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Randy R. Shorb

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TAXATION OF EMPLOYMENT AND STOCK PURCHASE AGREEMENTS: *Alves v. Commissioner*

On May 22, 1970, Lawrence J. Alves accepted a position as Vice President of General Digital Corporation. Acceptance of this managerial position obligated Alves to execute an employment and stock purchase agreement that required him to purchase forty thousand shares of the company's common stock. Alves executed the agreement and purchased each share of the stock at its fair market value. One-third of the common stock was subject to a four-year restriction, another one-third carried a five-year restriction, and the remaining one-third was not burdened by any restrictions. The stock purchase agreement executed by Alves and other executive personnel stated that the stock had been sold "in order to raise capital for the Company's initial operations while at the same time providing the Employee with an additional interest in the Company." Since the difference between the fair market value of the stock and...
the purchase price was zero, Alves did not include the receipt of the stock in his gross income for 1970.

Pursuant to an option granted to the company in the stock purchase agreement, Alves was forced to sell a substantial number of the restricted shares at prices considerably higher than the initial fair market value purchase price. Alves reported the gain from the sale of the five-year stock as ordinary income on the joint federal income tax return that he and his wife filed for 1974. He did not, however, include as income the difference between the value of the four-year stock when restrictions on that stock lapsed on July 1, 1974, and the initial purchase price of that stock. Similarly, Alves did not report as income the excess value of the retained five-year shares when their restrictions lapsed in 1975. The Commissioner of Internal Revenue notified the Alveses of deficiencies in their 1974 and 1975 income tax returns. The basis of these deficiencies was the failure to report the gains due to the increase in market value of the restricted stock at the time the restrictions lapsed as required by section 83 of the Internal Revenue Code.

5. On June 26, 1970, Technology Ventures, Inc. (T.V.I.) purchased 467,000 shares of the company's preferred stock and was assigned the repurchase option granted to the company by Alves and his fellow employee-shareholders. When T.V.I. exercised this option on Nov. 9, 1973, Alves was forced to sell 4667 four-year shares at $18 per share, for a total price of $84,006. T.V.I. again exercised this option on June 27, 1974, requiring Alves to sell 2240 five-year shares at four dollars per share, for a total price of $8,960.

6. The appreciation in value of stock received as compensation for services performed is recognized as ordinary income. I.R.C. § 83(a) (1976).

7. Section 83(a) requires that any appreciation in the value of the stock at the lapse of the restrictions over the initial purchase price be reported as ordinary income for the year the restrictions lapse. Id. Since Alves failed to elect to report the acquisition of stock in the year of the transfer, the appreciation in value of any stock received as compensation for services was ordinary income. Id. § 83(b).

8. The parties agreed that the restrictions on the five-year shares would terminate on Mar. 24, 1975.

9. The Commissioner of Internal Revenue increased Alves's reportable income for 1974 by $27,535 and by $5078 for 1975. In notifying Alves of the deficiencies the Commissioner stated that the excess of the fair market value of the stock on the dates on which the stock restrictions lapsed over the $10 per share paid for it was taxable as ordinary income pursuant to § 83 of the Internal Revenue Code. In a subsequent amendment to the Commissioner's answer to Alves's petition, Alves's deficiency was increased by $16,007.81 to reflect the ownership of 7093 rather than 2426 shares of five-year stock on Mar. 24, 1975, the date the restrictions on those shares lapsed with the market value then at $3.43 per share.


(a) General rule

If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property, shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such prop-
Alves challenged the deficiencies in the Tax Court, contending that his purchase was not a bargain transaction since he had paid full market price for the restricted stock and that the stock was not issued as compensation for performance of services, thus rendering section 83 inapplicable. Alves also sought a refund of a portion of the tax assessed on the gain that he had reported from the 1974 sale, claiming that it should have been characterized as capital gain rather than ordinary income since the stock had not been received as compensation for services. The full membership of the Tax Court reviewed the case. Held, affirmed: Section 83 is applicable to restricted stock transfers made in connection with the performance of services by the transferee for the company even when the employee pays full fair market value (without regard to any restrictions) for the stock. *Alves v. Commissioner*, 79 T.C. 864 (1982).

