Jordan v. Commissioner, 60 T. C. 872 (1973)

Expenditures for stock acquisition, including those related to rescission offers, must be fully allocated to the cost basis of the stock, and corporate income can be attributed to the controlling shareholder under certain circumstances.

Summary

In Jordan v. Commissioner, the Tax Court addressed issues related to the cost basis of stock acquired through a rescission offer and the attribution of corporate income to a controlling shareholder. The petitioners, who organized Republic Life Insurance Co. , sold stock options to Quad City Securities Corp. , which then sold the stock to the public. Facing potential SEC violations, the petitioners offered to repurchase the stock. The court held that all costs associated with this offer, including interest and expenses, must be included in the stock's cost basis. Additionally, the court ruled that the income and expenses of a corporation controlled by the petitioner should be attributed to him under Section 482, as he performed all services. Lastly, the court found no reasonable cause for the corporation's late filing of its tax return.

Facts

Petitioners Glen A. Jordan and others organized Republic Life Insurance Co. and received stock options. They sold these options to Quad City Securities Corp. , which exercised them and sold the stock to the public. The stock issued under these options was unrestricted, unlike the original shares sold to the public. After being advised of potential SEC violations, the petitioners offered to repurchase the stock at the original purchase price plus interest, incurring significant costs. Jordan also organized Insurance Sales & Management Co. , which received commissions from Republic for services performed by Jordan. The corporation did not file its tax return on time.

Procedural History

The Commissioner of Internal Revenue determined tax deficiencies for the years 1962 through 1966 against the Jordans and Insurance Sales & Management Co. The case was heard by the U. S. Tax Court, which issued its decision on September 12, 1973.

Issue(s)

1. Whether expenditures made in connection with the acquisition of stock under an offer of rescission are allocable to the cost basis of the stock.
2. Whether the income and deductions of Insurance Sales & Management Co. should be attributed to Glen A. Jordan under Section 61 or 482.
3. Whether the failure of Insurance Sales & Management Co. to file a timely tax return was due to reasonable cause.

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Holding

1. Yes, because the entire amount expended, including interest and expenses, is allocable to the purchase of the stock and must be included in its cost basis.
2. Yes, because under Section 482, the income and deductions of the corporation are attributable to Jordan, as he performed all services and the corporation was merely a conduit for his income.
3. No, because there was no evidence showing reasonable cause for the late filing.

Court's Reasoning

The court reasoned that the expenditures for the stock acquisition were not divisible between the stock purchase and other purposes like protecting business reputation, as the stock acquisition was the essence of the rescission offer. The court rejected the petitioners' claim that the stock's fair market value was lower than the purchase price, finding insufficient evidence to support this contention. For the attribution of corporate income, the court applied Section 482, noting that Jordan performed all services and the corporation had no employees of its own, making it a mere conduit for Jordan's income. The court also found no reasonable cause for the late filing of the corporate tax return, as the petitioners failed to provide any evidence to justify the delay.

Practical Implications

This decision clarifies that all costs associated with acquiring stock, even those related to rescission offers, must be included in the stock's cost basis, affecting how taxpayers report such transactions. It also underscores the IRS's authority under Section 482 to attribute corporate income to controlling shareholders when the corporation is used as a conduit for personal income. Practitioners should be cautious in structuring corporate arrangements to ensure they reflect the true economic substance of transactions. The ruling on late filing emphasizes the importance of timely tax return submissions and the burden on taxpayers to prove reasonable cause for delays. Subsequent cases have cited Jordan in discussions about cost basis allocation and Section 482 applications.

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