I. Introduction

While there are many considerations during the formation of start-up ventures, federal income tax issues are perhaps the most complex and intimidating for the entrepreneur. Furthermore, seeking tax counsel in the formation stage of an entity’s operations is not always at the forefront of founders’ minds, as they often seek to save capital wherever and whenever possible. However, proper legal and tax planning can provide both stability and authenticity to a venture’s operations by attracting and maintaining desirable employees, investors, and shareholders, while also saving significant capital later in the entity’s operation.

One federal tax consideration that requires both proper planning and execution is taxable compensation for services rendered. While property contributed to a corporation in exchange for the corporation’s
shares will not cause the transferor to recognize gain or loss on the transfer, when shares are received as compensation for services, any gain will be properly recognized as ordinary income to the Recipient and deductible as a business expense for the issuing corporation. However, if the issued shares meet certain transfer and forfeiture risk requirements, the Recipient’s taxable gain is deferred until such time as the forfeiture risk is eliminated, unless the Recipient elects to recognize the gain at the time of the initial transfer. This election allows the corporation to immediately deduct the amount of gain that the Recipient recognizes upon the transfer, offsetting other current income to the venture.

As a result of the foregoing income recognition and election options, section 83 of the United States Federal Income Tax Code provides both great advantages and risks for the corporation and founders during the initial phases of operations and financing. Through proper planning and drafting, a start-up corporation may maximize the desirable benefits and prepare for and minimize the risks of initial share issuances.

This paper proceeds in four principle parts to help provide both context and guidance in considering and capitalizing upon the federal income tax consequences for Tennessee start-up ventures. First, a brief history and overview of section 83(a) is presented to provide context with respect to the default tax recognition of property received for services rendered. Second, the availability and procedural requirements for section 83(b) elections is discussed. Following that discussion, the

addition, the term “share” will be used pursuant to the proper terminology under the Tennessee Code. See TENN. CODE ANN. § 48-16-101(b) (2015).


5 Note that this paper focuses primarily upon the issuance of corporate shares in connection with services rendered. Although section 83 applies when any property is exchanged in connection with services, the primary occurrence of section 83(b) availability arises when non-vested corporate shares are issued. See I.R.C. § 83 (2004).

6 Hereinafter, the person performing the services and thus will be taxed on the transfer will be referred to as the “Recipient.”


8 I.R.C. § 83(a)-(b) (2004).

9 I.R.C. § 83(h) (2004); see infra Parts III, IV, and accompanying notes.

10 Hereinafter the “Code.”

11 See infra Part IV and accompanying notes.

12 See infra Part II and accompanying notes.

13 See infra Part III and accompanying notes.
benefits and the drawbacks of making an election under section 83(b) for both the start-up venture and founders are evaluated to determine whether such an election is, on balance, an attractive option for a start-up venture. Finally, additional practice guidelines are discussed with respect to making a section 83(b) election in the context of a corporation’s equity incentive plan.

II. Section 83: History and Overview

A comprehension of the general recognition that occurs without a section 83(b) election is necessary to accurately contemplate the availability and desirability of making an election. By understanding the history of section 83(a)’s deferred gain recognition, entrepreneurs and practitioners will have context for understanding why gain is deferred until rights with respect to the issued shares have substantially vested. Similarly, by recognizing the applicability and operation of the default scenario under section 83(a), parties may be able to recognize how the election may impact their relative tax liability.

A. A Brief History of Section 83

The current version of section 83 of the Code was adopted in 1969 in response to disputes concerning the proper valuation and taxation of restricted stock received as compensation for services rendered. Prior to the 1950’s, property received in exchange for services rendered that was subject to a substantial risk of forfeiture was difficult to value, and therefore difficult to include in the Recipient’s taxable income for the year received. In Kuchman v. Commissioner and Lehman v. Commissioner, this inability to accurately value restricted stock lead the Tax Court to find that there was no taxable gain upon the stock transfer, or when the restriction expired. Consequently, the Recipients enjoyed preferential capital gain treatment upon the ultimate stock sale, even though the stock was originally received as compensation for

14 See infra Part IV and accompanying notes.
15 See infra Part V and accompanying notes.
19 Kuchman, 18 T.C. at 163.
20 Lehman, 17 T.C. at 654.
services. In the late 1950’s, Treasury Regulations attempted to resolve the issue by stating that ordinary compensation income is to be recognized when the substantial risk of forfeiture has been extinguished. However, section 83 eventually preempted this regulation, providing further guidance for the recognition of income upon receiving stock for services rendered.

