

# Mechanics of Making an 83(b) Election & IRS Revocation Guidance

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**PRACTICES** Employee Benefits and Executive Compensation

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When a company grants an equity interest that is subject to vesting to an employee, consultant, or non-employee director (each, a “service provider”), the service provider is normally taxed on the date that the unvested equity interest vests. Section 83(b) of the Code, however, allows the service provider to elect to include the value of the restricted equity in income and pay the tax in the year the restricted equity is granted, even if it is unvested, provided certain conditions are met.

While a Section 83(b) election may sound great to some service providers, there are some risks associated with making the election and some important steps that must be followed to make it effective. For example:

- A Section 83(b) election must be mailed to the IRS office where the service provider files his or her income tax return within 30 days following the grant date, and the election is required to include the grant date, number and value of the shares, purchase price paid, if any, and applicable stock restrictions. If the 30th day following the grant date falls on a weekend or legal holiday, the election will be considered timely filed if it is postmarked by the next business day. If the election is not timely filed, the election is ineffective.
- There is a risk to a Section 83(b) election: the election is made while the restricted equity is still unvested, and if the restricted equity is actually forfeited, the Code prohibits a deduction for any amount that was previously included in income as a result of the Section 83(b) election. To illustrate this point, if the service provider was required to include \$0.10 in income for each share of an equity interest that is later forfeited, the service provider will have paid tax on that \$0.10 per share but will not receive a deduction to offset the \$0.10 per share included in the service provider’s taxable income. This aggregate amount could ultimately be substantial based on the size of the equity award.
- A Section 83(b) election should be viewed as irrevocable once made. The Commissioner of the IRS generally only allows for revocations in very limited circumstances. For example, if a request to revoke is filed within the 30-day period following the grant date, consent to revoke the election will generally be granted by the IRS, regardless of the reason for which it is filed. However, after this 30-day period, a request to revoke will only be granted if made within 60 days of discovery of a mistake of fact as to the underlying transaction. A mistake of fact is narrow in scope and must concern a fact which forms the very basis of the transaction. For instance, the IRS provided an example of an approved mistake of fact where a service provider is granted the wrong class of stock, files an election on that basis and later discovers the mistake.
- A copy of the election should also be provided to the company granting the restricted equity so the company can properly withhold and report income and employment taxes due for an employee and for contractors and non-employee directors, report the income on a Form 1099 for the year the equity is granted.

Due to the tax consequences summarized above, companies should encourage any service provider that is awarded restricted equity interests to discuss the mechanics of a Section 83(b)

election with his or her own tax adviser. IRS guidance regarding the filing of a Section 83(b) election and a possible revocation is available [here](#) and [here](#).