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Section 83(b) Elections by Nonresident Aliens

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It has become increasingly common in recent years for U.S. multinational companies to extend their stock option plans to nonresident aliens working abroad for their foreign branches and subsidiaries. [1] However, it is less common for U.S. parent companies to extend so-called "restricted stock plans" to their foreign-based employees because so many foreign countries impose immediate tax on the current market value of such stock on the date of transfer, and ignore the fact that the stock will be forfeited unless the employee continues working until the end of a "vesting period." For that reason, the U.S. parent will often vary its restricted stock plan and instead make an unfunded promise to deliver its stock to the foreign employee at the end of the vesting period (often referred to as "deferred stock" or "restricted stock units").

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[1] For comments by this author on the subject in 1999, see Bissell and Giardina, "Extending U.S. Equity-Based Compensation Plans to Foreign Subsidiaries: U.S. and Foreign Tax Issues," 27 Tax Mgmt. Comp. Plan. J. 263 (10/1/99). The only significant change since then has been the enactment of §409A, which placed significant restrictions on unfunded deferred compensation plans. However, §409A does not apply to restricted stock plans.

If the U.S. parent does decide to deliver restricted stock to a particular nonresident alien working and resident abroad, the U.S. parent may want to advise him of the potential advantages of making a so-called "83(b) election" for U.S. tax purposes within 30 days after receipt of the U.S. parent's stock. Such an election may be made for U.S. tax purposes without regard to whatever the foreign tax consequences may be. If effective, the election imposes U.S. income tax — at least in theory — on the value of the stock as of the stock transfer date. [2] If all of the nonresident alien's services that relate to the restricted stock were rendered outside the United States, however, no actual U.S. tax may be imposed on the value. [3] If the nonresident alien subsequently moves to the United States and becomes a resident alien for U.S. tax purposes before the end of the vesting period, the value of the stock as of the end of the vesting period should not be taxed to him under the normal rules of §83, bec ause of the prior 83(b) election. Instead, he will only be taxed on the value of the stock when he actually sells it (assuming that he is still a resident alien at that time), and then usually at the lower applicable long-term capital gains tax rate. His U.S. tax basis in the stock will be the fair market value when it was transferred to him.

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[2] Under most restricted stock plans, the employee does not pay anything in exchange for the stock, and the only requirement is that he must continue to work for the employer up to the end of a subsequent "vesting period" in order to become the unrestricted owner of the stock. In a small minority of plans, however, the employee does pay cash to the employer "up front" for part of the value of the stock. This commentary assumes that the employee pays nothing in return for the stock, and that the only "consideration" in return for the stock is that he must render services throughout the subsequent vesting period.

[3] The IRS has never ruled on how to source gross income that arises as the result of an 83(b) election. However, the New York State Department of Taxation and Finance ruled in TSB-M-07(7)I on 10/4/07 that §83(b) income should be sourced in the same manner as regular compensation that is realized by the employee during the same taxable year. It is believed that this rule is followed for U.S. income tax purposes by many U.S. companies and their employees.

To the extent that restricted stock may also be transferred to foreign employees in those countries where immediate foreign tax is imposed on the value of the stock on the transfer date, an 83(b) election may nevertheless be advisable if there is a possibility that the employee may relocate to the United States during the vesting period. If that does happen and no 83(b) election was made, the value of the stock as of the vesting date would be taxed in full to the employee on the vesting date (i.e., at the end of the forfeiture period) under §83 because of his newly acquired resident alien status under U.S. law. Although a large part of the resulting income under §83 would often be foreign-source income for U.S. income tax purposes, a foreign tax credit for the foreign tax imposed on the stock transfer date would usually not be available to him under §901 beca use of the individual's nonresident alien status on that date. [4] Thus, the effect of the 83(b) election would be to avoid double taxation on the value of the restricted stock.

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[4] If the United States has an income tax treaty with the foreign country where the individual previously worked and was resident, in theory some kind of relief (albeit time-consuming and costly) under the Competent Authority provisions of the treaty may be available.

If a particular nonresident alien working abroad receives restricted stock and there is a possibility that he may someday move to the United States, [5] two obvious questions arise. First, is it certain that an effective 83(b) election may be made by a

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nonresident alien working and living abroad, especially if all of the resulting income is excluded because it is foreign-source? Second, if an 83(b) election can be made, how should it be done procedurally in order to be effective for U.S. tax purposes?

[5] Even if the nonresident alien recipient of restricted stock does not plan to move to the United States, an 83(b) election may be advisable if he expects to make business trips into the United States during the vesting period, and if as a result he could be subject to U.S. tax on part of the value of the stock at the end of the vesting period.

The IRS has never explicitly ruled on whether a nonresident alien may make an 83(b) election, whether or not any of the resulting income is potentially taxable as a result of U.S. workdays. There is a strong implication in PLR 8711107, however, that a nonresident alien may make an 83(b) election. An 83(b) election would also conform with the IRS position under other Code sections to the effect that when a nonresident alien who has never been subject to U.S. tax becomes subject to U.S. tax — usually by moving to the United States and becoming a resident alien — his personal and investment assets have attached to them a "hypothetical U.S. tax history" [6] which ignores how a particular asset was treated under foreign law, and instead applies the rules of the Code to both U.S.-situs and non-U.S.-situs assets that were acquired by the individual before becoming a resident alien subject to U.S. tax.

