



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

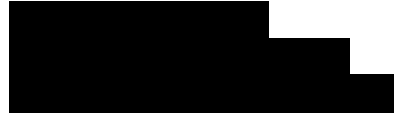
OFFICE OF  
CHIEF COUNSEL

August 20, 2001

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CC:TEGE:EB:EC:EMMadden  
COR-135003-01

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Dear [REDACTED]:

This is in reply to your letter of April 2, 2001, to Commissioner Charles Rossotti requesting revocation of the section 83(b) election that your husband filed in 2000. We hope the following general information is helpful to you.

Your letter states that your husband took advantage of an early exercise date for incentive stock options his company gave employees to start the one-year holding period required for long-term capital gains treatment. You state that you and your husband were under the impression that the section 83(b) election and the early exercise of his stock options had to be done as a single transaction. In making this decision, he received information from his company and consulted with an independent accountant. In making the decision, however, the possibility that your husband would be terminated prior to vesting was not considered.

For general federal income tax purposes, incentive stock options are governed by section 421 of the Income Tax Code (the Code). Under section 421, if a share of stock is transferred to an individual in a transfer that meets the requirements of section 422, then no income is recognized by the employee when the option is granted or exercised. In such cases, capital gains income is generally recognized only upon the sale or disposition of the underlying stock. Such income is equal to the difference between the sale price and the sum of (i) the exercise price paid by the employee and (ii) the amount paid (if any) for the actual option.

However, for alternative minimum tax (AMT) purposes, section 421 of the Code does not apply. Rather, for AMT purposes, the compensation income attributable to an incentive stock option is determined under the rules of section 83.

Under section 83, unless an option has a "readily ascertainable fair market value" when it is granted, which appears not to have been the case here, sections 83(a) and 83(b) apply when the option is exercised, sold or otherwise disposed of. If, as was your husband's case, the option is exercised, section 83(a) generally applies to the

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transfer of stock pursuant to the exercise. Under section 83(a) (and, thus, under the AMT rules), compensation income related to the transfer of the shares of stock to your husband arises when the stock is either transferrable or not subject to a substantial risk of forfeiture. Thus, without more, if the stock your husband received was subject to a vesting schedule or if he could not transfer the stock, then section 83(a) would not have applied at the time he exercised the option and received the stock.

However, under section 83(b), the recipient of substantially nonvested stock may elect to have section 83(a) apply to the stock in the year in which it is received, even though the stock is substantially nonvested when transferred. For AMT purposes only, a section 83(b) election may be made for substantially nonvested incentive stock option stock. Thus, if an 83(b) election is made, the recipient has compensation for AMT purposes equal to the fair market value of the stock at the time the option is exercised less the exercise price and less any amount paid for the option itself.

Section 1.83-2(f) of the Income Tax Regulations provides that an election under section 83(b) may not be revoked without the consent of the Commissioner of Internal Revenue. The regulations also provide that such consent will only be granted whether the person filing the election is under a “mistake of fact” as to the underlying transaction.

A mistake of fact is an ignorance of a fact, past or present, material to a transaction, and it exists where a person understands the fact to be other than they are. The mistake must concern a fact which forms the very basis of the transaction. The term “mistake of fact” does not include an erroneous belief concerning a collateral matter which does not relate to the essence of the underlying transaction.

In your letter, you indicate that your husband’s decision to make an 83(b) election was based, on part, upon information he received from his first accountant. Your first accountant did not take into consideration the possibility (and the resulting tax implications) that your husband would be terminated prior to when his stock became vested. Your letter does not indicate that your husband was under a mistake of fact as to the underlying transaction, i.e., the transfer of the stock to him. Rather, the expressed reason your husband desires to revoke his election is that he did not understand the tax implications of making the election. In such a case, the Commissioner does not have the authority to consent to a revocation of an election under section 83(b).

Stated another way, if the Internal Revenue Service was asked to rule formally on the matter, it appears likely that your husband’s request for revocation of his section 83(b) election would be denied. However, if he desires a ruling on the matter, he may request one under the procedures contained in Revenue Procedure 2001-1, 2001-1 I.R.B. 1. In this regard, we note that the user fee that he would need to submit along with such a request is non-refundable even if his requested revocation is denied.

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Various bills which would affect the AMT are currently under consideration by Congress. One bill under consideration is H.R. 2794, which is co-sponsored by, among others, Representatives Robert Matusi and Zoe Lofgren from California. Under this bill, the valuation of the tax preference on ISOs would be changed by allowing taxpayers to pay taxes only on the basis of the stock on the date of exercise (retroactive to January 1, 2000) minus the fair market value of the stock as of April 15, 2001, or on any gain realized on the date of sale. If enacted, this legislation would reduce the amount of tax owed as a result of the AMT. If you are interested, you should contact your Senators and Representative regarding this legislation.

Additionally, the Service has in place an "offer in compromise" program. This purpose of this program is to settle a taxpayer's liability for less than the full amount owed. An offer in compromise may be reached in circumstances where the collection of the tax liability in full would create economic hardship. For more information concerning the "offer in compromise" program, please see Publication 656, Understanding the Collection Process; Form 656, Offer in Compromise; and Form 433-A, Collection Information Statement for Individuals. These forms and publication can be ordered by calling 1-800-829-3676 or downloaded from the Internal Revenue Service website at [www.irs.gov](http://www.irs.gov) (at the bottom of the screen click on "Forms and Pubs").

We hope the information provided in this letter is helpful to you and your husband. If you have any questions concerning this reply, please call Erinn Madden at (202) 622-6030.

Sincerely,

Robert Misner

Robert Misner  
Assistant Branch Chief,  
Executive Compensation Branch, Office of  
the Associate Chief Counsel (Tax Exempt  
and Government Entities)