Robinson v. Commissioner, 82 T. C. 444 (1984)

A nonqualified stock option is taxable upon exercise when granted after the effective date of Section 83 of the Internal Revenue Code.

Summary

Prentice I. Robinson received a nonqualified stock option from Centronics Data Computer Corp. The key issue was whether the option was taxable upon exercise in 1974 or upon grant. The court found that the option was granted on May 1, 1969, after the effective date of Section 83, and thus taxable upon exercise in 1974. This decision hinged on the interpretation of when an option is "granted" under Delaware law, which required a formal written agreement. The court also determined that the stock was transferable and not subject to a substantial risk of forfeiture at the time of exercise, further supporting taxation in 1974.

Facts

Robinson, an employee of Wang Laboratories, Inc. , began discussions in January 1969 with Centronics to leave Wang and join Centronics. The informal agreement included Robinson receiving an annual salary and stock from Centronics' shareholders. The board of directors of Centronics passed a resolution on April 10, 1969, authorizing the grant of an option to Robinson, effective upon his entering into written agreements. These agreements were executed between April 17 and April 30, 1969, but were intended to be effective as of May 1, 1969. Robinson fully exercised the option on March 4, 1974.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Robinson's 1974 income tax based on his failure to report income from exercising the stock option. The case was brought before the United States Tax Court, which consolidated the issue of the timing of the tax liability with a related issue concerning Centronics' entitlement to a deduction for the same option.

Issue(s)

1. Whether the nonqualified stock option granted to Robinson was taxable upon exercise in 1974 or upon grant in 1969.
2. Whether the stock acquired by exercising the option was transferable or subject to a substantial risk of forfeiture at the time of exercise.

Holding

1. Yes, because the option was granted on May 1, 1969, after the effective date of Section 83, making it taxable upon exercise in 1974.
2. Yes, because the stock was both transferable and not subject to a substantial risk

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of forfeiture at the time of exercise on March 4, 1974.

Court’s Reasoning

The court interpreted the term “grant” under Section 83 and Delaware law, concluding that a valid stock option requires a formal written agreement. The court found that the option was granted on May 1, 1969, when Robinson acquired a vested right to purchase stock under a formal agreement. The court also determined that the stock was transferable and not subject to a substantial risk of forfeiture at the time of exercise. The court rejected Robinson’s arguments that certain restrictions (Sections 2 and 3 of the Option Agreement and Section 16(b) of the Securities Exchange Act) rendered the stock nontransferable or subject to a substantial risk of forfeiture. The court relied on the ordinary meaning of “grant” and the specific requirements under Delaware law for a valid stock option, as well as the regulations under Section 83 regarding transferability and substantial risk of forfeiture.

Practical Implications

This decision clarifies that nonqualified stock options granted after April 22, 1969, are taxable upon exercise under Section 83. Practitioners should ensure that formal written agreements are in place to establish the grant date of stock options. The decision also underscores that transfer restrictions, even if not tax motivated, are generally disregarded for tax purposes under Section 83. This case has been cited in subsequent cases addressing the taxation of stock options and the application of Section 83, influencing how similar cases are analyzed. Businesses granting stock options should be aware of the tax implications at the time of exercise and consider the potential impact on their financial statements and tax planning.

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