December 7, 2000

NEW YORK STATE BAR ASSOCIATION
TAX SECTION

REPORT ON POSSIBLE MODIFICATIONS TO SECTION 83 AND THE REGULATIONS THEREUNDER

This report[1] identifies and discusses a number of issues arising under section 83[2] that may be due for reassessment, and it considers possible changes to address those issues. Some of the changes considered here would require legislative action, while others could be made administratively.

Section 83 was enacted in 1969 and has been generally unchanged in the ensuing thirty-one years. While the Tax Section is ordinarily reluctant to suggest reexamination of longstanding rules, we have done so in this case because we believe that some of the assumptions about market practice upon which the rules of section 83 were based may no longer hold true. Section 83 was originally enacted to deal with current transfers of employer stock to an employee at a deep discount to fair market value in order to defer tax on compensation income that had already been earned. Due to the success of section 83, these types of deferred compensation plans have largely been supplanted by straightforward equity-based compensation plans that rarely involve transfers at a deep discount to fair market value. Grants of nonqualified options on employer stock have become widespread, and such options may be more susceptible to valuation than in the past. In addition, restricted employer stock today often may be issued to employees who are required by investors to buy it at fair market value as a condition of employment. Meanwhile, the scope and coverage of equity-based

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1 This report was prepared by the Committee on Individuals of the Tax Section of the New York State Bar Association. The principal drafter of this report was Kimberly S. Blanchard. Helpful comments were received from Andrew Berg, Sherwin Kamin, Richard Reinhold, Robert Scarborough, Michael Schler, David Schizer, Marc Silberberg and Willard Taylor.

2 All section references are to the Internal Revenue Code of 1986, as amended.

compensation plans have expanded greatly over the years, increasing the number of individual taxpayers who are affected by section 83's sometimes arcane provisions

We believe that the tax results that follow from the operation of section 83 should be, insofar as possible, those that a reasonable taxpayer would expect, and should not create unnecessary traps for the unwary or the unadvised. Although this standard might be important in evaluating any provision of the tax laws, it is particularly important, we think, in the context of section 83 because virtually all of the taxpayers likely to be adversely affected by counterintuitive rules are individuals. Individuals do not always have access to tax advice, and when they do seek it out may not think to do so until tax-filing season. Although more sophisticated key employees can usually be expected to negotiate their compensation packages and to seek competent tax advice, restricted stock and option programs that implicate section 83 are being extended to ever broader classes of employees. In our experience many of these employees are unlikely to receive timely and thorough tax advice, and are unsophisticated in terms of applying what advice they do receive.

We also have found in practice that in many cases the rules under section 83 are unclear and susceptible to competing characterizations, creating the potential for whipsaw of the government. Because the tax interests of the service provider (hereafter, the "employee") and the service recipient (the "employer") are often adverse, the government's interest could in many cases be protected simply by ensuring that the employer and employee take consistent positions under section 83. Congress has repeatedly underscored its reliance on the adverse tax interests of employers and employees by emphasizing that section 83 is, and is intended to be, revenue neutral. For example, in 1969, the estimated revenue effect of section 83, even though the new law radically altered pre-existing rules, was deemed "negligible" because "restricted stock plans, for the most part, have the effect of transfering [sic] tax liability from the employees to the company."[3] Again, in 1984, when Congress enacted a transition rule to mitigate the unexpected effect of the *Alves* decision, it was observed that "[t]he proposed amendment to section 83 does not involve any significant revenue loss or gain: what the employee is taxed on the employer can deduct. *Section 83 is and should remain essentially revenue neutral.*"[4] Again, the revenue effect was scored as "negligible."[5]

This report is divided into five sections. Part I provides some background concerning the enactment of, and developments under, section 83. Part II discusses the rule of *Lawrence J. Alves,*[6] in which the government successfully maintained that an employee who paid fair market value for property subject to a substantial risk of forfeiture, and who failed timely to make a section 83(b) election, received his shares in connection with services and therefore realized compensation income on lapse of the forfeiture restriction. Our report recommends that consideration be given to modifying existing Reg. §1.83-2(a) so that a transfer to an employee who pays fair market value for restricted property would be treated as not being in connection with the performance of services. It further recommends that the regulations provide examples of cases in which the mere existence of a substantial risk of forfeiture would not, without more, give rise to a presumption that the restricted property was transferred in connection with the performance of services. These regulations could also address the application of section 83 to cases where a substantial risk of forfeiture is placed on previously-unrestricted property.

Part III of this report recommends that the requirement of section 83(b)(2), that a section 83(b) election be filed within 30 days of a transfer, be replaced with a grant of

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3 H.R. Rep. No. 413 (Part 1), 91st Cong., 1st Sess. 89 (1969). To the same effect is S. Rep. No. 552, 91st Cong., 1st Sess. 124 (1969).

4 130 Cong. Rec. S. 4509 (April 12, 1984) (emphasis added).

5 Staff of the Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 891 (Dec. 31, 1984).

6 79 T.C. 864 (1982), *aff'd*, 734 F.2d 478 (9^{th} Cir. 1984).

authority to the Secretary to prescribe a time for filing. Part III also recommends the repeal of the rule of section 83(b)(1) that disallows any deduction in respect of a forfeiture following a section 83(b) election.

Part IV discusses the definition of "readily ascertainable fair market value" applicable to options in Reg. §1.83-7. While our report makes no specific recommendations in connection with the option rule, we do note that the regulations—because they construe this phrase so narrowly as to make section 83 inapplicable to options in practice—appear inconsistent with Congressional intent. We discuss whether Reg. §1.83-7(b)(3) might be revised to incorporate use of a financial option valuation formula.

Finally, Part V makes recommendations for clarifying and amending the definition of what constitutes a "transfer" of property in Reg. §1.83-3(a). We suggest that additional examples be added to that regulation, addressing specifically the purchase of restricted property with a nonrecourse note of the employee.

I. BACKGROUND

Section 83 applies where property subject to a substantial risk of forfeiture is transferred in connection with the performance of services. The excess of the fair market value of such property[7] at the time the forfeiture risk lapses[8] over any amount paid for the property–that is, the "spread"–is includible in the employee's income in the year of vesting as compensation. An employee may alter this default result by making a timely election under section 83(b) to include as compensation, in the year in which the restricted property is transferred, an amount equal to the spread on the transfer date. The

7 Fair market value here is determined without regard to any lapse restriction. Whenever the term "fair market value" is used in this report, it is used in this sense unless specifically indicated otherwise.

