JULIAN GARCIA LAW
Modern Business Counsel

EQUITY, VESTING & 83(b) ELECTIONS

HOW TO MINIMIZE TAX SUPRISES

PREPARED FOR THE FOUNDER RESOURCE VAULT

2025 EDITION

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Founder Shares

Equity compensation is a powerful tool. However, if structured carelessly, it can create unexpected tax liabilities, investor red flags, and muddy your cap table. If you're issuing founder shares, employee equity, or setting vesting schedules, read this guide before you act.

What Triggers Tax Liability on Equity?

If you receive equity in connection with providing services (including as a founder), it's considered income, whether or not you paid cash for it. The IRS uses these two core principles:

- **IRC § 83**: Equity is taxable when it is no longer subject to a "substantial risk of forfeiture" (typically, when it vests).

- **Fair Market Value (FMV)**: Taxable amount = FMV of the equity when it vests, minus what you paid for it ("tax basis"), if anything.

Insight: The FMV may be miniscule when you incorporate, but could be much higher by the time shares vest. That difference becomes taxable income, subject to federal, state, and employment taxes, even if you haven't sold any shares.

What is an 83(b) Election?

An 83(b) election allows you to accelerate tax liability to the date you receive the equity, even if it is still subject to vesting. This can drastically reduce your tax bill, since the FMV of early-stage equity is often close to zero.

Example:

- You receive 1M founder shares at $0.001 per share, subject to a 4-year vesting schedule.

- If you file an 83(b) within 30 days, your total taxable income would be $1,000 (1M x $0.001).
- If you don't, and your shares vest over time when FMV is $0.10, $1.00, $5.00… you pay taxes on each tranche as it vests—potentially tens or hundreds of thousands of dollars in taxable income.

83(b) Filing Checklist

To take advantage of 83(b), you must:
1. File the election within 30 days of receiving the shares
2. Include a copy with your federal return
3. Provide a copy to the company
4. Use IRS-approved forms

Insight: You cannot make an 83(b) election on stock options.

When Does Vesting Apply?

Founders, employees, and advisors often receive equity that vests over time. Common reasons:
• To ensure long-term commitment
• To align interests with company performance
• To protect the company if someone leaves early

Standard Founder Vesting Schedule:
- 4 years total, with a 1-year cliff
- I.e., 25% of shares vest after 12 months, then monthly or quarterly thereafter

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Potential Consequences of Not Filing an 83(b)

• Significant tax liability as the company grows
• Need to liquidate or borrow to pay tax on non-liquid shares
• Complications during due diligence (83(b) elections are usually expected by investors)
• Missed opportunity to start the capital gains holding period early

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Best Practices

• **File early**: Do it immediately after incorporation or grant
• **Get a FMV valuation** (especially for priced equity) to defend your tax position
• **Keep proof**: Send 83(b) forms to the IRS via certified mail with return receipt
• **Use an expert**: Consult JG Law or another tax, business, and legal professional

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Bottom Line

If you're granting or receiving equity subject to vesting, an 83(b) election is often the smartest tax move you can make. But the window is tight, and mistakes are costly.

Key Citations

• IRC § 83 – Property transferred in connection with services
• Treasury Reg. §1.83-3 – Substantial risk of forfeiture
• Rule 701 – Exemption for equity comp in private companies

Every business is unique. Before making legal decisions, especially those involving contracts, equity, or disputes, you should consult a qualified attorney.

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