

Congress: Please Fix 83(b) Elections

Congress is trying to make life easier for early stage and startup companies. This is good.

But so far, nothing has been proposed to fix Section 83(b) of the Internal Revenue Code.

Section 83(b) haunts every founder who receives shares subject to vesting.

If you are founding an early stage technology company with other founders, you will probably impose vesting on all of the shares issued to the founders. Vesting in this context means the following: if you quit providing services, the company has the right to buy back your "unvested" shares. The purchase price is the lesser of either (i) the FMV of the shares at the time of repurchase, or (ii) the price you paid for them (usually this is not a big number). This lower-of-fmv-or-cost repurchase right lapses over the vesting period, usually 4 years with a cliff of some kind.

Vesting is critical to include in company formation documents. If a 30% founder leaves, your company will essentially be un-fundable if a 30% owner is no longer working at the company.

But the current tax law does not make life easy for founders in this circumstance.

The Current Tax Law

The current tax law requires founders to file an 83(b) within 30 days of receiving their shares or suffer horrible, potentially debilitating tax consequences.

If you file the election, you typically won't owe any tax as a result of filing. And your filing the form timely means that you won't owe any tax when your shares vest.

If you don't file the election, you will owe tax when your shares vest if the shares have gone up in value. The tax you owe will be based on the difference between the fair market value of the shares at the time of vesting over what you paid for them. If you are an employee, you will have to write a check to the company so that the company can send the funds to the IRS to pay the employee's side of income and employment tax withholding. This can get expensive fast.

The tax code should not be written like it is now. We shouldn't put founders on a 30 day ticking time bomb whenever they found a company. This is hostile to people founding companies.

Instead, we should reverse the presumption in Section 83(b). What I mean is that an 83(b) election is "deemed filed" if the Founder would not owe any tax as a result of filing it.

This would allow founders to sleep at night, and making forming and starting companies easier. Isn't that what we want Congress?

I drafted proposed legislation along these lines a few years back. You can find it [here](#).

If you happen to run into legislators or legislative staff working on federal tax issues, please mention this idea to them.