I. Development of Internal Revenue Code Section 83

A. Early Developments

Restricted stock options were very popular prior to the enactment of

...
Internal Revenue Code section 83 in 1969. The usual restricted stock option involved a transfer of restricted stock to the employee, usually as a bonus or in compensation for services, at little or no cost to the employee. The stock was normally subject to forfeiture upon early termination of the employment relationship or subject to some other material restriction. Initially no specific statutory provisions regulated taxation of such transfers. Because of the contingent nature of the transfer the stock received was generally thought to have little or no ascertainable value.

The Tax Court initially followed this rationale in concluding that an em-

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15. One such option involved the transfer of 10,000 shares of stock at a bargain price designed to induce the executive to accept employment with the corporation. Although the stock was restricted only by a vague oral agreement preventing the employee from selling the stock, the Tax Court’s determination that the stock’s market value was ascertainable and that the transfer was in recognition for performance of services, MacDonald v. Commissioner, 23 T.C. 227, 234-35 (1954), was reversed by the appellate court’s decision that the market value was unascertainable, there being no market for that which cannot be sold. MacDonald v. Commissioner, 230 F.2d 534, 539 (7th Cir. 1956), on remand, 16 T.C.M. (CCH) 208 (1956), rev’d and remanded, 248 F.2d 552 (7th Cir. 1957); see also Edwards, Executive Compensation: The Taxation of Stock Options, 13 Vand. L. Rev. 475, 484-85 (1960) (application of MacDonald).

16. A restrictive stock option is often considered to mean a transfer at “no cost or at a bargain price.” Hindin, Internal Revenue Code Section 83 Restricted Stock Plans, 59 Cornell L. Rev. 298, 298 (1974). The option in MacDonald v. Commissioner is a good example of such a bargain transfer. See also Nolan, Tax Court’s Section 83 Decision in “Alves” Critiqued, Tax Notes, May 9, 1983, at 553 (former Treasury Secretary John S. Nolan’s analysis that Section 83 was designed to apply only to bargain purchases).


19. In Kuchman v. Commissioner, 18 T.C. 154 (1952), the Tax Court held that the value of restricted stock at the time of its receipt was not ascertainable and, hence, nontaxable. Id. at 163. Significantly, § 83 does not raise revenue through application to restricted stock options. The employer-transferor is entitled to a deduction equal to the amount of taxable income an employee-transferee realizes from transfers in compensation for services performed. I.R.C. § 83(h) (1976); see Nolan, supra note 16, at 555 (§ 83 would have no effect on total revenue raised assuming employer and employee are in equal tax brackets).
ployee did not recognize ordinary income either at the time of receipt or when the restrictions ultimately lapsed. Subsequent Treasury Regulations rejected this approach, requiring recognition of ordinary income when the restrictions lapsed. Upon lapse of the restrictions the amount of ordinary income recognized was the lesser of the fair market value of the stock (without restrictions) at the time of transfer or at the time when the restrictions lapsed. The purchase price, if any, was subtracted from the fair market value in computing the gain to be recognized. The appreciation in value of the stock above the amount included in the income of the employee and deducted by the employer was treated as capital gain rather than ordinary income.

This unique pro-taxpayer situation evolved in the early 1950s despite the Commissioner's contentions to the contrary. In _Lehman v. Commissioner_ the Internal Revenue Service argued that an employee realized ordinary income equal to the entire appreciation in value at the time the restrictions on the stock lapsed. The Tax Court rejected this contention, holding that the termination of the restrictions did not cause a realization of ordinary income. The court noted that values of shares purchased at a bargain price are subject to a great deal of fluctuation; consequently, the market value of the restricted shares was unascertainable at the time the stock was transferred. Since the future value of the stock at the time of transfer was purely speculative, the Tax Court held that a determination of ordinary income at the lapse of the restrictions would not accurately reflect the compensatory nature of the original transfer. Therefore, termination

