DarrowEverett LLP

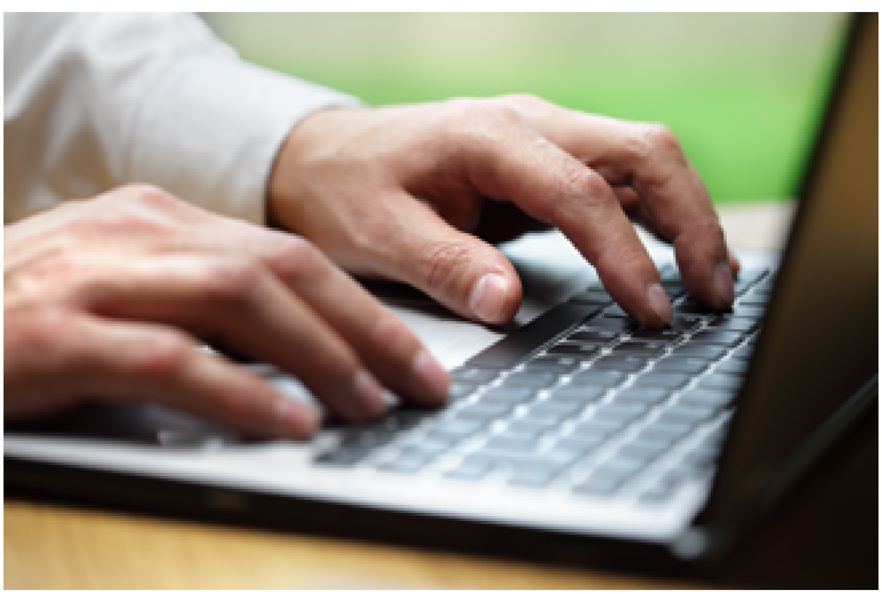
TAX AND COMPLIANCE ALERT

Section 83(b) Election Filing Requirements Modified

Section 83 of the Internal Revenue Code addresses the tax consequences of a transfer of property in connection with the performance of services, generally requiring the service provider to recognize income on the property received (for example, equity granted in lieu of cash compensation) unless the property is received subject to a substantial risk of forfeiture. Typically, such restricted property is taxed as and when the substantial risk of forfeiture lapses – whether that is a specific future date or a series of dates as on a "vesting schedule". Section 83(b) allows taxpayers to elect to be taxed upon receipt of property subject to a substantial risk of forfeiture.

Why would someone elect to pay tax on receiving something they do not yet truly own outright?

For some taxpayers holding restricted stock, especially in a growing start up, a Section 83(b) election allows the stockholder to lower the overall tax burden by recognizing ordinary income on the current, ostensibly lower value of the stock, while starting the clock to treat future appreciation as capital gains (at a lower tax rate). Since most common applications of Section 83(b) involve restricted equity in varying forms, whether limited liability company interests or shares of corporate stock, we refer to such property in this article as "stock". The rule of thumb is that if a taxpayer anticipates that the value of the stock will increase, forcing the taxpayer to pay higher taxes at the time the substantial risk of forfeiture lapses, they should file a Section 83(b) election.



The election has historically been made by firstly mailing a Section 83(b) election letter to the IRS within 30 days after the stock grant and secondly including a copy of the election letter with the income tax return filed at the end of the year.

The IRS recently issued final regulations under Section 83 eliminating the requirement for taxpayers making such a secondary Section 83(b) election.

The final regulations assist taxpayers who wish to file electronically their annual income tax return, as the required submission of a proper copy of their Section 83(b) election letter to accompany their income tax return could not be electronically filed and had to be completed by more traditional mailing.

However, taxpayers should note that the first Section 83(b) election must still be filed with the IRS **no later than 30 days** after the date the stock or other property subject to the election is transferred to or received by the service provider.

The final regulations apply to any stock or other property transferred on or after January 1, 2016. Taxpayers may also rely on the final regulations for such property transferred on or after January 1, 2015.

This publication is prepared for the general information of our clients and other interested persons. Due to the general nature of its content, it should not be regarded as legal advice. You should consult with your DarrowEverett LLP attorney to discuss transfers of property subject to potential forfeitures and otherwise implicating Section 83(b) in advance of or promptly after any such transfer.

If you have any questions regarding this alert, please reach out to any of our partners or counsel listed under the Our Professionals section of our website.

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