

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

Refer Reply To:
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Date:
July 23, 2020

LEGEND:

Taxpayer =
Plan 1 =
Plan 2 =

Dear :

This is in response to a request for a private letter ruling, dated January 30, 2020, submitted on behalf of Taxpayer by your authorized representative, requesting rulings under section 83(i) of the Internal Revenue Code (Code). The facts, as represented, are as follows.

Taxpayer is a corporation that has no stock traded on an established securities market. Taxpayer maintains two stock option plans, Plan 1 and Plan 2 (referred to herein as the Plans), which were adopted before January 1, 2018. Taxpayer has issued stock options to its employees under the Plans.

Taxpayer intends to allow employees who are qualified employees under section 83(i)(3)(A) to make an election under section 83(i)(1)(A) (the Election) to defer income tax on gain realized upon the exercise of options issued under the Plans. An employee will be required to execute the Election before the related stock options are exercised. The Election includes the following provisions:

- The employee will have no right to sell, give, assign, pledge, hypothecate or otherwise transfer or dispose of the stock subject to the election (the "Transferability Restrictions") until the earliest of (i) five (5) years from the exercise date of the option, (ii) the first date that any of the Taxpayer's stock becomes readily traded on an established securities market within the meaning of section 83(i), or (iii) the date the employee becomes an excluded employee as defined under Section 83(i).

- The Taxpayer will have the unilateral right to repurchase any stock subject to the election (the “Repurchase Right”) for its fair market value at any date before the Transferability Restrictions lapse.

Specifically, Taxpayer is requesting a ruling that the Transferability Restrictions and the Repurchase Right will not prevent the shares subject to the Election from satisfying the limitation applicable to qualified stock described in section 83(i)(2)(B).

Taxpayer is also requesting a ruling that, as a result of the Transferability Restrictions, the stock subject to the Election is not transferable (within the meaning of section 83(i)(1)(B)(i)) until the earliest of (i) five (5) years from the exercise date of the option, (ii) the first date that any of the Taxpayer’s stock becomes readily traded on an established securities market within the meaning of section 83(i), (iii) the date the employee becomes an excluded employee as defined under Section 83(i), or (iv) the exercise of the Repurchase Right by the Taxpayer.

Taxpayer is requesting the above rulings with respect to stock options that were granted under the Plans prior to January 1, 2018.

Section 83(i)(1)(A) provides that if qualified stock is transferred to a qualified employee who makes an election under section 83(i) with respect to such stock, the amount determined under section 83(a) with respect to such stock will be included in income in the taxable year determined under section 83(i)(1)(B). Accordingly, such income shall be included in the taxable year of the employee which includes the earliest of:

- (i) the first date such qualified stock becomes transferable (including, solely for purposes of this clause, transferable to the employer);¹
- (ii) the date the employee first becomes an excluded employee;
- (iii) the first date on which any stock of the issuing corporation becomes readily tradable on an established securities market;
- (iv) the date that is 5 years after the first date the rights of the employee in such stock are transferable or not subject to a substantial risk of forfeiture, whichever occurs earlier; or
- (v) the date on which the employee revokes the election (at such time and in such manner as the Secretary of the Treasury (Secretary) provides).

Section 83(i)(3)(A) defines a “qualified employee” as any individual who is not an “excluded employee” and who agrees to meet such requirements as are determined by the Secretary to be necessary to ensure that the withholding requirements of the

¹ The legislative history of section 83(i) states, in reference to this provision, “Thus, for this purpose, the qualified stock is considered transferable if the employee has the ability to sell the stock to the employer (or any other person).” House Conf. Rpt. 115-466, 498 (2017).

corporation under chapter 24 (Collection of Income Tax at Source on Wages) with respect to the qualified stock are met.

An “excluded employee” is defined under section 83(i)(3)(B) as, with respect to any corporation, any individual:

- (i) who is a 1 percent owner at any time during the calendar year or who was a 1 percent owner at any time during the 10 preceding calendar years;
- (ii) who is or has been at any prior time (I) the chief executive officer (or an individual acting in such capacity) or (II) the chief financial officer (or an individual acting in such capacity);
- (iii) who bears a relationship described in section 318(a)(1) to any individual described in subclause (I) or (II) of clause (ii); or
- (iv) who is one of the 4 highest compensated officers of the corporation for the taxable year, or was one of the 4 highest compensated officers of such corporation for any of the 10 preceding taxable years, determined on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934 (as if such rules applied to such corporation).

Section 83(i)(2)(A) defines “qualified stock” as any stock in a corporation that is the employer of a qualified employee, if such stock is received (i) in connection with the exercise of a stock option or in settlement of a restricted stock unit (RSU), and (ii) such stock option or RSU was granted in connection with the performance of services as an employee and during a calendar year that the employer corporation was an eligible corporation. Section 83(i)(5) provides that, for purposes of this subsection, all persons treated as a single employer under section 414(b) shall be treated as one corporation. Section 83(i)(2)(B) provides that qualified stock does not include any stock if the employee may sell the stock to, or otherwise receive cash in lieu of stock from, the corporation at the time that the employee’s rights to the stock first become transferable or not subject to a substantial risk of forfeiture.

