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Contribution of Nonbusiness Assets to a Corporation

I. INTRODUCTION

A nonbusiness asset¹ is often contributed to a corporation without considering the tax consequences which will arise from shareholder or employee use of the asset,² expenses incurred in connection with maintaining the asset,³ or gains or losses resulting

1. A nonbusiness asset is one held for personal use rather than one used in a trade or business or held for profit. Treas. Reg. § 1.165-1(e) (1960), *amended*, T.D. 6735, 1964-1 C.B. 100; T.D. 7522, 1978-1 C.B. 59. Neither the regulations nor case law provide an all-inclusive definition of the term "trade or business." Although found in several provisions of the Internal Revenue Code its meaning must be derived from an analysis of the facts with respect to the taxpayer's particular enterprise. The term may have different connotations with respect to the deductibility of business expenses, losses or nonbusiness debts. Although the corporation must conduct the business in good faith with an intention of making a profit, the profit factor is only significant for the purpose of distinguishing businesses carried on in good faith from those conducted as hobbies. A business, under any definition, means an activity engaged in for profit. A corporation is normally deemed to be engaged in a "trade or business"; however, it is not engaged in a trade or business if it is operated solely for the pleasure and recreation of its stockholders. 4A J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 25.08, at 31-37 (rev. ed. 1972). See *American Properties, Inc.*, 28 T.C. 1100 (1957), *aff'd*, 262 F.2d 150 (9th Cir. 1958).
2. Shareholder use of the assets may be characterized as compensation income or a constructive dividend. *Walker v. Commissioner*, 362 F.2d 140 (7th Cir. 1966), *aff'g* 34 T.C.M. (P-H) 154 (1965) (use of corporate lodge constructive dividend to shareholder to extent corporate expenditures exceeded rental amounts paid by shareholder); *Nicholls, North, Buse Co.*, 56 T.C. 1225 (1971) (shareholder received constructive dividend equalling its fair rental value from his own use and his son's use of a corporate boat). Employee use of the corporation's assets may be additional compensation. Treas. Reg. § 1.61-2(d)(1) (1957), *amended*, T.D. 6696, 1963-2 C.B. 23; T.D. 7554, 1978-36 I.R.B. 5. In public corporations, employee, and perhaps shareholder, use will in all likelihood be characterized as additional compensation since ownership and control are divorced. In contrast, because of the informal corporation-shareholder relationship in a closely held corporation, as well as the merger of ownership and control, shareholder use will constitute a constructive dividend. See notes 140-69 & accompanying text *infra*.
3. *International Trading Co.*, 27 T.C.M. (P-H) 447 (1958), *aff'd*, 275 F.2d 578 (7th Cir. 1960) (corporation denied depreciation and expenses of maintenance on

from disposition of the asset.⁴ Also involved are possible violations of corporate law,⁵ management problems,⁶ and tax problems in transferring the asset from the corporation to its shareholders. Most often the shareholder contributes the asset with the intent of obtaining ownership benefits similar to those possessed by one holding the property individually. Moreover, the shareholder commonly expects the corporation to deduct depreciation and other expenses related to the property even though the shareholder would not be entitled to the deductions if the property were owned individually.

This comment will discuss the advantages of incorporating non-business assets, identify the risks involved in transferring them to the corporation, and examine possible methods practitioners can use to minimize the risks.⁷

A. Reasons for Incorporating Nonbusiness Assets

1. Tax Advantages

One reason for contributing nonbusiness assets to a corporation is to obtain deductions for expenses incurred in maintaining the asset—deductions which would not be allowed if the asset was owned by an individual.⁸ An individual cannot deduct expenses incurred in maintaining a nonbusiness asset, since those expenses

summer residence held primarily for the personal benefit of the shareholders). See notes 23-40 & accompanying text *infra*.

4. Corporations are not entitled to the one time exclusion of gain from the sale of a taxpayer's principal residence. I.R.C. § 121(a). Thus, for example, incorporation of the family farm house will prevent later exclusion of gain from the sale or exchange of the house. See notes 170-72 & accompanying text *infra*. *W.L. Schautz Co. v. United States*, 567 F.2d 373 (Ct. Cl. 1977) (loss deduction denied corporation on sale of winter vacation home used solely by shareholders and not in the corporation's trade or business; disallowance provisions of section 274 affect losses as well as expenses). See notes 64-139 & accompanying text *infra*.
5. Generally, in the absence of a provision creating preferences in the articles of incorporation, by-laws or statutes, dividends among shareholders of the same class must be pro rata, equal and without discrimination or preference. 11 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 5352 (1971). See notes 173-74 & accompanying text *infra*.
6. See § II-B-2 of text *infra*.
7. A direct purchase of the nonbusiness asset by the corporation for the shareholder's benefit may have the same advantages and pitfalls as a shareholder contribution of the asset. No attempt will be made in this comment to make any comparisons between shareholder contributions or corporate purchases of the nonbusiness asset.
8. It is important to note that incorporating the asset is not necessary to obtain the benefits of sections 162(a) and 167(a). It need only be shown that the asset was used in the taxpayer's trade or business or used in an activity entered into for profit. Assume for purposes of this discussion that the taxpayer

represent personal, living or family expense.⁹ However, if the asset is incorporated, a corporation can attempt to deduct the expenses of maintaining the asset as incurred in its trade or business. Since a corporation is a business entity, it is presumed that all corporate transactions arise in its trade or business.¹⁰

This distinction in tax treatment between deductions by an individual shareholder and by a corporation concerning the use of the same asset has been referred to as the "shareholder/corporation" dichotomy.¹¹ This dichotomy arises when the corporation is allowed to deduct expenses, depreciation or losses incurred in providing property for the personal benefit of its shareholders, but individuals under similar circumstances would not have been entitled to the deductions.¹² By deducting expenses incurred in connection with providing personal, recreational or family benefits to shareholders, close corporations, in effect, assume expenses which the shareholder would otherwise bear, thereby reducing taxes on other profitable activities.¹³ Payment of expenses for personal requirements is one way for the corporation to disguise a dividend to its shareholders.¹⁴ This avoids the double taxation normally associated with corporate dividends. Thus, by contributing nonbusiness assets to the corporation, shareholders are able to use the corporation as a vehicle for obtaining tax advantages from nonbusiness property that they would not have received as individuals under similar circumstances.

An additional income tax advantage is that a regular corpora-

was not able to establish use under either alternative as a sole proprietorship.

9. "Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses." I.R.C. § 262.
10. B. BITTKER & J. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ¶ 5.03, at 5-6 (3d ed. 1971).
11. Comment, *Corporate Loss Deductions for Nonbusiness Assets: A Proposal*, 21 U.C.L.A. L. REV. 1611, 1612 (1974).
12. Generally, individuals cannot deduct expenses, depreciation or losses incurred in connection with nonbusiness assets. See notes 23-40 & accompanying text *infra* (discussion of limitations on the deduction of expenses and depreciation); notes 64-139 & accompanying text *infra* (discussion of limitations on the deduction of losses).
13. Comment, *supra* note 11, at 1611-12; Note, *Constructive Dividends: An Alternative to Profit Motive as a Test for the Disallowance of Corporate Business Deductions*, 40 GEO. WASH. L. REV. 749 (1972). The potential abuse in using corporations to maintain assets for the shareholders' personal pleasure is unlikely to occur except in closely held corporations. This assumption is based on the fact that the chances for abuse are greater in a close corporation because of the informal corporation/shareholder relationship and the merger of control and ownership.
14. See Nicholls, North, Buse Co., 56 T.C. 1225, 1238-42 (1971); Note, *supra* note 13, at 749.

tion may be able to deduct all losses resulting from transactions involving nonbusiness assets, whether or not the assets are used in its trade or business or used in an activity engaged in for profit.¹⁵ An individual or small business corporation¹⁶ would not be entitled to deduct a loss resulting from transactions entered into primarily as a hobby, for entertainment, amusement, or recreation, or for personal purposes unless the loss results from a casualty or theft.¹⁷ Aside from the income tax benefit the corporation obtains

15. I.R.C. § 165(a). Section 165(a) provides in pertinent part: "There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise." Corporate loss deductions are not subject to any "trade or business" limitation, and it appears that corporate losses with respect to nonbusiness assets are deductible except to the extent that the entertainment deduction rules apply. I.R.C. § 274. Section 274 provides in pertinent part:

(a) Entertainment, amusement or recreation—

(1) In general.—No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) Activity.—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business, or

(B) Facility.—With respect to a facility used in conjunction with an activity referred to in subparagraph (A).

In the case of an item described in subparagraph (A), the deduction shall in no event exceed the portion of such items which meets the requirements of subparagraph (A).

For a further discussion of section 274, see notes 41-63 & accompanying text *infra*.

The "hobby loss" rules of section 183 do not apply to regular corporations:

(a) General Rule.—In the case of an activity engaged in by an individual or an electing small business corporation (as defined in section 1371(b)), if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

16. I.R.C. § 1371(b).

17. (c) Limitation on losses of individuals.—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business:

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. A loss described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds \$100. For purposes of the \$100 limitation of the preceding sentence, a husband and wife making a joint return under section 6013 for the taxable year in which the loss is allowed as a deduction shall be treated as one individual. No loss described in this paragraph shall be al-

from the loss deduction, the shareholder benefits from the reduced taxes paid by the corporation and from the fact that the value of the company's stock decreases with the decline in value of corporate assets.¹⁸ The shareholder can recognize the loss directly by selling his or her stock.¹⁹ In effect this creates a double tax benefit, one at the corporate level and the other at the shareholder level. This double tax benefit has been termed the "shareholder/nonshareholder" dichotomy because the shareholder's potential benefit exists whether or not the corporate loss is allowed.²⁰

An estate tax advantage also results from incorporating non-business assets which will appreciate in value more than the value of the stock, the value of which for estate tax purposes may be set by a buy-sell agreement.²¹ This is especially applicable to closely held corporations.

2. Other Advantages

There are a number of non-tax reasons for transferring personal assets to a corporation. One reason might be to hide assets from a spouse. This may be accomplished if one spouse is not involved in the other's business affairs and, in any event, probably views extravagant expenses for the business more favorably than extravagant personal expenditures.²² A similar reason may be to

lowed if, at the time of filing the return, such loss has been claimed for estate tax purposes in the estate tax return.

I.R.C. § 165(c).

18. This assumes that changes in the value of stock reflect changes in the value of corporate net worth. Other factors may affect the value of the stock.
19. If the shareholder and corporation elect to be taxed under Subchapter S of the Internal Revenue Code an individual shareholder will recognize the tax benefit of the loss without selling any stock. I.R.C. § 1374.
20. Comment, *supra* note 11, at 1613.
21. Treas. Reg. § 20.2031-2(h) (1958).

