# Financial, Legal & Tax Advisory

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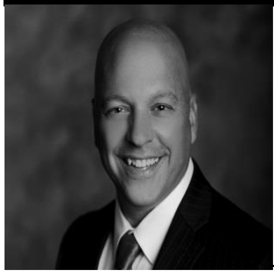

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## 83(b) Election: What is it?

Within the Internal Revenue Code (IRC), there is a provision known as an 83(b) election. The 83(b) election applies to equity that is subject to vesting. When this election is made, the Internal Revenue Service (IRS) is notified that the elector, whether it be an employee or startup founder, wishes to pay tax for the ownership at the time of granting, rather than at the time of stock vesting. An 83(b) election must be made within 30 days after the issuance of restricted shares.

While the IRS is to be notified of the election, the recipient of the equity must also submit a copy of the completed form to their employer. An 83(b) election is important due to the ability of being able to pre-pay your tax liability on a lower valuation, assuming any equity value increases in subsequent years. However, if the company's value declines, this tax strategy would ultimately lead you to overpay in taxes. Typically, whenever a founder or employee receives compensation in the form of equity, the stake is subject to income tax based on its value. The tax liability is based upon the Fair Market Value (FMV) of the equity at the time of granting, less any costs of exercising or buying the shares.

The tax must be paid in the actual year the stock is issued. In many cases, individuals may receive equity vesting over several years as employees earn the shares from being employed over time. In this scenario, the tax on the equity is due at the time of vesting. If the company performs well and increases in value over the vesting period, the taxes paid during each vested year will also rise in conjunction. When is it beneficial to make an 83(b) election? This election is beneficial to the elector if the restricted stock's value is going to increase in subsequent years.

Along with this, if the amount of income reported is small at the time of granting, this election could be quite beneficial. When is making an 83(b)-election detrimental? If the stock value falls or the company goes on to file for bankruptcy, then the elector has overpaid in taxes. The IRS does not allow an overpayment claim under this election. Another instance in which this election could be detrimental is if the employee decides to leave the firm before the vesting period is over. This is because the taxpayer has paid taxes on shares that they would never receive. Also, if the amount of income reported is substantial at the time of granting, this election may not be beneficial.

An 83(b) election allows someone to pay taxes on their stock awards at the time they are granted, rather than when they are vested. This tax law is often most beneficial to startup employees, who may receive large parts of their compensation in the form of restricted stock or stock options. With most startups hoping that their share value will increase rapidly, an 83(b) election allows for major tax savings. Contact the professionals at The Center for Financial, Legal, and Tax Planning, Inc. Our office can assist in the process of making an 83(b) election. Please contact us at (618) 997-3436 or visit our website at www.taxplanning.com.

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