8 Or, if earlier, the time that the property becomes capable of being transferred free and clear of the forfeiture restriction. In this report the earlier to occur of these events will be referred to simply as "vesting."

election must be filed with the IRS within 30 days of the date of the transfer. Under section 83(h), the employer is generally entitled to claim a compensation deduction for the amount included in the employee's income under section 83(a) or (b) in the same year that the amount is includible in the employee's income.

Prior to the enactment of section 83, the tax law allowed deferral where employer stock or other property transferred to an employee was subject to a lapse restriction that affected the value of the property. The restriction did not need to rise to the level of a "substantial risk of forfeiture." A typical example, mentioned in the legislative history of the 1969 Act, was a transfer of shares subject to a restriction that prohibited the employee from selling or disposing of the shares for a period of years.

The first and most important purpose of section 83 was to require current taxation, to the employee, of the value of property transferred where any lapse restrictions affecting the value of such property did not rise to the level of a substantial risk of forfeiture. The House Report began its discussion of section 83 by noting that:

> Under existing regulations if property is transferred subject to a restriction which has a significant effect on value, no part of the amount attributable to the transfer of such property is included in gross income until the time the restriction lapses or the property is sold or exchanged, whichever occurs earlier….[u]nder new subsection (a) even if property transferred is subject to a restriction which has a significant effect on value, if the beneficial interest in such property is not subject to a substantial risk of forfeiture, the amount attributable to such transfer shall be included in gross income for the taxable year in which such beneficial interest is transferred.[9]

Congress enacted section 83 primarily to limit the benefit of deferral to cases in which the property transferred was subject to a *substantial* risk of forfeiture, usually tied to the employee's service. In the absence of a substantial risk of forfeiture, section 83 applied to treat a transfer as complete for tax purposes and thus as immediately taxable. Congress made this change because it believed that employers and employees

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9 H.R. Rep. No. 413 (Part 2), 91st Cong., 1st Sess. 61-62 (1969).

were using restrictions, like the period-of-years restriction, merely to achieve deferral. Congress believed this type of restriction had no independent nontax purpose. As correctly summarized in Judge Whitaker's dissent in *Alves*: "The statute was designed to counter the then-existing practice of attaching lapse restrictions to stock in order to reduce temporarily its value, thus creating the compensation element which was deferral of tax on the economic gain at the time of purchase…."[10]

Prior to the enactment of section 83, the *amount* of gross income reportable by the employee in the year the restriction lapsed was the *lesser* of the fair market value of the property at the time of the original transfer or at the time the restriction lapsed. Thus, there was no penalty attached to deferral; the employee had no risk of having to report a larger amount of ordinary compensation income if, in the year the restriction lapsed, the value of the property had increased.

The second purpose of section 83 was to attach a penalty to deferral, even where deferral was permitted due to the presence of a substantial risk of forfeiture. Under section 83(a), any growth in the value of restricted property up until the vesting date will eventually be taxable at ordinary income rates and not at lower capital gain rates.

Given the addition of this penalty for deferral, it is curious that the original House version of section 83 did not contain the present section 83(b) election. Section 83(b) was added by the Senate, apparently as an afterthought, "[t]o provide flexibility."[11] The need for a rule like section 83(b) was probably at first overlooked because the types of arrangements to which section 83 was addressed very rarely (if ever) involved the employee paying anything approaching fair market value for property. As written, section 83(b) refers to the "excess" of the value of property on the transfer date (disregarding any lapse restrictions) over the amount paid for the property. There is no

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10 79 T.C. at 884.

11 S. Rep. No. 552, 91st Cong., 1st Sess. 123 (1969).

evidence that Congress considered that section 83 would apply where an employee paid fair market value for property, *i.e.*, where such an "excess" did not exist. It is quite likely that Congress could barely conceive of an employee paying fair market value (determined without regard to restrictions) for restricted property, especially given the new rule permitting deferral only where the restriction constitutes a substantial risk of forfeiture. Arrangements involving a substantial risk of forfeiture were apparently so rare that Congress repeatedly referred to section 83 as addressing "deferred compensation" plans, in which the compensation element had already been earned, rather than plans pursuant to which the employee's right to the property was conditioned upon the future performance of substantial services.

Today, many employees pay true fair market value, or close to it, for restricted stock. Common situations where employees pay full value or something close to it include stock subscriptions by founders, some of whom (typically key employees) are required to accept a substantial risk of forfeiture and others of whom are not, but all of whom pay the same price per share; employees who participate in management buyouts (typically leveraged) of existing businesses; employees who are given the chance to buy into existing businesses at a price determined by appraisal or by market trading to be full value; employees whose previously-owned unrestricted shares are exchanged for restricted shares in connection with refinancings; and employees or directors who are required to purchase shares of employee stock pursuant to "best corporate practice" guidelines insisted upon by shareholders. Given the often significant cost of restricted stock, it is not uncommon for employers to assist in financing these purchases, often with a combination of recourse and nonrecourse loans.

Employees who pay full value or nearly full value for restricted stock recognize little or no income if the transfer is treated as currently effective, but pay a substantial penalty—taxation of subsequent appreciation as ordinary income—if the recognition of the transfer is deferred. Such employees have, from a tax standpoint, little to gain but much to lose from deferral of recognition. The assumption that employees generally desire deferral, and so generally would not want to elect to recognize a transfer currently for tax purposes, thus may no longer hold true. Accordingly, the section 83(b) election has attained an importance unimagined in 1969.

Section 83 was overwhelmingly successful in eliminating the tax-motivated deferral arrangements Congress took aim at in 1969. In the more than 30 years that have passed since section 83 was enacted, taxpayers have become so accustomed to living with the rules of section 83 that it is easy to forget what the section was aimed at, and casually to misapply its standards to transactions at which it was not directed.

II. REASSESSING THE RULE OF *ALVES*

In *Alves*, the taxpayer had early discussions with another individual about forming a new business and joining that business as a key employee. The first individual—who also became an employee of the new company—subscribed for stock at $x per share on the same date as another founder made the same per share investment. Neither of these two founders' shares were subject to any forfeiture restriction.

The taxpayer subscribed for his shares two weeks later at the same $x per share, but received both unrestricted and restricted shares of stock. He did not make a section 83(b) election with respect to the restricted shares. At trial, the government stipulated that the taxpayer had paid full fair market value for his restricted shares. The government argued that the taxpayer was required to report, as ordinary income, the excess of fair market value at the time of vesting (or earlier disposition) over the amount paid.