[6] The author is not aware that the IRS has ever used this particular term in any rulings or other guidelines, or that it has ever appeared in any court decisions. However, the author often uses this term in articles and in speeches as a "shorthand" way of referring to the application of the Code to a nonresident alien's personal and investment assets.

Thus, the IRS ruled in Rev. Rul. 84-139 that foreign-situs property that was inherited by a nonresident alien had a U.S. tax basis under §1014 equal to its date-of-death value. Similarly, in PLR 8251014, the IRS ruled that a Canadian "registered retirement savings plan" (RRSP) that had a zero basis under Canadian law had a fair market value basis for U.S. tax purposes in the hands of a Canadian nonresident alien who had moved to the United States and became a resident alien. Where the "hypothetical U.S. tax history" principle has not applied, it has been because Congress amended the Code to expressly override it — as in §72(w) (applicable to distributions from certain foreign retirement plans) and in §877(e)(3)(B) (all owing expatriating long-term green card holders to elect to step up the basis of their assets to their market value as of their resident alien starting date).

If it is correct that an 83(b) election may be made by a nonresident alien who has no U.S. tax liability, the electing alien should follow the guidelines in Regs. §1.83-2. Thus, the election must be filed within 30 days after transfer of the stock "with the internal revenue officer with whom the person who performed the services files his return." Presumably, therefore, the election is filed with the IRS in Austin, Texas, which is where all nonresident alien tax returns (on Form 1040NR) are required to be filed when no payment is being made with the return. Because the alien must provide his "taxpayer identification number" on the form, if he has never acquired a U.S. social security number or "Individual Tax Identification Number" (ITIN), he should probably apply simultaneously for an ITIN on IRS Form W-7, and indicate on the election form that he has applied for an ITIN. Regs. §1.83-2(c) also requires the alien to attach a copy of the election form to "his income tax return for the taxable year in which such property was transferred." If the alien is not required to file Form 1040NR for the applicable year, [7] it may nevertheless be advisable for him to file a Form 1040NR (attaching a copy of the election form), with an explanation that Form 1040NR is being filed only in order to be certain that the 83(b) election has been made properly.

[7] If the nonresident alien has no effectively connected income for the year, was not engaged in a U.S. trade or business at any time in the year, and has no U.S.-source "FDAP" on which too little tax was withheld at source under §1441, he would technically not be required to file Form 1040NR. See Bissell, 907 T.M., U.S. Income Taxation of Nonresident Alien Individuals, at VII, B.

Assume alternatively that a nonresident alien working abroad fails to make an 83(b) election and later moves to the United States before the end of the vesting period, and then learns that he could have realized significant U.S. tax advantages if he had made a timely 83(b) election while working abroad. The question arises whether the 30-day rule in the regulations might still be satisfied if the alien makes a late 83(b) election within 30 days of his resident alien starting-date under §7701(b)(2)(A). A possible analogy could be made to §453, which provides that an individual who makes an installment sale and wishes to avoid installment treatment (the §453 "default" rule) and instead include the entire gain in gross income in the year of sale must elect out of installment treatment by attaching an election to his tax return for the year of sale. In PLR 8708002 and PLR 9412008, the IRS ruled that a nonresident alien who sold property on the installment basis and who later moved to the United States and became a resident alien could elect out of installment treatment on his first U.S. tax return, in order to avoid U.S. tax on the installment payments that he received after the move. In so ruling, however, the IRS stressed that the 1980 legislative history of §453 specifically asked the IRS to issue regulations to permit such an election by a former nonresident alien [8] — another example of a selective overriding of an alien's "hypothetical U.S. tax history" by Congress. There is no similar legislative history under §83(b). Thus, it seems unlikely that the IRS, or the courts, would permit a resident alien to make an 83(b) election in this situation.

[8] Although no regulations on this issue have yet been issued, presumably the IRS would rule the same way if the issue were to arise today,

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on the basis of the 1980 legislative history. Notwithstanding the two private letter rulings just cited, there is dictum in CCA 003750 to the effect that a nonresident alien who wishes to elect out of the §453 default treatment must do so on a timely filed U.S. tax return.

If a nonresident alien working and living abroad contemplates making an 83(b) election, other issues should also be considered that are beyond the scope of this commentary. Those issues include U.S. and foreign social security taxes and other U.S. and foreign payroll taxes, the possible application of an income tax treaty and/or a social security totalization agreement, U.S. state and local tax issues, the fact that the U.S. source-of-income issues are not clearly defined in this area, and, of course, foreign personal income tax issues. In addition, whether or not any nonresident aliens make 83(b) elections, the U.S. parent company should always be concerned about the relevant U.S. and foreign corporate income tax and payroll tax issues.

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