Restricted Stock

By Gina L. Gwozdz, CPA
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My client, Janet, just purchase some of her company's stock for $10 a share and wanted to know if she should make a Section 83(b) election. Janet purchased 1,000 shares and the FMV of her company's stock is $23 per share. Janet must return the stock if she leaves the company within the next 5 years.

Generally, income is not recognized when an employee receives restricted stock. If the employee decides to make the Section 83(b) election then the employee has to include in their income the amount that the FMV of the stock, at the date of transfer, is greater than what they paid for the stock. In this case that would be $13 per share times 1,000 shares or $13,000. Janet would have to pay income and employment taxes on this amount. Why would anyone want to make this election?

By making this election now, there are no tax consequences when this stock vest, in Janet's case, 5 years from now. So one reason to make the Section 83(b) election is if you believe that the stock will be worth more when the stock vests than it is worth on the date of transfer. Any appreciation in the stock's value is not recognized until the date the stock is sold and then it is taxed at capital gains rates. Also, if the company pays any dividends on the stock, once the Section 83(b) election is made they are treated as dividends, instead of compensation, avoiding some payroll taxes.

Why wouldn't you want to make this election? If you think the stock will not vest – in this case if Janet isn't sure she will be with the company for 5 years. If you don't think the stock will have a substantial increase in value. If you think the stock might decrease in value. If you don't have the cash to pay the taxes necessary by making this election.

Since no one can predict the future, each taxpayer has to decide for himself or herself which direction they want to go.

Gina L. Gwozdz *is a CPA who has chosen to specialize in taxes.* Visit her website at http://GLGcpa.com to view more Tax Tip Articles.