For example, assume Bill owns two assets, a yacht, *i.e.*, a nonbusiness asset, and 50% of the stock in ABC, Inc. Each asset cost Bill \$1000. Assume further that Bill incorporates the yacht into ABC corporation. Later X enters into a bona fide arrangement, buy/sell agreement, whereby Bill and Mary, Bill's spouse, contract to buy the others' stock for \$2,500. Later, at the time of Bill's death the fair market value of Bill's stock was \$2,500, while the value of the yacht had appreciated to \$6,000. Under this assumption Bill would only be required to include \$2,500, the value of the stock, in his gross estate. If Bill had not incorporated the yacht, his gross estate would have included its value, \$6,000, plus the value of his stock. By incorporating the asset Bill can exclude from his gross estate \$4,500, which represents the difference in appreciation between the value of the yacht, \$5,000 and the value of the stock, \$500, assuming all the appreciation in the value of the stock is attributed to the yacht.

22. Incorporation of the nonbusiness asset may affect the value of the stock. Generally, the value of the nonbusiness asset is the same whether in the hands of the corporation or individual, but the value of the corporate stock to

avoid the appearance of being a spendthrift. An individual may feel that the appearance of being frugal may be beneficial to the person in business and social affairs. Incorporation of a nonbusiness asset, such as a yacht, is one way to disassociate ownership of an asset from the individual while still enabling the individual to obtain use of the asset.

Incorporation of nonbusiness assets may also enhance the balance sheet position of the corporation for loan purposes and may possibly avoid the shareholder incurring liability as a guarantor. Another advantage of transferring certain types of nonbusiness assets to the corporation, such as a yacht or hunting lodge, is that it relieves the shareholder of tedious management and caretaking problems assuming the corporation is large enough that those responsibilities will be transferred to someone other than the shareholder.

II. RISKS OF INCORPORATING NONBUSINESS ASSETS

A. Corporate Risks

1. *Denial of Depreciation and Other Expenditures*

Of the otherwise available code provisions pertaining to corporate business and nonbusiness deductions, sections 162(a)²³ and 167(a)²⁴ are the business expense provisions most often used by close corporations to deduct the expenses of maintaining nonbusiness assets for the personal benefit of their shareholders. By sub-

the individual may change as a result of the incorporation. Where the value of the corporate stock is based on a capitalization of earnings (earnings x capitalization rate), the deductions incurred with respect to the nonbusiness asset reduce the corporate earnings. The direct result of this is a deduction in corporate net worth, barring other factors occurring in the market. In the event of divorce, the shareholder benefits in the property settlement because the nonbusiness asset is hidden in the corporation and the reduction of the corporate net worth has lowered the value of the shareholder's stock.

In some situations, individuals who want to socially benefit their friends by offering them the free use of their nonbusiness assets, such as a yacht or hunting lodge, are turned down because their friends view this as charity when it comes from the individual personally. But, if the hunting lodge or yacht were incorporated, the friends would find it easier to accept the invitation when they know that it comes from the corporate pocketbook. The underlying rationale is that laymen presume the corporation will take it as a deduction, whereas the individual cannot.

23. I.R.C. § 162(a) provides: "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business"
24. I.R.C. § 167(a) provides in pertinent part: "There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(1) of property used in the trade or business, or (2) of property held for the production of income."

sidizing personal living expenses, the corporation distributes tax-free dividends to its shareholders while using the expenses to reduce its tax liability on other profitable activities.²⁵

Monetarily, business expenses and losses constitute the bulk of all allowed deductions.²⁶ Section 162(a) permits a deduction for all "ordinary and necessary" expenses paid or incurred during the taxable year.²⁷ Section 167(a) provides as a deduction a reasonable allowance for exhaustion, wear and tear of property.²⁸ To be deductible by the corporation, depreciation, maintenance and other expense deductions made in connection with nonbusiness assets must meet a "trade or business" test.²⁹ The expenditure must be directly connected with a trade or business carried on by the corporation. Generally, laymen presume that all corporate expenditures are deductible because they are incurred in a trade or business, but there is no basis for this presumption in the Code or the Regulations.³⁰

Neither the Code nor the Regulations provide a definition of what constitutes a "trade or business"; however, the Internal Revenue Service has defined a "trade or business" as: "(1) A pursuit carried on for livelihood or profit. (2) A pursuit in which a profit motive is present and where there is some type of economic activity involved. (3) An enterprise that has some type of regular activity and transactions and the production of income."³¹ If property is held primarily for the personal benefit of the shareholders, the corporation will be denied depreciation and maintenance expenses.³² By losing the deduction, the corporation will have incurred no real detriment because it would not have received the deduction in the first place if the asset had not been incorporated. Yet, by virtue of incurring the expenses, the corporation's cash flow will have been reduced without a corresponding tax benefit, and in the process there may have been a constructive dividend to the shareholder

25. Note, *supra* note 13, at 13.

26. 4A J. MERTENS, *supra* note 1, § 25.01.

27. See note 23 *supra*.

28. See note 24 *supra*.

29. *Id.*

30. See note 10 & accompanying text *supra*.

31. I.R.S., PUB. NO. 334, TAX GUIDE FOR SMALL BUSINESS 3 (1977 ed.).

32. See Richard R. Riss, Sr., 56 T.C. 388, 415 (1971), *modified*, 57 T.C. 469 (1971) (expenditures associated with maintenance of residential property held by corporation and occupied primarily by wife and daughter of principal stockholder are not deductible because the property was not held as part of its trade or business, nor for the production of income); Challenge Mfg. Co., 37 T.C. 650 (1962), *Progressive Eng'r, Inc.*, 44 T.C.M. (P-H) 404 (1975); Whipple Chrysler-Plymouth, 41 T.C.M. (P-H) 242 (1972); Forster Mfg. Co., 41 T.C.M. (P-H) 675 (1972); International Trading Co., 27 T.C.M. (P-H) 447 (1968), *aff'd*, 275 F.2d 578 (7th Cir. 1960).

using the asset. The fact that the character of the asset in the hands of the shareholder was nonbusiness does not mean this label carries over to the corporation. Its character in the hands of the corporation is determined by reference to the benefit conferred upon shareholders, officers or other controlling individuals. If the asset is characterized as nonbusiness, the asset's character is not changed, however, by the mere fact that it was held for sale or that a gain was made on its disposition.³³

The fact that an expense is incurred in part for business purposes and in part for personal purposes will not cause the total expenditure to be denied. For example, if the yacht is used for both business and personal pleasure, a proportionate part of the expenditures for operation and maintenance is deductible.³⁴

A key consideration in determining an asset's business or non-business character is the purpose or intention the taxpayer had in incorporating the property.³⁵ A nonbusiness asset can be converted into income producing property if in light of all the facts and circumstances the intent is to hold the property for the production of income.³⁶ If the intent is merely to seek recovery of all or part of the investment rather than to realize a profit representing postconversion appreciation, it will be difficult to find that the property was held for the production of income.³⁷

Deductions for depreciation, maintenance and other expenses will be allowed for property primarily associated with profit-motivated purposes, notwithstanding any personal use by shareholders or employees, if the use is "distinctly secondary and incidental."³⁸ The fact that the use may be extravagant does not prevent the deduction of a legitimate business expenditure.³⁹ Depreciation, maintenance and other expenses incurred in furnishing corporate

33. See *Carter-Colton Cigar Co.*, 9 T.C. 219, 221 (1947) (to be considered part of the corporation's trade or business, the property must have been purchased with a view to using it in the business activities of the corporation).

34. *International Artists, Ltd.*, 55 T.C. 94, 104 (1970); *Sigel G. Roush, D.D.C., Inc.*, 47 T.C.M. (P-H) 517, 520 (1978); *Frederick Von Hessert*, 30 T.C.M. (P-H) 1221, 1129 (1961).

35. *Alamo Broadcasting Co.*, 15 T.C. 534, 541 (1950) (property "used in a trade or business" means devoted to a trade or business and includes property initially purchased with a view to future business use, even though subsequent events thwart this use).

36. *Frank A. Newcombe*, 54 T.C. 1298, 1303 (1970).

37. *Id.* at 1301-02.

38. *International Artists, Ltd.*, 55 T.C. 94, 104 (1970). See *Robert J. Denison*, 46 T.C.M. (P-H) 1754, 1758 (1977) (corporation allowed business expense deduction for use of Cadillac in business, despite some personal use by shareholders and the claim that the use was extravagant).

39. See note 23 *supra*. See also *Robert T. Denison*, 46 T.C.M. (P-H) 1754 (1977); Rev. Rul. 63-144, 1963-2 C.B. 129, 137.

housing to shareholder employees may be deductible if the housing is an ordinary and necessary business expense.⁴⁰

2. *Special Rules of Section 274*

The general rule of deductibility of corporate expenses, depreciation and losses is subject to the provisions of section 274,⁴¹ which imposes limitations on those deductions when incurred in connection with entertainment facilities. An "entertainment facility" is one used in conjunction with an activity which is of a type generally considered to constitute entertainment, amusement or recreation.⁴² The term includes items of real or personal property, owned, rented or used by a taxpayer in conjunction with an entertainment activity.⁴³ Entertainment facilities are generally considered to include yachts, hunting lodges, fishing camps, swimming pools, tennis courts, bowling alleys, automobiles, airplanes, apartments, hotel suites, and homes in vacation resorts.⁴⁴

Prior to the Revenue Act of 1978,⁴⁵ an expenditure incurred in connection with an entertainment facility was deductible if it met the requirements of section 274.⁴⁶ Compliance with section 274

40. F.R. McDowell, 43 T.C.M. (P-H) 345 (1974) (corporation allowed to deduct depreciation, maintenance and other expenses incurred in furnishing to two shareholder-employees a ranch house; they were required to live on the ranch for the convenience of the employer since there was no other available housing, and any personal benefit they derived was incidental).

