



PIASCIK & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

Main / 804-527-1815

Toll Free / 866-527-1815

Fax / 804-527-1816

Innsbrook Corporate Center

4470 Cox Road, Suite 250

Glen Allen, Virginia 23060

October, 2007

Mr. A Smith
ABC Smith Company

Dear Mr. Smith:

Restricted Stock and Internal Revenue Code Sec. 83(b) Election

Ever think about the tax consequences to you of an award by your employer of restricted stock?

- The value of stock that is transferred to you by your employer as compensation for services that you performed is includible in your gross income either in the first tax year in which you are not subject to a substantial risk of forfeiture, or when you can transfer the stock free of the substantial forfeiture risk, whichever occurs earlier.
- You have informed us that you will be entitled to the 1,000 shares if you complete two years of employment following the date on which this restricted stock is granted. Under the tax rules, you can either defer the income attributable to the grant of this restricted stock until your rights in the stock become vested, or elect—by making a Code Sec. 83(b) election—to recognize income at the time the stock is granted.
- Under Code Sec. 83(b), a recipient of a restricted stock award may elect, within 30 days of grant, to include in his gross income the fair market value (FMV) of the shares on the date of grant, with the amount of the income based on the then FMV of the shares—instead of waiting until the restrictions lapse for the attribution of income. The stock's FMV to be reported as income is not reduced to reflect the restrictions on the stock, unless there is a permanent limitation on the transfer of the stock that would require you to resell the stock to your employer at a price determined under a formula.
- The advantage of accelerating income is that any future appreciation in the stock won't be taxed to you until you sell the stock and then it will be taxed at capital gain rates.
- If you don't make the Code Sec. 83(b) election, then you will be treated as receiving taxable income equal to the stock's FMV on the date the restrictions lapse.
- If you make the Code Sec. 83(b) election, then you will report taxable income in the year that you make the election. The amount of income will be the stock's FMV on the date the restricted stock award was granted. For example, assume that you are granted the 1,000 shares in Year 1 when their value is \$100 per share; the restrictions on the stock lapse in Year 2 when the stock is worth \$160 per share; and you sell the shares in Year 3 for \$200 per share. If you don't make a Code Sec. 83(b) election, then you will be treated as if you received \$160,000 in compensation, taxable at ordinary income tax rates, in Year 2, and



realized a capital gain of \$40,000 in Year 3. If you make the Code Sec. 83(b) election, then you will be taxed on \$100,000 of compensation income in Year 1, and on \$100,000 of capital gains in Year 3.

- The benefit of the Code Sec. 83(b) election to you, on the above assumed facts, is the postponement of tax on the \$100,000 post-election increase in the value of the stock until Year 3, and the taxation of the entire \$100,000 of appreciation at capital gain rates, rather than only \$40,000 if no election were made.
- Remember, however, that the reason why tax deferral is available is that there is a substantial risk that your right to the stock could be forfeited because you have to remain with your employer for two years after the grant to have your rights to the stock vest. If you do forfeit your rights to the stock, then you will not be entitled to a refund of any tax you paid upon making the Code Sec. 83(b) election. But you will be entitled to treat the forfeiture as a sale of the stock at a loss.
- Generally, the deferred compensation rules under Code Sec. 409A—which include deferred compensation in income to the extent not subject to a “substantial risk of forfeiture”—do not apply to property not includible in income in the year of receipt under Code Sec. 83 because the property is nontransferable and subject to a substantial risk of forfeiture, or to property includible in income solely because of a valid Code Sec. 83(b) election.

Clearly, the rules governing restricted stock awards are technically complex and call for some careful tax planning strategies to be used. Please call if you would like to discuss any of these matters in more detail.

Piasek & Associates, P.C., provides premier tax, business, and financial services to a broad range of clients throughout the United States, Canada, UK, Germany and abroad. For more information, please visit www.piascik.com, or call Ryan L. Losi directly at (804) 228-4179.

Very truly yours,
PIASCIK & ASSOCIATES, P.C.

Ryan L. Losi, CPA
Executive Vice President