

## A founder's guide to making a section 83(b) election: six commonly asked questions

One of the more important tax decisions founders of early-stage companies will face is whether or not to make an election under Section 83(b) of the Internal Revenue Code for stock awards or other acquisitions of shares subject to vesting. By making this decision promptly upon acquiring the shares, founders can avoid missing the 83(b) filing deadline and protect themselves from significant tax consequences down the line. Below, we have set out six of the most commonly asked questions about Section 83(b):

### What is a Section 83(b) election?

Section 83(b) of the Internal Revenue Code allows founders, employees and other service providers to accelerate the time for determining taxable income on restricted stock awards or purchases subject to vesting. A Section 83(b) election is made by sending a letter to the Internal Revenue Service requesting to be taxed on the date the restricted stock was granted or purchased rather than on the scheduled vesting dates.

Founders who decide to make an 83(b) election need to do so promptly to ensure that they do not miss the 83(b) filing deadline. **An 83(b) election must be filed with the IRS within 30 days after the grant or purchase date of the restricted stock.** The last possible day for filing is calculated by counting every day (including weekends and holidays) starting with the day after the grant date.

### What are the benefits of an 83(b) election?

There are several reasons why filing an 83(b) election may be beneficial for a founder. Most notably, Section 83(b) of the Internal Revenue Code allows founders to accelerate the determination of taxable income on an award or purchase of restricted stock to the date it was granted rather than on the date(s) the shares vest. If the restricted stock is purchased for an amount equal to its fair market value, an 83(b) election will result in no recognition of income as of the purchase date. Additionally, an 83(b) election advances the beginning of the one-year long-term capital gain holding period, often resulting in preferential capital gain rather than ordinary tax treatment upon sale (long-term capital gain tax rates are 0, 15 and 20 percent for most taxpayers). Simply stated, an 83(b) election can result in significant tax savings under the right circumstances.

### What happens if a founder does not file an 83(b) election?

If a Section 83(b) election is not filed by the deadline, a founder would pay taxes on restricted stock grants at each vesting date. The founder's tax would be assessed at ordinary income rates on the amount by which the stock's value on the vesting date exceeds the purchase price, if any. This may result in a significant tax obligation if the value of the shares has increased substantially over time.

### What are the risks of an 83(b) election?

Despite its benefits, the 83(b) election is not without risk. Making a Section 83(b) election accelerates the date that taxable income is recognized from the vesting date to the date the restricted stock is granted or purchased. This means that if a founder makes an 83(b) election, pays taxes on income based on the fair market value of the shares on the grant date, and then later forfeits his or her shares, the founder may have paid tax on *unrealized* income.

## What scenarios could make an 83(b) election more or less advantageous?

All things considered, a Section 83(b) election will likely be more (or less) advantageous for a founder in the following scenarios:

<b>Section 83(b) Election is More Advantageous</b>	<b>Section 83(b) Election is Less Advantageous</b>
the amount of income reported at grant is small	the amount of income reported at grant is large
the stock's growth prospects are moderate to strong	the stock's growth prospects are low to moderate
the risk of stock forfeiture is very low	the risk of stock forfeiture is moderate to high

## What are the steps to filing an 83(b) election?

To make an 83(b) election, the following steps must be completed within 30 days of the grant date:

1. Complete a Section 83(b) election letter
2. Mail the completed letter to the IRS within 30 days of your grant date:

Mail to the IRS Service Center where you file your tax return — the address for your IRS Service Center can be found [here](#).

Preferably send the letter by certified mail and request a return receipt.

3. Mail a copy of the completed letter to your employer.
4. Retain one copy of the completed and filed letter for your records and retain proof of mailing.

As always, founders should consult with their tax advisors to determine how a Section 83(b) election applies to their individual circumstances.

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