41. For text of section 274, see note 15 *supra*.

42. I.R.C. § 274.

43. Treas. Reg. § 1.274-2(e)(2)(i) (1963).

44. *Id.*

45. Pub. L. No. 95-600, 92 Stat. 2847.

46. Prior to amendment, I.R.C. § 274(a) provided in pertinent part:

(a) Entertainment, amusement, or recreation—

(1) In general—No deduction otherwise allowable under this chapter shall be allowed for any item—

(A) Activity.—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business, or

(B) Facility.—With respect to a facility used in connection with an activity referred to in subparagraph (A), unless the taxpayer establishes that the facility was used primarily for the furtherance of the taxpayer's trade or business and that the item was directly related to the active conduct of such trade or business.

and such deduction shall in no event exceed the portion of such item directly related to, or, in the case of an item described in subparagraph (A) directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or

was required whether or not the expenditure was "ordinary or necessary" in carrying on the corporation's business.⁴⁷ An expenditure with respect to an entertainment facility was deductible if the taxpayer established "(i) [t]hat the facility was used primarily for the furtherance of the taxpayer's trade or business, and (ii) [t]hat the expenditure was directly related to the active conduct of such trade or business."⁴⁸ For example, if the corporation could show that the facility was used more than fifty percent for business purposes which were ordinary and necessary within the meaning of sections 162 and 212, and that it was used forty percent for entertainment "directly related" to the active conduct of the corporation's business, then forty percent of the facility expenditures would be deductible. Under the "directly related" test the taxpayer must show that (1) he had more than an expectation of deriving income, or other specific benefit in the future; (2) he did engage in business during the entertainment period; and (3) the principal character or aspect of the combined business and entertainment was the transaction of business.⁴⁹

Under pre-1979 law, the characterization of the asset as an entertainment facility was important since it placed an additional burden on the corporation to substantiate expenses relating to the active conduct of its trade or business. The revisions made by the Revenue Act of 1978⁵⁰ make this determination even more important since expenses or losses incurred with regard to an entertainment facility are no longer deductible. For example, depreciation and other expenses incurred with respect to maintaining a hunting lodge incorporated primarily for the promotion of goodwill through the entertaining of customers at the lodge will be nondeductible notwithstanding the fact the facility was used primarily for the furtherance of the corporation's trade or business and that the depreciation and expenses were directly related to the active conduct of

otherwise), the portion of such item associated with, the active conduct of the taxpayer's trade or business.

47. John L. Asby, 50 T.C. 409 (1968).

48. Treas. Reg. § 1.274-2(a)(2) (1963).

49. Rev. Rul. 63-144, 1963-2 C.B. 129.

50. Pub. L. No. 95-600, § 361(a), 92 Stat. 2847 (effective for items paid or incurred after December 31, 1978, in taxable years ending after that date). Section 361(a) provides in part:

(a) Extension of rule disallowing deductions for facilities.—So much of paragraph (1) of section 274(a) (relating to disallowance of certain entertainment, etc., expenses) as follows subparagraph (A) is amended to read as follows:

"(B) Facility.—With respect to a facility used in connection with an actively referred to in subparagraph (A).

In the case of an item described in subparagraph (A), the deduction shall in no event exceed the portion of such item which meets the requirements of subparagraph (A)."

the trade or business.⁵¹

The reason for the change was to prevent potential abuses by taxpayers attempting to deduct, as business expenses, items essentially representing nondeductible personal expenses.⁵² One effect of section 274, as amended, is to shift the status of a facility from a business to a personal asset thus barring depreciation and the investment tax credit on such facilities.⁵³ However, the change in classification of a facility which may have been a business facility under pre-1979 law to a personal asset does not cause recapture of depreciation and investment credit.⁵⁴ Although the scope of section 274(a)(1)(B) is very broad, there are still exceptions to its application. Section 274(a)(1)(B), as amended, does not deny deductions for expenses involving the non-entertainment use of a facility.⁵⁵ For example, airplane or automobile expenses used on a business trip are still deductible.⁵⁶

Similarly, the legislation does not affect expenses which are deductible without regard to their connection with the taxpayer's trade or business, such as taxes, interest, and casualty losses.⁵⁷ Nor does it appear to disallow deductions for depreciation and expenses which do not exceed the gross income derived from the facility for the taxable year, reduced by the expenses otherwise allowable.⁵⁸

51. The deductions would have been allowed under section 274 (a)(1)(B) prior to amendment by the Revenue Act of 1978.

52. S. REP. NO. 1263, 95th Cong., 2d Sess. 172 (1978):

The committee believes that present law's treatment of expenses relating to entertainment facilities may encourage some taxpayers to attempt to deduct, as business expenses, items that essentially represent nondeductible personal expenses. Moreover, in some instances these expenses may be incurred largely as a method of providing additional compensation for highly paid employees and executives. The complexity of the provisions of present law makes its effective administration and uniform application extremely difficult and provides significant opportunities for abuse. Consequently, and notwithstanding the fact that the committee recognizes that some legitimate business expenses may be incurred with respect to entertainment facilities, the committee believes that such expenses should be disallowed as business deductions.

53. H. R. REP. NO. 1800, 95th Cong., 2d Sess. 249, 251, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 440.

54. S. REP. NO. 1263, 95th Cong., 2d Sess. 176, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 3.

55. Treas. Reg. § 1.274-2(f)(2)(v) (1963).

56. H.R. REP. NO. 1800, 95th Cong., 2d Sess. 249, 251, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 440.

57. *Id.*

58. This is similar to the treatment given individuals and subchapter S corporations whose activities are not engaged in for profit. Even though not an activity engaged in for profit, deductions will be allowed to the extent the corporation receives gross income from the activity. See I.R.C. § 183(b); notes

Section 274(a) does not disallow expenses incurred in providing entertainment facilities for recreational, social or similar activities which primarily benefit the corporation's employees.⁵⁹ These expenses are generally deductible if they meet the ordinary and necessary business expense test and the employees primarily benefitted are not officers, highly compensated employees, shareholders or others owning ten percent or more of the corporation's trade or business.⁶⁰ An employee is treated as owning any interest owned by his or her spouse, ancestors, lineal descendants, and brothers and sisters.⁶¹ If expenditures discriminate in favor of employees who are officers, shareholders, or highly compensated employees, they will not be considered made primarily for the benefit of employees generally.⁶² For example, discrimination occurs if non-owner use of a company-owned hunting lodge is one week compared to four weeks use by the sole shareholder. If the entertainment facility qualifies for the exception to disallowance in section 274(e)(5), the sole shareholder benefits from tax-free use of the asset and the goodwill of corporate employees even though use of the asset must be shared with the employees. Additionally, if expenses for entertainment facilities are treated as compensation by the employee who benefits from their use, the corporation's deductions are not disallowed by section 274.⁶³

Although Congress only curbed abuses with respect to entertainment facilities, it appears to have taken a step toward the complete denial of corporate expense deductions and losses with respect to nonbusiness assets. Incorporating entertainment facili-

127-43 & accompanying text *infra*. See generally *Walker v. Commissioner*, 362 F.2d 140 (7th Cir. 1966), *aff'd* 34 T.C.M. (P-H) 154 (1965) (allowing expenses and depreciation incurred in maintaining and furnishing summer home for sole shareholder to the extent the claimed deductions did not exceed amounts paid by the shareholder to the corporation); *International Trading Co. v. Commissioner*, 275 F.2d 578, 584 (7th Cir. 1960) (allowing deduction for depreciation and maintenance with respect to maintaining nonbusiness assets for the personal pleasure of its shareholder to the extent the deductions do not exceed the amount of income received from the shareholder for use of the asset, notwithstanding no established basis for the allocation). Cf. *Adirondack League Club*, 55 T.C. 796, 806 & n.2 (1971), *aff'd*, 458 F.2d 506 (2d Cir. 1972) (non-profit social club, which engaged in some profit seeking activities, was denied deduction of expenses incurred with respect to recreational activities to extent such expenses exceeded fees charged members; this was consistent with the Internal Revenue Service's position with respect to "hobby" cases).

59. I.R.C. § 274(e)(5).

60. *Id.*

61. *Id.*; I.R.C. § 267(c)(4). In the case of a closely held corporation with exact identity between owners and employees the exception would be inapplicable.

62. Treas. Reg. § 1.274-2(f)(2)(v) (1963).

63. I.R.C. § 274(e)(3).

ties under today's law involves a tremendous risk that any attempt to claim deductions will be denied and any personal use of the facility by shareholders will be considered constructive dividend income.

3. Denial of Loss Deductions

a. The Implied "Trade or Business" Test

Unlike the provisions for deducting depreciation, maintenance and other expenditures, section 165(a), which provides a loss deduction for corporations, does not have a specific "trade or business" limitation.⁶⁴ If a residence owned by a corporation were sold at a loss, it appears that section 165(a) would allow the deduction.⁶⁵ In contrast, the provision for losses by individuals requires that the loss to be deductible must be incurred in a "trade or business" or in a "transaction entered into for profit."⁶⁶ Because of this difference in tax treatment, certain abuses have developed with respect to loss deductions for nonbusiness assets.⁶⁷

Because there is no "trade or business" limitation in section 165(a), the courts have not generally succeeded in implying such a test. In *International Trading Co.*,⁶⁸ the tax court, which was reversed by the Seventh Circuit, restricted deductible corporate losses to those satisfying a "trade or business" test. The majority reached this result by invoking the judicial doctrine of "legislative intent" and concluded that the losses referred to in the statute providing for a general income tax on corporations were conceived of as arising out of the corporation's business.⁶⁹ The presumption

64. "There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise." I.R.C. § 165(a).

65. However, the general rule on corporate deductibility of losses is subject to section 274(a), which denies the loss deduction when incurred in connection with an entertainment facility. In the situation presented in the text a determination would have to be made as to whether the corporate residence constitutes an entertainment facility.

66. I.R.C. § 165(c) provides in part:

"In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business"

67. See notes 15-20 & accompanying text *supra*.

68. 57 T.C. 455 (1971), *rev'd*, 484 F.2d 707 (7th Cir. 1973) (corporation sold at a loss a piece of lakefront property, which was not used in the corporation's trade or business or for the production of income but for the personal pleasure of its shareholders).

69. "[T]here shall be assessed, levied, and collected . . . a tax of two percentum annually on the net profits or income above actual operating business expenses, including expenses for . . . losses" Act of August 27, 1894, ch. 349, § 32, 28 Stat. 509.

that a "trade or business" test is implicit in section 165(a) has also been stated by many commentators:

The requirement that the loss must arise from a transaction entered into for profit, or be incurred in a trade or business does not require proof in the case of corporate taxpayers. It is *presumed* that any transaction entered into by a corporation is either for profit or in connection with a trade or business.⁷⁰

It was argued that since all corporate transactions are presumed to arise in its trade or business, there was no need for section 165(a) to so provide. Further, the limitation in section 165(c) was necessary since the trade or business presumption did not apply.

