Stanley S. Watts v. Commissioner, T.C. Memo. 1948-065

When an executive receives proceeds from surrendering stock acquired through an employment-related trust upon resignation, those proceeds are considered compensation for services rendered and taxable as ordinary income, not capital gain.

Summary

Stanley Watts, an executive at Chrysler Corporation, received money upon his resignation and the transfer of shares he held in a company trust. The Tax Court addressed whether this money constituted compensation for services (taxable as ordinary income) or capital gain. The court relied heavily on the precedent set in *Frazer v. Commissioner*, a similar case involving Chrysler executives, and held that the proceeds were taxable as ordinary income. The court distinguished this case from *Commissioner v. Alldis* because *Frazer* was the more recent pronouncement and more factually similar to Watt's case.

Facts

- Stanley Watts was an officer of the Chrysler Corporation.
- He held 205 shares in a trust established by Chrysler for its executives.
- Upon his resignation from Chrysler, Watts received money in exchange for his shares in the trust.
- Watts argued that the money he received should be treated as capital gain rather than ordinary income.

Procedural History

The Commissioner of Internal Revenue determined that the money Watts received was taxable as ordinary income. Watts petitioned the Tax Court for a redetermination. The Tax Court reviewed the case, considering previous decisions related to similar Chrysler Corporation executive compensation plans (*Commissioner v. Alldis* and *Frazer v. Commissioner*).

Issue(s)

Whether the money received by Watts upon his resignation and the transfer of his shares in the Chrysler Corporation trust constitutes compensation for services rendered and is therefore taxable as ordinary income, or whether it should be treated as a capital gain.

Holding

No, because the court held, on the authority of *Frazer v. Commissioner*, that the net proceeds paid to Watts upon his resignation as an executive of the Chrysler Corporation are taxable as ordinary income for the year 1937.

Court's Reasoning

The court based its decision primarily on the precedent established in *Frazer v. Commissioner*, which also involved Chrysler executives and the same trust. The court acknowledged a potential conflict between *Frazer* and *Commissioner v. Alldis*, another similar case. However, the court emphasized that *Frazer* was a later pronouncement from both the Tax Court and the Sixth Circuit Court of Appeals. The court reasoned that it was bound to follow the *Frazer* decision. The court dismissed Watt's attempt to distinguish his case from *Frazer* based on an amendment to the trust instrument, finding that the amendment did not alter the fundamental nature of the transaction as compensation for services rendered.

Practical Implications

This case, following *Frazer v. Commissioner*, reinforces the principle that payments received by executives in exchange for stock acquired through employment-related trusts are generally treated as compensation for services and taxed as ordinary income. This has significant implications for tax planning, as ordinary income is typically taxed at a higher rate than capital gains. Attorneys advising executives receiving such payments must carefully analyze the specific terms of the trust and the circumstances surrounding the stock transfer to determine the appropriate tax treatment. Subsequent cases would need to distinguish themselves from *Frazer* and *Watts*, likely by demonstrating that the stock was acquired independently of employment or that the payment was truly unrelated to past or future services.