22. _See infra_ notes 38-42 and accompanying text.
23. The employer is entitled to a deduction equal to income realized by the employee due to appreciated value of restricted stock on the date such restrictions lapse. Nolan, _supra_ note 16, at 555. In accordance with Treas. Reg. § 1.421-6(d) the employee received the favorable tax treatment of taxation of the lesser excess appreciation of the stock, either at the lapse of the restrictions or at the time of the transfer. _Kuchman v. Commissioner_, 18 T.C. 154 (1952), involved a bargain transfer in compensation for services performed, and the employee's realization from this transfer was not taxed as ordinary income. _Id._ at 163; _see also_ Hindin, _supra_ note 16, at 300-02 (analysis of favorable treatment allowed transferees of restricted stock).
24. This capital gains treatment of appreciation in value led to favorable tax treatment and savings for employees receiving restricted stock in compensation for services performed. _See Hindin, supra_ note 16, at 301.
25. Prior to the enactment of § 83, restricted stock options were more advantageous than qualified plans because of the favorable tax treatment allowing both a hedge against future appreciation in value and a deferral of taxation. _See Comment, Property Transferred In Connection With Performance of Services Under Section 83—Effectuation of Tax Reform Act Purposes_, 17 WAYNE L. REV. 1267, 1272-73 (1971).
27. The Service reasoned that since the market value of the restricted stock was unascertainable at the time of the transfer, it was taxable at the ascertainable market value on the date the restrictions lapsed.
28. _Id._ at 654.
29. _Id._
30. _Id._
of the restrictions was not a taxable event.\textsuperscript{31}

Subsequently, in \textit{Kuchman v. Commissioner},\textsuperscript{32} the Tax Court considered the tax treatment to be accorded employees who were compensated for services under a complex stock option plan that entitled management employees to purchase stock at a price equal to one-tenth of its prior par value. Immediately after the options were exercised, the company ordered a five-for-one split of the stock. The Commissioner contended that the difference between the purchase price and the fair market value of the stock was ordinary income to the employee in the year the purchase was made. The Tax Court again disagreed, holding that the employee realized no income at the time of the transfer because the fair market value of the stock was not ascertainable.\textsuperscript{33} The \textit{Kuchman} decision indicates that an employee does not recognize income on the bargain purchase of stock at the time of transfer if the fair market value of the stock is not ascertainable.\textsuperscript{33} The \textit{Lehman} decision further holds that the employee does not recognize ordinary income when any restrictions on the stock lapse, since the inability to calculate fair market value on transfer makes calculation of the compensatory element of the transaction impossible. Hence, any appreciation in the stock's value is to be treated as long-term capital gain.\textsuperscript{34} Allowing such a bargain transaction to receive capital gains treatment seems odd, however, since a transfer in connection with services at less than fair market value is indicative of a compensatory element in the transaction.\textsuperscript{35} Conversely, a nonbargain transaction such as that in the \textit{Alves} case should receive capital gains treatment in view of the absence of a compensatory element.\textsuperscript{36}

The promulgation of Treasury Regulations stating that Internal Revenue Code section 421\textsuperscript{37} applied to stock option transfers helped clarify the

\begin{itemize}
  \item \textsuperscript{31} \textit{Id.}
  \item \textsuperscript{32} 18 T.C. 154 (1952).
  \item \textsuperscript{33} \textit{Id.} at 163.
  \item \textsuperscript{34} The employee would report as ordinary income the excess value of the stock in relation to the transfer price, if ascertainable, either at the time of the transfer or at the lapse of restrictions, whichever was less. Regardless of which event was deemed taxable, any additional excess value at the other point in time would be capital gain. \textit{See Nolan, supra note 16, at 553 (transfer to employee at zero purchase price).}
  \item \textsuperscript{35} Courts have uniformly refused to accord capital gains treatment to the disposition of an asset received in compensation for services. \textit{See, e.g., Pledger v. Commissioner, 641 F.2d 287, 293 (5th Cir.) (stock transfer to employee results in ordinary income), cert. denied, 454 U.S. 964 (1981); Cohn v. Commissioner, 73 T.C. 443 (1979) (property received by independent contractor held ordinary income when received as compensation for services); 3B J. MERTENS, supra note 13, \S 22.32. When an employee receives property from his employer without paying fair market value for it, the inference is that the bargain element represents compensation for the services rendered by the employee.}
  \item \textsuperscript{36} A nonbargain transaction in which the employee pays full fair market value for the restricted stock seemed to be outside the realm of \S 83. Nolan, \textit{supra} note 16, at 556 (\S 83 should not apply to transfers at full fair market price).
  \item \textsuperscript{37} I.R.C. \S 421 (1976 & Supp. V 1981). Section 421 generally provides that an employee who receives stock under one of the qualified stock plans defined in \textit{id.} \S 422-424 is entitled to receive capital gains treatment on the subsequent disposition of the stock. \textit{Id.} \S 421. Because of the strict requirements in the qualified stock provisions, employers frequently used restricted plans as a more flexible alternative. Hindin, \textit{supra} note 16, at 299-300.
\end{itemize}
tax treatment to be accorded such transfers.\textsuperscript{38} These regulations attempted to control bargain purchases of stock at deflated prices by specifying that a tax would be imposed only when the restrictions lapsed or the property was sold.\textsuperscript{39} A later Treasury Regulation permitted the employee to report the difference between the amount paid for the stock and the lesser of the fair market values at the time of transfer or lapse of the restrictions as ordinary income.\textsuperscript{40} The current version of this regulation specifically states that if property is transferred by an employer to an employee, and such property is subject to a restriction that has a significant effect on its value, then the amount of gain to be recognized as compensation is the lesser of

