



Should You Make The 83(b) Election On Your Restricted Stock?

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Increasingly, employee compensation packages, especially those of executives and other highly paid employees, are including some form of stock-based compensation. Restricted stock is now one of the most common forms of stock-based compensation. Not to be confused with restricted stock units (RSUs), restricted stock has several different characteristics, most notably the ability to make an “83(b) election.” Note: we provide a summary of the differences between Restricted stock and RSUs at the end of this article.

What is the 83(b) election?

For background, 83(b) is the section of the Internal Revenue Code (IRC) which states that you must include in your gross income any property received not subject to a substantial risk of forfeiture. However, under section 83(b) you can make an election to include property subject to substantial risk of forfeiture in gross income for the current year—hence the “83(b) election.”

Restricted stock that vests over time is a perfect example of property received that is subject to a substantial risk of forfeiture, because, generally, if you cease working for your employer prior to the vesting date, you forfeit your right to the stock.

If you make the 83(b) election, you pay ordinary income tax based on the fair market value of the

restricted stock at the time of grant. In doing so, any future appreciation of the stock becomes a capital gain taxed at a lower rate. The catch is that if your stock fails to vest, you have paid tax on something that you never actually received, and you are not allowed any subsequent tax credit or deduction. There are no “83(b) do-overs.”

Under what circumstances does it make sense to file an 83(b) election and pay taxes on your restricted stock at the time of grant?

1. If your restricted stock is worth a nominal amount at grant, you should almost always file an 83(b) election. For example, if you are granted 100,000 shares of restricted stock valued at \$0.01 per share (for a total value of \$1,000), you will pay just a few hundred dollars in taxes this year and not have to worry about paying potentially much more in taxes when the stock vests.
2. Making the 83(b) election is a bet that the value of your restricted stock will go up and that you will be with your company long enough for the stock to vest. So, you should be reasonably confident that both things will happen. If you are not sure your company will manage to stay afloat or you don't intend on sticking around to find out, then an 83(b)



election probably is not for you.

3. The 83(b) election is a tax-arbitrage opportunity, enabling you to trade ordinary income tax (at higher rates) for capital gains tax (at lower rates). The higher your tax bracket, the better deal this becomes for you. So, if you are highly compensated and particularly tax-sensitive, an 83(b) election could be an appealing option.

4. Going back to point #1 above, what if the restricted stock isn't worth a nominal amount and has substantial value? For example, what if you are granted 100,000 shares of restricted stock valued at \$1.00 per share? Now, by filing 83(b) election, you would owe tens of thousands of dollars in taxes this year. In such a situation, you need to make sure you have the money available to pay the taxes upfront or this could end up a painful experience come tax time.

5. Finally, if you think your company's share price is set to pop in the near future, then it could make good sense to file the 83(b) election and

lock in the potential upside at the lower capital gains rate. The added benefit of filing the 83(b) election is that your holding period begins at the grant date rather than the vest date, which enables you to sell your fully vested shares sooner and still have a long-term holding period to qualify for beneficial capital gains tax treatment.

The bottom line

Deciding whether to file the 83(b) election is one of the most important planning opportunities related to company stock compensation. It is a multi-faceted decision that requires an understanding of your personal financial situation, tolerance for risk, the likelihood of your shares vesting, and the company's overall financial performance. And don't forget, the decision to file an 83(b) election must be made no more than 30 days after the grant date so you don't have much time to decide.

Image 1: Restricted stock vs RSUs

	Restricted Stock	RSUs
Tax Treatment	Ordinary income at vesting	
Social Security and Medicare taxes	at vesting	
83b Election	Yes	No
Time of share issue	Grant (held in escrow)	Vesting or delivery later
Issuance	Issued as shares	Can be issued as cash or shares
Voting rights	Yes	No
Dividend rights	Yes	No, but company plan may provide dividend equivalents