequent forfeiture of the property.

SECTION 6. SAMPLE ELECTION

.01 The sample election in this section, if properly completed and executed by an individual taxpayer, would satisfy the requirements of § 1.83-2 regarding the required content of a § 83(b) election with respect to shares of common stock subject to a substantial risk of forfeiture. For the election to be valid, the service provider must in addition satisfy all other applicable requirements, including the requirements discussed above relating to the time for filing the election, filing the election with the Internal Revenue Service, attaching a copy of the election to the tax return, and providing a copy to the service recipient. An election under § 83(b) must contain all the information required by § 1.83-2(e), but need not use the exact format or language of the sample election set forth below. In the sample election below, bracketed items and blanks should be replaced with the applicable information for the taxpayer. An election with respect to property other than common stock should include an appropriate description of the property in item 2 and modifications to items 5 and 6 as necessary.

.02 The text of the sample election follows.

Section 83(b) Election

The undersigned taxpayer hereby elects, pursuant to § 83(b) of the Internal Revenue Code of 1986, as amended, to include in gross income as compensation for services the excess (if any) of the fair market value of the shares described below over the amount paid for those shares.

1. The name, taxpayer identification number, address of the undersigned, and the taxable year for which this election is being made are:

TAXPAYER'S NAME: _____

TAXPAYER'S SOCIAL SECURITY NUMBER: _____

ADDRESS: _____

TAXABLE YEAR: Calendar Year 20__

2. The property which is the subject of this election is _____ shares of common stock of _____.
3. The property was transferred to the undersigned on **[DATE]**.
4. The property is subject to the following restrictions: **[Describe applicable restrictions here.]**
5. The fair market value of the property at the time of transfer (determined without regard to any restriction other than a nonlapse restriction as defined in § 1.83-3(h) of the Income Tax Regulations) is: \$ _____ per share x _____ shares = \$ _____.
6. For the property transferred, the undersigned paid \$ _____ per share x _____ shares = \$ _____.
7. The amount to include in gross income is \$ _____. **[The result of the amount reported in Item 5 minus the amount reported in Item 6.]**

The undersigned taxpayer will file this election with the Internal Revenue Service office with which taxpayer files his or her annual income tax return not later than 30 days after the date of transfer of the property. A copy of the election also will be furnished to the person for whom the services were performed. Additionally, the undersigned will include a copy of the election with his or her income tax return for the taxable year in which the property is transferred. The undersigned is the person performing the services in connection with which the property was transferred.

Dated: _____

Taxpayer

SECTION 7: PAPERWORK REDUCTION ACT

.01 The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-2018. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

.02 The collection of information in this revenue procedure is in Section 6. The use of the sample election language provided under Section 6 is voluntary, however, this information is required in order for a taxpayer to make a valid election under § 83(b) of the Code. This information on the § 83(b) elections filed by the taxpayers with the IRS will be used by the IRS for matching with the income tax returns filed by the taxpayers. The likely respondents are individuals and business or other for-profit institutions.

.03 The estimated total annual reporting and/or recordkeeping burden is 33,000 hours.

.04 The estimated annual burden per respondent/recordkeeper varies from 10 to 30 minutes, depending on individual circumstances, with an estimated average of 20 minutes.

.05 The estimated number of respondents and/or recordkeepers is 100,000.

.06 The estimated frequency of responses (used for reporting requirements only) is on occasion.

.07 Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective June 25, 2012.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Michael Hughes of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue procedure contact Thomas Scholz or Michael Hughes on (202) 622-6030 (not a toll free call).