

Kilker Case Shows Stock for Services Can Kill

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Here at the M&A TAX REPORT, we tend to repeat ourselves. And one topic that seems a perennial is what to do (or more often what *not* to do) when it comes to receiving stock for services. There are the old saws, of course.

Don't fail to consider the particular kind of options in question, since the tax rules can vary materially. Are they nonqualified options or incentive stock options (ISOs)? If you

receive restricted stock, don't fail to consider the availability and advisability of making an Internal Revenue Code Section ("Code Sec.") 83(b) election.

There are specific timing constraints to Code Sec. 83(b), including the rule that the election must be made within 30 days of receiving the restricted property. Too many people fail to do so, and only wake up to consider the topic

during the next tax year. Since that simple one-page election can spell the difference between ordinary income and capital gain, it matters.

Nevertheless, sometimes it is the most basic of rules that can trip you up. That is one lesson of *Kilker*, TC Memo. 2011-250. This was not your average high-tech company. It was, rather, a simple printing business in a kind of pay-for-services situation. And one of the key issues was who was entitled to the stock in question.

Killer Facts

Denise Kilker was the owner and primary officer of Kilker Enterprises, a printing shop that did business as Allegra Print and Imaging. In 2003, in exchange for providing Zap Corp. with printing services, she received 73,529 shares of Zap stock. In effect, she got Zapped (sorry).

The Zap shares were restricted, so Denise could not sell or transfer them for at least one year. In 2004, at the end of her one-year holding period, she transferred the stock to her personal brokerage account. Thereafter, she sold 30,000 shares for a total of \$90,290.

On September 20, 2004, Kilker entered into an agreement with Zap to provide it with printing services for 12 months. In exchange, Zap agreed to pay with \$100,000 worth of Zap common stock. Denise directed Zap to issue her three stock certificates, each for 17,921 shares.

Name Game

Moreover, she requested that the stock certificates be issued in the names of Denise Kilker, Custodian for M.K.; Denise Kilker, Custodian for R.G.; and James Kilker.

Denise received the stock in 2004. Zap duly issued Kilker a Form 1099-MISC reporting that it had paid her \$100,000 in nonemployee compensation. Kilker didn't report the stock as income for 2004.

The IRS argued that Kilker received \$90,290 of long-term capital gain from the sale of 30,000 shares of Zap stock in 2004. In addition, the IRS maintained that she received \$100,000 of Zap stock in exchange for providing Zap with 12 months of printing services. Kilker agreed that she received the \$90,290.

However, with regard to the \$100,000, she claimed it was Allegra's income, not hers. She

acknowledged that she was Allegra's owner and sole officer at the time she signed the agreement to perform printing services. But she claimed that she was acting on its behalf.

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Furthermore, she claimed that she used the proceeds of the stock sale to pay the company's expenses. Indeed, she used the money in the business. In effect, she claimed the \$100,000 of Zap stock was compensation to Allegra.

Dead Letter

I think you know how this came out. Under the circumstances, the Tax Court had no choice but to conclude that the IRS's determination was correct. After all, Kilker had failed to present any evidence refuting the fact that she *personally* had received the stock. She also could not produce any evidence about any basis in the shares.

The Tax Court even sustained the IRS's determination with respect to the \$100,000 of compensation for services income. Kilker failed to produce any evidence to support her arguments, did not provide corporate tax returns reporting the stock as income, *etc.* She didn't even attempt to have Zap reissue the stock certificates in Allegra's name. Indeed, she didn't even provide support for her contention that she used proceeds from the stock sale to pay Allegra's expenses.



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Stock for services can be great. Restricted stock can be even better, especially combined with a Code Sec. 83(b) election. But don't fail to consider who is the recipient!