51 T.C. 937 (1969)

To qualify for ordinary loss treatment under Section 1244, stock must be issued pursuant to a written plan that strictly adheres to statutory and regulatory requirements, including specifying a limited offering period and a maximum dollar amount the corporation can receive for the stock.

Summary

Pierre Godart sought to deduct an ordinary loss on worthless stock, claiming it was Section 1244 stock. The Tax Court disagreed, holding that the stock of French-American-British Woolens Corp. (FAB) did not meet the strict requirements of Section 1244. The court found that the purported written plan (lease-and-license agreement and board minutes) failed to specify a period ending within two years for the stock offering and did not state a maximum dollar amount the corporation could receive for the stock. Additionally, FAB was not considered a 'small business corporation' under Section 1244 due to its authorized capital stock exceeding regulatory limits.

Facts

Petitioner Pierre Godart, involved with T.S.M. Corp. (TSM), entered into a lease-and-license agreement with S. Stroock & Co. (Stroock) to form FAB Corp. FAB was intended to take over Stroock's textile business and be financed by Stroock and Rusch & Co. The agreement outlined stock subscriptions: one-third to Stroock and two-thirds to Godart and TSM for $375,000. FAB was incorporated in December 1960. FAB's corporate minutes from December 30, 1960, authorized the stock issuance to Stroock, TSM, and Godart as per the agreement. Godart received 1,000 shares, paid for by Rusch & Co., and immediately pledged the stock to Rusch & Co. as security. FAB's stock became worthless in 1962, and Godart claimed an ordinary loss deduction.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioners' income tax for 1962. Initially, the notice of deficiency did not adjust the claimed FAB stock loss. However, in their petition to the Tax Court, the Godarts argued that the FAB stock qualified as Section 1244 stock, entitling them to an ordinary loss. The Tax Court proceeding focused solely on whether the FAB stock met the requirements of Section 1244.

Issue(s)

1. Whether the stock issued by FAB Corp. to Pierre Godart qualified as 'section 1244 stock' under Section 1244 of the Internal Revenue Code.
2. Whether the lease-and-license agreement and corporate minutes constituted a 'written plan' that met the requirements of Section 1244 and related

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regulations.
3. Whether the purported written plan ‘specified’ a period for the stock offering ending not later than two years after the plan’s adoption.
4. Whether the purported written plan ‘specifically stated, in terms of dollars, the maximum amount to be received’ by FAB for the stock.
5. Whether FAB Corp. qualified as a ‘small business corporation’ under Section 1244 at the time of the plan’s adoption.

Holding

1. No, the stock issued by FAB Corp. did not qualify as Section 1244 stock.
2. No, the lease-and-license agreement and corporate minutes, even when considered together, did not constitute a ‘written plan’ that satisfied the requirements of Section 1244 and its regulations because they were incomplete and required external references.
3. No, the purported plan did not specify a period of offering ending within two years; the closing date reference was too indefinite and required external inference.
4. No, the purported plan did not specifically state the maximum dollar amount FAB could receive for the stock; it only restricted stock issuance before closing but not afterward.
5. No, FAB Corp. was not a ‘small business corporation’ because its authorized capital stock and potential offering exceeded the $500,000 limit under Section 1244 regulations.

Court’s Reasoning

The court strictly interpreted Section 1244 and its regulations, emphasizing that preferential ordinary loss treatment for small business stock requires strict adherence to the statutory requirements. The court found the alleged ‘written plan’ deficient in several respects. First, it failed to explicitly specify a period for the stock offering ending within two years of plan adoption. The court stated, “Nowhere in the documents petitioner calls a plan is a period of offering ‘specified’ as required by the statute and respondent’s regulation.” The reference to a closing date shortly after stockholder approval was deemed too vague and not a ‘specified period.’ Second, the plan did not state a maximum dollar amount FAB could receive for the stock. The limitation on pre-closing stock issuance did not restrict post-closing issuances, failing to cap the total offering amount. The court also determined FAB was not a ‘small business corporation’ because its authorized capital of $1,000,000, with 10,000 authorized shares, exceeded the regulatory limits for Section 1244 stock at the time, even though only 3,750 shares were initially issued. The court relied on precedent like *James A. Warner* and *Bernard Spiegel*, which similarly required strict compliance with Section 1244’s written plan requirements.

Practical Implications

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Godart v. Commissioner underscores the necessity of meticulous planning and documentation when seeking ordinary loss treatment for small business stock under Section 1244. Attorneys advising clients on Section 1244 stock issuances must ensure the written plan explicitly and unambiguously states: (1) a period for the stock offering that ends within two years of plan adoption, and (2) the maximum dollar amount the corporation can receive from the stock issuance. Vague or implied terms, or reliance on external documents to complete the plan, are insufficient. Furthermore, careful consideration must be given to the definition of 'small business corporation,' particularly regarding authorized capital stock, to ensure compliance with Section 1244 requirements. This case serves as a cautionary example of how failing to strictly adhere to these formal requirements can result in the denial of ordinary loss deductions and treatment as a less favorable capital loss.

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