

amount of compensation) in respect of a transfer of property and such property is subsequently forfeited, the amount of such deduction, increase in basis or reduction of gross income shall be includible in the gross income of the person to whom it was allowable for the taxable year of forfeiture. The basis of such property in the hands of the person to whom it is forfeited shall include any such amount includible in the gross income of such person, as well as any amount such person pays upon forfeiture.

(d) *Special rules for transfers by shareholders*—(1) *Transfers*. If a shareholder of a corporation transfers property to an employee of such corporation or to an independent contractor (or to a beneficiary thereof), in consideration of services performed for the corporation, the transaction shall be considered to be a contribution of such property to the capital of such corporation by the shareholder, and immediately thereafter a transfer of such property by the corporation to the employee or independent contractor under paragraphs (a) and (b) of this section. For purposes of this (1), such a transfer will be considered to be in consideration for services performed for the corporation if either the property transferred is substantially nonvested at the time of transfer or an amount is includible in the gross income of the employee or independent contractor at the time of transfer under § 1.83-1(a)(1) or § 1.83-2(a). In the case of such a transfer, any money or other property paid to the shareholder for such stock shall be considered to be paid to the corporation and transferred immediately thereafter by the corporation to the shareholder as a distribution to which section 302 applies. For special rules that may apply to a corporation's transfer of its own stock to any person in consideration of services performed for another corporation or partnership, see § 1.1032-3. The preceding sentence applies to transfers of stock and amounts paid for such stock occurring on or after May 16, 2000.

(2) *Forfeiture*. If, following a transaction described in paragraph (d)(1) of this section, the transferred property is forfeited to the shareholder, paragraph (c) of this section shall apply both with

respect to the shareholder and with respect to the corporation. In addition, the corporation shall in the taxable year of forfeiture be allowed a loss (or realize a gain) to offset any gain (or loss) realized under paragraph (b) of this section. For example, if a shareholder transfers property to an employee of the corporation as compensation, and as a result the shareholder's basis of \$200x in such property is allocated to his stock in such corporation and such corporation recognizes a short-term capital gain of \$800x, and is allowed a deduction of \$1,000x on such transfer, upon a subsequent forfeiture of the property to the shareholder, the shareholder shall take \$200x into gross income, and the corporation shall take \$1,000x into gross income and be allowed a short-term capital loss of \$800x.

(e) *Options*. [Reserved]

(f) *Reporting requirements*. [Reserved]

[T.D. 7554, 43 FR 31919, July 24, 1978, as amended by T.D. 8599, July 19, 1995; T.D. 8883, 65 FR 31076, May 16, 2000]

§ 1.83-7 Taxation of nonqualified stock options.

(a) *In general*. If there is granted to an employee or independent contractor (or beneficiary thereof) in connection with the performance of services, an option to which section 421 (relating generally to certain qualified and other options) does not apply, section 83(a) shall apply to such grant if the option has a readily ascertainable fair market value (determined in accordance with paragraph (b) of this section) at the time the option is granted. The person who performed such services realizes compensation upon such grant at the time and in the amount determined under section 83(a). If section 83(a) does not apply to the grant of such an option because the option does not have a readily ascertainable fair market value at the time of grant, sections 83(a) and 83(b) shall apply at the time the option is exercised or otherwise disposed of, even though the fair market value of such option may have become readily ascertainable before such time. If the option is exercised, sections 83(a) and 83(b) apply to the transfer of property pursuant to such exercise, and the employee or independent contractor realizes compensation upon such transfer

at the time and in the amount determined under section 83(a) or 83(b). If the option is sold or otherwise disposed of in an arm's length transaction, sections 83(a) and 83(b) apply to the transfer of money or other property received in the same manner as sections 83(a) and 83(b) would have applied to the transfer of property pursuant to an exercise of the option.

(b) *Readily ascertainable defined*—(1) *Actively traded on an established market.* Options have a value at the time they are granted, but that value is ordinarily not readily ascertainable unless the option is actively traded on an established market. If an option is actively traded on an established market, the fair market value of such option is readily ascertainable for purposes of this section by applying the rules of valuation set forth in § 20.2031-2.

(2) *Not actively traded on an established market.* When an option is not actively traded on an established market, it does not have a readily ascertainable fair market value unless its fair market value can otherwise be measured with reasonable accuracy. For purposes of this section, if an option is not actively traded on an established market, the option does not have a readily ascertainable fair market value when granted unless the taxpayer can show that all of the following conditions exist:

(i) The option is transferable by the optionee;

(ii) The option is exercisable immediately in full by the optionee;

(iii) The option or the property subject to the option is not subject to any restriction or condition (other than a lien or other condition to secure the payment of the purchase price) which has a significant effect upon the fair market value of the option; and

(iv) The fair market value of the option privilege is readily ascertainable in accordance with paragraph (b)(3) of this section.

(3) *Option privilege.* The option privilege in the case of an option to buy is the opportunity to benefit during the option's exercise period from any increase in the value of property subject to the option during such period, without risking any capital. Similarly, the option privilege in the case of an op-

tion to sell is the opportunity to benefit during the exercise period from a decrease in the value of property subject to the option. For example, if at some time during the exercise period of an option to buy, the fair market value of the property subject to the option is greater than the option's exercise price, a profit may be realized by exercising the option and immediately selling the property so acquired for its higher fair market value. Irrespective of whether any such gain may be realized immediately at the time an option is granted, the fair market value of an option to buy includes the value of the right to benefit from any future increase in the value of the property subject to the option (relative to the option exercise price), without risking any capital. Therefore, the fair market value of an option is not merely the difference that may exist at a particular time between the option's exercise price and the value of the property subject to the option, but also includes the value of the option privilege for the remainder of the exercise period. Accordingly, for purposes of this section, in determining whether the fair market value of an option is readily ascertainable, it is necessary to consider whether the value of the entire option privilege can be measured with reasonable accuracy. In determining whether the value of the option privilege is readily ascertainable, and in determining the amount of such value when such value is readily ascertainable, it is necessary to consider—

(i) Whether the value of the property subject to the option can be ascertained;

(ii) The probability of any ascertainable value of such property increasing or decreasing; and

(iii) The length of the period during which the option can be exercised.

(c) *Reporting requirements.* [Reserved]

[T.D. 7554, 43 FR 31920, July 24, 1978]

§ 1.83-8 Applicability of section and transitional rules.

(a) *Scope of section 83.* Section 83 is not applicable to—

(1) A transaction concerning an option to which section 421 applies;

(2) A transfer to or from a trust described in section 401(a) for the benefit