B. Income Recognition Under Section 83(a)

Under section 83(a) of the Code, property received in connection with services rendered is taxable to the Recipient as ordinary compensation gain when that property is no longer subject to a substantial risk of forfeiture or becomes freely transferable, whichever is earlier. The Recipient is not required to be an employee of the corporation to be subject to section 83, though the person performing the services will be taxed even if another person actually receives the property distributed.

While property subject to this section is broadly defined, for the purposes of this Article, the property considered is the equity interest in the start-up venture, as these have become the preferred property issued as equity compensation. Property received does not include certain fringe benefits, as defined in section 132, because this property would not ordinarily be considered compensation for services.

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21 BITTKER & LOKKEN, supra note 16, at ¶ 60.4.1.


24 Although section 83 applies even if the property is received in exchange for refraining from certain activities, such property is most often issued in connection with the performance of certain services. Treas. Reg. § 1.83-3(f) (2014).


26 Cohn v. Comm’r, 73 T.C. 443, 445-46 (1979) (holding that independent contractors are also subject to the income recognition requirements under section 83).

27 See I.R.C. § 83(a) (2004) (“[P]roperty is transferred to any person other than the person for whom such services are performed”).


29 See generally Matthew A. Melone, The Section 83(b) Election and the Fallacy of “Earned Income,” 10 BERKELEY BUS. L.J. 53, 68 (2013) (pointing out that stock options, which were once the equity incentive compensation of choice, have yielded to the rise of the restricted stock option equity compensation for start-up ventures).


31 Id.
Furthermore, section 83 does not apply to certain enumerated property transfers, including issuances of stock pursuant to the Recipient’s option to purchase shares, an issuance of share options without a readily ascertainable value, a transfer to or from a trust, and transfers to a group term life insurance policy.  

When shares are issued without any restrictions or are not subject to a substantial risk of forfeiture, the income under section 83(a) is recognized in the taxable year of initial transfer. The deferred income recognition under section 83(a), which is then available for election under subsection (b), only occurs when shares are issued that are both subject to transfer restrictions and a substantial risk of forfeiture. Absent an election, the Recipient shall be taxed upon the difference between the fair market value of the shares when they are no longer subject to a substantial risk of forfeiture or are freely transferable, less the amount the Recipient paid for the shares. The Recipient’s gain is taxed as ordinary income for services rendered. This deferred recognition causes the Recipient to be taxed upon any appreciation between the time that the Restricted Shares are issued and the time that they are no longer subject to a substantial risk of forfeiture. Correspondingly, any depreciation in share value will protect the Recipient from additional gain recognition upon vesting. Even if the Recipient pays fair market value for the Restricted Shares upon issuance,

32 See I.R.C. § 83(c) (2004). As section 83 is not applicable to these particular property transfers, the election under subsection (b) is unavailable. See generally I.R.C. § 83 (2004).


34 See id. Shares that are both subject to a substantial risk of forfeiture and transfer restrictions shall hereinafter be referenced as “Restricted Shares.” Although ultimately determined based upon the facts and circumstances of the transfer, section 83 and the corresponding Treasury Regulations state that shares are subject to a substantial risk of forfeiture when the vesting of such shares is contingent upon the performance of future services for the corporation. I.R.C. § 83(c) (2004); Treas. Reg. § 1.83-3(c) (2014). The risk of forfeiture must be substantial, and this risk of forfeiture includes the required surrendered of the Recipient’s shares to the corporation upon the occurrence of certain triggering event(s). Treas. Reg. § 1.83-3(c)(2)-(4) (2014). Transferable shares, for purposes of vesting rights, are those shares that the Recipient may freely transfer to another person without a substantial risk of forfeiture. Treas. Reg. § 1.83-3(d) (2014).


36 Id.

37 See id.

38 See id.
any subsequent increase in value will be taxable to the Recipient. Furthermore, the Recipient’s holding period for the shares is deemed to commence when the compensation income is recognized.