\begin{itemize}
  \item[(a)] The difference between the amount paid for the property and the fair market value of the property (determined without regard to the restriction) at the time of the acquisition, or
  \item[(b)] The difference between the amount paid for the property and either its fair market value at the time the restriction lapses or the consideration received upon the sale or exchange, whichever is applicable.\textsuperscript{41}
\end{itemize}

These Treasury Regulations fostered the favorable tax treatment granted the taxpayer in the \textit{Kuchman} and \textit{Lehman} decisions. In essence, the employee was allowed to defer the taxation of ordinary income, yet hedge against future appreciation in value. Taxability was completely deferred until the year in which the restrictions lapsed. Only then did the taxpayer have to choose between the applicable fair market values to achieve the least amount of ordinary gain recognition.\textsuperscript{42}

\textbf{B. Legislative Response}

Congress felt that this choice gave restricted stock plans an unfair advantage over other employment compensation methods\textsuperscript{43} and in 1969 enacted section 83.\textsuperscript{44} The House Report indicated that the taxpayer would not be allowed to defer taxation while hedging against an increase or de-

\textsuperscript{38} See Treas. Reg. \textsection 1.61-2(d)(5).

\textsuperscript{39} Treas. Reg. \textsection 1.421-6(c)(2)(i), T.D. 6416, 1959-2 C.B. 126, 128; see also Sakol v. Commissioner, 67 T.C. 986, 990 (1977) (discussion of proposed regulations that would have taxed fair market value of stock at lapse of restrictions).

\textsuperscript{40} Treas. Reg. \textsection 1.421-6(d)(2)(i), T.D. 6540, 1961-1 C.B. 161, 163.

\textsuperscript{41} Treas. Reg. \textsection 1.421-6(d)(2)(i). This regulation was given retroactive application. \textit{Id.} \textsection 1.61-2(d)(5) (\textsection 1.421-6(d)(2) applicable to transfers on or before June 30, 1969). These regulations were promulgated to remedy bargain purchases specifically, with no mention of transfers at full market price.

\textsuperscript{42} Nolan, \textit{supra} note 16, at 553 (taxability deferred until lapse of restrictions).

\textsuperscript{43} Congress has historically bestowed favorable tax treatment upon qualified stock options, yet the restricted stock option, subject to no specific requirements, had become even more attractive to employees. \textit{See}, e.g., Kuchman v. Commissioner, 18 T.C. 154, 163 (1952) (employee receiving restricted stock with unascertainable market value realized no income); Lehman v. Commissioner, 17 T.C. 652, 654 (1951) (terminations of stock restrictions held nontaxable event).

crease in the stock's valuation on the lapse date.\textsuperscript{45} To curtail this practice, the taxpayer was required to choose between including in income the initial difference between the fair market value of the stock, absent any restrictions, and the purchase price, or including the difference between purchase price and the stock's fair market value on the date the restrictions lapsed.\textsuperscript{46} The Senate added section 83(b)(2),\textsuperscript{47} which required the election of taxability to be made within thirty days of the initial transfer of stock to the employee.\textsuperscript{48} This effectively ended the practice of deferring realization of income while simultaneously hedging against future appreciation in value.\textsuperscript{49} The employee could still opt for a tax deferral by reporting his income when the restriction lapsed, or hedge against future appreciation in value, but could not do both.\textsuperscript{50} Forcing the employee to choose between these two benefits eliminated the favorable treatment to which Congress had objected.\textsuperscript{51}

Section 83 has since withstood constitutional challenges under both the fifth\textsuperscript{52} and sixteenth amendments.\textsuperscript{53} Moreover, the Tax Court has held


\textsuperscript{46} I.R.C. § 83(b) (1976).


\textsuperscript{48} The employer is entitled to a corresponding deduction in the year the employee is taxed regardless of the employee’s election to invoke § 83(b). I.R.C. § 83(h) (1976).