The taxpayer argued that section 83 did not apply to his purchase of the shares because they were not transferred to him "in connection with the performance of services"–that like the other founders he had simply made an investment. He further argued that he was not only not *required* to make a section 83(b) election, but precluded from doing so, as section 83(b) on its face applies only where there is an "excess" of fair market value over purchase price.

The Tax Court held in favor of the government in an opinion affirmed by the Court of Appeals for the Ninth Circuit. To reach this result, the court was required to find and did find that the stock in question was transferred "in connection with the performance of services." Although the Tax Court made reference to all of the facts and circumstances attendant to the taxpayer's stock purchase, it came close to formulating a *per se* rule pursuant to which the mere existence of a forfeiture restriction tied to employment would always result in a finding that a transfer is "in connection with" the performance of services. Evidence included the fact that the two founders who received unrestricted stock at the same price the taxpayer paid for restricted stock were also employees of the company.[12] The Ninth Circuit's affirmance actually went so far as to suggest that a transfer that the parties clearly intend as *noncompensatory* may still be characterized as "in connection with" the performance of services.[13]

In rejecting the taxpayer's argument that the purchase of stock at what was stipulated to be its fair market value should not be treated as a transfer in connection with the performance of services, both courts relied in part on the following passage from the Senate report accompanying the 1969 enactment of section 83:

> It has been suggested by some that restricted stock plans are not in fact, deferred compensation arrangements, but rather are a means of allowing key employees to become shareholders in the business. This line of reasoning, however, overlooks the fact that in 1964 Congress specifically dealt with the matter of the appropriate means by which key employees could be provided with a stake in the business when it revised the treatment of qualified employee stock options.[14]

The *Alves* courts misread this passage from section 83's legislative history. The cited language reflects the Senate's assumption that an employee would never pay fair market value for stock. The reason that the cited passage refers to

12 In fact, the Tax Court relied on the absence of *any* nonemployee shareholders to turn Reg. §1.83-3(f) on its head. The regulation notes that evidence of the noncompensatory character of a transfer may be found where nonemployees purchase property on identical terms and conditions. The Tax Court felt free to ignore this regulation because all of the shareholders in *Alves* were employees. 79 T.C. at 875.

13 734 F.2d at 482.

14 S. Rep. No. 552, at 120.

qualified options—the precursor of today's incentive stock options ("ISOs")—is that to obtain the benefit of capital gain treatment, the exercise price of the option had to be no less than the fair market value of the underlying stock, measured at the option grant date. In this passage, Congress was not saying that the purchase of stock at fair market value was within section 83. What Congress was saying was that to make a bargain purchase without being taxed on ordinary compensation income, it was necessary to do so pursuant to a previously-granted ISO.

The Tax Court's 1982 decision in *Alves* was criticized by Congress even as it was being affirmed by the Ninth Circuit. Calling the result "unintended," one Senator had this to say:

> This is a questionable tax policy result, and its main impact will fall on founders of successful new high technology and other enterprises, who had no warning that such a tax trap could be involved in a routine corporate formation. The proposed amendment to section 83 does not involve any significant revenue loss or gain; what the employee is taxed on the employer can deduct. Section 83 is and should remain essentially revenue neutral.[15]

Congress accordingly enacted, in 1984, a one-time grace period from the 30-day rule for filing section 83(b) elections applicable to employees who paid fair market value for restricted property at any time after June 30, 1976 and November 18, 1982 (the date of the Tax Court's decision in *Alves*).[16]

Even the *Alves* decisions acknowledged that "cheap stock" was Congress' principal focus in enacting section 83; the Ninth Circuit's affirmation in *Alves* at least twice referred to the facts before it, where the employee paid fair market value, as "unusual." When Congress characterized the holding in *Alves* as a trap for the unwary, it appeared that Congress still perceived the facts of that case to be relatively unusual; the

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15 130 Cong. Rec. S. 4509 (April 12, 1984).

16 Tax Reform Act of 1984, Pub. L. No. 98-369, § 556 (1984).

remark on the Senate floor quoted above referred to the trap as falling on "founders of successful new high technology and other enterprises…in a routine corporate formation."

If it was practically unheard of for an employee to pay fair market value for restricted stock prior to 1969, and "unusual" for him to do so as late as 1984, we believe it is common today. In our experience, in the more than 30 years since section 83 was added to the Code, it has become more common for employees to act as co-investors with nonemployees and to pay the same price per share of employee stock that others pay, notwithstanding the forfeiture restrictions attached to their own shares. Even where other nonemployee investors are not purchasing shares of employer stock on a contemporaneous basis, employees often purchase restricted stock for what both employee and employer reasonably believe to be fair market value (without regard to the forfeiture risk). In some cases the stock may be publicly traded and easily susceptible to valuation, while in other cases valuation will be based on an appraisal or other facts and circumstances.

Because section 83(a) imposes meaningful penalties upon deferral by converting future appreciation that would otherwise be capital gain into ordinary income, and by triggering income recognition in advance of a liquidity event, every employee who pays fair market value or close to it for restricted property would be advised by competent tax counsel to file a section 83(b) election. In fact, most do so. However, some employees are not made aware of the necessity of filing the election in time to do so, if ever. The practical problem is particularly acute in a case where the employee, having paid fair market value for his stock, has no reason to suspect that the government would deem his purchase to be a compensatory transfer within the meaning of section 83. As Judge Fay put it in a dissenting opinion in *Alves*: "I do not think Congress intended to require a taxpayer to elect to include something in gross income when that taxpayer had nothing to include in gross income."[17]

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17 79 T.C. at 881.

It might be argued that, over 15 years since *Alves* was decided, employees should be familiar with the need to file a section 83(b) election even where fair market value is paid for restricted property. Perhaps they should be, but in many cases they are not. Section 83 enacted rules that were almost certainly consistent with what a reasonable layman unfamiliar with tax rules might expect in cases to which the rules were addressed—the transfer of property at a bargain price. However, it is unreasonable to believe that a taxpayer would know that an election would need to be filed, much less within 30 days of a purchase, simply because his shares are subject to forfeiture.

If the rule of *Alves* were to be overturned, it would be necessary to provide some parameters for determining when a transfer should be treated as a purchase at fair market value.[18] To help understand the issues that arise in developing such parameters, we think it useful to begin by considering the government's stipulation in *Alves* that Mr. Alves had in fact paid fair market value for his restricted shares.

