No. 03-547

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

JAMES G. ROBINSON AND BARBARA L. ROBINSON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

When an employer transfers property (such as stock) to an employee in connection with the performance of services, Section 83(h) of the Internal Revenue Code allows the employer a deduction "equal to the amount included" in the gross income of the employee with respect to the transfer. 26 U.S.C. 83(h). The question presented in this case is:

Whether, under Section 83(h), the employer may deduct only the amount that is actually "included" in the employee's income with respect to the transfer or may, instead, deduct a different amount that, in a proceeding to which the employee is not a party, the employer claims *should* have been "included" in the employee's income.

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PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-17a) is reported at 335 F.3d 1365. The opinion of the United States Court of Federal Claims (App., *infra*, 18a-30a) is reported at 52 Fed. Cl. 725.

JURISDICTION

The judgment of the court of appeals was entered on July 15, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE AND REGULATION INVOLVED

The relevant portions of Section 83 of the Internal Revenue Code, 26 U.S.C. 83, and 26 C.F.R. 1.83-6 are set forth in the Appendix, *infra*, 31a-34a.

STATEMENT

1. Respondents are the sole shareholders of a group of S-corporations that are known collectively as Morgan Creek. App., *infra*, 2a. S-corporations are generally not themselves subject to the income tax. Instead, the items of income and expense of S-corporations pass through to their shareholders and are recognized by the shareholders on their individual income tax returns. 26 U.S.C. 1363, 1366; see *Bufferd* v. *Commissioner*, 506 U.S. 523, 525 (1993).

From 1989 to 1997, Gary Barber conducted the business of Morgan Creek as its Chief Operating Officer. App., *infra*, 2a. In 1995, Morgan Creek and Barber entered into an employment agreement and a related stock subscription agreement. Under these agreements, Barber obtained a 10 percent interest in each of the Morgan Creek companies (i) that was to vest gradually over time and (ii) that was subject to a partial forfeiture or reversion to Morgan Creek in the event of an early termination of his employment. *Ibid.*

At the time that the stock was transferred to Barber pursuant to his employment agreements, he paid Morgan Creek $2 million as consideration for the stock. App., *infra*, 4a. The actual value of the stock obtained by Barber in 1995 is in dispute, but respondents now estimate that it was worth approximately $28,800,000 at that time. *Id.* at 5a. Respondents therefore now claim that there was a "bargain element" of $26,800,000 in the transfer that represented employment compensation to Barber. *Ibid.*

2. Because the Morgan Creek stock was transferred to Barber as compensation for his performance of services, the tax treatment of the transfer is governed by Section 83 of the Internal Revenue Code, 26 U.S.C. 83. In general, an employee who receives property from his employer as compensation for services must treat as ordinary income the amount by which the fair market value of the property exceeds any amount that the employee paid for the property (the so–called "bargain element"). 26 U.S.C. 83(a). If the transferred property is subject to restrictions on transfer or a risk of forfeiture, the fair market value of the property is to be determined as of the time that the property ceases to be subject to a risk of forfeiture or restrictions on transfer, and the employee is to include the amount of the "bargain element" in gross income as of that time. 26 U.S.C. 83(a). As a consequence, any appreciation in the value of restricted property between the date of its transfer to the employee and the lapse of restrictions on further transfer will be treated as ordinary income.

The employee may, however, within 30 days of receiving property as compensation, elect to recognize the income from the transferred property in the year of its receipt. If such a timely election is made, the full value of the property (without taking restrictions into account) is determined as of the time of the transfer. 26 U.S.C. 83(b). By making such an election, the employee may treat any appreciation in the value of the property that occurs between the date of its receipt and its subsequent disposition as a capital gain.

Barber filed an election under Section 83(b) with the Internal Revenue Service within 30 days after receiving the Morgan Creek stock. In his election, he claimed that *no* bargain element was involved in the stock transferred to him and that the $2 million he paid in

connection with the transfer represented the full value of the stock. App., *infra*, 20a. Barber therefore did not include any amount in gross income in 1995 in connection with his receipt of the Morgan Creek stock.

3. The tax consequences for an employer who transfers property as compensation for services are set forth in Section 83(h) of the Code, 26 U.S.C. 83(h). If (as is ordinarily the case) the compensation is an "ordinary and necessary" expense that would qualify as a deductible business expense under Section 162(a) of the Code, 26 U.S.C. 162(a), then Section 83(h) allows the employer to deduct "an amount equal to *the amount included* under subsection (a), (b), or (d)(2) *in the gross income of the person who performed such services*." 26 U.S.C. 83(h) (emphasis added). The statute specifies that "[s]uch deduction shall be allowed" in "the taxable year in which * * * *such amount is included in the gross income of the person who performed such services*." 26 U.S.C. 83(h) (emphasis added).

4. Even though a substantial portion of Barber's rights in the Morgan Creek stock vested between 1995 and 1998, respondents (like Barber) reported no "bargain element" associated with the transfers of stock and therefore claimed no deduction for such transfers.[1] In 1998, however, Morgan Creek and Barber terminated their employment relationship. In settling their ensuing litigation, Morgan Creek paid Barber $13.2 million for the 8 percent of the Morgan Creek stock that had by

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[1] Under 26 U.S.C. 83(h), the employer's deduction for the "bargain element" arises, at the latest, on the date that the property becomes transferable by the employee. See 26 U.S.C. 83(a). In this case, the deduction actually arose earlier—when the employee elected under 26 U.S.C. 83(b) to take this amount into income in the year of the initial, restricted transfer. See App., *infra*, 5a.

then vested in his ownership. App., *infra*, 5a. In connection with that settlement, respondents claim that they learned for the first time that Barber had made a Section 83(b) election in 1995 to take into income the value of the property transferred to him in that year and that, in making that election, he reported no "bargain element" to the stock transfer (and thus no income from the transfer) in that year. *Ibid.*

After settling the employment litigation with Barber, Morgan Creek issued Barber an amended Form W–2 that reported additional compensation to him for 1995 in the amount of $20,716,400. App., *infra*, 21a. None of this compensation had been reported by Barber, or claimed as a deduction by Morgan Creek, during the year that the stock was transferred to Barber. The company now claims, however, that this is the amount by which the value of the stock transferred to Barber in 1995 exceeded the $2 million that Barber paid for the stock. *Ibid.*

After issuing the amended Form W-2, respondents then filed amended personal income tax returns for 1995 on which they claimed a tax refund of $8,854,281. They based their refund claim on the assertion that Morgan Creek is entitled to an additional $20,716,400 deduction in 1995 for the "bargain element" of the stock transferred by Morgan Creek to Barber in that year. App., *infra*, 6a. The Internal Revenue Service took the position that respondents "are not entitled to a decision on their claim for a refund" until the amount properly to be included in Barber's income for 1995 is determined in his pending audit. *Id.* at 22a. When the Service thus

declined to act on the refund claim, respondents commenced this refund suit in the Court of Federal Claims.[2]

5. In the Court of Federal Claims, respondents claimed that they were entitled to a deduction equal to the amount that *should* have been included in Barber's income with respect to the 1995 stock transaction, without regard to the amount that *actually* had been included in his gross income. They asserted that they were entitled to establish the value of the stock (and the associated "bargain element") in their personal tax refund suit, without regard to the value placed on the same stock in a separate determination of Barber's income tax liability. App., *infra*, 21a.

The government asserted that the plain language of Section 83(h) precludes respondent's claim, and that Morgan Creek is not currently entitled to any deduction for the stock transferred to Barber because Barber has not "included" *any* amount in his gross income with respect to that stock transfer. 26 U.S.C. 83(h). The government contended that Morgan Creek is entitled only to a deduction equal to the amount that is ultimately "included" in Barber's income in calculating his tax liability, as determined in a tax proceeding binding on Barber.

The Court of Federal Claims agreed with the government and dismissed respondent's refund suit without prejudice, as unripe. App., *infra*, 30a. The court held that, under the plain language of both Section 83(h) and its implementing regulations, respondents' "entitlement to a deduction for 1995 depends upon a

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[2] A refund suit may be commenced in federal court if the Internal Revenue Service has either denied the taxpayer's administrative refund claim or has not acted on the claim within six months. 26 U.S.C. 6532(a)(1).

final determination of the amount included in Mr. Barber's income." *Ibid.* In reaching that conclusion, the court relied on the reasoning and conclusion of the Tax Court and the Sixth Circuit in *Venture Funding, Ltd.* v. *Commissioner*, 110 T.C. 236, 240 (1998), aff'd, 198 F.3d 248 (1999) (per curiam), cert. denied, 530 U.S. 1205 (2000), which construed the term "included" in Section 83(h) to mean the amount actually taken into account in determining the employee's tax liability. App., *infra*, 24a-28a. The Court of Federal Claims pointed out that (*id.* at 23a):

> the critical question in this case is whether any amount has been included in Mr. Barber's gross income. * * * If the amount included in the employee's gross income remains to be decided by another tribunal, it remains possible that the parties' dispute will resolve itself, for plaintiffs' complaint is predicated [entirely] on their fear that the IRS will determine, in the process of reviewing Mr. Barber's return, that Mr. Barber should have included less than the amount that plaintiffs claim as a deduction.

"Because [respondents'] entitlement to a deduction for 1995 depends upon a final determination of the amount included in Mr. Barber's income, [respondents'] claim is unripe" and the complaint was therefore dismissed without prejudice. *Id.* at 30a.

6. The court of appeals reversed. App., *infra*, 1a-17a. The court concluded that the word "included" in Section 83(h) means "included as a matter of law," and that the statute therefore entitles the employer to a deduction based on the amount that was required to be included in the employee's gross income, without regard to the amount that was actually included on his

return or that ultimately may be taken into account in calculating his tax liability. App., *infra*, 17a.

