

Worthy v. Commissioner, 66 T. C. 75 (1976)

Payments received from stock redemption can be treated as compensation if they are intended to provide an economic benefit for services rendered.

Summary

In *Worthy v. Commissioner*, Ford S. Worthy, Jr. , received payments from the redemption of stock he obtained without cash consideration. The court had to determine if these payments were capital gains or compensation. The Tax Court ruled that the payments were compensation, as the stock was transferred to Worthy to incentivize his services in the development of a shopping center. The court also disallowed Worthy's deduction of country club dues, as he failed to prove that the club was used primarily for business purposes. This case underscores the importance of examining the intent behind stock transfers and the need for clear evidence when claiming business expense deductions.

Facts

Ford S. Worthy, Jr. , worked for Cameron Village, Inc. , and assisted J. W. York in developing the Northgate Shopping Center. In 1962, York transferred 30 shares of Northgate stock to Worthy without cash consideration, as an incentive for his services. The stock was subject to repurchase options based on Worthy's continued association with York. In 1965, Northgate exercised its option to redeem the stock, and Worthy received payments totaling \$50,000 over 10 years. Worthy treated these payments as capital gains on his tax returns. Additionally, Worthy claimed deductions for country club dues, asserting they were primarily for business purposes.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies in Worthy's income taxes for 1967, 1968, and 1969, treating the stock redemption payments as ordinary income and disallowing some country club dues deductions. Worthy petitioned the Tax Court to challenge these determinations.

Issue(s)

1. Whether payments received by Worthy from the redemption of Northgate stock constituted additional compensation or capital gains.
2. Whether Worthy's use of the Carolina Country Club was primarily for business purposes, thus entitling him to deduct the dues.

Holding

1. Yes, because the stock transfer to Worthy was intended to provide an economic benefit for his services in the development of Northgate, making the redemption

payments additional compensation.

2. No, because Worthy failed to establish that the club was used primarily for business purposes.

Court's Reasoning

The court applied the principle from *Commissioner v. Smith* that any economic benefit conferred on an employee as compensation is taxable. It found that the transfer of stock to Worthy without cash consideration was to incentivize his services, aligning with the principle in *Commissioner v. LoBue* that assets transferred to secure better services are compensation. The court noted that the stock's value was highly speculative at the time of transfer, and its redemption was tied to Worthy's continued service, reinforcing the compensatory intent. For the country club dues, the court relied on section 274(a)(1)(B) of the Internal Revenue Code, requiring objective proof that the facility was used primarily for business. Worthy's evidence showed less than 10% of his club usage was for business, and business-related expenditures were minimal, thus failing to meet the required standard.

Practical Implications

This decision impacts how stock transfers and redemption payments should be analyzed for tax purposes. Businesses must carefully document the intent behind stock transfers to employees to avoid unexpected tax liabilities. The ruling underscores that stock transfers intended as compensation will be treated as such, regardless of how the corporation accounts for them. For deductions related to club memberships, taxpayers must maintain clear records and demonstrate significant business use to substantiate claims under section 274. This case has influenced subsequent tax rulings, emphasizing the need for clear evidence of business purpose in both stock transactions and expense deductions.