Both courts involved with the *Alves* case seemed genuinely confused by the parties' stipulation that the restricted shares purchased by the taxpayer, at the same price per share as the founders paid for unrestricted shares, had a fair market value equal to their purchase price. Because the taxpayer purchased both restricted and unrestricted shares, the courts surmised that the taxpayer must have paid *more* per share for his unrestricted shares and correspondingly *less* for the restricted shares, such that the "average" price just happened to coincide with the founder's price per unrestricted share. However, the actual number of restricted and unrestricted shares actually purchased by Mr. Alves do not support this surmise.

There are, we think, two quite different ways of explaining why an employee such as Mr. Alves pays the same price per share for restricted shares that a nonemployee investor pays for unrestricted shares. One explanation is that the employee

18 We note that the transition relief enacted by Congress in 1984 applied only where property was purchased at fair market value, but did not elaborate on how such a determination should be made.

in fact does receive stock worth more than what he paid for it, even though it is not "cheap stock" in the traditional sense of that term. To take an extreme example, if a nonemployee investor pays $1,000,000 for 1,000 shares of stock and permits an employee to purchase ten shares of stock for $10,000 (the same $1,000 per share), it might be said that the employee is piggybacking upon the investor's outlay or that the investor should be seen as entitled to a volume discount for his much larger investment. In other words, the arms'-length price for the small lot of shares would be higher than the price for the larger lot. In response, however, it might be argued that the employee in such a case should be entitled to a minority discount even for unrestricted shares, and is receiving stock that, even unrestricted, would be worth less rather than more than he paid.

The other way of explaining what occurs in a case such as this is to posit that in some cases, at least, the employee is required as a condition of employment to pay *more* than fair market value for his shares. This fact pattern has become increasingly prevalent, as witnessed by a recent IRS information letter finding no transfer where forfeiture restrictions are placed on "old and cold" founders' shares at the insistence of new investors.[19] If one accepts that Mr. Alves may well have been required as a condition of employment to pay in excess of fair market value for his shares, it is very difficult to argue that a section 83(b) election was required, or even permitted, to be filed; section 83(b) speaks solely in terms of the "excess" of fair market value over purchase price. While it may be possible to say that the "excess" can be zero, as the courts in *Alves* concluded, it is very difficult to maintain that the "excess" can be negative.

Like all questions involving value, the question whether an employee has paid fair market value comes down to the facts and circumstances in a given case. But unlike other areas where value is at issue, in this area the consequences of being wrong would be draconian if the rule of *Alves* were repealed only where the employee were found to have in fact paid (at least) fair market value. If *Alves* continues to apply to an

19 IRS Information Letter dated June 12, 2000 from Robert B. Misner, Assistant Chief, Branch 1, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities).

employee who has failed to make an election because he reasonably believes he has paid fair market value, the doctrine not only would convert what would otherwise be future capital gain into ordinary income, but also would impose tax when the restriction lapses rather than when the taxpayer sells the stock and generally has the money to pay the tax. This is a harsh penalty for a minor footfault, especially given the 30-day hair-trigger rule. If Mr. Alves's shares had *not* been subject to a forfeiture restriction, section 83 would not have applied. In that case, even if the transfer to him had been "in connection with the performance of services," the government's stipulation as to value meant that he would not be in receipt of compensation. Because his shares were subject to forfeiture, however, the result was to treat as compensation not zero but the full amount of the spread at vesting. Given that the penalties for guessing wrong are so draconian, consideration should be given to reversing the rule in *Alves* in such a way that an employee who pays a good-faith estimate of fair market value should be able to overcome the presumption that the property was transferred in connection with the performance of services.

We believe the Treasury Department has the authority to promulgate a rule that would treat transfers as noncompensatory where the employee pays fair market value for property and where the employee's estimate of fair market value is made in good faith. We note in this connection that the *Alves* courts paid deference to language in Reg. §1.83-2(a) stating that "[t]he fact that the transferee has paid full value for the property transferred, realizing no bargain element in the transaction, does not preclude the use of the [section 83(b)] election…" We believe that the administration has the authority to modify this language–perhaps retaining the words "does not *preclude*" as a safe harbor–to remove and indeed overturn any implication that the election is necessary where the absence of a bargain element leads both employee and employer to report no compensation income (or expense) in respect of the transfer.

In other closely related contexts, a good faith estimate of fair market value is respected. For example, under Reg. §1.61-15(b)(2), a person who acquires an option that has a readily ascertainable fair market value is permitted to show that the option is not compensatory by showing that she paid an amount for the option equivalent to fair market value. Ironically, there is no similar regulation under section 61 permitting a person who acquires stock or other property at fair market value to demonstrate the noncompensatory nature of such transfer.[20]

Section 422 provides a second example. In order for an option granted to an employee to qualify for tax-favored ISO treatment, under section 422(b)(4) the option price must be no less than the fair market value of the underlying stock on the date the option is granted. Section 422(c)(1) provides that an option will not fail to qualify as an ISO if there is a good-faith attempt to satisfy the fair market value rule even if the fair market value of the stock turns out to be higher than the option price. Proposed regulations adopt a facts and circumstances test to resolve the question of whether the option price was set in good faith, and give as an example of good faith the use of a valuation for nonpublicly-traded stock that is the "average of the fair market values as of such date set forth in the opinions of completely independent and well-qualified experts."[21]

As a third example, section 83(d)(2) specifically contemplates that an employee should be able to demonstrate that the cancellation of a nonlapse restriction is not compensatory in nature, but only if the employer does not claim a deduction in respect thereof. The regulations apply a facts and circumstance approach to this inquiry. While the regulations recognize that "[o]rdinarily the fact that the employee…is required to perform additional services…indicates that such cancellation has a compensatory purpose," they would normally regard as noncompensatory the cancellation of a buy-sell restriction in the context of an IPO.[22]

If a rule is adopted excluding property transferred at fair market value from the scope of section 83, the IRS should not be permitted to invoke section 83 if it

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20 *Cf.* Reg. §1.61-2(d)(1), (2), (4).