In reaching that decision, the court of appeals expressly rejected the contrary conclusion of the Tax Court and the Sixth Circuit in *Venture Funding*. App., *infra*, 16a. The court also declined to give any weight to the Treasury's formal regulations (26 C.F.R. 1.83-6(a)), which reflect the same interpretation of Section 83(h) that was adopted by the courts in the *Venture Funding* case. The court of appeals opined that the text and history of the statute require the conclusion that the employer be allowed to deduct the amount that *should* have been included in the employee's income ("as a matter of law"), even if it was not. App., *infra*, 15a, 17a. The court stated that, since "the meaning of the statute is clear," it would not "defer to a contrary regulatory interpretation." *Id.* at 14a.

The government pointed out that the interpretation sought by respondents permits the employer and the employee to take inconsistent positions on the "bargain element" of the transaction and thus allows the government to be "whipsawed" by inconsistent judicial determinations—with the employer seeking a high valuation (to maximize its deduction) and the employee seeking a low valuation (to minimize its income). The court of appeals concluded, however, that the employer's separate interest in the tax consequences of the transaction justifies duplicative and potentially inconsistent litigation of the same valuation issue. App., *infra*, 15a-16a.

Because the court concluded that Section 83(h) entitles the employer to deduct the amount that should have been included ("as a matter of law") in the employee's income from the transfer of property, the court held that respondents' case is presently ripe for deci-

sion without regard to the ultimate determination of the employee's tax. The court of appeals remanded the case to the trial court for a factual determination of the 1995 fair market value of the stock transferred by Morgan Creek to Barber. App., *infra*, 17a.

REASONS FOR GRANTING THE PETITION

The court of appeals acknowledged that its decision in this case conflicts directly with the decision of the Tax Court and the Sixth Circuit in *Venture Funding, Ltd.* v. *Commissioner*, 198 F.3d 248 (1999) (per curiam), aff'g 110 T.C. 236 (1998), cert. denied, 530 U.S. 1205 (2000).[3] And, in reaching its decision in this case, the court of appeals rejected the formal regulations adopted by the Treasury that interpret and implement this statute. As a consequence, the decision in this case precludes uniform national enforcement of this widely applicable tax provision.

This Court has stressed the importance of avoiding "inequalities in the administration of the revenue laws." *Commissioner* v. *Sunnen*, 333 U.S. 591, 599 (1948). The need to resolve the conflict among the circuits created by the decision in this case is particularly compelling. All cases within the deficiency jurisdiction of the Tax Court (whose interpretation of the statute has been upheld by the Sixth Circuit) will be decided under one understanding of the statute, while all cases within the refund jurisdiction of the Court of Federal Claims will be decided under a conflicting interpretation. Absent resolution of this conflict by this Court, the dual scheme

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[3] The Sixth Circuit decision in *Venture Funding* is published in the AFTR Reporter but not in the Federal Reporter. The Rules of the Sixth Circuit specify that unpublished decisions of that circuit may be cited as "precedential" when "there is no published opinion" of that circuit on the issue addressed. 6th Cir. Rule 28(g).

that Congress has created for the review of tax controversies will therefore consistently yield inconsistent results.[4] The result of these conflicting interpretations would be that taxpayers who lack the ability to pay taxes as they are assessed will be treated differently than those who are able and willing to pay these taxes and bring suit for a refund in the Court of Federal Claims. See note 4, *supra*.

The question addressed in this case and in the agency's regulations has substantial recurring importance. In recent years, many start-up and technology companies issued stock and stock options to employees and independent contractors as compensation. If the decision in this case is permitted to stand, a large number of these companies would be able to claim refunds based on deductions for compensation expenses that are *not* matched by the compensation previously reported by the company or included on the employees' returns. Even in situations in which the Internal Revenue Service is able to audit the individual returns of the employees, the decision of the court of appeals in this case will cause duplicative litigation of the same facts and unavoidably yield inconsistent determinations.

1. a. In its decision in this case, the court of appeals ignored the "familiar rule" that "an income tax deduction is a matter of legislative grace" and that provisions allowing deductions are to be narrowly construed.

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[4] A judicial refund suit may not be brought until the taxpayer makes "full payment" of the amount claimed by the government to be due. *Flora* v. *United States*, 362 U.S. 145, 177 (1960). To permit taxpayers who lack the ability (or the desire) to make "full payment" to challenge the tax without first paying it, Congress provided jurisdiction for the Tax Court to review tax determinations "before payment of the deficiency." *Id.* at 158.

INDOPCO, Inc. v. *Commissioner*, 503 U.S. 79, 84 (1992) (quoting *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 593 (1943)); *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440 (1934). The statute involved in this case allows employers to deduct only "the amount included" in an employee's income upon the transfer of property. 26 U.S.C. 83(h). The statute further specifies that "[s]uch deduction shall be allowed" only "in the taxable year in which * * * *such amount is included*" in the employee's income. 26 U.S.C. 83(h) (emphasis added). As the Tax Court and Sixth Circuit held in the *Venture Funding* case, and as the Treasury concluded in its interpretive regulation under this statute (26 C.F.R. 1.83–6(a)(1)), the plain text of this statute allows a deduction only *at the time* and *in the amount* that the employee recognizes income from the transfer.

The statute directs the employee who receives such property to include any "bargain element" of the transfer in his income at the time the property is received or at the time that any restrictions on further transfer of the property are removed. 26 U.S.C. 83(a). In the alternative, the employee may elect to include the "bargain element" of the property at the time of its initial transfer, even if restrictions on further transfer exist at that time. 26 U.S.C. 83(b). In the present case, the employee made such an election and, in doing so, claimed that the stock he received was equal in value to the $2 million he paid for it. He therefore "included" *no* "bargain element" in his income in that year. App., *infra*, 20a. Since the plain text of the statute allows only "such amount"—the amount "included" as income by the employee—to be claimed as a deduction by the employer, the statute expressly precludes the employer's

present claim for a deduction in this case. 26 U.S.C. 83(h).

b. The applicable Treasury regulations explain that, as used in Section 83(h), "the amount included means the amount reported on an original or amended return or included in gross income as a result of an IRS audit of the [employee]." T.D. 8599, 1995–2 C.B. 12, 13. The Treasury has recognized, however, that, when restrictions on transfer are placed on stock, it may be years before the tax consequences of the transfer are determined. To avoid uncertainties that could result from such delays, the Treasury regulations provide a safe harbor that treats "in-kind" compensation that is timely reported to the IRS by employers (on Forms W-2 or 1099) as if it had been "included" in the employee's income at that time even if, in fact, it had not then yet been recognized by the employee. 26 C.F.R. 1.83-6(a)(1).

This elective safe-harbor provided by the regulations was not followed by the employer in this case. Instead, the employer first delayed any reporting of the transfer for several years and then, when the transfer was finally reported by the employer, the employer claimed a deduction greater than the amount the employee "included" in his income in connection with the transfer. See pages 4-5, *supra*. For the reasons explained in the *Venture Funding* case, and summarized above, the employer's claim for an inflated deduction in this case is not authorized under either the statute or its implementing regulations.

2. Rejecting the interpretation of Section 83(h) that has been adopted by the Treasury, the Tax Court, the Sixth Circuit, and the Court of Federal Claims, the Federal Circuit held in this case that, notwithstanding the plain text of the statute, the amount "included" by

the employee in his income is irrelevant to the deduction under Section 83(h). The court held that the statute instead authorizes a deduction for the amount that *should* have been included in the employee's income ("as a matter of law"), even if that amount in fact was not. App., *infra*, 15a, 17a.

a. The court acknowledged that its decision in this case directly conflicts with the decision in *Venture Funding*. App., *infra*, 16a. The Tax Court and Sixth Circuit in *Venture Funding* held that, under the plain text of the statute, "[a]n amount is deductible under section 83(h) in the year that the corresponding income is 'included' in the recipient employee's income, which means to us that the amount is taken into account in determining the tax liability of the employee for that year." 110 T.C. at 240; 84 A.F.T.R.2d (RIA) 99-6929, 99-2 U.S. Tax Cas. (CCH) ¶ 50,972 at 90,383 (adopting the opinion for the Tax Court of Judge Laro).

In its decision below, the Court of Federal Claims similarly looked first to the controlling statutory language and found it clear. It stated (App., *infra*, 24a):

> The first step in construing a statute "is to determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Robinson* v. *Shell Oil Co.*, 519 U.S. 337, 340, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997). The term "included" has just such a plain and unambiguous meaning in the tax code, one that distinguishes it from the term "includible." *E.g.*, *Grant Oil Tool Co.* v. *United States*, 180 Ct. Cl. 620, 632, 381 F.2d 389, 397 (1967); *Venture Funding*, 110 T.C. at 240-41 & n. 3; *id.* at 249-51 (Colvin, J., concurring); *see also Day* v. *Heckler*, 735 F.2d 779, 784 (4th Cir. 1984) (distinguishing between "allowed"

> and "allowable"). I.R.C. §83 requires that the employer's deduction equal the amount included in the employee's gross income and that it be taken in the year that ends the taxable year in which the employee included the amount in gross income. That the employee should have, or could have, included a particular amount in gross income in a particular year does not, on its own, trigger the allowance of a deduction.