Six judges in *International* dissented on the ground that the language of section 165(a) is clear and puts no limitations on the deductibility of losses by corporations.⁷¹ But, the majority, after going into the legislative history of section 165(a), concluded that it was "simply assumed" that losses by corporations would arise out of its trade or business. "Since such an assumption cannot be made with respect to losses suffered by an individual, the limitations set forth in section 165(c) are necessary and their absence from section 165(a) appropriate."⁷²

The court's refusal to follow a literal reading of the statute was supported by its reliance on *United States v. Kirby*,⁷³ in which the Supreme Court held that the reason of the law should prevail over its letter,⁷⁴ and *Helvering v. Owens*,⁷⁵ in which the Supreme Court applied the rule of statutory construction to a revenue act.⁷⁶ In *Owens* the Court limited a taxpayer's casualty loss deduction on his personal automobile to the difference between its cost less depreciation, which had not been allowed because of the personal

70. A. PARKER, DEDUCTIONS AND CREDITS 76-77 (rev. ed. 1967) (footnote omitted; emphasis added). See, e.g., 4A J. MERTENS, *supra* note 1, § 25.08, at 37; B. BITTKER & J. EUSTICE, *supra* note 10, ¶ 5.03, at 5-6.

71. 57 T.C. 455, 466-69 (1971).

72. *Id.* at 461 (footnote omitted). Besides section 165, there are other sections of the Code which distinguish between corporate and individual taxpayers. See I.R.C. § 108 (discharge of indebtedness); § 163 (interest); § 166 (bad debts); 170 (charitable contributions). Arguably, the distinction made by these Code provisions assumes that corporate transactions are entered into in connection with the corporate trade or business, whereas in the case of an individual taxpayer, it is the exception rather than the rule. Therefore, it would be redundant to place the "trade or business" limitation in every section of the Code applicable to corporations.

73. 74 U.S. (7 Wall.) 482 (1868).

74. "All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to injustice, oppression or an absurd consequence." *Id.* at 486.

75. 305 U.S. 468 (1939).

76. *Id.* at 471.

use of the automobile, and the value after the accident.⁷⁷ The basis was adjusted for the depreciation which was denied in spite of the fact that a literal reading of the statute would have allowed a loss in the amount of the difference between the cost and the value after the casualty.⁷⁸

The court in *International* noted that a necessity existed for an integrated approach to the Code.⁷⁹ The corporation had previously been denied a depreciation deduction with respect to improvements erected on the lakefront property because it was not used in its trade or business or held for the production of income. The court reasoned that to allow a loss deduction on the sale would give the corporation the benefit of a substantial portion of the depreciation previously denied.⁸⁰ This has been referred to as a "corporate level" dichotomy.⁸¹ The denial of the loss deduction was necessary to achieve integration of the loss and depreciation provisions.

Additionally, the court argued that to permit the corporation to take a loss deduction on the disposition of a nonbusiness asset would allow the corporation the benefit of a loss carryover or carryback.⁸² Normally, depreciation is included in the computation of a net operating loss,⁸³ but a nonbusiness asset would not qualify for depreciation and, therefore, there would be no depreciation deduction to help generate a net operating loss. Thus, to permit the corporation to take a capital loss deduction on the sale of the same nonbusiness asset would substantially allow the corporation the benefit of the disallowed depreciation deduction.

One problem with the implied "trade or business" test pro-

77. *Id.*

78. *Id.*

79. 57 T.C. at 461.

80. *Id.* at 462.

81. Comment, *supra* note 11, at 1612. The dichotomy exists whenever a corporate loss deduction is allowed after denying deductions for depreciation and expenses. For example, assume ABC corporation purchased an automobile to be used solely for the personal benefit of its shareholders. The automobile cost \$2,000 and had a five year life. After three years, straight-line depreciation would have been \$1,200 and its adjusted basis would have been \$800. Because the automobile was not used in the corporation's trade or business, within the meaning of section 167, the tax benefit of the depreciation deduction was lost. The basis of the automobile remained at \$2,000. However, if the automobile was sold for \$800 and a \$1,200 loss recognized, the corporation would get a tax benefit of \$1,200 from the loss deduction under section 165(a). The corporation thus obtained the same tax benefit, other than the loss deduction deferral, that it would have received from the depreciation deductions.

82. I.R.C. § 172(a).

83. "[T]he term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income." I.R.C. § 172(c).

posed in *International* is that if the property is destroyed by fire or other casualty the rule would deny any loss to the corporation.⁸⁴ Such a result would be worse than if the shareholders had owned the property directly.

Arguably, the majority of the court in *International* did not need to go so far as to deny the total loss, since a partial loss deduction could be allowed without frustrating the depreciation or the casualty loss provisions. The *Owens* case, cited by the majority, does not require that section 165(a) be rewritten but that the measure of loss be geared to the economic realities.⁸⁵ *Owens* could be applied to limit the corporation's loss to the "difference between the proceeds of sale and the original cost less depreciation, albeit nondeductible depreciation."⁸⁶ As decided, the effect of *International* is to make the presumption of business use rebuttable with the result that the "any loss" language of section 165(a) may be ignored if the court does not find that the property was used in the corporation's trade or business.

A strong argument can be made that the integrated approach developed by the tax court in *International* should be adopted in order to effectuate the legislative design that all taxable income be reached, unless specifically excluded, by reading the Code provisions with respect to their relation to each other.⁸⁷ To permit deductions under one section of the Code where another Code provision denies the deduction regarding the same res would defeat congressional intent and reduce the effectiveness of the Code.⁸⁸

As could be expected, there has been much criticism of the implied trade or business test.⁸⁹ The Seventh Circuit reversed the

84. 57 T.C. at 468 (Tannenwald, J., dissenting). Prior to the decision in *International*, corporate casualty losses had been deductible. Individuals were also entitled to casualty loss deductions by virtue of § 165(c)(3). The clear import of the majority opinion is to deny all deductions to the corporation. Thus, an individual taxpayer would be in a better position than the corporation, even though the individual's casualty loss property was not used in his or her trade or business.

85. *Id.*

86. *Id.*

87. See General Am. Investors Co. v. Commissioner, 348 U.S. 434, 436 (1955). This has been the position of commentators. See, e.g., Comment, *supra* note 11; 43 Miss. L.J. 746 (1972).

88. See Note, International Trading Company: Limitations Imposed Upon Corporate Loss Deductibility Under Section 165(a), 33 U. PITT. L. REV. 829, 833 (1972).

89. See, e.g., Note, Federal Income Taxation—Section 165(a)—Losses: Corporate Loss Deduction Denied on Sale of Realty Because Property Was Not Held for Use in Trade or Business—International Trading Co., 14 B.C. IND. & COM. L. REV. 171 (1972); 43 Miss. L.J. 746 (1972) (decision represents judicial legislating beyond the authority of the court).

tax court, holding that section 165(a) does not require that corporate losses be incurred in a trade or business to be deductible.⁹⁰ The decision of the court of appeals was based on a finding that the tax court was legislating by reading words into the statute that Congress had not intended.⁹¹ Supporting the court's analysis was its conclusion that enactment of section 274 by Congress was evidence of an intent to foreclose a deduction under section 165(a) and not a desire to recognize that it was already foreclosed judicially.⁹²

Although a literal interpretation of section 165 supports corporate loss deductions for nonbusiness assets, from the standpoint of tax policy the tax court was correct in *International* in trying to integrate the corporate loss and expense provisions with respect to nonbusiness property. Recently, Congress enacted specific legislation in the form of an amendment to section 274 designed to integrate the corporate loss and expense provisions.⁹³ It would appear that any future activity by Congress in this area will await the evaluation of the tax effect brought about by the amendment to section 274.

b. "Substance Over Form"

Aside from the limitations in section 274(a) and the arguments for integrating the corporate loss and depreciation provisions through application of an implied "trade or business" test, there exists yet another approach which has been used to deny corporate loss deductions from the sale of nonbusiness assets. In *Johnson v. United States*,⁹⁴ the district court used a "substance over

90. *International Trading Co. v. Commissioner*, 484 F.2d 707, 711 (7th Cir. 1973).

91. *Id.* The Seventh Circuit stated that no matter how absurd the results of the statute may be courts have no power to rewrite legislative enactments to give effect to their ideas of policy and symmetry in statutes. *Id.* at 713. The court does not have a license for judicial legislation when a taxpayer achieves benefits under one section of the Code which are denied under another section. A literal reading of section 165 would not support the tax court's position since Congress was explicit in placing a nonbusiness limitation on individual losses, while excluding corporate losses from such limitations. In addition, the title heading of section 165(c) specifically limits the losses of individuals.

92. Note, *supra* note 89, at 177 (1972).

93. See notes 49-62 & accompanying text *supra* (discussion of section 274). *W.L. Schautz Co. v. United States*, 567 F.2d 373, 375 (Ct. Cl. 1977) (corporation denied loss deduction incurred in the sale of property used solely as a winter vacation home for corporate shareholders; section 274(a)(1) disallows losses as well as expenses); *International Trading Co.*, 57 T.C. 455 (1971), *rev'd*, 484 F.2d 707 (7th Cir. 1973); Treas. Reg. § 1.274-2(e)(2)(i) (1963); Rev. Rul. 63-144, 1963-2 C.B. 129, 137.

94. 25 A.F.T.R.2d 1310 (W.D. Mo. 1970) (opinion is inarticulate in its references to the "substance over form" analysis, but its logic follows the traditional judicial doctrine).

form”⁹⁵ analysis in conjunction with section 165(a) to deny a corporation a loss on the sale of its residential property—a nonbusiness asset placed in the corporation for the benefit and personal use of its shareholders.⁹⁶ Although title to the residential property was in the corporation’s name, it failed to establish that the residence was used in its trade or business or acquired for any legitimate business interest.⁹⁷ Under the “substance over form” approach used by the court, the corporate entity is disregarded and the tax consequences of ownership of the nonbusiness assets are attributed to the shareholders.⁹⁸

The concept of beneficial ownership as used in *Johnson* is predicated upon some type of “shareholder benefit,” such as when the shareholder is considered to have received a constructive dividend.⁹⁹ For this reason not every nonbusiness asset is subject to the “substance over form” analysis. For example, a shareholder benefit from a loss on the sale of a nonbusiness asset is likely to be found only in closely held rather than publicly held corporations. This is obvious given the nature of the relationship between the corporation and the shareholder and the fact that a loss does not bring an economic benefit to the shareholder of a public corporation.¹⁰⁰

95. “Questions of taxation must be determined by viewing what was actually done, rather than the declared purpose of the participants and when applying . . . income tax laws . . . we must regard matters of substance and not mere form.” Weiss v. Stearn, 265 U.S. 242, 254 (1924).

96. Johnson and Bowersock each owned one-half of the stock of Selectivend Corp., which purchased a yacht and a residence for the personal use of its shareholders. Neither asset was used in the corporation’s trade or business or for the production of profit. Both assets were sold at a loss and claimed as a deduction by the corporation. It is interesting to note that the district court relied on section 274(a)(1)(B) to disallow the loss deduction on the yacht, but used a substance over form analysis in connection with section 165(a) to deny the loss deduction on the residence. The court does not explain why a distinction was made. 25 A.F.T.R.2d at 1312-13.