\textsuperscript{49} Hindin, \textit{supra} note 16, at 303 (§ 83 is in response to “concern for equitable treatment among taxpayers and the elimination of unwarranted tax deferral and avoidance”); Nolan, \textit{supra} note 16, at 553. Congress realized that enactment of § 83 would not raise additional revenue; increasing revenue was not the purpose of this section. Nolan, \textit{supra} note 16, at 555.

\textsuperscript{50} \textit{See} I.R.C. § 83(b) (1976). Section 83(b) allows the employee, at his option, to include the difference in value and amount paid for the stock at the time of the transfer in ordinary income for that year. \textit{Id.} Such elections have usually been viewed cautiously since the employee is, in essence, gambling that the value of the stock will increase. \textit{See} Helpern, \textit{supra} note 18, at 371 (election is normally a gamble); Hindin, \textit{supra} note 16, at 328 (“[T]he election . . . allows an unwarranted gamble which serves no rational purpose.”); Nolan, \textit{supra} note 16, at 556 (employee must be informed of and exercise this option within 30 days of transfer). A strong reason for not opting for the § 83(b) election is the fact that the taxpayer may recover only his actual expenditure upon a subsequent loss from sale or forfeiture of the restricted stock. Moreover, the taxpayer who has previously reported ordinary income pursuant to a § 83(b) election may not deduct this amount even though it was only a paper gain. Hindin, \textit{supra} note 16, at 327.


\textsuperscript{52} In Pledger v. Commissioner, 71 T.C. 618 (1979), \textit{aff’d}, 641 F.2d 287 (5th Cir.), \textit{cert. denied}, 454 S. Ct. 964 (1981), the taxpayer challenged the validity of § 83, asserting that its application to restricted stock transfers is arbitrary and violates due process of law. \textit{See} U.S. CONST. amend. V (no individual may be deprived of property without due process of law). The taxpayer asserted that the statute raises a conclusive presumption as to the amount of income derived from a restricted stock transfer, that this presumption is irrebuttable, and that the resultant taxation amounted to a deprivation of property without due process. 71 T.C. at 628. The Tax Court concluded that application of § 83 is not arbitrary and that the statute was enacted as a reasonable remedy for an area of substantial tax abuse. \textit{Id.} at 627-
that section 83 will be applied according to its terms even though unfairness and inequity may result in a specific setting.\textsuperscript{54} Thus, prior to the \textit{Alves} case, the Tax Court had rejected contentions that section 83 was unconstitutional on its face or as applied. In \textit{Alves v. Commissioner},\textsuperscript{55} however, the Tax Court faced a more serious situation of unfairness to the taxpayer than it had encountered before.

\section*{II. \textit{Alves v. Commissioner}}

The petitioner's payment of full fair market value\textsuperscript{56} for the restricted stock separated \textit{Alves} from previous cases dealing with section 83. The Tax Court initially considered whether a transfer of restricted stock for which an employee pays full fair market value is connected with the employee's performance of services for the company. The court first turned to the company's initial board resolution authorizing issuance of the stock.\textsuperscript{57} The minutes of the board meeting stated that the purpose of the issuance of some of the restricted stock was "to enable this corporation to obtain qualified employees or directors and to permit this corporation to compete with other companies for the services of qualified and competent employees and directors."\textsuperscript{58} The court stated that the resolution authorizing issuance of stock to specific individuals who all became company officials supported a finding that the issuance of stock to those individuals was related to their employment with the company.\textsuperscript{59} The court rejected the contention that shares issued solely to named individuals could have been issued to obtain funds for the company.\textsuperscript{60} While the usual restricted stock transfer involves bargain purchases of stock,\textsuperscript{61} or imposition of restrictions that make the fair market value unascertainable,\textsuperscript{62} the court refused to

\begin{notes}
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28; see also Sakol v. Commissioner, 67 T.C. 986, 996 (1977) (same conclusion on similar due process challenge), aff'd, 574 F.2d 694 (2d Cir.), \textit{cert. denied}, 439 U.S. 859 (1978).

53. Section 83 has been challenged as exceeding the taxation power granted to Congress by the sixteenth amendment. See \textit{U.S. Const. amend. XVI}. In Sakol v. Commissioner, 67 T.C. 986 (1977), \textit{affd}, 574 F.2d 694 (2d Cir.), \textit{cert. denied}, 439 U.S. 859 (1978), the petitioner contended that the statute's disregard of contractual restrictions for purposes of computation of taxable income taxed income that had not been realized. 67 T.C. at 991. The Tax Court concluded that the sixteenth amendment is not a limit on congressional taxing power and that $\textsection$ 83 is a valid exercise of that power. \textit{Id.} at 991, 996.