The Court of Federal Claims correctly concluded that the clear text of Section 83(h) requires that the "bargain element" of the property actually be "included" in the employee's gross income as a precondition for the deduction claimed by the employer.[5]

b. Even if the text of this statute were thought to be ambiguous in providing that the deduction is limited to the amount "included" in the income of the employee

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[5] Barber's tax return for 1995 is currently under audit. Under the Treasury's regulations, Morgan Creek is entitled to a deduction for the amount, if any, that Barber is ultimately required by final judicial decision or administrative settlement to include in his gross income with respect to the stock transferred to him. 26 C.F.R. 1.83-6(a). The approach mandated by the Treasury regulations thus ensures that the deduction allowed for the employer is identical to the amount of income recognized by the employee, as Section 83 plainly intends. By contrast, the remand ordered by the Federal Circuit in this case would require a determination of the 1995 value of the stock transferred to Barber by Morgan Creek in a proceeding that would not be binding on Barber and would have no legal effect on the correct amount to be "included" in Barber's income. Since Barber is not a party to these proceedings, he will not be bound by any factual determination of the value of his stock made in this case. And, it is, of course, quite unlikely that the fact-intensive question of the market value of the stock transferred to Barber in 1995 would be resolved in an identical manner in the two separate proceedings contemplated by the court of appeals.

(26 U.S.C. 83(h)), that ambiguity is properly resolved by the formal regulations adopted by the Treasury to interpret and implement this statute. The text and history of these regulations demonstrate that the agency's interpretation is reasonable and therefore entitled to deference from the courts.

As the Tax Court majority explained in *Venture Funding*, 110 T.C. at 244–247, since regulations were first proposed to implement this statute, the Treasury has recognized that employers who seek a deduction under Section 83(h) may have difficulty establishing that a specific amount has actually been "included" in an employee's income.[6] In response to numerous comments, the Commissioner undertook to adopt final regulations that would provide employers with a safe harbor to ensure that they could take a deduction for compensation paid to an employer in property other than money without having to establish that the employee

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[6] The first proposed regulations under Section 83(h) directly tracked the language of the statute. They provided in relevant part as follows (proposed Treas. Reg. § 1.83–6, 36 Fed. Reg. 10,793 (1971)) (quoted in *Venture Funding*, 110 T.C. at 244 (emphasis added)):

> § 1.83–6. *Deduction by employer.*—(a) *In general.* In the case of a transfer of property in connection with the performance of services * * *, there is allowed as a deduction under section 162 or 212, to the person for whom such services were performed, an amount equal to the amount *included*, under subsection (a) * * * of section 83 as compensation, in the gross income of the person who performed such services, but only to the extent such amount meets the requirements of section 162 or 212 and the regulations thereunder. Such deduction shall be allowed only for the taxable year of such person in which or with which ends the taxable year for which *such amount* is *included* as compensation in the gross income of the person who performed such services.

had actually included the value of the compensation in his gross income. The safe harbor of the regulations adopted in 1978 therefore allowed a deduction by the employer in the amount "includible" as compensation in the employee's gross income in the year the income was "includible" in the employee's income, but only "if either the employer deducts and withholds" the amount of taxes that would be due by the employee on the income for which the deduction is claimed by the employer. 26 C.F.R. 1.83–6(a)(2) (1979).

In 1995, in response to difficulties reported by employers in satisfying the withholding requirements for the safe harbor provision, the regulations were amended for taxable years beginning on or after January 1, 1995. T.D. 8599, 1995–2 C.B. 12 at 14. The amended regulations do not use the word "includible" and do not require an employer's compliance with the withholding provisions of the Code as a prerequisite to a deduction under Section 83(h). The amended regulations, which apply to this case, specify that the employer is allowed a deduction only for the amount *included* in the employee's gross income. 26 C.F.R. 1.83–6(a)(1). The employee is *deemed* to have "included" the amount in gross income, however, if the employer timely issues the employee a Form W–2 or Form 1099 to report the income and provides a copy of that Form to the Commissioner. 26 C.F.R. 1.83–6(a)(2).

The preamble to the amended regulations explains that they replace "the former general rule and special rule" with "a revised general rule that more closely follows the statutory language of section 83(h). The service recipient is allowed a deduction for the amount 'included' in the service provider's gross income. *For this purpose, the amount included means the amount reported on an original or amended return or included*

in gross income as a result of an IRS audit of the service provider." T.D. 8599, 1995–2 C.B. at 13 (emphasis added). When an employer fails to qualify for the safe harbor, he must "demonstrate that the employee actually included the amount in income in order to support its deduction of the amount." *Ibid.* Contrary to the decision of the court of appeals in this case (App., *infra*, 13a-14a), the agency's regulations thus unambiguously define the word "included" to mean the amount reported on the employee's return or included in his gross income as a result of an IRS audit.

These regulations are issued under the authority granted to the Treasury by Congress to "prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code]." 26 U.S.C. 7805(a). This Court has made clear that courts are to defer to Treasury regulations adopted under this statute if "they implement the congressional mandate in some reasonable manner." *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200, 218–219 (2001) (internal quotation marks and citation omitted); *United States* v. *Correll*, 389 U.S. 299, 307 (1967). Even if the statute reasonably could bear more than one permissible interpretation, "[t]he choice among reasonable interpretations is for the Commissioner, not the courts." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 488 (1979). In reviewing a Treasury regulation, "the task that confronts [the court] is to decide, not whether the Treasury Regulation represents the best interpretation of the statute, but whether it represents a reasonable one." *Atlantic Mutual Ins. Co.* v. *Commissioner*, 523 U.S. 382, 389 (1998).

c. Under these standards, the court of appeals manifestly erred in refusing to defer to the agency's interpretation of the statute. The agency's interpretation of

the word "included" in Section 83(h) to mean "actually included" falls well within the permissible boundaries of the statutory text. The regulation also reasonably addresses the conflicting interests of employees (who must recognize income) and employers (who seek to claim deductions) by providing a safe-harbor method for employers to validate deductions even in situations in which employees fail to report income from the transfer of property. 26 C.F.R. 1.83-6(a); see page 16, *supra*.

The court of appeals, however, did not address whether the agency's interpretation was reasonable. Instead, it stated that (App., *infra*, 14a-15a) (emphasis added):

> if *the meaning of the statute is clear*, we have the responsibility to apply the statute as written, not to defer to a contrary regulatory interpretation. *See Chevron*, 467 U.S. at 842-43. In this instance, the statutory language and other 'traditional tools of statutory construction,' *id.* at 843 n.9, lead us to conclude that Congress used the word 'included' in Section 83(h) to mean included as a matter of law. We therefore reject the contrary interpretation set forth in the present version of Treasury Regulation § 1.83-6(a).

The court thus concluded that the regulation is invalid because it believed that "the meaning of the statute is clear" and that the word "included" in Section 83(h) unambiguously means should have been included "as a matter of law." See App., *infra*, 14a, 15a. That theory, however, is untenable on the face of the statute and has properly been rejected by every other court that has addressed this same question. See pages 13-14, *supra*.

In particular, the court of appeals erred in its effort to rely on isolated fragments of legislative history to support its interpretation of the "unambiguous" text of the statute.[7] The court looked to the Senate Finance Committee's explanation of Section 83(h), which states (S. Rep. No. 552, 91st Cong., 1st Sess. 123 (1969)):

> The committee provided rules for the employer's deduction for restricted property given to employees as compensation. The allowable deduction is the amount which the employee is required to recognize as income. The deduction is to be allowed in the employer's accounting period which includes the close of the taxable year in which the employee recognizes the income.

The court reasoned that (App., *infra*, 11a-12a) (emphasis added):

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[7] The court of appeals also erroneously suggested that there is no logical reason to limit the employer's deduction under Section 83(h) to the amount of the "bargain element" of the compensation "included" in the employee's income, because Section 162 permits the employer to claim the net value of in-kind compensation as a deduction. App., *infra*, 10a-11a. In making that statement, the court overlooked the fact that Section 83(h) is, by its express terms, a modification of the general provisions of Section 162—a modification that affects both "the time and amount of deductions otherwise allowable" under Section 162 when property is transferred in connection with services. *Duncan Industries, Inc.* v. *Commissioner*, 73 T.C. 266, 285 (1979); see 26 U.S.C. 83(h).

The revenue rulings cited by the court of appeals under Section 162 (App., *infra*, 11a (citing Rev. Rul. 69-75, 1969-1 C.B. 52; Rev. Rul. 62-217, 1962-2 C.B. 59) all pre-date the enactment of Section 83(h). The possibility that respondents might have been able itself to litigate the value of the transferred stock under Section 162 if Congress had *not* enacted Section 83(h) is obviously not relevant in interpreting the specific, limiting provisions that Congress *has* enacted in Section 83(h).

> [t]he Committee's use of the expression 'the amount which the employee is required to recognize as income' indicates that the Committee intended the employer's deduction to be based on the amount includible in the employee's gross income, not the amount the employee actually reported on his income tax return. *While the Committee report refers to the timing of the deduction in terms of when the employee actually recognizes the income, the amount of the deduction is clearly identified as the amount that the employee 'is required to recognize as income.'*

This snippet of legislative history does not support the court's conclusion. In particular, it does not support the strained suggestion that Congress intended the word "included" in Section 83(h) to have different meanings in two adjacent sentences of the same statute. The text of Section 83(h) uses the same word—"included"—to define both the *amount* of the deduction ("an amount equal to the amount included * * * in the gross income of the" employee) and the *timing* of the deduction ("the taxable year of [the employer] in which or with which ends the taxable year in which such amount is included in the gross income of the" employee). When the same words are used in an identical manner in two adjacent sentences of the same statute, those words should be given the same meaning in both places. *Sorenson* v. *Secretary of the Treasury*, 475 U.S. 851, 860 (1986).

