31 T.C. 100 (1958)

Gain realized from the cancellation of stock options, initially granted as compensation for services, is taxable to the employee, even if the options were assigned to family members.

Summary

The case concerns the taxability of income derived from a stock option granted to an employee. Robert C. Enos received a stock option from his employer, which he subsequently assigned to his wife and daughters. Years later, they surrendered the option to the employer for a sum of money. The Commissioner of Internal Revenue determined that the gain from this surrender was taxable to Enos as compensation. The Tax Court agreed, holding that the assignment to family members did not shield Enos from the tax liability because the gain was derived from compensation for his services, and he could not avoid taxation by assigning his rights to others.

Facts

Robert C. Enos was a director and later chairman of the board of E. W. Bliss Company. In 1947, Bliss granted Enos an option to purchase 25,000 shares of its stock. The option was contingent on Enos's continued employment with Bliss. The option agreement allowed for assignment. Enos assigned portions of the option to his wife and daughters for a nominal consideration. In 1952, Enos's wife and daughters surrendered the option rights to Bliss for $2 per share. The Commissioner determined that the gain realized from the cancellation of the stock options constituted compensation taxable to Enos.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency in Enos's income tax for 1952, based on the gain from the cancellation of the stock options. Enos challenged this determination in the United States Tax Court. The Tax Court adopted a stipulated set of facts and ruled in favor of the Commissioner.

Issue(s)

1. Whether the gain realized from the cancellation of the stock options in 1952 constituted compensation for the services of petitioner Robert C. Enos and was therefore taxable to him as ordinary income.

Holding

1. Yes, because the court found that the amounts realized as a result of the assignments of the option rights to Bliss in 1952 were compensation for services rendered by petitioner.

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Court’s Reasoning

The court examined whether the stock option was compensation for services. The option was contingent on continued employment, and the court found that the option had no ascertainable market value when granted. The court cited *Commissioner v. LoBue*, which established that the issuance of an option may be considered compensation. Because the option was granted in connection with Enos’s employment and was intended to provide additional compensation for his services, and because the gain from the cancellation of the option in 1952 represented compensation for services rendered, the court held that the gain was taxable to Enos. The court reasoned that Enos could not avoid taxation on compensation by assigning his rights. The court cited *Lucas v. Earl*, which states that compensation for services is taxable to the person rendering those services. The court distinguished between the case at hand and cases where the option was granted directly to a family member.

Practical Implications

This case clarifies that the tax liability for compensation derived from stock options cannot be avoided through an anticipatory assignment of the option to family members or other third parties. The court focused on the substance of the transaction: the option was granted as compensation for services. When the option was ultimately canceled for consideration, that gain was taxable to the individual who provided the services, even though the family members received the payment. This decision is particularly relevant for tax planning. It underscores the importance of correctly characterizing compensation for services and the limitations on shifting tax liability through assignments.

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