97. *Id.* at 1314.

98. The effect is to treat the corporation as a mere conduit or title-holding nominee and the shareholders as the beneficial owners of the nonbusiness assets. Comment, *supra* note 11, at 1631-32.

99. Shepard v. Commissioner, 340 F.2d 27, 30 (6th Cir. 1965); Johnson v. United States, 25 A.F.T.R.2d 1310 (W.D. Mo. 1970); B. BITTKER & J. EUSTICE, *supra* note 10, ¶ 7.05, at 7-24. (constructive or disguised dividends are more likely to be found in closely held corporations, where the dealings between the corporation and its shareholders are more often than not characterized as informal).

100. In most publicly held corporations, losses on the sale of a nonbusiness asset will have little or no effect on the fair market value of the stock. Consequently, the shareholder does not receive an economic benefit in terms of any decrease in gain or increase in loss if the shareholder were to subsequently sell his or her stock.

To obtain the result in *Johnson* the corporate entity must be disregarded through the application of the judicial doctrine of "substance over form." Although corporations generally are considered legal entities separate and distinct from their shareholders,¹⁰¹ the courts have not been hesitant to disregard the corporate entity to combat tax avoidance.¹⁰² "Under long-standing judicial principles, sounding in sham, form versus substance, tax avoidance, and business purpose, the separate existence of a corporation may be disregarded if the particular organization is so evanescent as to lack economic reality."¹⁰³ Although these judicial doctrines appear to be overlapping routes to the same end, the courts view them as separate doctrines.¹⁰⁴

Disregard for the corporate entity most often occurs when the property involved in the transaction is not used in the corporation's trade or business.¹⁰⁵ Because this arises mostly in close or family corporations the courts will give special scrutiny to the transaction.¹⁰⁶ If the corporate entity is disregarded, all gains or losses from the transaction should be attributed to the shareholders.¹⁰⁷ It is not necessary to totally disregard the corporate entity, but merely to disregard it for purposes of the particular transaction.¹⁰⁸ Under these circumstances, any proceeds retained by the corporation on the disposition of nonbusiness assets should be

101. The rule has exceptions which in some circumstances cause the corporation not to be completely independent. Section 318, relating to the constructive ownership of stock, and sections 1371 to 1379, relating to the election power of certain small business corporations to have their income taxed to shareholders, are examples.

102. B. BITTKER & J. EUSTICE, *supra* note 10, ¶ 1.05.

103. Eustice, *Tax Problems Arising From Transactions Between Affiliated or Controlled Corporations*, 23 TAX. L. REV. 451, 458 (1968). See Watts, *Tax Problems of Regard for the Corporate Entity*, 20 N.Y.U. INST. FED. TAX. 867 (1962).

104. For cases relying on the "business purpose" doctrine, see, e.g., Gregory v. Helvering, 293 U.S. 465 (1935); National Investors Corp. v. Hoey, 144 F.2d 466 (2d Cir. 1944). For a case explaining the "step transaction" doctrine, see Thomas F. Abbott, Jr., 33 T.C.M. (P-H) 491 (1964), *aff'd per curiam*, 342 F.2d 997 (5th Cir. 1965). "Substance over form" has been relied on by many cases, see, e.g., Weiss v. Stern, 265 U.S. 242, 254 (1924); Juniper Inv. Co. v. United States, 338 F.2d 356, 360 (Ct. Cl. 1964). See National Lead Co. v. Commissioner, 336 F.2d 134 (2d Cir. 1964), *cert. denied*, 308 U.S. 908 (1965) (relying on the "sham" transaction doctrine and "no economic reality"). Finally, for cases relying on a "conduit" approach, see, e.g., Commissioner v. Court Holding Co., 324 U.S. 331 (1945); General Guaranty Mortgage Co., Inc. v. Tomlinson, 335 F.2d 518 (5th Cir. 1964).

105. Watts, *supra* note 103, at 874.

106. Juniper Inv. Co. v. United States, 338 F.2d 356, 359-60 (Ct. Cl. 1964); Ingle Coal Corp. v. United States, 127 F. Supp. 573, 578-79 (Ct. Cl. 1955).

107. See National Lead Co. v. Commissioner, 336 F.2d 134, 141 (2d Cir. 1964).

108. *Id.*

considered capital contributions.¹⁰⁹

The transfer to the corporation of nonbusiness assets originally acquired by the shareholder should be disregarded.¹¹⁰ If the corporation purchases the nonbusiness assets primarily for the personal benefit of its shareholders and the shareholders are the beneficial owners of the property, then the corporate purchase should be treated as a distribution in kind with the shareholders being taxed accordingly.¹¹¹ Additional tax consequences associated with attribution of nonbusiness asset ownership to the shareholders are that corporate expenditures and depreciation deductions taken with respect to the assets should be treated as constructive dividends. Offsetting the constructive dividends would be any rent paid by shareholders to the corporation for the use of the property.¹¹²

Another case that denied a corporate loss deduction based on a "substance over form" analysis was *Juniper Investment Co. v. United States*.¹¹³ In *Juniper*, the sole shareholders transferred cash legacies under their mother's will to certain relatives, friends, and long-standing employees, in exchange for immediate payment from the corporation. The court found the transaction to have no business or profit motive or legal obligation, and the transaction was found to be prompted solely by the shareholders' humanitarian motives to allow the specified beneficiaries to receive immediate payment rather than have them wait until final disposition from the estate. Because tax deficiencies depleted the estate, the corporation recovered nothing. The loss deduction taken by the corporation was denied by the Service. The court of claims disallowed the loss deduction even though section 165(a) allowed all corporate losses to be deducted.

[T]he circumstances of the present case make it evident that the corporate entity should be disregarded and the loss attributed to Juniper's controlling stockholders . . . [notwithstanding] the general rule . . . that a corporation and its stockholders must be considered separate and distinct entities for Federal tax purposes. . . .

. . . "[T]ransactions between close or family corporations and [their] stockholders are subject to special scrutiny to determine their true pur-

109. Comment, *supra* note 11, at 1640.

110. James M. Hallowell, 56 T.C. 600, 609 (1971).

111. Comment, *supra* note 11, at 1640. Other than having the original purchase constitute the corporate distribution, alternative dates are possible. For assets originally purchased for business purposes and later converted to personal use, the conversion date should probably control. Finally, the date of corporate sale could be a third possible distribution date. The distribution date is important for purposes of determining the tax consequences of the distribution. *Id.*

112. *E.g.*, International Artists, Ltd., 55 T.C. 94 (1970).

113. 338 F.2d 356 (Ct. Cl. 1964).

pose and effect; . . . transitory phases of an arrangement that add nothing of substance to the completed affair should be disregarded for tax purposes, and . . . substance and reality should prevail over form and sham."

Here it is apparent that Juniper . . . acted as an alter ego on behalf of its two controlling stockholders who wanted for personal reasons to expedite payment of legacies from their mother's estate. . . . [The shareholders] did not treat Juniper as a legal entity distinct and apart from themselves. Thus, it seems evident that the interposition of the corporate entity into the transaction was a mere formality.¹¹⁴

It is apparent that the court was conscious of the tax avoidance potential in this type of transaction:

The consequences [of allowance] would be, of course, that as individuals they would obtain no loss deduction because of the limitations imposed by section 165(c) of the Code upon losses by individuals but that Juniper might obtain a deduction under the more liberal provisions in section 165(a) with respect to corporate losses—a deduction which would obviously benefit them indirectly as the shareholders of the company.¹¹⁵

Recently, the tax court in *Milton O. Brown*,¹¹⁶ found that a corporation which was incorporated solely in an effort to avoid the limitation on the deductibility of gambling losses by individuals was merely a "sham" set up to handle the taxpayer's gambling losses.¹¹⁷ The taxpayer had formed the corporation and had adopted a plan to issue section 1244 stock.¹¹⁸ The corporation's stated purpose was to engage in all legal activity plus gambling where legalized, and it invested in a system for betting on horses. Subsequently, the investment was lost. The taxpayer claimed an

114. *Id.* at 359-60 (citations omitted).

115. *Id.* at 360-61. A "substance over form" argument was also made in *International Trading Co. v. Commissioner*, 484 F.2d 707, 712 (7th Cir. 1973), but the court found the record insufficient to support the government's contention that the corporate entity should be disregarded:

The government's appeal brief argued for the corporate entity to be disregarded. . . . In fact, the government relied on *Juniper* and concluded that "[f]or tax purposes, the situation must be viewed as if taxpayer distributed the funds for the resort property to the shareholders as dividends, and the shareholders then expended the distributions on the property." . . . The reply brief pointed out that the government's argument was first raised at the appellate level and was in direct contradiction with stipulated facts, which agreed that *the corporation suffered the loss*. Apparently, the court agreed with appellant that the government should be precluded from arguing an alter ego theory.

Comment, *supra* note 11, at 1643 n.141 (citations omitted; emphasis in original).

116. [1979] TAX CT. MEM. DEC. (P-H) ¶ 1979-91.

117. *Id.* ¶ 1979-93.

118. I.R.C. § 1244. This section provides that an individual or partnership may treat a loss on qualified stock as an ordinary loss rather than a loss from the sale or exchange of a capital asset.

ordinary loss but the tax court held it could not deduct the gambling loss under the guise of section 1244:

In the instant case, . . . [the corporation], not only failed to meet the "operating company" test, but it was merely a "paper company" set up to avoid the limitation on the deduction of gambling losses. . . .

Petitioner has merely attempted to convert a nondeductible wagering loss under section 165(d) into an ordinary loss by utilizing section 1244.

The same reasoning . . . applies to petitioner's . . . claim that he sustained a capital loss on account of the worthlessness of the stock. . . .¹¹⁹

Thus, *Brown* indicates that the tax court is conscious of attempts to use corporations as vehicles to obtain deductions specifically denied to individuals.

There are a number of advantages to using the "substance over form" and "sham" analysis to deny the corporate loss deduction rather than implying a "trade or business" test into section 165(a). First, they are well established judicial doctrines and their use is not subject to the criticism that the court is legislating.¹²⁰ Second, use of these doctrines is not contrary to the legislative history of section 165(a).¹²¹ In addition, this doctrine does not deny the corporation casualty losses, which was one of the criticisms against application of the implied "trade or business" test, since the casualty would be attributed to the shareholders.¹²² Also, denial of corporate losses on the disposition of nonbusiness assets under this doctrine works in conjunction with the constructive dividend analysis and the denial of depreciation and expenses incurred in connection with nonbusiness assets.¹²³ Finally, this doctrine solves all three dichotomies and the inequities arising from allowing the corporate loss deduction.¹²⁴ As previously discussed, to simply deny the loss deduction does not solve the shareholder/nonshareholder dichotomy because the shareholder still benefits by the reduction in the value of the stock. Application of the "substance over form" doctrine would eliminate this inequity by either taxing the shareholder for a distribution in kind on the corporation's purchase of the asset or disregarding the shareholder transfer of nonbusiness assets to the corporation.