Under the reading of the legislative history adopted by the court of appeals, however, the word "included" must be assumed to have two different meanings in the same statutory provision. According to the court, this fragment of legislative history indicates that the timing

of the deduction is based on the tax year in which the employee "actually" includes the income in his return, but the amount of the deduction is based on the amount that the employee *should* have included as income. App., *infra*, 12a.

Such internal ambiguities in the legislative history can provide no support for the court's singular conclusion that "the meaning of the statute is clear." App., *infra*, 14a. Instead, the ambiguities that the court recites from the legislative history support the conclusion that the formal interpretation of the statute adopted by the agency should have been sustained. See *United States* v. *Correll*, 389 U.S. at 307 (in reviewing ambiguities in revenue statutes, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments") (quoting *Commissioner* v. *Stidger*, 386 U.S. 287, 296 (1967)).

d. The court of appeals also erred in suggesting that the government's interpretation of this statute is unfair to employers who seek to take tax deductions for property they transfer to their employees. App., *infra*, 15a-16a. Even when an employee does not report any "bargain element" of income from a transfer, an employer is able to take a number of steps to protect its claims to tax deductions for the transferred property. For example, an employer who enters into stock transfer arrangements with employees can insist on the inclusion of provisions in the stock agreement that place an agreed value on the transferred stock. The employer can also insist on an agreement with the employee either to make, or to waive, the Section 83(b) election to recognize income. And, if the employer is unsettled about the facts concerning the "bargain element" of any transfer, it can preserve its claim to a deduction by invoking the regulatory safe-harbor by

filing a protective Form W-2 or Form 1099 reporting income for the employee from the transfer. 26 C.F.R. 1.83-6(a)(2). The concerns over "fairness" raised by the court of appeals are thus fully addressed by the safe-harbor provision of Section 1.83–6 of the regulations—a provision that respondent simply failed to invoke.[8]

3. This case has substantial administrative importance. During the last few decades, numerous companies issued stock and stock options to employees and independent contractors as compensation. Highly skilled technology employees, in particular, often demanded and received equity interests in cash-strapped technology start-ups. Numerous employers and employees share fact patterns similar to those in *Venture Funding* and in this case.

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[8] Respondents seek to excuse Morgan Creek's failure to file a Form W-2 reporting its transfer of stock to Barber in time to bring itself within the regulatory safe harbor by claiming that Barber never informed Morgan Creek that he had made an election under Section 83(b) to report income in the year of the transfer. But if, as respondents claim, Morgan Creek was unaware of Barber's election prior to 1998, the company was still required to claim a deduction (prior to 1998) for any "bargain element" for the shares of stock that vested in Barber in 1995, 1996, and 1997. See 26 U.S.C. 83(a); note 1, *supra*. To invoke the safe harbor in each of those years, Morgan Creek should have issued and filed a Form W–2 reporting the income associated with the vested shares if, indeed, the company then held the view that a "bargain element" existed in the transfer. See note 1, *supra*. Morgan Creek, however, did not file a Form W-2 in 1995, when the transfer occurred, or in the following years (1996-1998) in which shares vested under the subscription agreement. Respondents first took the position that Barber should have included "bargain element" income from the transfer after they settled employment litigation with him in 1998. App., *infra*, 5a.

In particular, many companies issued stock options to employees during the stock market boom of the 1990's. In many cases, those options were exercised before the company completed its initial public offering, at a time when there was no established market value for the stock. If the employers in such cases are now belatedly allowed to obtain tax refunds based on compensation that was never reported by their employees, the revenue consequences for the government would be substantial. Moreover, even in situations in which the IRS would still be able to audit the employee, the decision of the court of appeals in this case will cause a proliferation of duplicative litigation, in which employers and employees would be free to take inconsistent positions on factual valuation issues.

The decision of the court below would also make the safe-harbor reporting requirement of the regulation meaningless and ineffective. That reporting mechanism is instrumental in the proper and timely administration of the statute. The secrecy that surrounds unreported property transfers invites collusion between employers and employees and provides unscrupulous taxpayers with a method for understating and evading their tax obligations.

For example, the Internal Revenue Service has recently identified a number of potentially abusive transactions involving equity compensation and has issued Notice No. 2003-47, 2003-30 I.R.B. 132, to address one such transaction that involves a purported transfer for value of compensatory stock options to a family limited partnership or trust. The object of such transactions is to defer for many years the time at which the service provider is required to report ordinary income as a result of the transfer or exercise of the option and related transactions and to freeze the amount of such

ordinary income at the time of the purported sale. If the service recipient in such cases is free to claim a deduction based on an inconsistent position as to value and without satisfying applicable information reporting requirements of the regulations, the potential adverse revenue effects of such transactions will be substantial. Under the decision of the court of appeals in this case, however, the agency's ability to detect such inconsistencies within the statute of limitations will be seriously diminished.

The decision in this case has thus created a direct conflict among the circuits on a recurring issue of substantial importance both to the public and to the public fisc. Resolution of this conflict by this Court is warranted by the importance of the question presented and by the need to avoid inconsistent treatment of taxpayers and to prevent "inequalities in the administration of the revenue laws." *Commissioner* v. *Sunnen*, 333 U.S. at 599.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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OCTOBER 2003

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

02-5154

JAMES G. ROBINSON
AND BARBARA L. ROBINSON, PLAINTIFFS-APPELLANTS

v.

UNITED STATES, DEFENDANT-APPELLEE

Decided: July 15, 2003

On Appeal From The
United States Court of Federal Claims

Before: RADER, *Circuit Judge*, PLAGER, *Senior Circuit Judge*, and BRYSON, *Circuit Judge*.

BRYSON, *Circuit Judge*.

This appeal from the United States Court of Federal Claims requires us to construe section 83(h) of the Internal Revenue Code, a provision that addresses deductions for employers who use property transfers (other than money) to compensate employees. That statute provides that the amount of the employer's deduction is "equal to the amount included" in the employee's gross income as a result of the transfer.

The issue presented to us is whether the amount of the employer's deduction is the value of the transferred property that is includible in the employee's gross income as a matter of law or only the amount that is actually included in the employee's gross income. The Court of Federal Claims held that the amount of the employer's deduction under section 83(h) is limited to the value of the transferred property that is actually included in the employee's gross income, either on the employee's return or as a result of a final determination between the employee and the IRS that is binding on the employee. *Robinson* v. *United States*, 52 Fed. Cl. 725, 729 (2002). We disagree with that construction of the statute and therefore reverse.

I

Appellants James G. Robinson and Barbara L. Robinson are the sole shareholders of a group of related S-corporations collectively known as Morgan Creek. The tax consequences of an S-corporation flow through to the shareholders, so the shareholders recognize the corporation's income and expenses on their individual tax returns. 26 U.S.C. §§ 1363, 1366.

From 1989 to 1997, Gary Barber was the Chief Operating Officer of Morgan Creek and was responsible for all of the company's legal, financial, administrative, and other business affairs. In January 1995, Morgan Creek entered into an employment agreement with Mr. Barber that gave him a 10 percent ownership interest in the company. Under that contract, full ownership of the stock representing the 10 percent ownership share would vest gradually over time according to a schedule that would lead to partial forfeiture of his ownership rights in the event of early termination of his employ-

ment. Mr. Barber paid Morgan Creek $2 million as consideration for the stock.

Because the stock given to Mr. Barber was part of his salary, and because it was conveyed with restrictions on Mr. Barber's ownership rights, the tax treatment of the transfer of the stock is governed by section 83(a) of the Internal Revenue Code ("the Code"), 26 U.S.C. § 83(a). Section 83(a) provides that the transfer of property in connection with performance of services yields taxable income to the service provider in the amount of the excess of "the fair market value of such property" over "the amount (if any) paid for such property." That amount is known as the "bargain element" of the property transfer. Section 83(a) provides that the amount of the bargain element "shall be included in the gross income" of the service provider. *Id.*[1]

Section 83(a) addresses, inter alia, transfers that include restrictions on vesting or on retransfer of the property. In the case of property that is conveyed subject to such restrictions, the bargain element is ordinarily treated as income to the employee in the year that the employee's rights in the property are no longer "subject to a substantial risk of forfeiture." 26 U.S.C. § 83(a); *see also* Treas. Reg. §§ 1.83-1(a), 1.83-3(a) & (b). It is then taxed as ordinary income. Section 83(b) of the Code, however, gives the employee the opportunity within 30 days of the transfer to elect to recognize the income in the year of receipt, notwith-

[1] Section 83 applies to property transfers to any service provider, not just an employee, but because the service provider in this case was an employee, we refer in this opinion to the operation of the statute as it applies to employees and employers.

standing the existence of restrictions on ownership. 26 U.S.C. § 83(b). By making that election, the employee is subject to immediate tax liability for the amount of the compensation. However, electing that option enables the employee to treat as a capital gain any appreciation in the value of the property between the time of the transfer and the time that the restrictions lapse. *See Venture Funding, Ltd.* v. *Comm'r*, 110 T.C. 236, 239-40 (1998), *aff'd*, 198 F.3d 248 (6th Cir. 1999) (unpublished table decision).