Section 83(i)(2)(C)(i) defines an “eligible corporation” as any corporation that, with respect to any calendar year, (i) has none of its (or any predecessor’s) stock readily tradable on an established securities market during any preceding calendar year, and (ii) has a written plan under which, in such calendar year, not less than 80% of all employees who provide services to the corporation in the United States (or any possession of the United States) are granted stock options, or are granted RSUs, with the same rights and privileges to receive qualified stock. As provided in section 83(i)(2)(C)(iii), for purposes of section 83(i)(2)(C)(i)(II), the term “employee” does not include any excluded employee or any employee described in section 4980E(d)(4) (certain part-time employees).

Section 83(i)(2)(C)(ii)(I) provides that the determination of rights and privileges shall be made in a manner similar to the determination under section 423(b)(5). However, in accordance with section 83(i)(2)(C)(ii)(II), employees shall not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not equal in amount, so long as the number of shares available to each employee is more than a de minimis amount. In addition, section 83(i)(2)(C)(ii)(III) provides that rights and privileges with respect to the exercise of an option shall not be treated as the same as rights and privileges with respect to the settlement of an RSU. Finally, in the case of any calendar year beginning before January 1, 2018, section 83(i)(2)(C)(iv) provides that neither stock options nor RSUs are required to have been granted with the same rights and privileges for the stock received to be treated as qualified stock.

Section 83(i)(4)(A) provides that an election with respect to qualified stock shall be made no later than 30 days after the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, and shall be made in a manner similar to the manner in which an election is made under section 83(b). Section 83(i)(4)(C) provides that the term “deferral stock” is used to refer to stock with respect to which a section 83(i) election has been made.

Section 83(i)(4)(B) provides that no election may be made under section 83(i) if the qualified employee has made an election under section 83(b) with respect to such qualified stock, or if any stock of the corporation which issued the qualified stock is readily tradable on an established securities market at any time before the election is made. In addition, no election may be made under section 83(i) with respect to any qualified stock if the corporation that issued the stock purchased any of its outstanding stock in the calendar year preceding the calendar year which includes the first date the rights of the employee are transferable or are not subject to a substantial risk of forfeiture, unless (i) not less than 25% of the total dollar amount of the stock so purchased is deferral stock, and (ii) the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.

Section 1.83-3(d) provides that, for purposes of section 83 and the regulations thereunder, the rights of a person in property are transferable if such person can transfer any interest in the property to any person other than the transferor of the property, but only if the rights in such property of such transferee are not subject to a substantial risk of forfeiture. Accordingly, property is transferable if the person performing the services or receiving the property can sell, assign, or pledge (as collateral for a loan, or as security for the performance of an obligation, or for any other purpose) his interest in the property to any person other than the transferor of such property and if the transferee is not required to forfeit the property or its value in the event the substantial risk of forfeiture materializes.

Section 83(i)(1)(A)(i) makes clear that qualified stock may not be transferable from the employee to the employer. The legislative history of section 83(i) further clarifies that qualified stock is considered transferable if the employee has the ability to sell the stock to the employer. Notwithstanding the inability of the employee to sell or transfer qualified stock to the employer, the statutory provision contemplates that the corporation may be able to repurchase qualified stock from the employee without causing the program to fail to meet the requirements of section 83(i). Specifically, section 83(i)(4)(B)(iii) provides that no election may be made under section 83(i) with respect to any qualified stock if the corporation that issued the stock purchased any of its outstanding stock in the calendar year preceding the calendar year which includes the first date the rights of the employee are transferable or are not subject to a substantial risk of forfeiture, unless (i) not less than 25% of the total dollar amount of the stock so purchased is deferral stock, and (ii) the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis. Accordingly, a unilateral repurchase right on the part of the corporation does not make qualified stock transferable for purposes of section 83(i)(1)(A)(i).

The Transferability Restrictions and the Repurchase Right do not provide the employee the unilateral right to sell the stock to, or otherwise receive cash in lieu of stock from, the Taxpayer at the time that the employee's rights to the stock first become transferable or not subject to a substantial risk of forfeiture.

Further, as a result of the Transferability Restrictions, the deferral stock is not transferable until the earliest of (i) five (5) years from the exercise date of the option, (ii) the first date that any of the Taxpayer's stock becomes readily traded on an established securities market within the meaning of section 83(i), (iii) the date the employee becomes an excluded employee as defined under Section 83(i), or (iv) the exercise of the Repurchase Right by the Taxpayer.

Therefore, based solely on the facts presented, we rule as follows with respect to stock options granted under the Plans prior to January 1, 2018:

1. The Transferability Restrictions and the Repurchase Right will not prevent the shares subject to the Election from satisfying the limitation applicable to qualified stock described in section 83(i)(2)(B).
2. As a result of the Transferability Restrictions, the stock subject to the Election is not transferable (within the meaning of section 83(i)(1)(B)(i)) until the earliest of (i) five (5) years from the exercise date of the option, (ii) the first date that any of the Taxpayer's stock becomes readily traded on an established securities market within the meaning of section 83(i), (iii) the date the employee becomes an excluded employee as defined under Section 83(i), or (iv) the exercise of the Repurchase Right by the Taxpayer.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning (i) the tax consequences of any other provision of the Plans or the Election; (ii) whether the shares subject to the Election are qualified stock within the meaning of section 83(i)(2) of the Code; and (iii) whether any other requirements described in section 83(i) or in Notice 2018-97, including the requirement to establish an escrow arrangement, have been satisfied.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

This ruling is based on the information and representations submitted by your authorized representative and accompanied by a penalty of perjury statement executed by you. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

THOMAS D. SCHOLZ
Senior Counsel
Executive Compensation Branch
Office of the Associate Chief Counsel
(Employee Benefits, Exempts Organizations,
and Employment Taxes)