

Sakol v. Commissioner, 67 T. C. 986 (1977); 1977 U. S. Tax Ct. LEXIS 134

Section 83(a) of the Internal Revenue Code, which measures income from restricted stock plans without regard to contractual restrictions, is constitutional under the Fifth and Sixteenth Amendments.

Summary

In *Sakol v. Commissioner*, the U. S. Tax Court upheld the constitutionality of Section 83(a) of the Internal Revenue Code, which requires employees to include in their gross income the difference between the market value of restricted stock and the amount paid for it, disregarding any contractual restrictions that will lapse. Miriam Sakol challenged the tax treatment of her stock purchase from Chesebrough-Pond's, Inc. , arguing that Section 83(a) violated her due process rights and exceeded Congress's taxing power. The court, however, found that the provision was a valid exercise of Congress's authority to prevent tax avoidance and did not infringe on Sakol's constitutional rights.

Facts

Miriam Sakol, an employee of Chesebrough-Pond's, Inc. , participated in a stock purchase plan, acquiring 140 shares at a discounted price of \$21. 20 per share. The shares were subject to a one-year forfeiture risk and a five-year restriction on transferability. On May 7, 1972, the shares became non-forfeitable, and their market value was \$66. 50 per share. The IRS determined that the difference between the market value and Sakol's purchase price, \$6,342, was taxable income under Section 83(a). Sakol contested this, arguing that the section's disregard of the transferability restriction was unconstitutional.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Sakol's 1972 federal income tax, which led to Sakol's petition to the U. S. Tax Court. The court, after considering the arguments and stipulated facts, upheld the constitutionality of Section 83(a) and ruled in favor of the Commissioner.

Issue(s)

1. Whether Section 83(a) of the Internal Revenue Code violates the Fifth Amendment by imposing a conclusive presumption of income without allowing taxpayers to rebut the presumption.
2. Whether Section 83(a) exceeds Congress's taxing power under the Sixteenth Amendment by taxing income not yet realized.

Holding

1. No, because the court found that Section 83(a) was a rational response to tax

avoidance and did not infringe on due process rights.

2. No, because the court determined that Section 83(a) was within Congress's broad authority to define income and did not impose a direct tax requiring apportionment.

Court's Reasoning

The court's decision was based on the following reasoning:

- Congress has broad authority to define income for tax purposes, and Section 83(a) was designed to prevent tax avoidance through restricted stock plans.
- The court rejected Sakol's reliance on earlier cases defining income narrowly, noting that subsequent cases had expanded the definition of income to include non-receipt and anticipatory assignments of income.
- The court applied a rational basis test, finding that Section 83(a) was rationally related to the legitimate goal of preventing tax avoidance and that any imprecision in the statute was justified by the ease and certainty of its operation.
- The court distinguished cases like *Heiner v. Donnan*, where a conclusive presumption was struck down, noting that Section 83(a) did not impose a tax on property never owned by the taxpayer but rather on the value of property received in connection with services performed.
- The court also noted that the tax consequences were clearly delineated in the stock purchase plan, and Sakol was presumably aware of the measure of her compensation.

Practical Implications

The Sakol decision has several practical implications for tax practitioners and taxpayers:

- It affirms the constitutionality of Section 83(a), providing certainty for employers and employees participating in restricted stock plans.
- It reinforces the principle that Congress has broad authority to define income and prevent tax avoidance, even if that means disregarding certain contractual restrictions.
- Taxpayers participating in restricted stock plans must be aware that they will be taxed on the value of the stock at the time it becomes transferable or non-forfeitable, regardless of any restrictions that will lapse.
- The decision may encourage employers to structure compensation arrangements in ways that do not rely on temporary restrictions to defer tax liability.
- Later cases, such as *Robinson v. Commissioner* (80 T. C. 902 (1983)), have applied Sakol in upholding the application of Section 83(a) to other types of restricted property transfers.