Section 83(h) addresses the tax consequences to the employer of a property transfer made under section 83. With respect to value, section 83(h) states that the employer shall receive "a deduction" under section 162 of the Code in "an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed the services."[2] 26 U.S.C. § 83(h). With respect to timing, section 83(h) states that the deduction "shall be allowed for the taxable year of such person . . . in which such amount is included in the gross income of the person who performed such services." *Id.*

In 1995, Mr. Barber made a timely election under section 83(b) to include the bargain element of the Morgan Creek stock in his income for that tax year. However, because Mr. Barber represented that the $2 million that he paid for the stock reflected its fair market value–that is, that the bargain element of the transfer was zero–he did not report any income from the transfer. The Robinsons allege that Mr. Barber

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[2] Section 83(d)(2) addresses the cancellation of certain restrictions on property that will never lapse. 26 U.S.C. § 83(d)(2). It is not pertinent to this case.

was incorrect to assign a zero value to the bargain element, because the $2 million payment represented only a small fraction of the stock's true value, which they contend was approximately $28.8 million at the time of the transfer.

Under Treasury Department regulations, Mr. Barber was required to file a copy of the section 83(b) election with his employer notifying the employer of his election. *See* Treas. Reg. § 1.83-2(c), (d). Because Mr. Barber was the chief operating officer of Morgan Creek, the person he notified was himself. Subsequently, in June 1998, Morgan Creek and Mr. Barber terminated their employer-employee relationship. As part of the separation agreement, Morgan Creek repurchased from Mr. Barber the portion of the stock that had vested. The purchase price was $13.2 million, based on an estimated company value of $165 million. At that point, the Robinsons discovered that Mr. Barber had made a section 83(b) election in 1995. As a result, Morgan Creek calculated the 1995 value of the property that had been transferred to Mr. Barber and issued corrected W-2 forms reflecting that value. The modification increased Mr. Barber's wage income by more than $20 million. Morgan Creek also paid the employer's share of the employment taxes for that compensation. The IRS has since audited Mr. Barber's 1995 tax return and issued an audit report proposing to increase his gross income by $26,759,800 based on a stock value of $28,759,800. However, the agency and Mr. Barber have not yet reached a final determination as to the amount, if any, by which his gross income will be increased for purposes of calculating his 1995 tax liability.

In 1999, the Robinsons filed an administrative claim with the IRS seeking a refund of a portion of their 1995 taxes. They contended that because Mr. Barber made a section 83(b) election, Morgan Creek was entitled to deduct the bargain element of the stock transfer under section 83(h). When their administrative claim proved unsuccessful, the Robinsons filed suit in the Court of Federal Claims seeking a refund of overpaid income taxes in the amount of $8,854,281 plus interest. The Robinsons later moved for partial summary judgment, arguing that Morgan Creek was entitled to a deduction under section 83(h) for the compensation paid to Mr. Barber in 1995, and that the case should proceed to trial to determine the value of the stock. The government filed a cross-motion for dismissal or, in the alternative, for summary judgment on the ground that the case was not ripe for adjudication. In its summary judgment motion, the government contended that the Robinsons were not yet entitled to any deduction for the stock transferred to Mr. Barber because he had not included any amount in gross income on his 1995 tax return for receipt of that stock and the IRS had not made a final determination regarding the amount, if any, that Mr. Barber must include on that return.

The Court of Federal Claims granted the government's summary judgment motion. The court ruled that the value of transferred property is "included" in an employee's gross income, for purposes of the deduction allowed to the employer under section 83(h), only when that amount is actually taken into account in determining the tax liability of the employee for that year. *Robinson*, 52 Fed. Cl. at 727-28. The court noted that its interpretation was consistent with the applicable Treasury Regulation, which defines the amount

"included" in the employee's gross income to mean "the amount reported on an original or amended return or included in gross income as a result of an IRS audit of the service provider," *Deductions for Transfers of Property*, 60 Fed. Reg. 36,995, 36,996 (July 19, 1995), and with a decision of the Tax Court, which construed the term "included" in section 83(h) to mean the amount actually taken into account in determining the employee's tax liability, *Venture Funding*, 110 T.C. at 240. Merely because "the employee should have, or could have, included a particular amount in gross income in a particular year does not, on its own, trigger the allowance of a deduction," the court held. *Robinson*, 52 Fed. Cl. at 728.

The court also rejected the Robinsons' argument that they were entitled to invoke the "safe harbor" provision of the Treasury Regulation for section 83(h), which allows an employer to take a deduction based on the actual value of the transferred property if the employer satisfies all the pertinent reporting requirements "in a timely manner." Treas. Reg. § 1.83-6(a)(2). The court held that the Robinsons did not qualify for that exercise of administrative grace because their report of the 1995 stock transfer was untimely. Although the Robinsons argued that they filed corrected W-2 forms in 1998, as soon as they learned of Mr. Barber's election, the court refused to read into the regulation a "reasonable cause" exception for untimeliness, as urged by the Robinsons. Because Mr. Barber had not reported any gross income attributable to the bargain element of the stock transfer and because the Robinsons had not satisfied the requirements of the safe harbor regulation, the court held that the Robinsons were not entitled to a deduction until and unless Mr. Barber's gross income for 1995

was increased either by amendment or by administrative resolution.

The central issue on appeal is the meaning of the word "included" as used in section 83(h). That section provides:

> In the case of a transfer of property to which this section applies . . . there shall be allowed as a deduction under section 162 [that is, for trade or business expenses], to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year in which such amount is included in the gross income of the person who performed such services.

26 U.S.C. § 83(h). The government argues that "the amount included . . . in the gross income of the person who performed such services" means the amount actually included on the employee's tax return, while the Robinsons argue that the term "included," as used in section 83(h), refers to the amount included in the employee's gross income as a matter of law. For the reasons set forth below, we agree with the Robinsons.

The statutory context in which the term "included" is used supports the Robinsons' construction. Section 61 of the Code, the pivotal Code section that defines gross income, provides that "gross income means all income from whatever source derived." 26 U.S.C. § 61(a). Section 61(b) then states that "[f]or items specifically *included* in gross income, see part II (sec. 71 and following). For items specifically *excluded* from gross

income, see part III (sec. 101 and following)." 26 U.S.C. § 61(b) (emphasis added). Because section 61 addresses gross income as a legal concept, the term "included" in section 61(b) plainly refers to items that are included in gross income as a matter of law or legally deemed to be included in gross income. Part II of the Code, to which section 61(b) refers, contains section 83. Thus, the statutory reference in section 61 to items that are "included in gross income" as a matter of law is powerful evidence that the same term meant to have the same meaning in the cross-referenced section 83.

Significantly, other statutory provisions in the same portion of the Code also use the term "included" to mean "included as a matter of law." For example, section 79 provides that the cost of employees' group-term life insurance "shall be included in the gross income of employees," 26 U.S.C. § 79(a), and section 82 uses the same formulation in referring to reimbursement for moving expenses, 26 U.S.C. § 82. The government does not suggest that any deduction to employers for such expenses depends on whether the employees actually report those benefits on their tax returns. The same principle should presumably apply to the parallel provision in section 83. *See Venture Funding*, 110 T.C. at 259-60 (Ruwe, J., dissenting) (analyzing numerous Code provisions using variations of the word "include" and concluding that the word denotes benefits that are legally required to be treated as income).

The government argues that if Congress had intended for "included" to mean included as a matter of law, it would have used the word "includible" or the phrase "should have been included." It is true that the Code uses the word "includible" in some instances to mean de jure inclusion. *See*, *e.g.* 26 U.S.C.

§ 72(m)(3)(B) (noting that a contribution to a life insurance contract "is includible in the gross income of the participant" under specified circumstances); § 88 (mandating that certain amounts with respect to nuclear decommissioning costs "shall be includible" in the gross income of the taxpayer). As noted, however, the term "included" is often used to mean "included as a matter of law," and Congress has used a different formulation when it has meant to require that income actually be reported. For example, section 1367(b)(1) of the Code provides, "An amount which is required to be included in the gross income of a shareholder and shown on his return shall be taken into account under [other subparagraphs of this section] only to the extent such amount is included in the shareholder's gross income on his return." 26 U.S.C. § 1367(b)(1). If Congress had regarded the ordinary meaning of the term "included" to be "included on a tax return," there would have been no need in that provision to refer to the return after using the word "included."

The relationship between section 83(h) and section 162 of the Code provides further support for the Robinsons' construction of section 83(h). Section 162 is the general provision allowing a deduction for "all the ordinary and necessary expenses incurred during the taxable year in carrying on any trade or business," including "salaries or other compensation for personal services actually rendered." 26 U.S.C. § 162. Section 83(h) is directed to the same subject matter–a deduction for payments by a business for services–and section 83(h) expressly provides that in the case of a transfer of property to which section 83 applies, "there shall be allowed a deduction under section 162" to the employer.

The amount of the deduction allowed under section 162 does not depend on the amount the employee reports as income; rather, the amount of the deduction is based on the value of the property transferred by the employer as of the time of the transfer. *See*, *e.g.*, Rev. Rul. 69-75, 1969-1 C.B. 52; Rev. Rul. 62-217, 1962-2 C.B. 59. There is no logical reason for the amount of the deduction under the parallel provision of section 83(h) to be based on the reporting activity of the employee, rather than the fair market value of the transferred property, simply because the employee's rights in the transferred property may not vest immediately.

Besides being contrary to the approach employed under the cross-referenced section 162, the government's interpretation of section 83(h) is contrary to the legislative history and contemporaneous interpretation of section 83. When Congress passed the Tax Reform Act of 1969, which introduced section 83 into the Code, the Senate Finance Committee referred to the section 83(h) deduction as follows:

> The committee provided rules for the employer's deduction for restricted property given to employees as compensation. The allowable deduction is the amount which the employee is required to recognize as income. The deduction is to be allowed in the employer's accounting period which includes the close of the taxable year in which the employee recognizes the income.

