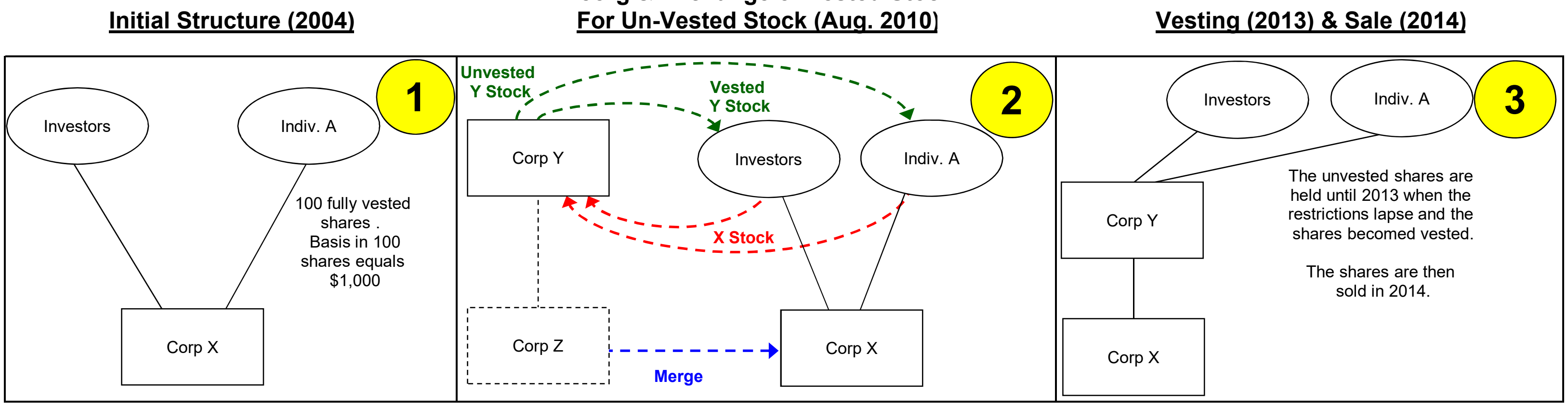
Revenue Ruling 2007-49, Situation 2

Vested Stock to Nonvested Stock In Tax-Free Reorg Exchange



Individual A owns 100 fully vested shares of stock in Corp X with a basis in the stock of $1,000. Corp Y, a corporation unrelated to Corp X, agrees to acquire all of the stock of Corp X. Accordingly, on August 9, 2010, Corp Y causes Corp Z (a newly formed wholly-owned subsidiary of Corp Y) to merge into Corp X in a transaction that qualifies as a reorganization described in §368(a). In the merger, the shareholders of Corp X receive solely Corp Y voting stock in exchange for their Corp X stock. The fair market value of the Corp X stock on August 9, 2010, is $310 per share.

In the merger, A's 100 shares of substantially vested Corp X stock are exchanged for 100 shares of Corp Y stock subject to a restriction that will cause the stock to be “substantially nonvested” within the meaning of §1.83-3(b). Under this restriction, if A's employment with Corp X is terminated for any reason before August 9, 2013, A must sell the substantially nonvested Corp Y shares to Corp Y in exchange for the lesser of $310 per share (the fair market value of the shares on August 9, 2010) or the fair market value at the time of forfeiture. In addition, the shares are nontransferable before that date. No other shareholder of Corp X receives Corp Y stock subject to a restriction.

A timely files an election under §83(b) with respect to the substantially nonvested Corp Y stock A receives in the merger. A continues to be employed by Corp X until August 9, 2013 at which time the fair market value of the stock is $500. A sells the stock on October 31, 2014 when the fair market value of the stock is $550 per share.

A receives 100 shares of Corp Y stock with an exchanged basis of $1,000 in the tax-free reorganization. Because the substantially vested Corp X stock is exchanged for stock that is subjected to a restriction causing the shares to be “substantially nonvested,” the substantially nonvested shares are treated as having been transferred in connection with the performance of services, and thus, are subject to §83. As a result of the §83(b) election, A becomes the owner of those shares.

The “amount paid” for the stock under §83 on the transfer of the substantially nonvested shares is the fair market value of the substantially vested Corp X stock exchanged for the substantially nonvested Corp Y stock ($31,000) on the exchange date, August 9, 2010. On A's election under §83(b), $31,000 is treated as the amount paid for the Corp Y stock for purposes of applying §83. On A's return for the 2010 taxable year, A does not report any taxable income from the transfer of the Corp Y stock under the §83(b) election because the fair market value of the stock less the amount paid is $0. A does not include any amount in compensation income in the 2013 taxable year when the stock becomes substantially vested because of the prior §83(b) election. A's basis in the Corp Y stock continues to be $1,000. Upon the sale of the shares in 2014, A recognizes capital gain of $54,000, the amount by which $55,000 ($550, the fair market value of the stock, x 100 shares) exceeds A's $1,000 basis in the shares.