New Rules on Section 83(b) Elections

Prior to a recent change, in order for a Section 83(b) election to be effective, the taxpayer had to:

- File the Section 83(b) election within 30 days of the receipt of restricted property (typically, restricted stock) with the Internal Revenue Service (the "IRS");
- Provide a copy of the election to the service recipient (typically, the employer); and
- Attach a copy of the election to the taxpayer's tax return for the year of the election.

New regulations eliminate the requirement that a copy of the election be submitted with the taxpayer's tax return. This change is intended to facilitate e-filing of individual tax returns.

Discussion

Section 83 of the Internal Revenue Code addresses the tax consequences of a transfer of property (typically stock of the employer) in connection with the performance of services. Section 83(a) provides generally that the excess of the fair market value of the transferred property over the amount (if any) paid for the property is included in the gross income of the service provider (typically, an employee) as of the time that such person's rights in the property vest; that is, when the property is transferable or is not subject to a substantial risk of forfeiture. Section 83(b) permits the service provider to elect to include in gross income, as compensation for services, 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.

The Section 83(b) election is popular with employees and other service providers who work for start-ups and other companies with significant upside potential. It allows them to receive restricted stock or other property in exchange for services and to trigger a gross income inclusion (often a nominal or zero amount) while the value is still low. No taxable event happens upon vesting and future appreciation recognized in a subsequent sale generally is eligible for long-term capital gain treatment. The trade-off is that if the stock or other property is forfeited or loses value, the service provider generally is not entitled to take a tax loss.

On July 25, 2016, the Department of the Treasury and the IRS published final regulations eliminating the requirement that a copy of the Section 83(b) election be submitted with the taxpayer's income tax return for the taxable year in which the property is transferred. The requirements that the election be sent to the IRS within 30 days of the property transfer and that a copy of the election be provided to the employer (or other service recipient) have not changed. The new regulations apply to Section 83(b) elections made with respect to property transferred on or after January 1, 2015.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

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