S. Rep. No. 91-522, at 123 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2155. The Committee's use of the expression "the amount which the employee is required to recognize as income" indicates that the Committee intended the employer's deduction to be based on the

amount includible in the employee's gross income, not the amount the employee actually reported on his income tax return. While the Committee report refers to the *timing* of the deduction in terms of when the employee actually recognizes the income, the *amount* of the deduction is clearly identified as the amount that the employee "is required to recognize as income."

Following the enactment of section 83, the report of the Joint Committee on Taxation confirmed the understanding of the basis for deductions under section 83(h) that was set forth in the Senate Committee report. *See* Staff of the Joint Committee on Internal Revenue Taxation, 91st Cong., *General Explanation of the Tax Reform Act of 1969*, at 112 (1970) ("The Act allows the employer a deduction equal to the amount which the employee is required to recognize as income."). Contemporaneous practitioner commentaries reached the same conclusion. *See* Joint Committee on Continuing Legal Education of the American Law Institute and the American Bar Association, *The Tax Reform Act of 1969*, at 120-21 (1970) (the section 83(h) deduction is equal to "the amount of compensation taxable to the person performing services" as opposed to the amount reported on the employee's tax return); Commerce Clearing House, *Explanation of the Tax Reform Act of 1969*, at 83 (1969) ("An employer transferring restricted property to an employee is entitled to a business deduction equal to the amount which the employee is required to report as income.").

The early regulatory history of the statute also supports the Robinsons' construction of section 83(h). In 1971, when the IRS first proposed a regulation relating to section 83(h), the proposed regulation allowed a deduction in "an amount equal to the amount included,

under subsection (a), (b), or (d)(2) of section 83 as compensation, in the gross income of the person who performed such services." *Treatment of Property Transferred in Connection With Performance of Services*, 36 Fed. Reg. 10787, 10793 (proposed June 3, 1971). After notice and comment, the IRS revised the proposed regulation. The new version explicitly stated that the allowable deduction was "equal to the amount *includible* as compensation in the gross income of the service provider, under section 83(a), (b), or (d)(2)." *Treatment of Property Transferred in Connection With the Performance of Services*, 43 Fed. Reg. 31911, 31919 (July 24, 1978). The agency offered the following explanation for the change in wording:

> [A] deduction is allowed to the person for whom services were performed in an amount equal to the amount of compensation includible in the gross income of the person who provided the services, at the time the compensation becomes includible in the gross income of the person who performed the services. This timing rule is a change from the regulations as proposed in 1971, which allowed a deduction at the time an amount was actually included in gross income. This change was suggested by public comments to the regulations as proposed in 1971.

Id. at 31912. That version of the regulation was in effect until the IRS adopted the current version in 1995. The text and explanation of the regulation thus make clear that until relatively recently the IRS understood the term "included," as used in section 83(h), to mean "includible."

When the 1995 version of Treasury Regulation § 1.83-6(a) was published in the Federal Register, the IRS made the following statement in the preamble.

> Under these regulations, the former general rule and special rule are replaced by a revised general rule that more closely follows the statutory language of section 83(h). The service recipient is allowed a deduction for the amount "included" in the service provider's gross income. For this purpose, the amount included means the amount reported on an original or amended return or included in gross income as a result of an IRS audit of the service provider.

60 Fed. Reg. at 36996. The government contends that this regulation sets forth the agency's contemporaneous understanding of the meaning of the statute and that we must defer to the regulation under the Supreme Court's decision in *Chevron U.S.A.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984). We are mindful of the deference due to administrative agency interpretations of statutes contained in regulations that are the result of notice and comment rulemaking, *see Barnhart* v. *Walton*, 535 U.S. 212, 221-22 (2002), a principle that is fully applicable to the Treasury Department's regulatory interpretations of the Internal Revenue Code, *see*, *e.g.*, *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 2002, 218-19 (2001) ("[W]e defer to the Commissioner's regulations as long as they implement the congressional mandate in some reasonable manner." (internal quotation marks omitted)); *Fulman* v. *United States*, 434 U.S. 528, 536 (1978) (upholding a regulation that had a "reasonable basis" in the statutory history, even though the taxpayer's challenge to its policy had "logical force").

Nonetheless, if the meaning of the statute is clear, we have the responsibility to apply the statute as written, not to defer to a contrary regulatory interpretation. *See Chevron*, 467 U.S. at 842-43. In this instance, the statutory language and other "traditional tools of statutory construction," *id.* at 843 n.9, lead us to conclude that Congress used the word "included" in section 83(h) to mean included as a matter of law. We therefore reject the contrary interpretation set forth in the present version of Treasury Regulation § 1.83-6(a).

The government contends that the Robinsons' interpretation of section 83 creates a "whipsaw" problem for the Internal Revenue Service. The government explains that if the employer and the employee disagree about the value of the bargain element of a section 83 transfer, the disputes could give rise to separately litigated cases, which could lead to decisions adverse to the government in both cases, resulting in the allowance of a deduction for the employer greater than the income recognized by the employee. While that outcome is possible, we think the similar "whipsaw" policy argument made by the Robinsons is even more compelling. The IRS can at least participate in the cases involving both the employer and the employee and thus can take steps to protect itself against an inconsistent result. The employer, however, has no standing to participate in a dispute between the employee and the IRS regarding the amount claimed by the employee as gross income from the section 83 transfer. Moreover, because any reduction in the amount claimed by the employee results in a reduction in the amount that can be deducted by the employer, the IRS would have little economic incentive to insist on the employee reporting the full value of the transferred property. In that

setting, the employer would be helpless to avoid a settlement between the IRS and the employee that significantly understated that value, and thus resulted in an artificially low deduction for the employer. Accordingly, we do not find the policy argument regarding possible "whipsaws" sufficient to persuade us to read the statute as the government urges. Instead, we conclude that the "whipsaw" argument cuts in favor of the employer's interpretation, not the government's.

III

The Robinsons challenge the trial court's refusal to give them the benefit of the safe harbor provision of Treasury Regulation § 1.83-6(a)(2). They contend that because they filed corrected W-2 forms for the 1995 tax year as soon as they became aware of Mr. Barber's section 83(b) election, the safe harbor provision should be applied to give them the right to a deduction equal to the true value of the bargain element of the property transfer. Because we interpret section 83(h) to permit a deduction in the amount equal to the bargain element of the property transferred in connection with services irrespective of whether the employee actually reports the income, we do not need to consider whether the Robinsons are entitled to the protection of the regulatory safe harbor provision.

IV

In sum, we reverse the trial court's decision and remand for a determination of the value of the Morgan Creek stock that was transferred to Mr. Barber. We recognize that our decision conflicts with language in the decision of the Tax Court (although that court was divided 9-8 on the issue), *see Venture Funding, Ltd.* v. *Comm'r*, 110 T.C. 236 (1998), which was affirmed by the

Sixth Circuit in an unpublished ruling, 198 F.3d 248 (6th Cir. 1999), but we are persuaded by the arguments made by the Robinsons and by the dissenting judges of the Tax Court. We therefore conclude that the Robinsons are entitled to a deduction based on the amount that was legally required to be included in Mr. Barber's gross income, without regard to the amount that was actually included on his return or that Mr. Barber and the IRS ultimately agree should be included on that return for purposes of calculating his tax liability.

REVERSED AND REMANDED.

APPENDIX B

UNITED STATES COURT OF FEDERAL CLAIMS

No. 01-102T

JAMES G. AND BARBARA L. ROBINSON, PLAINTIFFS

v.

THE UNITED STATES, DEFENDANT

Filed: June 24, 2002

ORDER

MILLER, Judge

This case is before the court after argument on defendant's motion to dismiss and the parties' cross-motions for summary judgement. Whether a taxpayer-employer's claim under 26 U.S.C. § 83(h) (2000), to deduct the value of property transferred to an employee is limited to the amount, if any, determined by the Internal Revenue Service (the "IRS") to have been included in the employee's gross income presents the ultimate legal issue. However, the ripeness of the taxpayer's claim is the antecedent inquiry, and defendant takes the position that plaintiff's claim cannot be addressed until the IRS makes the determination of the amount to have been included.

FACTS

The following facts are undisputed. James G. and Barbara L. Robinson ("plaintiffs") own all of the issued and outstanding stock in a group of related S-corporations in the commercial film production business, collectively known as "Morgan Creek." From 1989 through 1997, Gary Barber was the Chief Operating Officer of Morgan Creek and, as such, was responsible for all of Morgan Creek's legal, financial, administrative, and other business. Pursuant to an employment agreement dated January 1, 1995, and a common stock subscription agreement entered into as of January 30, 1995 (the "Stock Agreement"), Morgan Creek renewed Mr. Barber's contract and transferred to him a restricted 10% ownership interest in Morgan Creek (the "stock").[3]

26 U.S.C. (I.R.C.) § 83 (2000), governs the taxation of property transferred to an employee in connection with services provided by the employee. In general, such property is not taxable until it has become "substantially vested" in the employee. I.R.C. § 83(a); Treas. Reg. § 1.83-1(a) (1978); Treas. Reg. § 1.83-3(a) & (b) (as amended in 1985). Once the property substantially vests, the employee must include in gross income in that year the excess of the current fair market value of the property over any consideration paid by the employee for the property (the "bargain element"). I.R.C. § 83(a). Accordingly, any appreciation in the property between the year of transfer and the year the property substantially vests is reported as ordinary income.

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[3] The Stock Agreement provided for various vesting schedules that represented a risk of forfeiture to Mr. Barber in the event of an early termination of his employment.

