Kaplan v. Commissioner, 59 T. C. 178 (1972)

Stock must be issued pursuant to a written plan within two years and for money or other property to qualify for ordinary loss treatment under Section 1244 of the Internal Revenue Code.

Summary

Marcia Kaplan sought to claim ordinary loss deductions under Section 1244 for losses on stock in Aintree Stables, Inc. The Tax Court held that the stock did not qualify as Section 1244 stock because it was not issued pursuant to a written plan within two years as required, and the stock issued for cancellation of purported debt was actually exchanged for equity, not money or property. The decision underscores the strict requirements for stock to qualify for favorable tax treatment under Section 1244.

Facts

Marcia Kaplan acquired 50 shares of Aintree Stables, Inc. on May 20, 1964, for $1,000 in cash. On January 23, 1967, she acquired another 50 shares in exchange for canceling $24,000 of the corporation's purported indebtedness to her. Aintree was undercapitalized from its inception, and Kaplan's advances to the corporation were treated as equity rather than debt due to the absence of promissory notes, interest provisions, and maturity dates.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Kaplan's Federal income tax for 1964 and 1967. Kaplan petitioned the U. S. Tax Court, arguing her stock in Aintree qualified for ordinary loss treatment under Section 1244. The Tax Court ruled in favor of the Commissioner, finding Kaplan's stock did not meet Section 1244 requirements.

Issue(s)

1. Whether the 50 shares of Aintree stock acquired by Kaplan on May 20, 1964, were issued pursuant to a written plan as required by Section 1244(c)(1)(A) of the Internal Revenue Code?
2. Whether the 50 shares of Aintree stock acquired by Kaplan on January 23, 1967, were issued for money or other property as required by Section 1244(c)(1)(D) of the Internal Revenue Code?

Holding

1. No, because the alleged plan did not comply with the two-year requirement of Section 1244(c)(1)(A) as it included options exercisable beyond two years.
2. No, because the stock was issued in exchange for the cancellation of purported

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debt that was treated as equity, not money or other property as required by Section 1244(c)(1)(D).

Court’s Reasoning

The court applied the statutory requirements of Section 1244 and the corresponding regulations. For the first issue, the court found that the minutes of the May 20, 1964, board meeting did not constitute a written plan because they included options exercisable over a 10-year period, violating the two-year offering period required by Section 1244(c)(1)(A). For the second issue, the court determined that Kaplan’s advances to Aintree were equity, not debt, due to factors such as Aintree’s undercapitalization, lack of formal debt instruments, absence of interest provisions, and lack of maturity dates. Consequently, the stock issued in exchange for the cancellation of this purported debt did not meet the requirement of Section 1244(c)(1)(D) that stock be issued for money or other property. The court emphasized that the objective intent of the parties, as evidenced by these factors, took precedence over their subjective intent to treat the advances as debt.

Practical Implications

This decision clarifies the strict requirements for stock to qualify for Section 1244 treatment, impacting how businesses and investors structure their equity and debt. It underscores the importance of adhering to the two-year plan requirement and ensuring that stock is issued for money or other property, not in exchange for existing equity interests. Practitioners must carefully document plans for issuing stock and ensure that any purported debt is structured with formal indicia of indebtedness to avoid recharacterization as equity. The ruling may influence business practices by encouraging more formal structuring of corporate financings to achieve desired tax outcomes. Subsequent cases have reinforced these principles, emphasizing the need for strict compliance with Section 1244 requirements.

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