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IRS (Permanently) Allows Digital Signatures for Section 83(b) Elections

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Good news – the IRS announced that it will allow taxpayers to make and file Section 83(b) elections with a digital signature. This decision makes permanent a practice that the IRS temporarily allowed during the COVID-19 crisis.^[1]

Below, we provide a refresher of certain requirements and considerations when making a Section 83(b) election.

How are Equity Awards Generally Taxed?

In general, stock awards (and other property) given to employees or consultants are subject to income taxation when the awards are no longer subject to a “substantial risk of forfeiture.” For example, if a grant of restricted stock is subject to a vesting schedule whereby the restricted stock is forfeited if the employee leaves the company before the vesting date, that vesting schedule will constitute a substantial risk of forfeiture.

A substantial risk of forfeiture can also occur if the employee is required to sell back at a potential discount or forfeit the equity awards upon a termination of employment (or upon certain types of “bad leaver” terminations of employment), even if an award is already vested.

When an equity award is no longer subject to a substantial risk of forfeiture, the award is subject to income taxation on an amount equal to the excess of the fair market value of the property at the time the risk of forfeiture lapses minus the amount the employee paid for the property. The equity award will generally be subject to taxation at ordinary income tax rates.

What is a Section 83(b) Election?

If an employee makes a timely Section 83(b) election, then the employee will be subject to income taxation upon grant of the equity award, rather than upon the later lapse of risk of forfeiture. Although many taxpayers would not normally want to accelerate the timing of income taxation, making a Section 83(b) election can be valuable because the increase in value from grant date to the subsequent sale of the equity award will be subject to capital gains rates.

For example, assume an employee is granted a restricted stock award with a value of \$10,000 in Year 1, and the award is subject to a forfeiture provision if the employee leaves before a change in control of the company. If a change in control occurs in Year 5 when the restricted stock is worth \$100,000, then the employee will be subject to ordinary income taxation in Year 5 for the full \$100,000 amount. However, if the employee had timely made a Section 83(b) election in Year 1 and sold the restricted stock in Year 5 on the change in control, then the \$10,000 award in Year 1 would have been taxed at ordinary income rates, but the subsequent \$90,000 increase in value would have been taxed at preferential capital gains rates in Year 5.

Assuming the employee was subject to an income tax rate of 37% and long-term capital gains rate of 20% in each year (and excluding other income and employment taxes, state taxes, and the time value of money), the employee would be better off on an after-tax basis if the employee made the Section 83(b) election in Year 1:

	With Section 83(b) Election	Without Section 83(b) Election
Income Tax in Year 1	\$3,700	\$0
Income Tax in Year 5	\$18,000	\$37,000
Value of Award (in Year 5), less Income Tax	\$78,300	\$63,000

What are the Downsides to a Section 83(b) Election?

Because Section 83(b) elections accelerate the timing of income taxation, these elections are not helpful in every situation. For example, a participant should generally not file a Section 83(b) election if he or she does not believe the value of the company will substantially rise over the vesting period. In addition, a participant should generally not file a Section 83(b) election if he or she is worried that the vesting conditions will not be satisfied.

If a participant files a Section 83(b) election and then subsequently forfeits the award, the participant will not be entitled to a tax refund. The participant would have paid tax at ordinary income tax rates and would only be entitled to a capital loss upon forfeiture of the equity award. This situation may not be as relevant if a participant makes a Section 83(b) election for a profits interest award with \$0 fair market value or a stock award from an early-stage company with a low valuation. But if a participant made a Section 83(b) election on a company with a substantial valuation, then this timing and character mismatch may create an unfortunate situation for the participant.

Can a Section 83(b) Election be made for all Equity Awards?

Most often, Section 83(b) elections are considered with grants of restricted stock and restricted LLC or partnership units (including grants of restricted stock that are received following an early exercise of a stock option before it is fully vested). Many taxpayers also make Section 83(b) elections with respect to grants of profit

interests in an LLC (taxed as a partnership). The IRS indicated in Rev. Proc. 2001-43 that a Section 83(b) election is not required for grants that fit within the profits interest safe harbor. However, many practitioners recommend making a prophylactic Section 83(b) election upon receipt of a profits interest in case the IRS later challenges that the award does qualify as a profit interest.

Section 83(b) elections are not available for all types of equity awards, however. Options and restricted stock units^[2] are generally not eligible for Section 83(b) elections. In addition, grants of phantom equity or other equity-like arrangements where no stock or equity is transferred at grant are not eligible for Section 83(b) elections.

How do I make a Section 83(b) election?

The Section 83(b) election must be made and filed with the IRS within **30 days** after the equity is granted/transferred to the participant. The IRS does not allow late elections if a participant misses the 30-day deadline. This election is generally irrevocable.

The regulations under Section 83(b) require the taxpayer to provide certain information about the award:

- Name, address, and taxpayer identification number (ex: TIN/SSN)
- Description of the property (ex: number of shares or units, name of entity)
- Date of transfer of property
- Taxable year for which election is made
- Restrictions to which property is subject
- Fair Market Value of the property
- Amount paid for the property

This election must be signed, but as noted above, the IRS will now allow a digital signature for this election.

The taxpayer must timely mail the Section 83(b) election to the IRS service center where the taxpayer files their tax return. Although not required, it is common to send this election via certified mail, return receipt requested, to send a cover letter, and to send two copies of the election to the IRS with a return envelope for the IRS to return a stamped copy of the election. The IRS no longer requires an employee to attach the Section 83(b) election with the individual's federal tax return, although it is advisable for the individual to check with their tax professional to see if a state will require it to be attached on the state income tax return. The taxpayer must also send a copy of the signed election to the taxpayer's employer.

Footnotes

^[1] In general, a tax return, statement, or other document (such as a Section 83(b) election) must contain a wet signature unless the IRS waives the requirement and allows for a digital signature or alternative method for signing or subscribing. See Code Section 6061. The IRS previously issued several memorandums during the COVID-19 crisis that waived the wet signature requirement for certain tax forms and for Section 83(b) elections. See [Form 13016 \(Rev. 2-2001\) \(irs.gov\)](#). This memorandum most recently extended the date of the

digital signatures for these forms until October 31, 2023. On October 17, 2023, the IRS released a new IRM noting that the IRS would accept electronic and digital signatures from certain tax forms and for the Section 83(b) election. [10.10.1 IRS Electronic Signature \(e-Signature\) Program | Internal Revenue Service](#).

[2] Restricted stock units are promises to deliver stock at a later date (commonly after they vest) and differ from restricted stock grants which transfer beneficial ownership of the stock at the time of grant subject to a risk of forfeiture (and transfer of the stock back to the employer) until they vest.