



IRS Opens the Door to Revoke an 83(b) Election - But Only a Crack

Section 83 provides that a service provider, generally an employee or an independent contractor, has taxable income upon the transfer of property equal to the fair market value of the property at the time the employee either has met the vesting requirements or can freely transfer the property. Under section 83(b), the employee can make an election to recognize the income when the property is first transferred, even though it is subject to a substantial risk of forfeiture. The election must be made within 30 days of the date the property is transferred to the service provider. The law provides that an 83(b) election can be revoked with permission of the IRS, but to date, the IRS has never granted such permission.

In Revenue Procedure 2006-31, the IRS sets forth for the first time the requirements for revoking an 83(b) election. Under the terms of the Rev. Proc., a service provider can only revoke the election in two situations: (1) the election can be revoked if the revocation is made within the same 30 day period that is allowed for making the election, and (2) the election can be revoked if the service provider is under a mistake of fact as to the underlying transaction and requests revocation within 60 days of the date on which the mistake of fact first became known to the person who made the election. Neither a mistake as to the value (or decline in the value) of the property for which the election was made nor the failure of anyone to perform an act that was contemplated at the time of transfer of the property constitute a mistake of fact for this purpose.

When Can a Service Provider Revoke an 83(b) Election

In an example in the Rev. Proc., an employee makes an election to report the value of restricted stock received from his employer. Later, he finds out that he would forfeit the stock even if he was terminated without cause by his employer. Further, he did not understand the tax impact of filing the election (that he would have taxable income even if he forfeited the stock). More than 30 days after making the election, the employee filed to revoke the election based on the fact that he did not understand the tax treatment of the election. The IRS denied the request because misunderstanding the tax impact of the election is not a mistake of fact as to the underlying transaction. However, if the employee had filed the request to revoke the election within the initial 30 days after the transfer was made, the IRS would accept the revocation.

In another example, under an employment contract, an employee was supposed to receive Class A shares of common stock of his employer subject to a substantial risk of forfeiture. The employer actually transfers Class

B common stock and the employee makes an 83(b) election with respect to the transfer of the stock. He later discovers that he did not receive Class A shares. The employee can revoke the 83(b) election if the request is made within 60 days of the date when he first discovered that the incorrect class of stock was transferred.

Private Letter Ruling is Required

Even though this allows some leeway in revoking an election, the IRS requires that the individual request a private letter ruling in order to revoke the 83(b) election. This is a costly and often lengthy procedure. Most employees will have to hire an outside advisor to file the private letter ruling request. Thus, although the Rev. Proc. would seem to open the door to allow employees to revoke the election, it does not appear to have much practical use.

For more information on the topic discussed in this *HRS Insight* or to change your address, contact your local PricewaterhouseCoopers professional.

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