As the Recipient must include this gain as ordinary income and compensation for services, the corporation may deduct the amount included in the Recipient’s income as employee compensation where appropriate. Thus, if the Recipient’s gain is deferred due to the receipt of Restricted Shares, the corporation will be allowed a greater deduction if those Restricted Shares appreciate in value between the time of receipt and the time the restriction expires. If a corporate shareholder transfers Restricted Shares to the Recipient, then the transfer is deemed to be through the corporation, resulting in redemption treatment under section 302 for the contributing shareholder’s cash received for the Restricted Shares and compensation in connection with services rendered for the Recipient. This particular transfer is worth mentioning in connection with start-up ventures, because Restricted Shares are likely to be issued to founding employees from primary investor shareholders of the corporation.

In summary, start-up ventures must consider the consequences of section 83 whenever shares are transferred to a Recipient. The risk of forfeiture for those shares will determine whether they are generally subject to deferred recognition, which will in turn dictate the amount of income recognized by the Recipient and expense deductible by the corporation. Consequently, the relative corporate share values between the time of the share issuance and the restriction lapse can make a significant impact on the Recipient’s tax liability and the corporation’s

39 See id.; MacNaughton v. United States, 888 F.2d 418, 421 (6th Cir. 1989) (holding that section 83 applies “regardless the amount paid for it”) (citing Alves v. Comm’r, 734 F.2d 478, 479 (9th Cir. 1984)); MacNaughton, 888 F.2d at 412 (“[S]ection 83 is not limited to stock transfers which are compensatory in nature”).


41 See I.R.C. § 83(h) (2004); Treas. Reg. § 1.83-6(a) (2003) (stating that these amounts are deductible under Code sections 162 or 212 as applicable to the transaction). Even if the Recipient fails to include such amounts in the appropriate year, the corporation may still claim these deductions under the safe harbor as outlined in the Treasury Regulations. See Treas. Reg. § 1.83-6(a)(2) (2003).

42 See I.R.C. § 83(a) (2004). As mentioned previously, any decrease in share value between the time of the share issuance and expiration of the share restriction will result in a lesser corporate deduction. See id.


44 Melone, supra note 29, at 82-83 (discussing the desirability for restricted stock issuances in start-up corporations).

III. Election under Section 83(b)

If a Recipient’s shares are subject to deferred vesting pursuant to section 83(a), the Recipient may chose to recognize gain upon receiving those Restricted Shares by making an election under section 83(b). The Recipient’s tax liability if the election is made will be the difference between the fair market value of the Restricted Shares at the time of transfer less any value paid for the shares. This election allows the Recipient to recognize any guaranteed ordinary income gain during the year in which the Restricted Shares are received, avoiding gain recognition for the year in which the restrictions lapse. Consequently, any appreciation (or depreciation) that occurs between the time of the transfer and when the restrictions lapse is deferred until ultimate disposition of the shares and converted into capital gain (or loss). Moreover, the Recipient’s holding period for the shares received commences at transfer, resulting in a longer holding period than that observed when the election is not made.

However, with this desirable deferred compensation and capital gain comes a somewhat significant risk: the Recipient may not deduct any losses resulting from forfeiture. This risk derives from the fact that

46 See id.
47 I.R.C. § 83(b) (2004).
48 Id.
49 See id.
50 Treas. Reg. § 1.83-2(a) (1978) (“[A]ny subsequent appreciation in the value of the property is not taxable as compensation to the person who performed the services”); see id.
52 Id. Note, however, that the applicable Treasury Regulations state that forfeiture for the shares while substantially non-vested would be treated as disposition with a realized loss of the amount paid less amount realized at forfeiture. Treas. Reg. § 1.83-2(a) (1978). However, in most restricted stock agreements, the amount realized upon forfeiture will be equal to the amount paid for the shares, resulting in no available deduction for the Recipient. See id.
the Recipient will be recognizing gain upon the receipt of Restricted Shares even though those shares have a substantial risk of forfeiture.\(^{53}\)

When a Recipient wishes to make an election under section 83(b), there are strict procedural requirements that must be followed.\(^{54}\) The Recipient must file a written copy of the election with the appropriate Internal Revenue Office where the Recipient files his or her annual returns within 30 days following the transfer.\(^{55}\) A copy of the statement must also be filed with the Recipient’s annual income tax return\(^ {56}\) and another copy of this statement should be sent to the issuing corporation.\(^ {57}\) Treasury Regulation § 1.83-2 provides the required content of these statements,\(^ {58}\) and Revenue Procedure 2012-29 contains guidelines for sample language to be included in these documents.\(^ {59}\)