54. 67 T.C. at 996.

55. 79 T.C. 864 (1982).

56. Alves and the Commissioner of Internal Revenue agreed for the record that each share of stock had a market value of $10\textcent{}.

57. 79 T.C. at 873.

58. \textit{Id.} at 866. The Tax Court has held § 83 applicable to the transfer of stock in recognition of services performed even though the transferee was not an employee of the company transferring the stock. See Cohn v. Commissioner, 73 T.C. 443, 446 (1979).

59. 79 T.C. at 873.

60. \textit{Id.}


\end{notes}
characterize the employee-purchaser who pays full market value as a pure investor. The court conceded that payment of full fair market value by a taxpayer for property transferred to him by his employer supported a finding that the property was not transferred in connection with the performance of services, but stated that such payment was not determinative. The court concluded that this factor was outweighed by the stated purposes of the agreement of raising capital and "providing the employee with an additional interest in the company." According to the court, this purpose clearly indicated a connection between the stock issuance and the performance of services. Moreover, the repurchase restriction upon early termination of the employment relationship indicated a compensatory transaction designed to guarantee the performance of services. The majority concluded that Alves would not have received the stock but for his employment relationship with the firm and that any inference that might otherwise be drawn from a full fair market value purchase was inconsequential.

Having determined that the stock was received in connection with the performance of services, the court next considered the extent to which section 83 applied. The taxpayer argued that section 83 should not be applied to the mere acquisition of an interest in a company by its employee, but rather should apply only to bargain purchases. The taxpayer contended that this interpretation of section 83 is implicit in the language of section 83(b), which refers to the excess of the fair market value of the property transferred over the amount paid for the property. The court rejected this reading, however, concluding that in the instant case the excess would simply be zero. Moreover, the court noted that Treasury Regulation section 1.83-270 specifically states that a section 83(b) election is not precluded where the transferee paid full value for the property transferred.

63. 79 T.C. at 873-74. The legislative history indicates Congress had considered the quasi-investor status of some employees. Congress noted that other stock option plans were available that allowed employees to invest and enjoy the tax benefits of this status. Such plans are subject to specific requirements, however, and Congress concluded that allowing participants of mere restricted stock options to enjoy investor-status benefits was unfair. See S. Rep. No. 552, 91st Cong., 1st Sess. 120-21 (1969), reprinted in 1969-3 C.B. 423, 500-01; H.R. Rep. No. 413, 91st Cong., 1st Sess. 87 (1969), reprinted in 1969-3 C.B. 200, 254-55.
64. 79 T.C. at 873.
65. Id.
66. Id.
67. Id.
68. Id. The petitioner contended that language in the legislative history of § 83 defining a restricted stock plan as one "where the stock is subject to certain restrictions which affect its value" indicated that a full market price purchase amounted to an investment. S. Rep. No. 552, 91st Cong., 1st Sess. 119 (1969), reprinted in 1969-3 C.B. 423, 500. The court concluded, however, that the statute would apply in spite of any investment motives, so long as the transfer was in connection with the performance of services. 79 T.C. at 875.
69. 79 T.C. at 877.
71. 79 T.C. at 877 n.7. Treas. Reg. § 1.83-2(a) states that "[t]he fact that the transferee has paid full value for the property transferred, realizing no bargain element in the transaction, does not preclude the use of [a § 83(b)] election . . . ." The taxpayer contended that this language, which was not included in the temporary regulations promulgated by the
court found that the legislative history of section 83, which indicated that the section was intended to have a very broad application, also supported its interpretation. Since purchase at full market price is not one of the specific transfers excepted from section 83, the court adhered to the view that section 83 applies to all transfers of property in connection with the performance of services. Further analysis of the legislative history of the section also revealed that Congress added section 83(b) to provide flexibility in the application of the statute. The court interpreted this specific grant of flexibility, in the absence of any mention of inapplicability of the statute to property transfers at fair market value, as supporting the application of the statute in the instant setting. The court concluded that the legislative history clearly indicated that "an election under section 83(b) is the sole means by which post-transfer appreciation may be removed from being treated as compensation." The court, while sympathetic to the likely possibility that the petitioner was unaware of his right to such an election, determined that the inequities of the situation did not warrant excepting this transaction from section 83.

