Mogab v. Commissioner, 70 T. C. 208 (1978)

For stock to qualify as section 1244 stock, the corporation must adopt a plan that specifies, in terms of dollars, the maximum amount to be received for stock issued under the plan.

Summary

In Mogab v. Commissioner, the court ruled that the petitioner's stock in London Beef House, Ltd. , did not qualify as section 1244 stock because the corporation's plan did not specify the maximum dollar amount to be received for the stock issued. Charles Mogab had purchased stock in London Beef House, Ltd. , hoping to claim an ordinary loss when the stock became worthless. However, the court held that strict compliance with section 1244's requirements, including a written plan with a stated dollar limit, was necessary. The court rejected Mogab's arguments that the plan's intent was clear and that subsequent solicitation letters could constitute the plan, emphasizing the need for a formally adopted, unambiguous plan.

Facts

Charles Mogab purchased 6,000 shares of London Beef House, Ltd. , stock for $2 per share in 1969. London's articles of incorporation included a plan to offer stock within two years of incorporation, aiming to qualify it as section 1244 stock. However, this plan did not specify a maximum dollar amount to be received for the stock. Subsequent letters from a shareholder, Harry L. Hilleary, mentioned offering 125,000 shares at $2 per share, but these were not formally adopted by the corporation. In 1972, Mogab's stock became worthless, and he claimed an ordinary loss under section 1244, which the IRS disallowed.

Procedural History

The IRS determined a $6,000 deficiency in Mogab's 1972 income taxes, disallowing the ordinary loss claimed on the worthless London stock. Mogab petitioned the U. S. Tax Court, which upheld the IRS's position and ruled in favor of the Commissioner.

Issue(s)

1. Whether the plan adopted by London Beef House, Ltd. , satisfied the requirements of section 1244(c)(1)(A) by specifically stating, in terms of dollars, the maximum amount to be received for the stock issued under the plan.

Holding

1. No, because the plan did not comply with the requirement to state the maximum dollar amount to be received, as mandated by section 1. 1244(c)-1(c) of the Income Tax Regulations.

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Court’s Reasoning

The court emphasized the necessity of strict compliance with section 1244’s requirements, particularly the need for a written plan specifying a maximum dollar amount, as supported by the legislative history and previous case law. The court rejected Mogab’s argument that the intent to qualify as section 1244 stock was sufficient without the formal dollar limit. The court also found that the subsequent solicitation letters did not constitute an adequate plan because they were not formally adopted by the corporation and were ambiguous about the total number of shares and price. The court cited cases such as Spillers v. Commissioner and Godart v. Commissioner to reinforce the importance of a clear, written plan.

Practical Implications

This decision underscores the importance of strict adherence to section 1244’s requirements for corporations seeking to issue qualifying stock. Legal practitioners advising clients on stock offerings must ensure that any section 1244 plan is formally adopted by the corporation and explicitly states the maximum dollar amount to be received. The ruling impacts how corporations draft their plans and how investors claim losses on worthless stock. Subsequent cases like Casco Bank & Trust Co. v. United States have continued to apply this principle, emphasizing the need for clear documentation in section 1244 plans.

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