As this election is available to the Recipient, the corporation does not have direct control over the occurrence of the election itself.\(^ {60}\)


\(^{58}\) Treasury Regulation § 1.83-2(e) states:

Content of statement. The statement shall be signed by the person making the election and shall indicate that it is being made under section 83(b) of the Code, and shall contain the following information:

1. The name, address and taxpayer identification number of the taxpayer;
2. A description of each property with respect to which the election is being made;
3. The date or dates on which the property is transferred and the taxable year (for example, “calendar year 1970” or “fiscal year ending May 31, 1970”) for which such election was made;
4. The nature of the restriction or restrictions to which the property is subject;
5. The fair market value at the time of transfer . . . of each property with respect to which the election is being made;
6. The amount (if any) paid for such property; and
7. . . . a statement to the effect that copies have been furnished to other persons as provided in [Treasure Regulation § 1.83-2(d)].


\(^{60}\) Melone, *supra* note 29, at 77 (“Section 83(b) is an unusual elective provision because it is exclusively provided to the employee although the election directly affects a third party’s tax consequences.”).
except and to the extent that the issuance of such stock is conditioned upon the Recipient’s election under section 83(b).  

Correspondingly, the corporation’s decision to require either election or non-election upon issuing Restricted Stock requires analysis of the possible tax liabilities and savings for both the Recipient and the corporation in the event of foreseeable appreciation or depreciation of corporate shares.  

Furthermore, for start-up ventures, the interests of the issuing corporation and the Recipient are even more inter-connected, because initial founders, employees, and shareholders that would be receiving Restricted Shares eligible for the election often happen to be corporate officers and directors.

IV. Relative Benefits and Risks of 83(b) Election for Start-Up Ventures

Start-up ventures are the classic example for electing gain recognition under section 83(b), and the desirability of this election is based on both tax and non-tax consequences. In addition, these ventures arguably face fewer of the substantial risks associated with making this election due to the low share value at initial issuance.

Generally, making an election under section 83(b) is most desirable for Recipients receiving Restricted Shares from a corporation with a low share value at issuance and very large potential appreciation in share value. In his article Is Equity Compensation Tax Advantaged?, David

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61 I.R.C. § 83(b) (2004); Jennifer L. Blouin & Mary Ellen Carter, The Economics of Restricted Stock and the Section 83(b) Election, 7 (February 2010) (unpublished manuscript), available at http://ssrn.com/abstract=1561923 (“[W]e observe firms requiring or prohibiting the [83(b)] election as a condition of the grant . . . .”).

62 In his article, The Section 83(b) Election for Restricted Stock: A Joint Tax Perspective, Michael Knoll examines the potential promises and pitfalls of the section 83(b) election by looking at consequences to both the Recipient and the corporation. Michael S. Knoll, The Section 83(b) Election for Restricted Stock: A Joint Tax Perspective, 59 SMU L. REV. 721, 725 (2006).

63 Elizabeth Pollman, Team Production Theory and Private Company Boards, 38 SEATTLE U. L. REV. 619, 645 (2015) (“In the startup context, however, shareholders and stakeholders are largely overlapping groups because founders and employees are typically granted restricted stock or options for common stock, VC investors hold preferred stock, and suppliers, lenders, and other creditors sometimes hold equity interests or warrants for stock.”).

64 Melone, supra note 29, at 82.

65 See id. at 82-83.

66 See I.R.C. § 83(b) (2004). In this case, the Recipient will incur a tax liability when the corporate share value is quite low, deferring gain on any appreciation until ultimate
Walker recognized that “early stage start-up companies often sell shares to key employees at a nominal value, which can be argued to be the fair market value of the stock in the fledgling venture.”

Due to the low share value, Recipients will be willing to pay fair market value for the Restricted Shares, resulting in no taxable gain upon initial receipt, even if an election in made. Any appreciation in the share value will therefore be taxed at more preferable capital gains rates, causing some scholars to criticize this election as a “conspicuous loophole” for startup founders.

In addition to the bare tax considerations that make section 83(b) elections a desirable option for start-up corporations, early recognition can make Recipients more sensitive to changes in share value, giving them more incentive to make the venture profitable. Moreover, receiving equity compensation with substantial transfer restrictions provides further incentives for founders to both remain at the corporation and provide further contributions to its success.

