Siebert v. Commissioner, 53 T. C. 1 (1969)

Stock must be issued pursuant to a written plan specifying a time period and maximum dollar amount to qualify as Section 1244 stock, allowing for an ordinary loss deduction.

Summary

In Siebert v. Commissioner, the taxpayers sought to deduct a loss from worthless stock as an ordinary loss under Section 1244. The Tax Court denied this, ruling that the stock did not qualify as Section 1244 stock because it was not issued under a written plan specifying a time period and maximum dollar amount. The court emphasized the necessity of strict compliance with the statutory and regulatory requirements for such stock, highlighting that the corporation's actions did not meet these criteria despite issuing shares.

Facts

William and Myrle Siebert purchased a one-half interest in Edward L. Bromley Excavating Co. and formed Bromley & Siebert Excavating, Inc. (Excavating). They transferred business assets to Excavating in exchange for 30,000 shares of stock, and each purchased an additional 5,000 shares. Later, William Siebert purchased another 5,000 shares. Excavating became insolvent in 1963, and the Sieberts' stock became worthless. They claimed an ordinary loss deduction under Section 1244, but the IRS disallowed it, treating the loss as a capital loss.

Procedural History

The Sieberts filed a petition with the U. S. Tax Court after the IRS disallowed their ordinary loss deduction for the worthless stock. The Tax Court ruled in favor of the Commissioner, determining that the stock did not qualify as Section 1244 stock.

Issue(s)

1. Whether the stock issued to the Sieberts by Excavating qualified as Section 1244 stock, entitling them to an ordinary loss deduction when it became worthless?

Holding

1. No, because the stock was not issued pursuant to a written plan that specified a period of time and a maximum dollar amount, as required by Section 1244 and the regulations thereunder.

Court's Reasoning

The court applied Section 1244 and its regulations, which require stock to be issued under a written plan specifying a time period not exceeding two years and a maximum dollar amount receivable by the corporation. The Sieberts argued that the corporate resolution and pre-incorporation agreement constituted such a plan, but the court found these documents did not meet the statutory and regulatory requirements. The court noted that Excavating's articles of incorporation authorized 49,000 shares, yet only 40,000 were initially issued, and additional shares were issued later, indicating no plan to limit stock issuance to a specific period or amount. The court cited the case of Spillers v. Commissioner, which similarly denied Section 1244 treatment due to non-compliance with these requirements. The court emphasized the need for strict adherence to the regulations to maintain uniformity in applying Section 1244.

Practical Implications

This decision reinforces the necessity for corporations to strictly adhere to the requirements of Section 1244 when issuing stock to ensure shareholders can claim ordinary loss deductions for worthless stock. Legal practitioners must advise clients to create a detailed written plan when issuing stock under Section 1244, specifying the time period and maximum dollar amount. This case has influenced subsequent decisions to uphold the strict requirements of Section 1244, impacting how businesses structure stock offerings and how losses are treated for tax purposes. It also highlights the importance of preemptive planning to avoid unintended tax consequences when stock becomes worthless.