Under Section 83(b) the employee may elect to include the bargain element in gross income for the year in which the property is transferred (determined without regard to any restrictions on ownership). *See* Treas. Reg. § 1.83-2(a) (1978). If the employee so elects, any subsequent appreciation of the property is not considered ordinary compensation, but will be recognized as capital gain. *See generally Alves* v. *Comm'r*, 734 F.2d 478, 480-81 (9th Cir. 1984) (discussing history, purpose, and operation of I.R.C. § 83); *Venture Funding, Ltd.* v. *Comm'r*, 110 T.C. 236, 239-40 (1998) (same), *aff'd*, 198 F.3d 248 (6th Cir. 1999) (unpublished table decision).

In February 1995, Mr. Barber filed with the IRS an election under I.R.C. § 83(b) to include in income the bargain element of the stock. Mr. Barber indicated that the bargain element was zero, thereby positioning himself to recognize no income from the transfer and to claim gains treatment on any gain from the subsequent sale of the stock.[4]

By regulation, an employee who makes an election under I.R.C. § 83(b) must file a written statement with the IRS and submit a copy of that statement to the

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[4] The parties disagree with respect to the fair-market value of the stock at the time of the transfer without regard to the restrictions, and therefore disagree on the value of the bargain element of the stock. In consideration for the stock, Mr. Barber paid $ 2 million in cash and notes to Morgan Creek. Under the Stock Agreement, the stock's value was to be determined as a strict percentage of the value of Morgan Creek and without regard to any discount for lack of marketability or minority status of the holder. Plaintiff estimates that the value of Morgan Creek at the time of the transfer was $288,000,000.00, which would translate to an ownership interest worth $28,800,000.00 to Mr. Barber and a bargain element of $26,800,000.00.

employer. Treas. Reg. § 1.83-3(c) &(d). The parties dispute when Morgan Creek was given notice of the election. Shortly after Mr. Barber filed his election, his attorneys provided Mr. Barber, in his capacity as Chief Operating Officer of Morgan Creek, with a copy of the election document. Defendant thus argues that, because Mr. Barber himself was an officer of Morgan Creek, an agent of Morgan Creek properly was advised of the election when it was made. Plaintiffs maintain that Morgan Creek first learned of Mr. Barber's I.R.C. § 83(b) election at the closing of a settlement agreement and mutual general release executed in June 1998 (the "Settlement Agreement"), in which Morgan Creek repurchased the then-vested portion of the stock (80% of the total shares) from Mr. Barber.[5] Plaintiffs insist that the first time an agent of Morgan Creek other than Mr. Barber learned of Mr. Barber's election was at the closing of the Settlement Agreement.

Morgan Creek subsequently issued amended 1995 Forms W-2 increasing Mr. Barber's wage income by $20,716,400.00 and paid the employer's share of employment taxes. The IRS audited Mr. Barber's 1995 tax return and, on or about December 14, 2001, issued an audit report proposing to increase Mr. Barber's gross income from wages by $26,759,800.00. The IRS has not finally determined Mr. Barber's 1995 tax liability.

On or about August 17, 1999, plaintiffs filed with the IRS an administrative claim for refund of 1995 income taxes, seeking deductions for additional compensation

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[5] The purchase price of the Settlement Agreement was $13,200,000.00 based on an agreed value of $165,000,000.00 million for Morgan Creek.

paid to Mr. Barber in 1995 and a tax refund of $7,626,575.00. On or about November 28, 2000, plaintiffs field an amended administrative claim seeking and [*sic*] additional tax refund of $1,227,706.00 based on the same transaction. On February 27, 2001, plaintiffs filed a complaint in the Court of Federal Claims seeking recovery of overpaid income taxes in the amount of $8,854,281.00, plus interest. Defendant argues that plaintiffs are not entitled to a decision on their claim for a refund until a final determination has been made of the amount, if any, to be included in Mr. Barber's 1995 income.

DISCUSSION

1. *Statutory framework and ripeness*

The question presented in this case is one of ripeness and, therefore, jurisdiction.[6] The "basic rationale" of the ripeness doctrine, according to the Supreme Court in *Abbott Labs* v. *Gardner*, 387 U.S. 136, 148-49 (1967),

> is to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies,

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[6] The ripeness doctrine is drawn both from Article III limitations on the judicial power and from prudential reasons for refusing to exercise jurisdiction. *See*, *e.g.*, *Buckley* v. *Valeo*, 424 U.S. 1, 114 (1976) (per curiam); *Socialist Labor Party* v. *Gilligan*, 406 U.S. 583, 588 (1972). Although not an Article III court, the Court of Federal Claims is vested with a "judicial power," *Freytag* v. *Comm'r*, 501 U.S. 868, 889-90 (1991), and has adjudicated cases on the basis that, except as Congress provides otherwise, its jurisdiction is similarly limited to "cases" or "controversies" and is subject to well-known prudential limitations, *e.g.*, *Mass. Bay Transp. Auth.* v. *United States*, 21 Cl. Ct. 252, 257- 58 (1990), *rev'd on other grounds*, 129 F.3d 1226 (Fed. Cir. 1997).

> and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties.

Accord Disabled Am. Veterans v. *Gober*, 234 F.3d 682, 690-91 (Fed. Cir. 2000). Not untypically, however, whether this case actually presents a live controversy depends on an interpretation of the underlying statute.

> I.R.C.§ 83(h) provides:
>
> > [T]here shall be allowed as a deduction under Section 162 [to the employer] an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

The critical word in this subsection is "included," and the critical question in this case is whether any amount has been included in Mr. Barber's gross income. *See Venture Funding*, 110 TC at 242 ("The statutory prerequisite to petitioner's deduction under Section 83(h) is that the corresponding amount must be 'included' in its employees' income . . . .") If the amount included in the employee's gross income remains to be decided by another tribunal, it remains possible that the parties' dispute will resolve itself, for plaintiffs' complaint is predicated on their fear that the IRS will determine, in the process of reviewing Mr. Barber's return, that Mr. Barber should have included less than the amount that plaintiffs claim as a deduction.

2. *Statutory meaning of "included"*

Because income tax deductions are a matter of "legislative grace," "they are strictly construed and allowed only 'as there is a clear provision therefor.'" *INDOPCO, Inc.* v. *Comm'r*, 503 U.S. 79, 84 (1992) (quoting *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440 (1934)). "[T]he burden of clearly showing the right to the claimed deduction is on the taxpayer." *INDOPCO*, 503 U.S. at 84.

The first step in construing a statute "is to determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." *Robinson* v. *Shell Oil Co.*, 519 U.S. 337, 340 (1997). The term "included" has just such a plain and unambiguous meaning in the tax code, one that distinguishes it from the term "includible." *E.g.*, *Grant Oil Tool Co.* v. *United States*, 180 Ct. Cl. 620, 632, 381 F.2d 389, 397 (1967); *Venture Funding*, 110 TC 240-41 & n.3; *id.* at 249-51 (Colvin, J., concurring); *see also Day* v. *Heckler*, 735 F.2d 779, 784 (4th Cir. 1984) (distinguishing between "allowed" and "allowable"). I.R.C. § 83 requires that the employer's deduction equal the amount included in the employee's gross income and that it be taken in the year that ends the taxable year in which the employee included the amount in gross income that the employee should have, or could have, included a particular amount in gross income in a particular year does not, on its own, trigger the allowance of a deduction.[7]

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[7] Section 83(h) was added to the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 588, by a Senate amendment. The report of the Senate Finance Committee states: "The allowable deduction is the amount which the employee *is required to recognize* as income.

Both the Tax Court and the IRS recognize that, by the plain meaning of the term, an amount is "included" in a taxpayer's income when that amount is actually "taken into account in determining the tax liability of the employee for that year." *Venture Funding*, 110 TC at 240. Recognizing that I.R.C. § 83(h) requires an employer to "demonstrat[e] that an amount has actually been included," T.D. 8599, 1995-2 C.B. 12, 12, the IRS created a limited safe-harbor provision under which an employee is "deemed" to have included a particular amount in gross income, Treas. Reg. § 1.83-6(a)(2) (as amended in 2000).[8] Aside from the safe harbor, however, "the employer generally is required to demonstrate that the employee actually included the amount in income in order to support its deduction of the amount." T.D. 8599, 1995-2 C.B. at 13; *see also Sutherland Lumber-Southwest, Inc.* v. *Comm'r*, 114 TC 197, 205 (2000).

Plaintiffs concede that a final determination regarding Mr. Barber's 1995 income tax liability has not been

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The deduction is to be allowed in the employer's accounting period which includes the close of the taxable year in which the employee *recognizes* the income." S. Rep. No. 91-552 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2155 (emphasis added). The Conference Report adopts the Senate amendment, indicating only that "[t]he amendment provides rules for deductions for the employer with respect to restricted property." H.R. CONF. REP. NO. (91-782 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2392, 2418. Although the language used by the Senate Finance Committee supports plaintiff's claim, *see Venture Funding*, 110 TC at 258, 261 (Ruwe, J., dissenting), the court nevertheless must apply the plain, unambiguous meaning of the statute. *E.g.*, *Garcia* v. *United States*, 469 U.S. 70, 75 (1984).

[8] As discussed below, plaintiffs did not avail themselves of the safe harbor.

made. They argue instead that the term "included" does not contemplate a final determination of the employee's tax liability. Plaintiffs rely primarily on language in the preamble of a 1995 amendment to the regulations implementing I.R.C. § 83:

> Under these regulations, the former general rule and special rule are replaced by a revised general rule that more closely follows the statutory language of Section 83(h). The service recipient is allowed a deduction for the amount "included" in the service provider's gross income. For this purpose, the amount included means the amount reported on an original or amended return or included in gross income as a result of an IRS audit of the service provider.