However, because the Recipient will recognize little to no gain when making a section 83(b) election, the corporation’s corresponding deduction will also be reduced as compared to the deduction available following share appreciation. Moreover, during early operations, there will be little income to offset with these deductions. The corporation disposition, when the Recipient will likely be taxed at a more preferential capital gain rate. See id.


68 Id. (“[E]mployees of start-ups can make a §83(b) election and incur little or no current tax, and they generally do.”). Note that Recipients may make this election even if there is no bargain in the transfer, allowing the Recipients to pay fair market value for the shares and correspondingly incur no tax liability upon election. Treas. Reg. § 1.83-2(a) (1978).

69 Fleischer, supra note 3, at 168; Melone, supra note 29, at 83; see also Treas. Reg. § 1.83-2(a) (1978). The Recipient who elects to include these shares in gross income at initial issuance will use the taxed income value for determining the Recipient’s basis upon ultimate disposition, often resulting in a larger gain at that point. See I.R.C. § 83 (2004); Melone, supra note 29, at 72, 83; infra notes 78-80 and accompanying text.

70 Melone, supra note 29, at 82 (noting that the employee shareholders will recognize more after tax income on shares following an election than they would have retained had the gain recognition been deferred).

71 Melone, supra note 29, at 69; see Blouin & Carter, supra note 61, at 4 (identifying the incentive effects of restricted share compensation).


73 Start-ups take a while to become profitable and often have no taxable income for several years. Fleischer, supra note 3, at 143. Early losses can become a significant corporate asset as they will be incorporated into the corporation’s net operating losses that may be carried forward into future taxable years, with some limitations. Id.; see I.R.C. § 172 (2014); I.R.C. § 382 (2014).
may have more beneficial tax consequences if it recognizes compensation deductions when the share rights actually vest. 74 Consequently, when looking solely at the corporate tax consequence of significant share appreciation after issuance, many corporations restrict the section 83(b) election to maximize later deductions for the corporation. 75

Alongside the corporate disincentives to a Recipient’s 83(b) election, the Recipient may also be reluctant to make such an election with respect to Restricted Shares in a start-up venture due to the high risk of forfeiture during the early stages of operation. 76 The unavailability of loss deductions could result in current taxable gain recognition on property that never truly vests. 77 Similarly, by electing to recognize income from the Restricted Shares upon issuance under section 83(b), the Recipient’s basis in those shares may be lower, resulting in a greater taxable gain upon ultimate disposition. 78 However, for start-up ventures, this loss is lowered by the fact that the Recipient’s taxable compensation upon initial transfer is often minimal. 79 Moreover, the Recipient’s gain upon ultimate disposition will be eligible for preferential capital gains rates even though the gain amount may be greater due to a lower basis value in the shares. 80

74 See I.R.C. § 83(b) (2004).

75 Blouin & Carter, supra note 61, at 3 (“[F]irms prohibit the election to potentially increase tax deductions. Firms with expected stock price appreciation and those in a high tax-paying status are more likely to prohibit the election.”). Melone also notes that the relative increase in marginal tax rate for the issuing corporation would result in a greater deduction benefit when deferred. Melone, supra note 29, at 77. However, as Michael Knoll identifies in his article, The Section 83(b) Election for Restricted Stock: A Joint Tax Perspective, corporations may hedge against the risks associated with a Recipient’s election under section 83 by purchasing its own stock following the Recipient’s share purchase. Knoll, supra note 62, at 749.


77 See I.R.C. § 83(b) (2004).

78 Melone, supra note 29, at 81-82.

79 See Walker, supra note 67, at 727.

80 See supra note 68-69 and accompanying text.
Although there are several risks associated with making an election under section 83(b), these risks are primarily driven by tax consequences. These risks are minimized in the context of a start-up venture because of the low share value at issuance, the availability of corporate loss carryovers in the years following the election, and the ability to hedge against undesirable share values when the corporation buys back shares following initial issuance. On the other hand, the benefits associated with making such an election extend beyond mere tax considerations, looking into both employee incentives and future share value appreciation. On balance, the potential benefits of making the election outweigh risks to start-up ventures because of the holistic approach to business planning and taxation.

V. Effectively using the Section 83(b) Election for Tennessee Start-Up Ventures

As an election under section 83(b) is generally desirable for both start-up ventures and corporate share Recipients, using proper procedure in all steps of the share issuance and election can reduce future risks associated with this election.