21 Prop. Reg. §1.422A-2(e)(2)(ii).

22 Reg. §1.83-5(b)(1).

turns out that a good-faith valuation is wrong. In such a case, where the employee and employer intended the transfer to be at fair market value, the excess of the property's finally-determined fair market value over the price paid by the employee should be taxable as compensation paid (and deductible by the employer) in the year of transfer. Thus, the results would be the same as if a section 83(b) election had been filed.[23]

The Treasury Department could also provide examples in regulations to refute the suggestion in the *Alves* cases that the mere existence of a forfeiture restriction leads, *per se*, to the conclusion that a transfer of property in connection with the performance of services has occurred. One situation in particular that should be addressed is addition of restrictions to previously-held unrestricted shares. As mentioned above, it has become increasingly common for new-money investors in companies to insist, as a condition of their making an investment, on placing forfeiture restrictions upon shares of stock previously owned by employee shareholders, as a means of tying the fortune of these key employee-owners to the business. In some cases, the vesting restrictions might be contractually added to "old and cold" shares; arguably no "transfer" has occurred within the meaning of section 83, but this conclusion is not free from doubt. In other cases, the employee-owner may be required to exchange his or her old and cold shares for new shares of a recapitalized or reorganized company. While some might argue that the exchange of unrestricted for restricted shares, especially if made in a tax-deferred transaction, is not within the ambit of section 83, there is some risk that the *Alves* rule could be applied to treat the new, restricted shares as being "transferred" to the employee in connection with services.[24] If, as is common, the fair market value of the shares exceeds the employee's basis therein, the spread might be taxable currently if a

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23 If property is transferred to a pure "investor" at a bargain price, the bargain element is not taxed; the transferee's basis is simply the amount paid. We are not suggesting here that this "pure investor" rule should be applied to transfers to employees.

24 *See* David V. MacNaughton, 60 AFTR 2d ¶ 5244 (E.D. Tenn. 1987), *aff'd*, 888 F.2d 418 (6th Cir. 1989) (courts refused summary judgment for taxpayer where unrestricted shares were exchanged for (arguably) restricted shares in a tax-free reorganization).

section 83(b) election is made.[25] If no section 83(b) election is made, the spread on vesting–including the portion thereof economically accrued prior to the exchange–might be treated as compensation paid at that time. For this reason, some tax practitioners recommend that a "protective" section 83(b) election be made, taking the position that the spread is not currently taxable.[26]

The problem of adding restrictions to old-and-cold shares could be addressed by guidance to the effect that the mere exchange of unrestricted property for property that is restricted but otherwise identical is not within the scope of section 83. Alternatively, it could be addressed by regulations specifically acknowledging that not every forfeiture risk tied to continuing employment gives rise to a transfer within the meaning of Section 83.

III. REPLACEMENT OF THE 30-DAY RULE OF SECTION 83(B)(2) WITH A GRANT OF AUTHORITY TO THE SECRETARY

The requirement that a section 83(b) election be filed within 30 days of the transfer of restricted property is statutory, and changing it would require legislation. We believe that consideration should be given to changing that rule, especially if the *Alves* rule is left undisturbed. We do not suggest, however, adoption of a particular period by statute. Instead we suggest that the Secretary of the Treasury be given the authority to prescribe a time period.

Thirty days is a very short period of time. Because the 30-day requirement is statutory, it cannot be waived pursuant to the exercise of the Secretary's discretion under Reg. §301.9100. There is no indication that the 30-day period was

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25 It appears, too, that the election triggers the start of a new holding period despite the general tacking rule in reorganizations.

26 The section 83(b) election may be advised for another reason. In an otherwise tax-free reorganization, if shares of the acquiring corporation are deemed transferred in connection with services and restricted within the meaning of section 83, such shares may not count as "stock" in the reorganization. *See* Matthias, "It's Dot.Stock, But Is It "Stock"?", 8 M&A Tax Rep. 1 (March 2000) (discussing CCA 199944001 (March 15, 1999)).

deliberately chosen by Congress as a means to achieve any particular policy goal. The legislative history of section 83 and the last-minute addition of the section 83(b) election to the statutory scheme suggests that Congress believed, in 1969, that the section 83(b) election would very rarely be used.

We can conceive of three possible reasons for the short 30-day election filing requirement. First, Congress may have wished to prevent the employee from whipsawing the government by waiting longer to determine whether the value of transferred property was increasing (in which case the employee would be more likely to make the election) or decreasing (less likely). Second, the short period might have derived from a concern about the effect of the employee's election upon the employer. Because the employer's deduction under section 83(h) must match the employee's income inclusion as to timing and amount, Congress may have assumed that the parties would promptly and jointly determine whether the election would be made. If the employee were given until the following year to decide whether to make the section 83(b) election, the well-advised employee, with the benefit of some hindsight, would always act to minimize her tax and thereby minimize the employer's deduction.

Third, Congress may have chosen the short 30-day period as a means of buttressing the penalty it enacted for making a section 83(b) election. The last clause of section 83(b)(1) provides that where a section 83(b) election is made and the restricted property is subsequently forfeited, no deduction is allowed to the employee in respect of the forfeiture. The prohibition of a deduction with respect to what is clearly a true economic loss serves no purpose we can divine, except as a penalty to offset a benefit believed to have been conferred. If a penalty was intended, it was buttressed by preventing the employee from using hindsight to determine whether to risk incurring that penalty.

None of these rationales for the 30-day period is particularly compelling. The penalty in section 83(b)(1) seems to us unduly draconian and noneconomic, and should probably itself be repealed. When a section 83(b) election is made, section 83(b)(1) disallows a deduction for *any* loss suffered by the employee attributable to the forfeiture of the transferred property, even where the employee included the spread upon transfer in income. Thus, for example, if an employer transfers restricted stock worth $10,000 to an employee who pays only $1,000 for the stock, and the employee includes $9,000 in income with a section 83(b) election, a later forfeiture at $1,000 will not give rise to a deduction for any part of the employee's $9,000 offsetting loss.

The only possible justification for this rule, which has the effect of taxing an employee on income never received, is that it was intended to counter a "windfall" benefit conferred by the section 83(b) election. But the election can be perceived as a windfall only if one is willing to assume that deferral is the norm and that deferral will generally be adverse to the employee. This, of course, is often but not always true, and usually difficult to predict, especially within 30 days of a transfer.

The notion that Congress was concerned about whipsawing the government seems unconvincing in light of Congress's repeated comments that symmetry between the employee and employer renders section 83 revenue neutral. Insofar as Congress may have been concerned abut whipsawing of the employer, in our experience many employers are either indifferent to the making of a section 83(b) election or unaware of its significance. An employer may be indifferent to the election for any number of reasons: because it cannot make use of a deduction, because it desires that the employee pay as little tax as possible, or simply because it does not consider important the after-tax cost of the property transfer. Employers impose the kinds of substantial risks of forfeiture that give rise to deferral under section 83 for nontax reasons; in fact they may have an incentive in the form of an immediate tax deduction for not imposing such restrictions. Accordingly, the employer is at least as likely to expect the tax results that would be derived with respect to a transfer of unrestricted property as it would be to expect deferral under section 83(a). In any case, the employer is usually more likely to have access to tax advice, and is usually in a better position to protect its interests, than the employee is.

