



## Restricted Stock and the Internal Revenue Code (IRC) Section 83 (b) Election – Valuation Requirement

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Restricted stock grants are currently becoming popular compensation vehicles because they are subject to the same accounting treatment as stock options, they are less dilutive than options, and they are exempt from the rules governing nonqualified deferred compensation under IRC Section 409A.

Start-up companies typically issue restricted stock to founders/key executives pursuant to Internal Revenue Code ("IRC") Section 351. As an incentive to encourage founders to remain with the company, start-ups often attach vesting provisions to the restricted stock. For example, the stock may vest 20.0% per year over a five year period, and may have forfeiture conditions attached.

**When a founder is granted restricted stock, the founder has thirty (30) days to make an IRC Section 83 (b) election**, whereby the founder/key executive elects to pay income tax on the fair market value of the restricted stock at the time the restricted stock is granted. This is instead of paying higher income tax at a later date, for example, when the price of the stock may be substantially higher, the founder is vested in the stock, and any risk of forfeiture of the stock has elapsed.

One common error we've seen occurs when such founders fail to "elect" to pay income tax at the time of the issuance under IRC Section 83 (b) within thirty (30) days of the grant date.

Managing the vesting of founders/key executives' equity can be tricky, and simple mistakes can create significant income tax liabilities for both the stock issuing company, and the founders/key executives.

A "must" for the company in order to make the IRC Section 83 (b) election is to determine the fair market value of the restricted stock as of the "grant date" in accordance with Internal Revenue Service (IRS) guidelines.

### Recent Situation:

**Telerik A.D.**, which was founded in 2002, is a leading vendor of ASP.NET UI components, content management solutions and add-ons for MCMS 2002 and SharePoint. Telerik assists customers take the richness and responsiveness of desktop applications to the web. They are a privately-held corporation with offices in Boston, Massachusetts and Sofia, Bulgaria. Newbury Piret valuation specialists determined the fair market value of the Company's common stock as of the May 9, 2008 valuation date, and facilitated the Internal Revenue Code Section 83 (B) election and IRS reporting process.

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Newbury Piret & Co. valuation specialists can assist your company in determining the fair market value of your restricted stock. For a free consultation call: **Ronald J. Adams**, CPA/CVA, Managing Director - Valuations, Newbury Piret & Co., Inc., at (617) 933-2018.

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