Prior to considering the election itself, the venture must ensure proper authority for issuing shares with vesting and transfer restrictions. The Tennessee Code authorizes the issuance of shares with transfer restrictions, and pursuant to this statute, the corporation must include such restrictions in the appropriate documentation under the statute. In addition, shares may be issued subject to certain vesting schedules upon the performance of certain services and meeting certain venture milestones. As many scholars have observed, corporations are frequently issuing restricted stock as equity compensation for employees. To ensure the right to issue the Restricted Shares under state corporate law, the founders should be sure to include the right to

81 See supra notes 72-76 and accompanying text.
82 See id.
83 See Blouin & Carter, supra note 61, at 3; see also supra notes 62-67 and accompanying text.
84 TENN. CODE ANN. § 48-16-208 (2014). This statute allows share transfer restrictions when included in either the charter, bylaws, or in a separate agreement between the shareholders or between the shareholders and the corporation. TENN. CODE ANN. § 48-16-208(a) (2014). In addition, this restriction must also be noted conspicuously on the Recipient’s share restriction. TENN. CODE ANN. § 48-16-208(b) (2014).
85 See id.
86 Blouin & Carter, supra note 61, at 4; Walker, supra note 67, at 726.
issue Restricted Shares within the charter at formation, however, a subsequent agreement would also provide sufficient authorization.\footnote{See TENN. CODE ANN. § 48-16-208 (2014).}

To comply with these and other corporate law requirements, many corporations adopt equity incentive plans, setting forth the various incentive structures for share vesting and transfer restrictions.\footnote{See TENN. CODE ANN. § 48-13-102(12) (2014) (stating that the corporation has the power to “establish . . . benefit or incentive plans for any or all of the current or former directors, officers, employees, and agents of the corporation or any of its subsidiaries” unless the corporate charter states otherwise). These plans must be drafted carefully to address any potential issues under Section 409A of the Code. Incentive plans that provide for Restricted Shares are not subject to Section 409A of the Code, while those issuing options are subject to section 409A. \textit{See I.R.C. § 409A}. As Restricted Shares are more frequently used as equity incentive compensation, start-ups seeking to minimize transaction, legal, and taxation costs should draft the equity incentive plan to only issue Restricted Shares. \textit{See supra} note 86 and accompanying text.} Although not explicitly required under state corporate law, best practices would include a shareholder approval upon adopting this equity incentive plan.\footnote{Both the NYSE and NASDAQ require listed companies to demonstrate shareholder approval upon adopting or materially altering an equity incentive plan. NYSE, Inc. Listed Company Manual § 303A.08 (2015), \textit{available at} http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp%5F1%5F8%5F3%5F8&manual=%2Flec%2Fsections%2Flec%2Dsections%2F; NASDAQ Rule 5635(c) Shareholder Approval (2015) \textit{available at} http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp%5F1%5F1%5F4%5F3%5F7%5F8&manual=%2Fnasdaq%2Fmain%2Fnasdaq%2FDequityrules%2F. Although start-up ventures are not listed on any national exchanges when these considerations arise, the normative nature of these exchanges help guide entrepreneurs of best practices of corporate governance. Furthermore, public companies are subject to shareholder approval requirements both in the adoption and retention of equity incentive plans under federal law. \textit{See} 15 U.S.C. § 77e (2012) (stating that, absent an exemption, any offer or sale of securities is subject to federal securities registration).}

Any equity incentive plan adopted by the corporation must also comply with relevant federal and state securities laws and regulations.\footnote{See 15 U.S.C. § 77e (2012) (stating that, absent an exemption, any offer or sale of securities is subject to federal securities registration).} To avoid federal securities registration, the start-up’s equity incentive plan must meet certain requirements under federal regulations.\footnote{17 C.F.R. §230.701(c) (2015) (setting forth requirements for federal registration exemption, including, but not limited to, the requirements that the shares be received as compensation for services rendered and that the Recipient be a natural person).} Similarly, Tennessee statute and regulatory guidance provide that employee compensation shares meeting certain requirements are exempt
from state securities registration. Start-up corporations must be sure to either comply with these safe harbors for registration exemption, or be prepared to file the appropriate registration.