In one of two dissenting opinions Judge Fay characterized the majority's treatment of section 83 as "an unwarranted extension of the statute." Treasury Department, was added in response to its request for a Technical Advice Memorandum issued during the course of its initial audit. The court found this contention immaterial since the specific language merely clarified what was already inherent in the statute. 79 T.C. at 877 n.7. But see T.D. 7021, 1970-1 C.B. 22 (reportable income equals excess of fair market value over stock purchase price). 72. 79 T.C. at 876 (quoting S. Rep. No. 552, 91st Cong., 1st Sess. 120-21 (1969), reprinted in 1969-3 C.B. 423, 500-01). 73. I.R.C. § 83(e) (1976) provides:
   (e) Applicability of section
This section shall not apply to—
   (1) a transaction to which section 421 applies,
   (2) a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2),
   (3) the transfer of an option without a readily ascertainable fair market value, or
   (4) the transfer of property pursuant to the exercise of an option with a readily ascertainable fair market value at the date of grant.
79. Judge Fay was joined in this dissent by Judges Featherston, Goffe, and Hamblen. 80. 79 T.C. at 881. The majority opinion in Aires acknowledged that every previous case dealing with § 83 involved bargain purchases. Id. at 878; see also Treas. Reg. § 1.83-2(a) (extending application of § 83).
As Judge Fay read section 83, the presence of a bargain element was necessary to trigger application of the statute. Since the parties had stipulated that the restricted stock's market value was equal to that of unrestricted stock, Judge Fay concluded that Alves had paid fair market price for the stock so that no bargain element was present. Moreover, where fair market value is paid for the transferred stock, according to Judge Fay, no part of the transfer is related to the performance of services and section 83 by its terms does not apply. Thus, purchase at full market price could not result in any compensation for performance of services, but was merely an equity investment in the company. Under this type of analysis the petitioner would be afforded the benefits of investor status since he realized no bargain element from his employment relationship with the company.

In noting the petitioner's failure to opt for a section 83(b) election, Judge Fay examined the Treasury Regulation that provides that the election under section 83(b) is not precluded when "full value" is paid for the stock. Noting that "full value" is not defined in the Treasury Regulation, Judge Fry suggested that if it means fair market value without regard to any restrictions, the regulation will only serve as a trap for the uninformed. Judge Fay argued that a taxpayer reading section 83(b) would be unlikely to make such an election when he had paid full market value for the stock and thus had nothing to include in gross income. Moreover, he thought it unlikely that Congress had intended to require a taxpayer "to elect to include something in gross income when that taxpayer had nothing to include." Judge Fay concluded that in view of the statutory purpose

81. 79 T.C. at 880.
82. Id. Because General Digital Corporation was an unknown entity with no prior reputation or references, the requisite demand for the corporation's stock probably did not exist. When considered with the strict California securities laws, this fact probably accounts for the estimation of full market price equaling the amount paid for restricted stock. Id. at 869 n.2; see also id. at 885 (Whitaker, J., dissenting) (concluding that stipulation effectively removed Alves transfer from the scope of § 83).
83. Id. at 880.
84. Id.
85. Id.
86. As an investor, any appreciation in value would be taxed as capital gain rather than as ordinary income.
87. The employee's payment of full fair market price is consideration for the transfer of the shares. He is not tendering performance of services as consideration. He fulfills the same contractual obligation in exchange for transfer of the shares as the investor does, that obligation being payment of full fair market price. See Nolan supra note 16, at 555 (concluding that Alves situation employee is entitled to investor status tax treatment).
89. 79 T.C. at 881; see Nolan, supra note 16, at 556. Judge Fay concluded that if "full value" means "fair market value [of the stock] without regard to the restriction, the regulation is . . . an unwarranted extension of the statute . . . ." 79 T.C. at 880-81. Prior to promulgation of Treas. Reg. § 1.83-2(a) in 1978, the regulation did not state that § 83 applied to transfers in which full market price was paid by the employee-transferee. 79 T.C. at 881 n.1.
90. 79 T.C. at 881; see also Nolan, supra note 16, at 555-56 (majority's reading of § 83 only penalizes uninformed).
91. 79 T.C. at 881.
of curbing the benefits of bargain or deflated price purchases, application of section 83 to full market price purchases stretched the statute beyond its intended scope.\textsuperscript{92}