The fact that Congress did not permanently repeal the 30-day rule in 1984, but only suspended it, does not mean that the 30-day rule should not be revisited today.

What was perhaps a rare and unanticipated type of transaction in 1984 is much more common today. Unlike the simple restrictions placed on employee stock to achieve tax deferral prior to 1969, a substantial risk of forfeiture by definition serves the nontax purpose of binding the employee to the fortunes of the employer.

Congress apparently believed, in 1984, that the problem with the 30-day rule was a "notice" or detrimental reliance issue, and that after *Alves* was decided employees would be on notice that they needed to make section 83(b) elections immediately after the receipt of restricted property even if purchased at fair market value. In our experience, however, the problem of taxpayer expectations continues to produce unwarranted and unfair results. Many individuals are accustomed to thinking about "tax planning" only in connection with the preparation and filing of their own tax returns or in connection with transactions that occur during a taxable year–such as sales of portfolio stock–that they reasonably expect to have tax consequences in that year.

Another type of transfer where the need to file a section 83(b) election may often be overlooked, especially in light of the short 30-day period, involves property the only forfeiture risk for which is the short-swing profits rules of Section 16(b) of the Securities Exchange Act,[27] or the "pooling of interest" restrictions, referred to in §252(b) of the Economic Recovery Tax Act of 1981 as a risk of forfeiture. In these cases, the election is prone to be overlooked not because the employee paid fair market value (although he often will have), but because he had no reason to expect that section 83 might apply merely because the "vesting" schedule is atypical.

The Secretary's lack of discretion to waive compliance with the statutory 30-day rule has on occasion led the IRS to apply the rule overzealously. For example, in LTR 199910010 (December 4, 1998), an employee purchased shares of restricted stock at what the parties agreed was fair market value, but failed to make a timely section 83(b) election. It appears that the parties realized too late the implications of *Alves* and then

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27 *See* section 83(c)(3).

took steps to rectify the mistake. The original shares–some of which had since vested–were cancelled, and new stock purchase agreements entered into. The facts in the ruling clearly indicate that by the time the original shares were cancelled, they had appreciated in value. Importantly, the employee paid the higher, current value for the new shares. The difference was made up to him by his employer paying a cash bonus in the year of repurchase.

The IRS found that there was no "business purpose" for the cancellation and repurchase, and that the cancellation and repurchase did not alter the economic positions of the parties, "taking into account that [the employee] was paid a bonus equal to the increase in the face amount of the promissory note" he used to purchase the shares. Based on these findings, the IRS thought it would be reasonable to argue that the cancellation and repurchase should be ignored, with the result that section 83(a) would apply to the original share issuance.

The "business purpose" and related "sham" analysis of the ruling appears strained, as the IRS was not alleging that the shares originally issued had not in fact been cancelled and new shares repurchased. The offered justification for the ruling was that the cancellation and repurchase did not change the economic position of the parties. Yet on the facts at hand, the parties' economic positions clearly were changed: As a result of the cancellation of the original shares, the employee lost the appreciation already accrued, and was forced to pay a higher price for the new shares. The fact that his employer paid him a (fully taxable) bonus to make up the difference hardly justifies the conclusion in the ruling that nothing of independent economic substance had occurred. If the employee had made a timely section 83(b) election, he would not have had to pay tax, at ordinary income rates, on the amount of economic gain that the bonus replaced. As he did pay tax on that income, there was no reason not to respect the independence of the second, replacement purchase. The effect of this ruling was to accord a talismanic purpose to the 30-day rule that we doubt it was intended to possess.

The inflexibility of a statutory 30-day rule also presents difficult issues where a nonresident alien or other foreign employee receives restricted stock (from a

U.S. or foreign employer) for services performed wholly outside the United States. If such an employee later establishes residency in the United States prior to vesting, he would apparently be taxable under section 83(a) unless a section 83(b) election had been filed. Such an employee would be unlikely to be made aware of the need to file a section 83(b) election while still a non-U.S. taxpayer. The Secretary might exercise the authority we suggest to give employees in this situation a specified period from their "residency starting date" in which to file the election.

IV. OPTIONS HAVING A READILY ASCERTAINABLE FAIR MARKET VALUE

Section 83(e)(3) provides that section 83 does not apply to the transfer of an option lacking a readily ascertainable fair market value ("RAFMV"). This rule existed long before the enactment of section 83 and is probably traceable to a reluctance to impose tax, even upon vesting, with respect to a property right that might never materialize into cash and that was, it was thought, difficult or impossible to value. We do not here propose changing this basic rule. We do, however, suggest reexamination of current standards for determining whether an option will be deemed to have a RAFMV.

Treasury regulations at § 1.83-7(b) define the circumstances in which an option has a RAFMV. There is a general consensus that the regulations are so heavily weighted against finding that an option has a RAFMV that it is virtually impossible to take the position that any compensatory option has a RAFMV.[28] Congress, however, clearly contemplated that section 83 would apply to some options. In this sense, the current regulations at §1.83-7(b) appear to be inconsistent with the intent of Congress.

Our conclusion that these regulations may not be consistent with Congressional intent is supported by the reference to section 421 in section 83. Section 83(e) excludes from the scope of section 83 not only "the transfer of an option without a readily ascertainable fair market value" but also "a transaction to which section 421

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28 *See, e.g.*, Richard A. Cramer, 101 T.C. 225 (1993), *aff'd*, 64 F.3d 1406 (9th Cir. 1995), *cert. denied*, 517 U.S. 1244 (1996).

applies." If the statutory exclusion for options lacking a RAFMV were intended to apply to every compensatory option, the exclusion for section 421 transactions would be superfluous. Clearly, Congress intended to exclude from section 83 both *qualified* options (now ISOs) and *other* options, but only those lacking a RAFMV.

In 1976, legislation was introduced to allow an employee an election to include the value of an option in income on the grant date, rather than at the later date of exercise. Although the proposed legislation was not enacted, Congress did instruct the Treasury and the IRS to "make every reasonable effort to determine a fair market value for an option…where the employee irrevocably elects…to have the option valued at the time it is granted…."[29] One year later, the Treasury in fact did release proposed regulations that would have permitted an employee, electing jointly with his employer, to value and report options as income on the grant date.[30] These regulations were never finalized.