Once the equity incentive plan has been properly adopted pursuant to Tennessee corporate law and the corporation’s charter, the corporation should consider whether the receipt of Restricted Shares should be conditioned upon making a section 83(b) election. While start-up share Recipients will be more likely to elect gain recognition under section 83(b) regardless of an election requirement, the corporation might wish to require such an election to ensure a particular deduction during the year of transfer. This requirement could help with accounting and tax planning by giving the corporation more control over

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92 Section 48-1-103(b)(9) of the Tennessee Code exempts from state securities registration:

Any transaction involving the issuance of a security:

(A) In connection with a stock bonus plan requiring payment of no consideration other than services;
(B) In connection with a stock bonus, pension, profit sharing, savings, thrift, or retirement plan for employees or self-employed individuals . . . or
(C) In connection with a transaction that meets the following requirements:
   (i) The offering meets the requirements of Rule 701 of the regulations under the Securities Act of 1933 codified in 17 C.F.R. § 230.701, as amended;
   (ii) The offering is exempt from the provisions of § 5 of the Securities Act of 1933, codified in 15 U.S.C. § 77e, as amended;
   (iii) The issuer files with the commissioner no later than fifteen (15) days after the first sale in this state a notice of transaction, on a form adopted by the commissioner, accompanied by a consent to service of process, and a nonrefundable filing fee of five hundred dollars ($500); and
   (iv) No commission, discount, or other remuneration is paid or given in connection with any transaction in this state under this subsection (b) unless paid or given to a broker-dealer or agent registered under this part . . .

93 Blouin & Carter, supra note 61, at 3; Knoll, supra note 62, at 725 (“[T]he employer designs the grant program, and thus can decide whether to require, prohibit, or permit the election.”).

94 The corporation cannot assure a particular deduction if gain recognition is deferred. See I.R.C. § 83 (2004).
the amount deductible during the current year.\textsuperscript{95} Furthermore, requiring a section 83(b) election for Recipients could maximize the beneficial incentive considerations arising from the present election.\textsuperscript{96}

Once the corporation has properly adopted an equity incentive plan and determined the proper requirements and conditions for the shares issued, it must then ensure that the Recipients follow the filing and procedural requirements under both the Code and applicable regulations.\textsuperscript{97} Following the election, the corporation may continue to develop and issue Restricted Shares to future employees as incentive based compensation. However, once the corporation’s shares begin to appreciate in value, the analysis for the section 83(b) election will change dramatically, and consequently may no longer be as attractive to the various stakeholders.\textsuperscript{98} Therefore, the foregoing analysis may not be applicable for entrepreneurs during later stages of a venture’s development, and re-evaluation for purposes of section 83(b) election is advisable.

\textbf{VI. Conclusion}

The issuance of Restricted Shares has become an increasingly popular form of incentive based compensation.\textsuperscript{99} The receipt of these shares, due to their deferred vesting, are subject to particular federal income tax treatment under section 83 of the Code.\textsuperscript{100} The election available under section 83(b) for these Restricted Shares can have very attractive consequences for start-up corporations and their initial employees, though the corresponding risks can also have detrimental consequences.\textsuperscript{101} By following applicable laws and regulations with respect to taxation, securities, and corporate governance, start-ups can

\textsuperscript{95} See I.R.C. § 83 (2004). While deferred gain recognition will subject the corporation to risks associated with share value fluctuation, requiring present recognition can ensure a certain deduction amount because the corporation is aware of the shares’ current fair market value. See id.

\textsuperscript{96} See supra notes 66-71 and accompanying text.

\textsuperscript{97} See I.R.C. § 83 (2004); supra notes 52-57 and accompanying text.

\textsuperscript{98} See Knoll, supra note 62, at 749-50 (identifying several scenarios where the election may not be desirable to the Recipient and the issuing corporation); supra Part IV and accompanying notes.

\textsuperscript{99} Knoll, supra note 62, at 749 (“Restricted stock is well on its way to becoming, along with ESOs, one of the two dominant forms of equity-based pay.”).

\textsuperscript{100} See I.R.C. § 83 (2004).

\textsuperscript{101} See supra Part IV and accompanying notes.
effectively adopt equity incentive plans, issue Restricted Shares, and require section 83(b) election for the share Recipients. In sum, thoughtful tax and corporate governance counsel and planning can have significantly beneficial results throughout the life of the corporate venture.

102 See supra Part V and accompanying notes.