119. [1979] TAX CT. MEM. DEC. (P-H) ¶ 1979-93. The tax court would have also denied petitioner's claim for deduction under section 1244 because the corporation was not "largely an operating company" within the meaning of the regulations. TREAS. REG. § 1.1244(c)-1(g)(2) (1960).

120. Comment, *supra* note 11, at 1641.

121. *Id.*

122. *Id.* at 1644. See note 84 & accompanying text *supra*.

123. Comment, *supra* note 11, at 1641.

124. See notes 11, 12, 19, 81 & accompanying text *supra*.

c. *Section 183*

In addition to the limitations imposed by sections 165 and 274 on individual and corporate loss deductions, section 183 denies or limits deductions by an individual or subchapter S corporation that are attributable to activities not engaged in for profit.¹²⁵ Although the section does not use the word hobby it has been referred to as the "hobby loss" provision.¹²⁶ The section does not appear to deny any deductions which were allowable before its enactment.¹²⁷ However, the legislation encourages court and treasury attention to the questionable deductibility of losses from activities not of a business nature.¹²⁸

Section 183 applies to deny deductions where the activity is not

125. (a) **General Rule.**—In the case of an activity engaged in by an individual or an electing small business corporation (as defined in section 1371(b)), if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

(b) **Deductions allowable.**—In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed—

(1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

(c) **Activity not engaged in for profit defined.**—For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212.

(d) **Presumption.**—If the gross income derived from an activity for 2 or more of the taxable years in the period of 5 consecutive taxable years which ends with the taxable year exceeds the deductions attributable to such activity (determined without regard to whether or not such activity is engaged in for profit), then, unless the Secretary establishes to the contrary, such activity shall be presumed for purposes of this chapter for such taxable year to be an activity engaged in for profit. In the case of an activity which consists in major part of the breeding, training, showing, or racing of horses, the preceding sentence shall be applied by substituting the period of 7 consecutive taxable years for the period of 5 consecutive taxable years.

I.R.C. § 183.

126. S. REP. NO. 91-552, 91st Cong., 1st Sess., *reprinted in* [1969] U.S. CODE CONG. & AD. NEWS 2027.

127. *Id.*

128. *Id.* at 104. The limitations of section 183 are applied at the corporate level in determining the allowable deductions for a subchapter S corporation. Any limitation on deductions at the corporate level will reduce the loss pass through to shareholders. I.R.C. § 1374(a); Treas. Reg. § 1.183-1(f) (1973). The Service takes the position that the not-for-profit rules apply to the activities of a partnership, and the provisions of section 183 are applied at the partner-

engaged in for profit. An activity is engaged in for profit if the deductions are incurred as a trade or business expense,¹²⁹ or in the production or collection of income, or in the management, conservation, or maintenance of property held for the production of income.¹³⁰ The Code provides a rebuttable presumption that an activity is not engaged in as a hobby if gross income derived from an activity for two out of five years in a period of five consecutive years exceeds the deductions attributable to the activity.¹³¹

Apart from this presumption, the determination of whether an activity is engaged in for profit can be found under the case law interpreting sections 162 and 212.¹³² Even though regular corporations are not subject to section 183, no inference is to be drawn that any activity of a regular corporation is or is not a business or engaged in for profit.¹³³ Thus, section 183 will not affect deductions of regular corporations carrying on the hobby activities of their owners, but it does not establish that the activity is carried on in the corporation's trade or business for purposes of section 162.

All facts and circumstances of the case must be taken into account in determining whether the activity is engaged in for profit.¹³⁴ The regulations list nine factors which should be considered:

1. Manner in which the taxpayer carries on the activity.
2. The expertise of the taxpayer or his advisors.
3. The time and effort expended by the taxpayer in carrying on the activity.
4. Expectation that assets used in the activity may appreciate in value.
5. The success of the taxpayer in carrying on similar or dissimilar activities.
6. The taxpayer's history of income or losses with respect to the activity.
7. The amount of occasional profits, if any, which are earned.
8. The financial status of the taxpayer.
9. Elements of personal pleasure or recreation.¹³⁵

The fact that a shareholder of a subchapter S corporation may derive personal pleasure from using a corporate asset, such as an airplane, is not sufficient to cause the airplane to be classified as an activity not engaged in for profit if it can be shown by other factors that the operation of the airplane was in fact engaged in for

ship level to reduce each partner's distributive share of losses. Rev. Rul. 77-320, 1977-2 C.B. 78-79.

129. I.R.C. § 162(a).

130. I.R.C. § 212(1)-(2).

131. I.R.C. § 183(d). For horse breeding, training, showing or racing, the presumption arises if gross income exceeds deductions for two out of seven years.

132. Treas. Reg. § 1.183-1(a) (1972).

133. *Id.*

134. Treas. Reg. § 1.183-2(b) (1972).

135. *Id.*

profit.¹³⁶ But subchapter S corporation losses incurred in connection with the operation of the airplane will be denied if the primary motive for owning the airplane is for the personal pleasure of the shareholders, notwithstanding that some income was made from the operation of the airplane.¹³⁷

Even though an activity may be found to be engaged in for reasons other than profit, not all deductions may be disallowed. Deductions are allowable under section 183(b) in the following order and amounts: (1) amounts deductible regardless of the type of activity engaged in, such as interest and taxes, whether or not the expenses exceed income from the activity;¹³⁸ and (2) deductions which would be allowable only if the activity were engaged in for profit, but only to the extent that gross income attributed to the activity for the taxable year exceeds the deductions allowable whether or not engaged in for profit.¹³⁹

Although section 183 causes no compliance problems where the nonbusiness asset is incorporated in a regular corporation, it does appear to encourage the Service to question deductions incurred in connection with transactions involving personal or recreational overtones.

B. Shareholder Risks

1. *Tax Disadvantages*

a. *Constructive Dividend Income*

Constructive dividend income has been one of the most common and constantly recurring problems of closely held corporations. This is because the dealings between closely held corporations and their shareholders are often marked by informality, in contrast to the dealings between publicly held corporations and their shareholders.¹⁴⁰

Close corporations have been used as vehicles to deduct expenses and depreciation incurred in maintaining nonbusiness assets for the personal benefit of shareholders. This not only provides an untaxed economic benefit to the shareholder, which would normally be taxed as a dividend if distributed, but it also

136. Treas. Reg. § 1.183-2(b)(9) (1972).

137. Michael Lyon, 46 T.C.M. (P-H) 980, 982 (1977). See also *Menfore v. United States*, 40 A.F.T.R.2d 5338 (Ct. Cl. 1977); Peter Hurd, 47 T.C.M. (P-H) 496 (1978).

138. I.R.C. § 183(b)(1). See note 125 *supra*.

139. I.R.C. § 183(b)(2). See note 125 *supra*. The regulations further set out the order in which the allowable deductions are to be taken. Treas. Reg. § 1.183-1(b)(1) (1972).

140. B. BITTKER & J. EUSTICE, *supra* note 10, ¶ 7.05.

enables the corporation to reduce corporate taxes on other profitable activities.

Informal distributions can be found in a wide variety of transactions which need not constitute distributions under state law in order to be treated as such for federal income tax purposes. For example, the following have been found to constitute informal distributions: excessive compensation paid for services rendered by shareholders;¹⁴¹ insufficient rental paid by shareholders for the use of corporate property;¹⁴² corporate loans to shareholders;¹⁴³ excessive payments by the corporation for the leasing of shareholder property;¹⁴⁴ transfers of property between shareholder and corporation at less than fair market value;¹⁴⁵ and payments made by the corporation for the benefit of shareholders.¹⁴⁶

The Service's objective in treating an item as a constructive dividend is to disallow the deductions claimed by the corporation with respect to the item because the expenses are not incurred in its trade or business,¹⁴⁷ and to tax the shareholder on dividend income. Thus, incorporation of nonbusiness assets may lead to the shareholder recognizing dividend income when the corporation is subsequently denied the claimed deductions. The net effect is to create income, without a corresponding economic benefit to either the corporation or the shareholder, from an asset which would not have otherwise been income producing in the hands of the shareholder.

The key issue in this area is whether the corporate expenditure was incurred primarily to benefit the corporation's trade or business or primarily to provide a personal benefit to its shareholders through the use of the asset.¹⁴⁸ A corporation is entitled to deduct the cost of maintaining an asset used primarily in the regular

141. See *American Foundry v. Commissioner*, 536 F.2d 289 (9th Cir. 1976); *Quarrier Diner, Inc.*, 32 T.C.M. (P-H) 310 (1963).

142. See *International Artists, Ltd.*, 55 T.C. 94 (1970); Rev. Rul. 58-1, 1958-1 C.B. 173.

143. See *Alterman Foods, Inc. v. United States*, 505 F.2d 873 (5th Cir. 1974); *Commissioner v. Makransky*, 321 F.2d 598 (3d Cir. 1963).

144. See *Ray E. Omholt*, 60 T.C. 541 (1973); *Stanwick's, Inc.*, 15 T.C. 556 (1950), *aff'd per curiam*, 190 F.2d 84 (4th Cir. 1951).

145. See *Green v. United States*, 460 F.2d 412 (5th Cir. 1972); *Timberlake v. Commissioner*, 132 F.2d 259 (4th Cir. 1942).

146. See *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929). *Challenge Mfg. Co.*, 37 T.C. 650 (1962); *Lang Chevrolet Co.*, 23 T.C.M. (CCH) 1554 (1964). (shareholder use of an automobile); *Estate of Charles W. Law*, 23 T.C.M. (CCH) 1554 (1964) (shareholder use of supplies and materials).

147. See *International Artists, Ltd.*, 55 T.C. 94 (1970); *Challenge Mfg. Co.*, 37 T.C. 650 (1962); *American Properties, Inc.*, 28 T.C. 1100 (1957), *aff'd per curiam*, 263 F.2d 150 (9th Cir. 1958).