Plaintiffs erroneously argue that, because the IRS has issued an audit report concerning Mr. Barber's income for 1995, the preamble's definition of "included" is satisfied. To the contrary, the preamble refers to an amount "included in gross income as a result of an IRS audit." The audit itself does not satisfy the preamble's definition of "included": The audit must result in an amount-certain included in the employee's gross income. Plaintiffs concede that this has not yet occurred.

Plaintiffs argue more generally that the essence of I.R.C. § 83's operation is not the actual inclusion of compensation in the employee's income, but notice to the IRS of the nature and amount of compensation. Plaintiffs reason that the purpose of the statute is satisfied when the IRS is made aware that property has been transferred as income and is put in a position to make any necessary adjustments to the tax liabilities of those involved. Plaintiffs again rely on the 1995

amendment to the implementing regulations, arguing that the events discussed in the preamble—submission of an original or amended return or an IRS audit—are not final determinations of an employee's tax liability, but rather, are events that put the IRS in a position to discover and correct any discrepancy between the employer's and the employee's returns.

Again, plaintiffs overlook the fact that the preamble refers to inclusion "as a result" of an audit—not an audit itself. As such, the preamble informally describes the means by which a final amount to be included in gross income is determined. Unless the IRS determines that an audit is necessary, the taxpayer's return is essentially a "self-assessment," *e.g.*, *Laing* v. *United States*, 423 U.S. 161, 191 (1976), and any amount included as gross income on that return is the amount ultimately taken into account in determining the employee's tax assessment for that year, 26 U.S.C. § 6201 (authorizing summary assessment of taxes shown on return); *Venture Funding*, 110 T.C. at 258 n.3 (Ruwe, J., dissenting) ("The alternative to reporting as gross income on the employee's . . . return would be an adjustment to gross income in a deficiency determination."); MICHAEL I. SALTZMAN, IRS PRACTICE & PROCEDURE ¶¶ 8.01, 10.01-10.03 (2d ed. 1991) (discussing examination and assessment process). The preamble thus is consistent with the plain meaning of "included" applied in *Venture Funding*: "taken into account in determining the tax liability of the employee for that year." *Venture Funding*, 110 T.C. at 240.

The fact that this case involves restricted stock and an election under I.R.C. § 83(b) does not affect application of the plain meaning of "included." Subsection (b) contains no language that would qualify or avoid the

requirement in subsection (h) that the deduction equal the amount included in the employee's gross income. The plain meaning of I.R.C. § 83(h), confirmed by the IRS's implementing regulations and applied by the Tax Court in *Venture Funding*, is that an employer is allowed a deduction only to the extent that an equal amount actually is included in the employee's gross income.

3. *The role of notice*

Plaintiffs may be correct that notice to the IRS adequately serves the purpose of I.R.C. § 83(h), which is to ensure consistent treatment of employers and employees. T.D. 8599, 1995-2 C.B. at 13. Nevertheless, '[t]he propriety of a deduction does not turn upon general equitable considerations, such as a demonstration of effective economic and practical equivalence." *Comm'r* v. *Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 148-49 (1974). More fundamentally, this court is in no position to fashion alternate methods of accomplishing Congress's will. Whatever merit plaintiffs' arguments may have as a policy matter, they would circumvent–and therefore contradict–the scheme Congress has chosen.

Similarly, although the court appreciates the vulnerability of plaintiffs to the outcome of Mr. Barber's administrative appeals, the court cannot avoid the unambiguous language of I.R.C. § 83(h) on this basis. Under that statute an employer's deduction rests on "its employee's inclusion in income of a corresponding amount." *Venture Funding*, 110 T.C. at 240. Although several courts applying I.R.C. § 83 according to its terms have recognized the inequities created in particular circumstances, *e.g.*, *Sakol* v. *Comm'r*, 574 F.3d

694, 700 (2d Cir. 1978); *Venture Funding*, 110 TC at 242; *Alves* v. *Comm'r*, 79 T.C. 864, 878 (1982), *aff'd*, 734 F.2d 478 (9th Cir. 1984), these courts consistently have refused "to create exceptions to the statute's coverage." *Alves*, 734 F.2d at 483. The result in this case is coherent, consistent with the Code's distinction between "included" and "includible," and, while unaccommodating of plaintiffs' reasonable concerns, is far from absurd.[9] Consequently, because the statute's language is plain, the court must enforce it according to its terms. *See Hartford Underwriters Ins. Co.* v. *Union Planters Bank*, N.A., 530 U.S. 1, 6 (2000); *Robinson*, 519 U.S. at 340.

4. *Safe-harbor regulation*

As noted above, IRS regulations recognize that it is often difficult for an employer to ascertain whether its employees actually included an amount in income. T.D. 8599, 1995-2 C.B. at 12, *see also Venture Funding*, 110 TC at 242. Treas. Reg. § 1.83-6(a)(2) accordingly provides a safe harbor to employers through which they can claim a deduction regardless of whether the employee actually includes the amount in income. Under the safe harbor, if the employer timely satisfies I.RC. §§ 6041 A., *i.e.*, files the appropriate form (usually a W-2) with the IRS reporting the compensation to the employee and furnishes a statement to the employee, the employee is "deemed" to have included the amount

[9] The court notes that an earlier version of the safe-harbor rule was available to plaintiffs when they negotiated Mr. Barber's employment contract. Moreover, plaintiffs were free to incorporate into the Stock Agreement their understanding of what Mr. Barber would report to the IRS and thereby fix any risk associated with his conduct.

reported by the employer as income for purposes of I.R.C. § 83(h). *See also* Treas. Reg. §§ 1.6041-1,-2 (as amended in 2000) (describing mechanics of compliance).

Plaintiffs concede that they did not report the bargain element of the Stock Agreement as compensation in accordance with the safe-harbor rule. Plaintiffs instead request that the court read into the regulations a "reasonable cause" exception. The court finds no basis in the statute or the regulation for such an exception. As discussed above, the statute requires that the employer's deduction equal the amount included in the employee's gross income. The statute itself admits of no exception, whether for reasonable cause or otherwise. *Cf.*, *e.g.*, I.R.C. § 6651(a) (imposing penalties for failure to file a return or pay tax "unless it is shown that such failure is due to reasonable cause"). In the safe-harbor provision, the IRS has provided one, and only one, qualification to the statute's general operation. The rule provides detailed instructions to employers on how to avail themselves of that safe harbor. This court is in no position to broaden that exception or to create additional exceptions.

CONCLUSION

Because plaintiffs' entitlement to a deduction for 1995 depends upon a final determination of the amount included in Mr. Barber's income, plaintiffs' claim is unripe. Accordingly, based on the foregoing, defendant's motion to dismiss pursuant to RCFC 12(b)(1) is granted, and the Clerk of the Court shall dismiss the complaint without prejudice as unripe.

IT IS SO ORDERED.

No costs.

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Christine Odell Cook Miller
Judge

APPENDIX C

1. Section 83 of the Internal Revenue Code, 26 U.S.C. 83, provides, in relevant part, as follows:

Property Transferred in Connection with Performance of Services.

(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 property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

(b) ELECTION TO INCLUDE IN GROSS INCOME IN YEAR OF TRANSFER.—

(1) IN GENERAL.—Any person who performs services in connection with which property is transferred to any person may elect to include in his gross income, for the taxable year in which such property is transferred, the excess of–

(A) the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), over

(B) the amount (if any) paid for such property.

If such election is made, subsection (a) shall not apply with respect to the transfer of such property, and if such property is subsequently forfeited, no deduction shall be allowed in respect of such forfeiture.

(2) ELECTION.—An election under paragraph (1) with respect to any transfer of property shall be made in such manner as the Secretary prescribes and shall be made not later than 30 days after the date of such transfer. Such election may not be revoked except with the consent of the Secretary.

* * * * *

(d)(2) CANCELLATION.—If, in the case of property subject to a restriction which by its terms will never lapse, the restriction is cancelled, then, unless the taxpayer establishes–

(A) that such cancellation was not compensatory, and

(B) that the person, if any, who would be allowed a deduction if the cancellation were

treated as compensatory, will treat the transaction as not compensatory, as evidenced in such manner as the Secretary shall prescribe by regulations,

the excess of the fair market value of the property (computed without regard to the restrictions) at the time of cancellation over the sum of–

(C) the fair market value of such property (computed by taking the restriction into account) immediately before the cancellation, and

(D) the amount, if any, paid for the cancellation,

shall be treated as compensation for the taxable year in which the cancellation occurs.

* * * * *

(h) *Deduction By Employer.*—In the case of a transfer of property to which this section applies or a cancellation of a restriction described in subsection (d), there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

2. 26 C.F.R. 1.83-6 provides, in relevant part, as follows:

Deduction by employer.

(a) *Allowance of deduction*—(1) *General Rule.* In the case of a transfer of property in connection with the performance of services, or a compensatory cancellation of a nonlapse restriction described in Section 83(d) and § 1.83-5, a deduction is allowable under section 162 or 212 to the person for whom the services were performed. The amount of the deduction is equal to the amount included as compensation in the gross income of the service provider under Section 83(a), (b), or (d)(2), but only to the extent the amount meets the requirements of Section 162 or 212 and the regulations thereunder. The deduction is allowed only for the taxable year of that person in which or with which ends the taxable year of the service provider in which the amount is included as compensation. * * *

(2) *Special Rule.* For purposes of paragraph (a)(1) of this section, the service provider is deemed to have included the amount as compensation in gross income if the person for whom the services were performed satisfies in a timely manner all requirements of Section 6041 or section 6041A, and the regulations thereunder, with respect to that amount of compensation. * * *

* * * * *