The second dissent in \textit{Alves} was written by Judge Whitaker.\textsuperscript{93} In challenging the majority's conclusion that the stock was transferred "in connection with the performance of services," Judge Whitaker noted that the statute does not define that phrase.\textsuperscript{94} Judge Whitaker therefore turned to the legislative history of the statute in an effort to determine the congressional intent underlying the phrase. As an initial proposition, the House Report regarding section 83 states that "if property is transferred subject to a restriction which has a significant effect on value," the procedure dictated by section 83(a) is applicable.\textsuperscript{95} Based on this and similar language in the Senate Report,\textsuperscript{96} Judge Whitaker concluded that property is not to be deemed issued in connection with the performance of services unless on the transfer date there is a discrepancy between the fair market value of the property subject to the restrictions and its fair market value without restrictions.\textsuperscript{97} This determination is consistent with prevention of the perceived abuse that section 83 was designed to cure. If no discrepancy in value existed on the transfer date, then there was no tax to defer and no tax avoidance motive to combat.\textsuperscript{98} Since the parties in \textit{Alves} agreed that the transaction was a full fair market value purchase, no bargain was involved, and the employee owed no tax.\textsuperscript{99} Judge Whitaker did note, however, that the parties had erroneously focused on the amount paid for the stock and not the parameters of the statute.\textsuperscript{100} Judge Whitaker found this to be a result of the "artificial" stipulation of the parties, since common sense plainly indicated that the restricted stock would have a lesser value than the shares without the restrictions.\textsuperscript{101} In view of the stipulation, however, Judge Whitaker concluded that the restrictions had not affected the value of the stock, and section 83 could not apply.\textsuperscript{102}

\textsuperscript{92} \textit{Id.}

\textsuperscript{93} Judges Featherston and Goffe also joined in Judge Whitaker's dissent.

\textsuperscript{94} 79 T.C. at 883.


\textsuperscript{97} 79 T.C. at 887.

\textsuperscript{98} When there is no avoidance of tax, as in the \textit{Alves} case, a legislative cure is unnecessary. While Judge Whitaker questioned the stipulation entered into by the parties concerning the fair market value of the restricted shares, he nonetheless concluded that this fact removed the case from the operation of § 83. \textit{Id.}

\textsuperscript{99} \textit{See} I J. \textsc{Mertens}, \textit{supra} note 2, § 5.13; Nolan, \textit{supra} note 16, at 556.

\textsuperscript{100} 79 T.C. at 887.

\textsuperscript{101} \textit{Id.}

\textsuperscript{102} \textit{Id.} Although Judge Whitaker acknowledged the value of a § 83(b) election under certain nonbargain transactions, such an election would be frivolous in situations like that in \textit{Alves}. Every informed taxpayer (employee-investor) would file an election within the required 30-day period. Only the uninformed taxpayer is penalized. \textit{Id.}; see also Nolan, \textit{supra} note 16, at 556 (distinguishing between employees who receive sophisticated tax advice and those who do not).

Counsel for the petitioner filed an appellant brief with the Ninth Circuit Court of Appeals on Sept. 15, 1983. A hearing will be scheduled after receipt of the appellee's brief. The
III. Conclusion

The increase in popularity of restricted stock plans resulting from the capital gains treatment of appreciation in value warranted the enactment of section 83. The Tax Court, by applying section 83 broadly to nonbargain transfers, has discriminated against employees who pay full market price for restricted stock. The outside investor who purchases unrestricted stock may report the long-term appreciation in value as capital gain. The employee who pays the same price for restricted stock, that is, fair market value without regard to any restrictions, should be entitled to similar treatment. Under the decision in *Alves v. Commissioner*, however, the employee-investor is required to report such appreciation as ordinary income should he fail to exercise the section 83(b) election. In *Alves* the Tax Court held that transfers of stock to employees for full fair market price are made in connection with the performance of services. Any appreciation in value of the restricted stock is taxable as ordinary income if no section 83(b) election is exercised.

Application of section 83 to nonbargain transfers of restricted stock serves no clear tax purpose. Such an application does not raise revenue or combat the perceived abuse of too favorable tax treatment of bargain purchases, but rather results in discriminatory treatment of the employee-investor. Recognition of the inapplicability of section 83 to full market price purchases would serve the purpose of that section without any resultant inequities to the employee-investor.

*Randy R. Shorb*