148. *International Artists, Ltd.*, 55 T.C. 94, 104 (1970).

course of its business.¹⁴⁹ For example, a corporation can deduct automobile expenses as an ordinary and necessary business expense where the automobile is used primarily for a valid business purpose. Conversely, if the primary motive of maintaining a corporate asset is for the personal benefit of a shareholder the deduction will be disallowed.¹⁵⁰ The fact that a shareholder may derive some personal use from the asset will not prevent the deduction, if such use is "distinctly secondary and incidental."¹⁵¹ Where the use of the corporate asset involves substantial business and shareholder personal use, allocation of the deductions claimed with respect to the asset becomes necessary.¹⁵²

Although the courts have applied the same rules of deductibility to the use of any assets, disallowance of corporate deductions occurs more frequently with the use of nonbusiness assets. When a nonbusiness asset is the subject of the corporate expenditure the claimed deductions are more suspect since the visibility of the asset has increased.¹⁵³

Thus, by incorporating a nonbusiness asset the shareholder runs a double risk—disallowance of corporate expenditures and realization of constructive dividend income. Money or property need not be transferred to the shareholder before a constructive dividend will be found, for it is sufficient merely to find some type of economic benefit running to the shareholder. Thus, a corporate business expense may constitute a constructive dividend "notwithstanding that the formalities of a dividend declaration are not observed; that the distribution is not recorded on the corporate books as such; that it is not in proportion to stockholdings, or even

149. See Frederic G. Krapf, Jr., 47 T.C.M. (P-H) 591, 597 (1978) (corporation, which had a bona fide business purpose, was allowed to deduct expenses of maintaining a yacht used primarily in its business); Robert J. Dennison, 46 T.C.M. (P-H) 1754, 1759 (1977) (corporate expenditures of maintaining a cadillac were ordinary and necessary business expenses).

150. International Artists, Ltd., 55 T.C. 94, 104 (1970); International Trading Co., 27 T.C.M. (P-H) 447 (1958), *aff'd*, 275 F.2d 578 (7th Cir. 1960).

151. International Artists, Ltd., 55 T.C. 94, 104 (1970); Robert J. Dennison, 46 T.C.M. (P-H) 1754, 1758 (1977) (court ignored shareholder use as de minimis because it was distinctly secondary and incidental).

152. International Artists, Ltd., 55 T.C. 94, 105 (1970).

153. *Examination of President Nixon's Tax Returns for 1969 Through 1972*, S. REP. No. 93-768, 93d Cong. 2d Sess. 159 (1974).

The apparent proliferation in the use of corporate-owned assets for the personal use of employees and shareholders as a device to provide tax-free fringe benefits or constructive dividends has received increased attention by the Service in recent years. However, there is not presently an announced uniform official policy on the general issue, probably because of the diverse types of benefits available, contrasting applicable tax theories, and the enforcement problems inherent in this area.

that some of the stockholders do not participate in its benefits.”¹⁵⁴

There are two approaches generally used to determine the amount of constructive dividend income which the shareholder is deemed to have received from the corporation due to the shareholder's use of corporate nonbusiness assets. One approach is to recognize constructive dividend income equal to the entire cost of the asset,¹⁵⁵ while the other defines constructive dividend income as equal to the fair value of the benefit received by the shareholder.¹⁵⁶

Under the first approach, the courts will find a constructive dividend equal to the cost of the asset whenever evidence of ownership of the asset points to the shareholder or is presumed to be in the shareholder.¹⁵⁷ This is true whether or not the asset is used substantially in the corporation's trade or business.¹⁵⁸ Some cases suggest that ownership will be presumed to be in the shareholder when the shareholder treats similar like-kind corporate and shareholder assets similarly, notwithstanding substantial business use

154. *Paramount-Richards Theatres, Inc. v. Commissioner*, 153 F.2d 602, 604 (5th Cir. 1946). To find that a shareholder has received a constructive dividend from a corporate business expense conflicts with the principles that a shareholder and corporation are separate taxable entities and that not every corporate action benefitting its shareholders will generate income taxable to them. B. BITTKER & J. EUSTICE, *supra* note 10, ¶ 7.05.

155. *George Proskauer*, 40 T.C.M. (P-H) 781, 782 (1971) (shareholder realized dividend income equal to the cost of sculpture); *Frederick Von Hessert*, 30 T.C.M. (P-H) 1221 (1961).

156. *See, e.g., Challenge Mfg. Co.*, 37 T.C. 650, 663 (1962); *Foster Mfg. Co.*, 41 T.C.M. (P-H) 675 (1972).

157. *Frederick Von Hessert*, 30 T.C.M. (P-H) 1221, 1229 (1961). According to *Von Hessert*, shareholder ownership may be found even though there is substantial business use of the asset. Although 60% of a yacht's use was for business purposes and only 40% was for the personal pleasure of the shareholder, the court found that the shareholder to be the owner. An important factor in the court's decision was the determination that the shareholder had title to the corporate yacht. The fact the shareholder requested that the Coast Guard certificate of registration be issued in his name so that he could deliver a valid bill of sale to a purchaser without any formal action suggested that the shareholder represented himself as owner. Also the shareholder used the corporate yacht in the same proportion as he used a smaller yacht previously owned by the shareholder. The coincidence of treatment between the corporate yacht and the shareholder's previously owned personal yacht helped the court to overcome any title ambiguity. The court charged the shareholder with a constructive dividend equal to the acquisition cost of the yacht. *Id.* at 1228.

It is interesting to note that this treatment is similar to that found under the "substance over form" analysis where the corporation purchases the non-business asset primarily for the benefit of its shareholders. *Von Hessert* appears to have applied a substance over form analysis to the corporate purchase of the yacht.

158. *See* note 154 *supra*.

and the technical indicia of title.¹⁵⁹

One commentator has suggested a number of steps which can be taken to avoid constructive dividend treatment based on the cost of the asset.¹⁶⁰ First, a program of reimbursement by the shareholder for the personal use of the corporate asset will avoid dividend treatment, but to the extent the fair market value of the asset or its use exceeds the shareholder payment there will still be dividend income. Second, no distinction should be made on the corporation's records between nonbusiness assets and business assets. Third, care should be taken to preserve *bona fide* distinctions between the use of corporate assets and similar personal assets. Finally, all technical indicia of ownership should be preserved. For example, bills of sale should be in the corporate name, as well as other documents which have legal significance and any corporate insurance on the asset should be payable to the corporation as the insured party.

The second approach employed by the courts for determining the amount of the constructive dividend is to examine the fair value of the benefit conferred on the shareholder from the personal use of the asset. Fair value has been determined as either fair rental value of the asset¹⁶¹ or the cost to the corporation in terms of the deductions, including depreciation, disallowed to the corporation because of the personal use by the shareholder.¹⁶² The Service appears to be favoring the use of the latter approach.¹⁶³ The fact that a deduction is disallowed pursuant to section 274 does not necessarily mean that a corresponding amount should be included in the income of the shareholder as a constructive dividend.¹⁶⁴ The rationale is that the failure to substantiate a

159. See note 157 *supra*.

160. Kohla, *Dividend Income from Personal Use of Business Assets*, 60 A.B.A.J. 1431 (1974).

161. For cases relying on the determination of a constructive dividend based on fair rental value, see, e.g., *Nicholls, North, Buse Co.*, 56 T.C. 1225 (1971); *Gordon S. Dole*, 43 T.C. 697 (1965).

162. For a case relying on fair value based on the cost to the corporation in terms of disallowed depreciation and other expense deductions, see, e.g., *Estate of William F. Runnels*, 54 T.C. 762 (1970).

163. [T]he present position of the Internal Revenue Service, where the personal nonbusiness use of corporate aircraft is involved, is to consider that the benefit is measured by the ratio of miles traveled for the personal benefit of the employee to the total miles the corporate aircraft traveled during the taxable year, multiplied by all costs (both operating and fixed) arising from the employer's ownership of the aircraft.

Examination of President Nixon's Tax Returns for 1969 Through 1972, S. REP. NO. 93-768, 93d Cong. 2d Sess. 162 (1974).

164. *John L. Asby*, 50 T.C. 409 (1968). In ascertaining business use the tax court imposed the same standard as the substantiation requirements of section 274.

deduction under section 274 is not equivalent to a finding that the asset serves no business purpose. In certain circumstances a shareholder may be attributed constructive dividend income resulting from the use of the nonbusiness asset by others,¹⁶⁵ as well as the mere availability of a corporate asset for personal use.¹⁶⁶ Although this looks like the doctrine of constructive receipt, it is not in the traditional sense, since here the issue is who should be taxed on the economic benefit and not when income is to be taxed.¹⁶⁷

The courts have not been limited to finding constructive dividend results, but have also found compensation income to have resulted from the personal use of corporate assets.¹⁶⁸ The amount of compensation income realized by the shareholder-employee or highly paid employee is computed as the fair value of the benefit received by the employee from the personal use of the corporate asset.¹⁶⁹ Compensation income will be more frequently found in public corporations than in closely held corporations. The separation between ownership and management in public corporations generally means that use of corporate facilities occurs as a result of a person's employee status, whereas use of corporate facilities in a closely held corporation occurs as a result of one's status as both a shareholder and employee.

Based on the foregoing analysis it is evident that personal use of corporate assets produces a considerable amount of uncertainty as to the possible income tax consequences flowing from an inadvertent taxable dividend. The possible adverse consequences to the shareholder in recognizing dividend income because of the shareholder's personal use of the corporate nonbusiness asset may be sufficient reason alone to avoid incorporation of the asset.

The decision in *Asby* implies that the court is going to impose the same substantiation requirements of business use for income items that are required under section 274 concerning certain types of deductions. It is, therefore, advisable to accurately document future corporate deductions concerning the business use of corporate assets.

165. *Nicholls, North, Buse Co.*, 56 T.C. 1225, 1242 (1971) (involving use by family members). *Cf. R.J. Bauer*, 42 T.C.M. (P-H) 484 (1973) (use by third parties). This may result in attributing the dividend income to a shareholder in a higher tax bracket.

166. *Offshore Operations Trust*, 42 T.C.M. (P-H) 949, 956 (1973).

167. *See, e.g., Hamilton Nat'l Bank*, 29 B.T.A. 63 (1933).

168. *Rodgers Dairy Co.*, 14 T.C. 66 (1950) (officer's use of a corporate automobile taxed to him as compensation income); *C.A. White Trucking Co.*, 46 T.C.M. (P-H) 18, 29 (1977).

169. *Rodgers Dairy Co.*, 14 T.C. 66 (1950); *C.A. White Trucking Co.*, 46 T.C.M. (P-H) 18, 29 (1977).

b. *Loss of One-Time Gain Exclusion from Sale of Principal Residence*

Incorporation of a shareholder's principal residence may have other adverse tax consequences. A corporation which owns the residence in which a shareholder lives is not entitled to the \$100,000 exclusion of gain from the sale of a principal residence. An individual aged 55 or over may elect to exclude up to \$100,000 of gain from the sale or exchange of a residence if he or she has owned and used the property as his or her principal residence.¹⁷⁰ To take advantage of the exclusion, the residence would have to be transferred out of the corporation to the shareholder.

