Spectacular Shows, Inc. v. Commissioner, 54 T. C. 791 (1970)

For stock to qualify as Section 1244 stock, it must be issued pursuant to a written plan that meets specific statutory and regulatory requirements.

Summary

In Spectacular Shows, Inc. v. Commissioner, the Tax Court determined the eligibility of stock for ordinary loss treatment under Section 1244. The court examined whether Spectacular Shows, Inc. adopted a valid plan to issue Section 1244 stock and if the stock issued met the plan's requirements. The court found that the initial plan was valid, but only the first $5,000 of stock issued qualified under it. Subsequent stock issuances failed to meet Section 1244 criteria due to the lack of a new plan. This case underscores the importance of adhering to the detailed requirements of Section 1244 and the necessity of a comprehensive written plan for stock issuance.

Facts

Spectacular Shows, Inc. was incorporated on May 19, 1960, with an initial authorization to issue 5,000 shares of common stock. On May 21, 1960, the corporation adopted a written plan to issue stock under Section 1244, specifying a maximum of $5,000 in stock to be issued within two years. The plan was documented in corporate minutes and a handwritten note. Between July 5, 1960, and November 29, 1961, shareholders made payments for additional stock, totaling more than the initial $5,000 limit. On September 26, 1960, the corporation increased its authorized capital to 50,000 shares but did not adopt a new Section 1244 plan for the additional shares.

Procedural History

The case was brought before the Tax Court to determine the eligibility of the stock issued by Spectacular Shows, Inc. for ordinary loss treatment under Section 1244. The court analyzed the validity of the initial plan and whether subsequent stock issuances qualified under the same plan or required a new one.

Issue(s)

1. Whether Spectacular Shows, Inc. adopted a valid written plan meeting the requirements of Section 1244(c)(1)(A) and the underlying regulations.
2. Whether the stock issued by Spectacular Shows, Inc. was issued pursuant to the valid plan adopted on May 21, 1960.

Holding

1. Yes, because the corporation adopted a written plan on May 21, 1960, that complied with the statutory and regulatory requirements for issuing Section 1244

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stock.
2. No, because only the first $5,000 of stock issued after the plan's adoption qualified under the plan; subsequent issuances did not meet the plan's requirements or lacked a new plan.

Court's Reasoning

The court found that the initial plan adopted by Spectacular Shows, Inc. met the requirements of Section 1244(c)(1)(A), as it was a written plan to issue common stock within a two-year period and specified the maximum amount to be received. The court determined that stock issued before the plan's adoption did not qualify as Section 1244 stock. The first $5,000 of stock issued after the plan's adoption was deemed to have been issued pursuant to the plan. However, subsequent stock issuances exceeding this amount did not qualify because they were not issued under a new plan meeting Section 1244 requirements. The court emphasized that the date of payment for stock, rather than the physical issuance of certificates, determined when stock was considered issued. The court distinguished this case from Wesley H. Morgan, noting that the payments here were investments in the ongoing business, not contributions for dissolution. The court also rejected the argument that a subsequent increase in authorized capital constituted a new plan, as it lacked the necessary details.

Practical Implications

This decision clarifies that for stock to qualify for ordinary loss treatment under Section 1244, a corporation must adhere strictly to the statutory and regulatory requirements. Corporations must ensure that any plan to issue Section 1244 stock is well-documented and specifies the maximum amount and time frame for issuance. Practitioners should advise clients that stock issued outside the plan's limits or without a new plan will not qualify. This case also emphasizes that the date of payment for stock, not the issuance of certificates, is critical for determining qualification under Section 1244. Future cases involving Section 1244 stock will need to carefully document plans and ensure compliance with all requirements to avoid similar issues.

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