

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,

property with respect to which this election is made shall be includible in gross income as of the time of transfer, even though such property is substantially nonvested (as defined in § 1.83-3(b)) at the time of transfer, and no compensation will be includible in gross income when such property becomes substantially vested (as defined in § 1.83-3(b)). In computing the gain or loss from the subsequent sale or exchange of such property, its basis shall be the amount paid for the property increased by the amount included in gross income under section 83(b). If property for which a section 83(b) election is in effect is forfeited while substantially nonvested, such forfeiture shall be treated as a sale or exchange upon which there is realized a loss equal to the excess (if any) of—

(1) The amount paid (if any) for such property, over,

(2) The amount realized (if any) upon such forfeiture.

If such property is a capital asset in the hands of the taxpayer, such loss shall be a capital loss. A sale or other disposition of the property that is in substance a forfeiture, or is made in contemplation of a forfeiture, shall be treated as a forfeiture under the two immediately preceding sentences.

(b) *Time for making election.* Except as provided in the following sentence, the election referred to in paragraph (a) of this section shall be filed not later than 30 days after the date the property was transferred (or, if later, January 29, 1970) and may be filed prior to the date of transfer. Any statement filed before February 15, 1970, which was amended not later than February 16, 1970, in order to make it conform to the requirements of paragraph (e) of this section, shall be deemed a proper election under section 83(b).

(c) *Manner of making election.* The election referred to in paragraph (a) of this section is made by filing one copy of a written statement with the internal revenue office with whom the person who performed the services files his return. In addition, one copy of such statement shall be submitted with this income tax return for the taxable year in which such property was transferred.

(d) *Additional copies.* The person who performed the services shall also submit a copy of the statement referred to in paragraph (c) of this section to the person for whom the services are performed. In addition, if the person who performs the services and the transferee of such property are not the same person, the person who performs the services shall submit a copy of such statement to the transferee of the property.

(e) *Content of statement.* The statement shall be signed by the person making the election and shall indicate that it is being made under section 83(b) of the Code, and shall contain the following information:

(1) The name, address and taxpayer identification number of the taxpayer;

(2) A description of each property with respect to which the election is being made;

(3) The date or dates on which the property is transferred and the taxable year (for example, "calendar year 1970" or "fiscal year ending May 31, 1970") for which such election was made;

(4) The nature of the restriction or restrictions to which the property is subject;

(5) The fair market value at the time of transfer (determined without regard to any lapse restriction, as defined in § 1.83-3(i)) of each property with respect to which the election is being made;

(6) The amount (if any) paid for such property; and

(7) With respect to elections made after July 21, 1978, a statement to the effect that copies have been furnished to other persons as provided in paragraph (d) of this section.

(f) *Revocability of election.* An election under section 83(b) may not be revoked except with the consent of the Commissioner. Consent will be granted only in the case where the transferee is under a mistake of fact as to the underlying transaction and must be requested within 60 days of the date on which the mistake of fact first became known to the person who made the election. In any event, a mistake as to the value, or decline in the value, of the property with respect to which an election under section 83(b) has been made or a failure to perform an act contemplated at the

time of transfer of such property does not constitute a mistake of fact.

[T.D. 7554, 43 FR 31915, July 24, 1978]

§ 1.83-3 Meaning and use of certain terms.

(a) *Transfer*—(1) *In general.* For purposes of section 83 and the regulations thereunder, a transfer of property occurs when a person acquires a beneficial ownership interest in such property (disregarding any lapse restriction, as defined in § 1.83-3(i)).

(2) *Option.* The grant of an option to purchase certain property does not constitute a transfer of such property. However, see § 1.83-7 for the extent to which the grant of the option itself is subject to section 83. In addition, 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. The determination of the substance of the transaction shall be based upon all the facts and circumstances. The factors to be taken into account include the type of property involved, the extent to which the risk that the property will decline in value has been transferred, and the likelihood that the purchase price will, in fact, be paid. See also § 1.83-4(c) for the treatment of forgiveness of indebtedness that has constituted an amount paid.

(3) *Requirement that property be returned.* Similarly, no transfer may have occurred where property is transferred under conditions that require its return upon the happening of an event that is certain to occur, such as the termination of employment. In such a case, whether there is, in fact, a transfer depends upon all the facts and circumstances. Factors which indicate that no transfer has occurred are described in paragraph (a) (4), (5), and (6) of this section.

(4) *Similarity to option.* An indication that no transfer has occurred is the extent to which the conditions relating to a transfer are similar to an option.

(5) *Relationship to fair market value.* An indication that no transfer has occurred is the extent to which the consideration to be paid the transferee

upon surrendering the property does not approach the fair market value of the property at the time of surrender. For purposes of paragraph (a) (5) and (6) of this section, fair market value includes fair market value determined under the rules of § 1.83-5(a)(1), relating to the valuation of property subject to nonlapse restrictions. Therefore, the existence of a nonlapse restriction referred to in § 1.83-5(a)(1) is not a factor indicating no transfer has occurred.

(6) *Risk of loss.* An indication that no transfer has occurred is the extent to which the transferee does not incur the risk of a beneficial owner that the value of the property at the time of transfer will decline substantially. Therefore, for purposes of this (6), risk of decline in property value is not limited to the risk that any amount paid for the property may be lost.

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

Example (1). On January 3, 1971, X corporation sells for \$500 to S, a salesman of X, 10 shares of stock in X corporation with a fair market value of \$1,000. The stock is non-transferable and subject to return to the corporation (for \$500) if S's sales do not reach a certain level by December 31, 1971. Disregarding the restriction concerning S's sales (since the restriction is a lapse restriction), S's interest in the stock is that of a beneficial owner and therefore a transfer occurs on January 3, 1971.

Example (2). On November 17, 1972, W sells to E 100 shares of stock in W corporation with a fair market value of \$10,000 in exchange for a \$10,000 note without personal liability. The note requires E to make yearly payments of \$2,000 commencing in 1973. E collects the dividends, votes the stock and pays the interest on the note. However, he makes no payments toward the face amount of the note. Because E has no personal liability on the note, and since E is making no payments towards the face amount of the note, the likelihood of E paying the full purchase price is in substantial doubt. As a result E has not incurred the risks of a beneficial owner that the value of the stock will decline. Therefore, no transfer of the stock has occurred on November 17, 1972, but an option to purchase the stock has been granted to E.

Example (3). On January 3, 1971, X corporation purports to transfer to E, an employee, 100 shares of stock in X corporation. The X stock is subject to the sole restriction that E must sell such stock to X on termination of employment for any reason for an amount