



# TaxNewsFlash

## United States

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### **Fourth Circuit: No deduction, upon corporate merger for stock previously issued to executive when not subject to substantial risk of forfeiture at grant**

The U.S. Court of Appeals for the Fourth Circuit affirmed a decision of the U.S. Tax Court, holding that a corporate taxpayer was not entitled to a deduction in 2008 under Code section 83 for stock issued to an executive employee because the stock was not subject to a “substantial risk of forfeiture” upon grant in 2002.

The Fourth Circuit found that there could be no deduction upon a corporate merger for stock previously issued to the executive when it was not subject to a substantial risk of forfeiture at grant.

The case is: *QinetiQ US Holdings, Inc. v. Commissioner*, No. 15-2192 (4<sup>th</sup> Cir. January 6, 2017). Read the Fourth Circuit’s [decision](#) [PDF 44 KB]

### **Summary**

At issue was whether the corporate taxpayer was entitled to a deduction (for salary and wage compensation) with respect to corporate stock that an executive acquired in 2002. The taxpayer asserted that the stock qualified as a trade or business expense in 2008 because the stock was transferred in connection with the executive’s employment and was subject to a substantial risk of forfeiture until the executive sold the shares in 2008 as part of a corporate merger.

The stock transferred to the executive, who was one of two shareholders, was pursuant to a shareholders agreement that recited certain conditions that would require the executive to return the stock—death, disability, or termination without cause. The agreement provided that the stock would be repurchased at a value corresponding to 100% of what was essentially the stock’s fair market value.

The agreement further provided that the only circumstances in which the executive would be required to forfeit his stock at a below-market price would be if he voluntarily resigned before 20 years of employment; if he voluntarily resigned and entered into competition with the taxpayer; or if he were terminated for cause.

The Fourth Circuit agreed with the Tax Court's findings, and concluded that the applicable regulations (Reg. section 1.83-3(c)(2)) provide that forfeiture provisions triggered by termination for cause or by engaging in competition do not constitute a substantial risk of forfeiture based on the facts and circumstances of this case—the employee had a significant ownership interest and close relationship with the other shareholder. The appellate court agreed with the Tax Court that the likelihood of forfeiture due to the executive's voluntary resignation did not amount to a substantial risk.

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