

the employer-employee relationship. Similarly, if an employer in order to prevent an employee's sustaining a loss on a sale of a house acquires the property from the employee at a price in excess of fair market value, the employee is considered to have received a payment attributable to employment to the extent that such payment exceeds the fair market value of the property.

(b) *Effective date*—(1) *In general.* Except as provided in subparagraph (2) of this paragraph, paragraph (a) of this section is applicable only to amounts received or accrued in taxable years beginning after December 31, 1969.

(2) *Election with respect to payments or reimbursements for expenses paid or incurred before January 1, 1971.* Paragraph (a) of this section does not apply with respect to moving expenses paid or incurred before January 1, 1971, in connection with the commencement of work by an employee at a new principal place of work where such employee had been notified by his employer on or before December 19, 1969, of such move and the employee makes an election under paragraph (h) of § 1.217-2.

[T.D. 7195, 37 FR 13533, July 11, 1972, as amended by T.D. 7578, 43 FR 59355, Dec. 20, 1978]

§ 1.83-1 Property transferred in connection with the performance of services.

(a) *Inclusion in gross income*—(1) *General rule.* Section 83 provides rules for the taxation of property transferred to an employee or independent contractor (or beneficiary thereof) in connection with the performance of services by such employee or independent contractor. In general, such property is not taxable under section 83(a) until it has been transferred (as defined in § 1.83-3(a)) to such person and become substantially vested (as defined in § 1.83-3(b)) in such person. In that case, the excess of—

(i) The fair market value of such property (determined without regard to any lapse restriction, as defined in § 1.83-3(i)) at the time that the property becomes substantially vested, over

(ii) The amount (if any) paid for such property,

shall be included as compensation in the gross income of such employee or independent contractor for the taxable year in which the property becomes substantially vested. Until such property becomes substantially vested, the transferor shall be regarded as the owner of such property, and any income from such property received by the employee or independent contractor (or beneficiary thereof) or the right to the use of such property by the employee or independent contractor constitutes additional compensation and shall be included in the gross income of such employee or independent contractor for the taxable year in which such income is received or such use is made available. This paragraph applies to a transfer of property in connection with the performance of services even though the transferor is not the person for whom such services are performed.

(2) *Life insurance.* The cost of life insurance protection under a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection is taxable generally under section 61 and the regulations thereunder during the period such contract remains substantially nonvested (as defined in § 1.83-3(b)). The cost of such life insurance protection is the reasonable net premium cost, as determined by the Commissioner, of the current life insurance protection (as defined in § 1.72-16(b)(3)) provided by such contract.

(3) *Cross references.* For rules concerning the treatment of employers and other transferors of property in connection with the performance of services, see section 83(h) and § 1.83-6. For rules concerning the taxation of beneficiaries of an employees' trust that is not exempt under section 501(a), see section 402(b) and the regulations thereunder.

(b) *Subsequent sale, forfeiture, or other disposition of nonvested property.* (1) If substantially nonvested property (that has been transferred in connection with the performance of services) is subsequently sold or otherwise disposed of to a third party in an arm's

length transaction while still substantially nonvested, the person who performed such services shall realize compensation in an amount equal to the excess of—

(i) The amount realized on such sale or other disposition, over

(ii) The amount (if any) paid for such property.

Such amount of compensation is includible in his gross income in accordance with his method of accounting. Two preceding sentences also apply when the person disposing of the property has received it in a non-arm's length transaction described in paragraph (c) of this section. In addition, section 83(a) and paragraph (a) of this section shall thereafter cease to apply with respect to such property.

(2) If substantially nonvested property that has been transferred in connection with the performance of services to the person performing such services is forfeited while still substantially nonvested and held by such person, the difference between the amount paid (if any) and the amount received upon forfeiture (if any) shall be treated as an ordinary gain or loss. This paragraph (b)(2) does not apply to property to which § 1.83-2(a) applies.

(3) This paragraph (b) shall not apply to, and no gain shall be recognized on, any sale, forfeiture, or other disposition described in this paragraph to the extent that any property received in exchange therefor is substantially nonvested. Instead, section 83 and this section shall apply with respect to such property received (as if it were substituted for the property disposed of).

(c) *Dispositions of nonvested property not at arm's length.* If substantially nonvested property (that has been transferred in connection with the performance of services) is disposed of in a transaction which is not at arm's length and the property remains substantially nonvested, the person who performed such services realizes compensation equal in amount to the sum of any money and the fair market value of any substantially vested property received in such disposition. Such amount of compensation is includible in his gross income in accordance with his method of accounting. However, such amount of compensation shall not