It is unclear under what circumstances Congress anticipated an option would have a RAFMV. It is fairly clear, however, that Congress used the words "readily ascertainable" only to forestall current taxation of purely speculative value and not specifically to *prevent* employees from claiming that they should be taxed currently.

Whatever Congress intended in 1969 and 1976, in today's environment it is more likely than ever that at least some types of options should be treated as having a RAFMV. The development of the Black-Scholes and other well-known methodologies for valuing options, widely in use in the financial industry, have at least begun to address the task of establishing the "option value" referred to in Reg. §1.83-7(b)(3). In other areas of the tax law, the IRS has demonstrated an increased willingness to require that options be valued. For example, recently-issued FSA 200003010 (Oct. 18, 1999) requires that compensatory options be valued for purposes of cost-sharing arrangements

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29 S. Rep. No. 1236, 94th Cong., 2d Sess. 438-439 (1976).

30 Former Prop. Reg. §§ 1.83-6(e), -6(f), -7(c), 42 Fed. Reg. 47,222 (1977).

between related parties. Revenue Procedure 98-34[31] requires options to be valued for estate and gift tax purposes. Code section 1273(c)(2) requires options to be valued where issued as part of an investment unit.[32] In PLR 9712033 (Dec. 24, 1996), the IRS permitted an insurance company to fund a pension trust with stock options priced using a "reasonable" option pricing model.

A rule that permits options to be valued and taken into account currently better conforms to the economic substance of compensatory transfers than does the current rule. While the value of an option (less the amount, if any, paid for the option) represents compensation, subsequent appreciation in the value of the option attributable to appreciation in the employer's stock arguably does not represent compensation economically, and instead represents a purely financial return.

The theory for treating the appreciation in the value of property between grant and vesting (in the case of restricted stock) and between grant and exercise (in the case of options) is that the employee would not have been provided the opportunity to benefit from the property's appreciation but for the employment relationship. Rather than attempting to bifurcate the transaction into a compensation component (any spread at grant) and a capital gain component (any increase in value subsequent to the time of grant), section 83 looks to the origin of the property transfer as "in connection with the performance of services" and then treats all of the income or gain associated with such property as ordinary.

This approach has its logical and practical limits, which is why section 83(b) exists and why options having a RAFMV fall outside the general rule. The principal reason that Congress urged the IRS in 1976 to treat more options as having a RAFMV was that, in several well-publicized cases, the amount included in the employee's income (and deducted by the employer) on the exercise of options

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31 1998-18 I.R.B. 15.

32 *See* Custom Chrome, Inc. v. Comm'r, 217 F.3d 1117 (9th Cir. 2000).

substantially exceeded the value of the entire employer corporation when the options were issued.[33]

On occasion, the IRS has reacted to the counterintuitive tendency of section 83 to inflate compensation by arguing, on audit, that the employer's section 83(h) deduction should be denied on the grounds that the excessive amount thereof constituted "unreasonable compensation."[34] We think that this argument misses the mark. The unforeseeable spread on the exercise of an option is, by definition, not tied to the value of the employee's services, any more than is the unforeseeable spread upon the vesting of restricted stock. Where equity-based, contingent compensation is used between parties with adverse interests, the expected value of the contingent amount is "reasonable" in a probabilistic, *ex ante* sense. However, because the actual contingent amount realized is not determined by the employee's services, it often may appear "unreasonable" in an *ex post* sense but nevertheless should be treated as reasonable compensation for those services under section 83. Presumably Congress enacted section 83(h) in part to make this clear, recognizing that if compensation income actually realized is delinked from the value of an employee's services, the ordinary rules applicable under section 162 should not apply.

An option granted at or out of the money is economically similar to a profits interest in a partnership, except that an option typically has a meaningful cost to exercise. Yet the employee who becomes a partner with a profits interest is not taxed on

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33 This fact pattern was clearly present in the case of Theophilos v. Comm'r, 85 F.3d 440 (9th Cir. 1996), *rev'g* T.C. Memo. 1994-45. To reach a pro-employee result under section 83, the Ninth Circuit rejected the government's argument that an executory contract to purchase stock was an option, instead finding the contract right to be "property." It may be supposed that the court arrived at this conclusion in an effort to do justice to the taxpayer, who had agreed to pay fair market value for employer stock but, due to unforeseen corporate difficulties, did not actually receive the stock until a later date, when its value was substantially higher.

34 *See*, *e.g.*, TAM 8403004 (Sept. 23, 1983) and TAM 8403005 (Sept. 23, 1983). To our knowledge the IRS has never tested such an argument in court. The principal author of this report encountered this issue on audit several years after these technical advice memoranda were issued.

receipt of the profits interest,[35] and is not taxed on the spread at "exercise" because there is no event of exercise. It does not appear sensible to accord *worse* tax treatment to the employee who must pay a price to participate in his employer's growth, and who will be required to hold illiquid the stock received on exercise for more than a year to achieve long-term capital gain treatment on further appreciation (if any).[36] If the regulations were amended so as to allow more options to be regarded as having a RAFMV, the tax treatment of options on corporate stock would more closely conform to the tax treatment of the substantially economically equivalent grant of a profits interest in a partnership.

Although we do not endorse any particular change to the current regulations, we think that consideration might be given to modifying existing Reg. §1.83-7(b) to reflect modern option valuation methods. Although the rule that an option must be transferable in order to have a RAFMV would be retained, value might be determined by use of the Black-Scholes or a similar option pricing model.

V. AMEND AND CLARIFY THE "TRANSFER OF PROPERTY" DEFINITION OF REG §1.83-3(A)

Current regulations at Reg. §1.83-3(a) seek to distinguish between the transfer of property and a mere promise to pay compensation in the future by reference to common law concepts of beneficial ownership and risk of loss. While this is obviously an important exercise, the regulations are poorly organized and confuse different concepts with one another.

To distinguish between a transfer of property and the mere grant of a stock appreciation right ("SAR") or phantom stock right, the regulations provide that a transfer does not occur when the employer retains the right to repurchase the "transferred"

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35 Rev. Proc. 93-27, 1993-2 C.B. 343.

