9 T.C. 1111 (1947)

r
r

Commissions paid by a corporation to a broker for selling its stock are not deducted from the price received for the stock when computing equity invested capital under Section 718(a)(1) of the Internal Revenue Code.

r
r

Summary

r

American Business Credit Corporation paid commissions to a broker, Hodson & Co., for selling its stock. The IRS sought to reduce the corporation's equity invested capital by the amount of these commissions, arguing they reduced the actual cash available to the company. The Tax Court held that the full amount paid by the stockholders for their stock should be included in equity invested capital, regardless of commissions paid to the broker. The court reasoned that the stockholder's investment, not the net proceeds to the corporation after expenses, is the determining factor under Section 718(a)(1) of the Internal Revenue Code.

r
r

Facts

r

American Business Credit Corp. engaged Clarence Hodson & Co. to sell its Class A common stock to the public. Agreements between the parties stipulated that Hodson would receive $1.25 per share sold as compensation for its services. Hodson would deduct this commission from the established price of the shares. Between 1937 and 1941, Hodson sold 903,713 shares of stock raising $6,131,919.25. Hodson deducted $1,129,641.25 in commissions, remitting the balance to American Business Credit. The corporation recorded the net amount received as capital stock and paid-in surplus. The corporation did not deduct the commissions as an expense for tax purposes. The Commissioner argued that these commissions should not be included in equity invested capital.

r
r

Procedural History

r

The Commissioner of Internal Revenue determined deficiencies in American Business Credit's excess profits tax and income tax liabilities for the fiscal years ended June 30, 1942 and 1943. The corporation petitioned the Tax Court for a redetermination of these deficiencies. The sole issue before the Tax Court was the proper calculation of equity invested capital, specifically whether stock issuance costs reduced this capital.

r
r

Issue(s)

r

Whether commissions paid by a corporation to its broker for selling its stock should be deducted from the price received for the stock when computing equity invested capital under Section 718(a)(1) of the Internal Revenue Code.

r
r

Holding

r

No, because the statute focuses on the money previously paid in for stock by the shareholder, and the amount the shareholder paid is the amount included in the equity invested capital calculation, irrespective of how the corporation uses those funds.

r
r

Court's Reasoning

r

The Tax Court emphasized that equity invested capital, as defined by Section 718(a)(1), is based on the amount of money "previously paid in for stock." The court stated, "When the phrase 'invested capital' is used, it is logical to impute an investment by someone who 'previously paid in [money] for stock,' and that person can be only the stockholder. Such is the natural and normal interpretation of the phrase." The court reasoned that the stockholder paid the scheduled amount for the stock, and that amount should be included in equity invested capital, regardless of how the corporation later uses those funds. The court distinguished the case from situations where stock is issued directly to a broker as compensation, in which case the value of those shares would not constitute