exceed the fair market value of the property disposed of at the time of disposition (determined without regard to any lapse restriction), reduced by the amount paid for such property. In addition, section 83 and these regulations shall continue to apply with respect to such property, except that any amount previously includible in gross income under this paragraph (c) shall thereafter be treated as an amount paid for such property. For example, if in 1971 an employee pays \$50 for a share of stock which has a fair market value of \$100 and is substantially nonvested at that time and later in 1971 (at a time when the property still has a fair market value of \$100 and is still substantially nonvested) the employee disposes of, in a transaction not at arm's length, the share of stock to his wife for \$10, the employee realizes compensation of \$10 in 1971. If in 1972, when the share of stock has a fair market value of \$120, it becomes substantially vested, the employee realizes additional compensation in 1972 in the amount of \$60 (the \$120 fair market value of the stock less both the \$50 price paid for the stock and the \$10 taxed as compensation in 1971). For purposes of this paragraph, if substantially nonvested property has been transferred to a person other than the person who performed the services, and the transferee dies holding the property while the property is still substantially nonvested and while the person who performed the services is alive, the transfer which results by reason of the death of such transferee is a transfer not at arm's length.

(d) *Certain transfers upon death.* If substantially nonvested property has been transferred in connection with the performance of services and the person who performed such services dies while the property is still substantially nonvested, any income realized on or after such death with respect to such property under this section is income in respect of a decedent to which the rules of section 691 apply. In such a case the income in respect of such property shall be taxable under section 691 (except to the extent not includible under section 101(b)) to the estate or beneficiary of the person who performed the services, in accordance with section 83

and the regulations thereunder. However, if an item of income is realized upon such death before July 21, 1978, because the property became substantially vested upon death, the person responsible for filing decedent's income tax return for decedent's last taxable year may elect to treat such item as includible in gross income for decedent's last taxable year by including such item in gross income on the return or amended return filed for decedent's last taxable year.

(e) *Forfeiture after substantial vesting.* If a person is taxable under section 83(a) when the property transferred becomes substantially vested and thereafter the person's beneficial interest in such property is nevertheless forfeited pursuant to a lapse restriction, any loss incurred by such person (but not by a beneficiary of such person) upon such forfeiture shall be an ordinary loss to the extent the basis in such property has been increased as a result of the recognition of income by such person under section 83(a) with respect to such property.

(f) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). On November 1, 1978, X corporation sells to E, an employee, 100 shares of X corporation stock at \$10 per share. At the time of such sale the fair market value of the X corporation stock is \$100 per share. Under the terms of the sale each share of stock is subject to a substantial risk of forfeiture which will not lapse until November 1, 1988. Evidence of this restriction is stamped on the face of E's stock certificates, which are therefore nontransferable (within the meaning of § 1.83-3(d)). Since in 1978 E's stock is substantially nonvested, E does not include any of such amount in his gross income as compensation in 1978. On November 1, 1988, the fair market value of the X corporation stock is \$250 per share. Since the X corporation stock becomes substantially vested in 1988, E must include \$24,000 (100 shares of X corporation stock × \$250 fair market value per share less \$10 price paid by E for each share) as compensation for 1988. Dividends paid by X to E on E's stock after it was transferred to E on November 1, 1973, are taxable to E as additional compensation during the period E's stock is substantially nonvested and are deductible as such by X.

Example (2). Assume the facts are the same as in example (1), except that on November 1, 1985, each share of stock of X corporation in E's hands could as a matter of law be trans-

ferred to a bona fide purchaser who would not be required to forfeit the stock if the risk of forfeiture materialized. In the event, however, that the risk materializes, E would be liable in damages to X. On November 1, 1985, the fair market value of the X corporation stock is \$230 per share. Since E's stock is transferable within the meaning of § 1.83-3(d) in 1985, the stock is substantially vested and E must include \$22,000 (100 shares of X corporation stock × \$230 fair market value per share less \$10 price paid by E for each share) as compensation for 1985.

Example (3). Assume the facts are the same as in example (1) except that, in 1984 E sells his 100 shares of X corporation stock in an arm's length sale to I, an investment company, for \$120 per share. At the time of this sale each share of X corporation's stock has a fair market value of \$200. Under paragraph (b) of this section, E must include \$11,000 (100 shares of X corporation stock × \$120 amount realized per share less \$10 price paid by E per share) as compensation for 1984 notwithstanding that the stock remains nontransferable and is still subject to a substantial risk of forfeiture at the time of such sale. Under § 1.83-4(b)(2), I's basis in the X corporation stock is \$120 per share.

[T.D. 7554, 43 FR 31913, July 24, 1978]

§ 1.83-2 Election to include in gross income in year of transfer.

(a) *In general.* If property is transferred (within the meaning of § 1.83-3(a)) in connection with the performance of services, the person performing such services may elect to include in gross income under section 83(b) the excess (if any) of the fair market value of the property at the time of transfer (determined without regard to any lapse restriction, as defined in § 1.83-3(i)) over the amount (if any) paid for such property, as compensation for services. The 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 election as provided for in this section. If this election is made, the substantial vesting rules of section 83(a) and the regulations thereunder do not apply with respect to such property, and except as otherwise provided in section 83(d)(2) and the regulations thereunder (relating to the cancellation of a nonlapse restriction), any subsequent appreciation in the value of the property is not taxable as compensation to the person who performed the services. Thus,