36 We note that the holding period rule exacerbates the cash flow problem faced by the employee who must pay tax on exercise but must hold the stock received for over a year to enjoy any long-term capital gain. This is, of course, not a problem where an employee makes a section 83(b) election with respect to restricted stock, as this holding period begins to run immediately.

property in perpetuity.[37] Such a fact pattern resembles an SAR, because in both cases all the employee has is the employer's promise to pay money in an amount linked to the value of the employer's stock.[38] The essence of this type of arrangement lies in the certainty that the property will in all events be returned. If there is instead a date after which it is certain that the employee will be entitled to retain the property, only a lapse restriction is present and the arrangement is not inconsistent with the occurrence of a present transfer.

Other rules in this regulation seek to describe when a transfer of property has occurred by asking whether the employee bears the risk of loss with respect to the property. Reg. §1.83-3(a)(2) states that "if the amount paid for the transfer of property is an indebtedness secured by the transferred property, on which there is no personal liability to pay all or a substantial part of such indebtedness, such transaction may be in substance the same as the grant of an option."[39] Example (2) at Reg. §1.83-3(a)(7) applies this rule in a case where the employee pays fair market value with a nonrecourse note that requires level amortization of principal, plus interest on unpaid principal, over five years. The example states, however, that the employee pays interest only and makes no principal payments (the example fails to state the number of years over which the employer permits this apparent default to occur without taking remedial action). Based on the nonrecourse character of the note *and* on the fact that the employee is not making principal payments, the example concludes that "the likelihood of [the employee] paying the full purchase price is in substantial doubt" and therefore that no transfer, but only the grant of an option, has occurred.[40] In such cases the transaction is treated as a mere

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37 Reg. §1.83-3(a)(3), (7), Example (3).

38 *See* Nat. Clothing Co. of Rochester, Inc., 23 T.C. 944 (1955).

39 The IRS will not issue a private ruling as to whether a transfer has occurred if the amount paid for property "involves" a nonrecourse obligation. Rev. Proc. 2000-3, 2000-1 I.R.B. 103, §3.01(2).

40 At least one taxpayer has attempted to use the "debt as option" rule affirmatively. In FSA 200029013 (April 19, 2000), the IRS took the position that a transfer of property, within the meaning of section 83, occurred when an employee's contractual right to purchase property vested. The taxpayer argued that the transfer, if there was one at all, was in substance tantamount

option at the outset, so that no transfer occurs even as payments are made, or even after a substantial part of the nonrecourse debt is paid.

These portions of the regulation raise several unresolved issues that arise in everyday situations. Although the nonrecourse debt rule requires that the employee's note be recourse in "all or a substantial part," nothing in section 83 requires that an employee pay full fair market value for transferred property. Nothing in the nonrecourse debt rule appears to turn on the ratio of the debt to the fair market value of the property purchased; on its face a transfer would appear to have occurred if the debt is recourse entirely or in substantial part but the face amount represents only an insubstantial percentage of the property's fair market value.

Suppose that, in Example (2) of the regulation, the employee had tendered a note having a face value of $10,000 equal to the fair market value of the transferred shares, and that only $1,000 (10%) of that note were recourse. Alternatively, suppose that the employee paid $1,000 in cash and gave a nonrecourse note of $9,000. If the nonrecourse debt rule applies, no "transfer" has occurred in either case, because the employee has no personal liability (in the second case) or personal liability only for an insubstantial part (in the first case). But the employee here has paid *at least* $1,000 for property worth $10,000, so an alternate conclusion—which we do not endorse—might be that the employee has income of $9,000 under section 83. Yet a third possibility is to apply a bifurcation approach that would treat the employee as having purchased property worth $1,000 for $1,000 in a completed transfer, and as receiving an option to purchase other property for $9,000.

We think that in the foregoing example, the employee should not be treated as realizing income of $9,000. The difference between the facts given in the example and a true bargain purchase is one of intent: in almost all cases, where the

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to a purchase with nonrecourse debt. The IRS replied that a "transfer of a contract occurred because the facts and circumstances in toto indicate that there was a likelihood that the purchase price would be paid."

employee delivers a nonrecourse note representing the full fair market value of transferred property, the intent of the employee (and the employer) is to pay the note, and not to acquire cheap stock in a compensatory transaction. Regulation §1.83-3(a)(6) suggests that the employee may bear a kind of risk of loss where the employee can lose the built-in bargain element with respect to property transferred for less than fair market value. In a true bargain purchase, an employee who pays $1,000 for restricted property worth $10,000 will receive a return of her $1,000 investment if a forfeiture event occurs, but will lose the built-in bargain of $9,000. If the same employee paid $1,000 and gave a nonrecourse note for $9,000, receiving credit upon a later forfeiture for her cash cost and having her note offset and cancelled, the net result is the same. In this second case, however, the employee does not face the risk of losing the bargain, because no bargain was intended.

The difference between a true option and a partially recourse note (or a nonrecourse note given in addition to cash) is that a true option, at least in the common compensatory context, does not involve putting any funds at risk until exercise because it does not involve a promise to pay. Although the bifurcation approach is arguably consistent with the theory underlying the regulations, *i.e.*, that the nonrecourse portion of a note is economically similar to an option, we believe that a bifurcation approach may be too difficult to administer.[41] For that reason, we do not advocate changing the "all or nothing" rule of the regulations. We do, however, believe that the mere fact that property is purchased substantially with a nonrecourse note should not in itself create a presumption that no transfer has occurred. In particular, we think it would be helpful and appropriate for the regulations to provide an additional example of a case involving the use of debt that is nonrecourse in substantial part, where the totality of the facts and circumstances supports the conclusion that a transfer has, in fact, occurred.

41 The bifurcation approach was contained in 1977 proposed regulations but later abandoned, probably for this reason.

We also suggest that Reg. §1.83-3(a) could be clarified so as to provide simple rules or safe harbors in this area. For example, one safe harbor might define what is a "substantial part" and might provide that if at least some fixed percentage (*e.g.*, 25%) of the fair market value of transferred property is at risk, the property should be treated as entirely transferred for purposes of section 83. (We believe that many taxpayers take the position, under current law, that if 25% to 50% of the fair market value is at risk, a transfer has occurred.)

Other examples could be provided to address the case where the employee's nonrecourse note was clearly intended to be paid. For example, where the face value of the note is far less than the value of the transferred property, such that forfeiture would cause the employee to lose the benefit of the bargain element, a compensatory transfer may have occurred. Another example might address the case where payments are regularly and timely made, notwithstanding the nonrecourse character of the debt.