Godart v. Commissioner, 51 T. C. 945 (1969)

Stock must be issued pursuant to a written plan that specifies a maximum offering amount and a period of offering not exceeding two years to qualify as Section 1244 stock.

Summary

In Godart v. Commissioner, the Tax Court ruled that stock issued to Pierre Godart by French-American-British Woolens Corp. (FAB) did not qualify as Section 1244 stock, which offers special tax treatment for losses on small business stock. The court found that the issuance of the stock did not comply with the statutory and regulatory requirements for Section 1244 stock, particularly lacking a written plan that specified both the maximum amount to be received and a period of offering ending within two years. The decision emphasizes the necessity of a clear, written plan for stock to qualify under Section 1244, impacting how businesses and investors structure stock offerings to benefit from this tax provision.

Facts

Pierre Godart and T. S. M. Corp. (TSM) entered into a lease-and-license agreement with S. Stroock & Co. , Inc. (Stroock) to form a new corporation, French-American-British Woolens Corp. (FAB), to take over Stroock's textile business. On December 30, 1960, FAB issued 1,000 shares to Godart, 1,500 shares to TSM, and 1,250 shares to Stroock. Godart's shares were paid for by Busch & Co. and pledged back to them as security. In 1962, the FAB stock became worthless, and Godart claimed a $100,000 loss on his tax return, asserting it was a loss on Section 1244 stock.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Godart's 1962 income tax. After concessions, the sole issue was whether the FAB stock qualified as Section 1244 stock. The case proceeded to the Tax Court, which held that the stock did not meet the requirements for Section 1244 stock.

Issue(s)

1. Whether the stock issued to Pierre Godart by FAB qualifies as Section 1244 stock under the Internal Revenue Code.

Holding

1. No, because the issuance of the stock did not comply with the requirements of a written plan specifying the maximum amount to be received and a period of offering ending within two years, as required by Section 1244 and the accompanying regulations.

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Court’s Reasoning

The Tax Court’s decision hinged on the interpretation of Section 1244 and the accompanying regulations, which require a written plan for stock to qualify as Section 1244 stock. The court found that the minutes of FAB’s board meeting and the lease-and-license agreement did not constitute a “written plan” as required by the statute. Specifically, the court noted that the documents failed to specify a period of offering ending within two years and did not state the maximum amount to be received by FAB in consideration for the stock. The court emphasized that the plan must be clear and complete within the documents themselves, without relying on external computations or inferences. The court also noted that FAB was not a “small business corporation” under Section 1244(c)(2) because the potential offering exceeded $500,000. The decision was supported by references to prior cases like James A. Warner and Bernard Spiegel, which also required strict compliance with the statutory requirements for Section 1244 stock.

Practical Implications

This decision underscores the importance of strict adherence to the requirements of Section 1244 for stock to qualify for special tax treatment. Businesses and investors must ensure that any stock issuance intended to qualify under Section 1244 is supported by a clear, written plan that specifies both the maximum amount to be received and a period of offering not exceeding two years. This ruling may influence how corporations structure their stock offerings and how tax practitioners advise clients on the qualification of stock under Section 1244. Subsequent cases, such as Wesley H. Morgan, have continued to apply this strict interpretation, emphasizing the need for detailed planning and documentation in stock issuances to benefit from this tax provision.

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