For individuals transferring their principal residence to the corporation, consideration should be given to the problems involved with distributing the residence from the corporation to the shareholder. For example, a farmer may have incorporated the farm house into the farm corporation at a time when the father had control of the corporation. Later when the father decides to retire, his children, who have in the interim succeeded to control, may decide that their father does not need to reside in the farmhouse anymore, but should move to town. Consequently, they refuse to approve a redeeming distribution of the farmhouse to the father.

In addition, the shareholder cannot suddenly decide to take advantage of the gain exclusion from the sale of his or her principal residence by redeeming stock in exchange for the residence and selling it. Section 121 requires the electing taxpayer, during the five-year period ending on the date of the sale or exchange, to have owned and used the property as his or her principal residence for periods aggregating three years or more.¹⁷¹ Additionally, the distribution of the residence to the shareholder could constitute a dividend.¹⁷²

170. I.R.C. § 121:

(a) **General Rule.**—At the election of the taxpayer, gross income does not include gain from the sale or exchange of property if—

(1) the taxpayer has attained the age of 55 before the date of such sale or exchange, and

(2) during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as his principal residence for periods aggregating 3 years or more.

(b) **Limitations.**—

(1) **Dollar Limitation.**—The amount of the gain excluded from gross income under subsection (a) shall not exceed \$100,000 (\$50,000 in the case of a separate return by a married individual).

171. *Id.*

172. I.R.C. § 301.

2. *Non-tax Disadvantages*

One problem which may always arise with incorporation of nonbusiness assets, as it most commonly does in a non-corporate situation, is the determination of who gets to use the nonbusiness assets. Shareholders who originally owned the property might naturally view the property as still part of their own and lay some superior right to use. Any conflict between shareholders or even employees as to priority of use may create management problems.

Another problem which could be of significance is the fact that any constructive dividend attributed to shareholders might be considered as non pro-rata dividend in violation of statutory or common law dividend distribution requirements.¹⁷³ Directors who vote for or assent to the declaration of a dividend contrary to statutory provisions limiting non pro-rata distributions are held to be jointly and severally liable to the corporation for the amount of the dividend distributed in excess of that amount which could have been distributed without violating statutory provisions.¹⁷⁴ Whether state courts will impose liability upon directors because federal tax law determines a constructive dividend exists is questionable since it cannot be said that the directors voted for or assented to the declaration of a dividend. But, it may be that as constructive dividend treatment becomes more commonly understood by directors, the courts will presume that the directors assented to the dividend treatment which resulted from transactions giving rise to the constructive dividend.

III. MINIMIZATION OF RISKS

Because of the risk involved in creating dividend income through the shareholder's use of the nonbusiness asset, it may be favorable from a tax viewpoint not to incorporate such assets. But, for those taxpayers who have already transferred nonbusiness assets to the corporation, consideration should be given to possible methods of avoiding the potential tax pitfalls.

One method, which is probably the simplest and most predictable for tax planning purposes, is a distribution of the nonbusiness asset to the shareholders. The transfer of the asset to the shareholder may constitute a dividend since it represents a distribution

173. The general rule is that in the absence of a provision creating preferences in the articles of incorporation, bylaws or statutes, dividends among shareholders of the same class must always be pro-rata, equal and without discrimination. *Miller v. M.E. Smith Bldg. Co.*, 118 Neb. 5, 223 N.W. 277 (1929); NEB. REV. STAT. § 21-2014(3) (Reissue 1977) (by negative implication, unless specifically provided for in the articles of incorporation, no class of shares may enjoy a preference as to dividends).

174. NEB. REV. STAT. § 21-2046 (Reissue 1977).

of property by the corporation to its shareholder in his or her capacity as shareholder. The transfer is preferable when the corporation has small or no earnings and profits since a corporate distribution represents a dividend includible in gross income to the extent it is out of current earnings or profits or accumulated earnings and profits of the corporation.¹⁷⁵ This method only works

175. I.R.C. § 301 provides:

(a) **In general.**—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(b) **Amount distributed.**—

(1) **General rule.**—For purposes of this section, the amount of any distribution shall be—

(A) **Noncorporate distributors.**—If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

. . . .

(c) **Amount taxable.**—In the case of a distribution to which subsection (a) applies—

(1) **Amount constituting dividend.**—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) **Amount applied against basis.**—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) **Amount in excess of basis.**—

(A) **In general.**—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) **Distributions out of increase in value accrued before March 1, 1913.**—That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

I.R.C. § 316 provides:

(a) **General rule.**—For the purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profit accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

with close corporations where there are few shareholders and less chance to have current or accumulated earnings and profits for the taxable year. That portion of the distribution which is not considered dividend income is treated as a return of capital and applied as a reduction to the adjusted basis of the shareholder's stock, and to the extent the distribution exceeds the adjusted basis of the shareholder's stock, it is taxed as a capital gain.¹⁷⁶

The advantage with making the distribution, even though some dividend income may be recognized, is that it prevents possible constructive dividend income problems from arising when the shareholders personally use the nonbusiness asset. If the corporation has small or no earnings and profits, the current value of the property distributed would be subtracted from the shareholder's basis in his or her stock. Even though the corporation could not recognize a deductible loss on the distribution, this reduction in shareholder basis may preserve the potential for loss.¹⁷⁷ But, at the same time, since the distribution reduces the shareholder's stock basis it in effect increases the potential for gain or decreases the potential for loss. Thus, to preserve the full loss potential the value of the stock would have to decrease by an amount equal to the shareholder's basis reduction.¹⁷⁸ To avoid dividend treatment the distribution could be structured as a section 302(a) redemption which provides for sale or exchange treatment on distributions in redemption of stock.¹⁷⁹ However, the redemption must fall within one of four categories provided for in section 302(b) in order to gain 302(a) treatment.¹⁸⁰ In order for a shareholder of a close corporation to come within one of the four categories, he or she may

176. I.R.C. § 301(c).

177. This assumes that the corporation would be denied the loss on disposition of the asset, because of either Section 274 or possible future application of an implied "trade or business" or "substance over form" analysis. This also assumes that the distribution of the nonbusiness asset will cause the fair market value of the stock to decrease.

178. This method does not solve the potential "double" loss deduction with respect to the shareholder/nonshareholder dichotomy. See note 19 & accompanying text *supra*. Even though the shareholder preserves the loss, the corporation does not take a loss deduction. COMMENT, *supra* note 11, at 1649.

179. "If a corporation redeems its stock (within the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock." I.R.C. § 302(a).

180. I.R.C. § 302(b):

(b) Redemptions treated as exchanges.—

(1) Redemptions not equivalent to Dividends.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

(2) Substantially disproportionate redemption of stock.—

(A) In general.—This paragraph shall not apply unless immediately after the redemption the shareholder owns

have to relinquish substantive control of the corporation which may not be desirable unless the shareholder is retiring from the business. Notwithstanding the fact that dividend treatment is avoided, there may still be some taxable gain to the corporation arising from the difference between the fair market value of the property distributed and the value of the stock relinquished.

Distribution of the nonbusiness asset to the shareholders should not be used to avoid possible "substance over form" analysis because the tax consequences of ownership of the asset have already been attributed to the shareholders and the distribution would, therefore, have no substantive effect.¹⁸¹ At the same time, however, there will be tax consequences upon the distribution where the percentage of beneficial ownership has changed among the shareholders.¹⁸²

less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

(B) **Limitation.**—This paragraph shall not apply unless immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

(C) **Definitions.**—For purposes of this paragraph, the distribution is substantially disproportionate if—

(i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time, is less than 80 percent of—

(ii) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

(D) **Series of Redemptions.**—This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not substantially disproportionate with respect to the shareholder.

(3) **Termination of shareholder's interest.**—Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder.

See Ludtke, *Planning for Family Corporate Control*, 58 NEB. L. REV. 644, 655-61 (1979).

181. Comment, *supra* note 11, at 1649. See notes 94-124 & accompanying text *supra*.

182. *Id.* For example, assume two shareholders were attributed the tax consequences of ownership of corporate nonbusiness assets because of their sole

A second alternative would be to convert the nonbusiness asset to a business use so as to meet the "trade or business" requirement of sections 162(a) and 167(a).¹⁸³ Most cases dealing with this question have involved the conversion of residential property to property "held for the production of income."¹⁸⁴ The test for determining whether there has been a conversion is different depending on whether the deduction sought is expenses and depreciation or losses.¹⁸⁵

The test for deducting expenses incurred in connection with the property and/or depreciation is that the property be held for the production of income.¹⁸⁶ Thus, offering a non-business asset for rent, such as a hunting lodge, qualifies as a conversion; but merely holding the property for resale will not qualify because it is hard to determine whether the property is being sold as business or personal property.¹⁸⁷ The courts have found residential property to be held for the production of income where the taxpayer intended to benefit from post-abandonment appreciation.¹⁸⁸ The test would appear to apply to corporations as well.¹⁸⁹ "To be considered part of a corporation's trade or business property must at least have been purchased with a view to using it in the commercial activities of the corporation."¹⁹⁰

In order to take a loss deduction the taxpayer must prove it was

personal use and each was considered a one-half equal owner. Subsequently, an additional individual buys stock and becomes a one-third owner in the corporation. If the corporation made a pro-rata distribution-in-kind at this time and beneficial ownership changed to coincide with legal title, the original two shareholders' one-half interests would be reduced to one-third. This transaction would be considered a taxable sale of their beneficial interests by the original shareholders.

183. See *id.* at 1649; Note, *supra* note 89, at 835.

184. I.R.C. §§ 167(a)(2), 212(1). See, e.g., Mary Laughlin Robinson, 2 T.C. 305 (1943); William C. Horrmann, 17 T.C. 903 (1951).

185. This distinction has developed in the context of the conversion of residential property into income producing property. In a situation other than a conversion of residential property, a court might feel free to use a single profit-seeking test. S. SURREY, W. WARREN, P. McDONALD & H. AULT, *FEDERAL INCOME TAXATION* 367 (1972).

186. I.R.C. §§ 167(a)(2), 212(1).

187. Marjorie M.P. May, 35 T.C. 865 (1961); Mary Laughlin Robinson, 2 T.C. 305, 309 (1943).

188. *Lowry v. United States*, 384 F. Supp. 257 (D.N.H. 1974); Frank A. Newcombe, 54 T.C. 1298 (1970) (although tax court rejected taxpayer's contention that an offer to sell a residence without attempting to rent it was sufficient to constitute a conversion for purposes of obtaining deductions under sections 167 and 212, the court would allow these deductions if taxpayer was holding the property in order to realize "post-conversion" appreciation).

189. Richard R. Riss, Sr., 56 T.C. 388, 416 (1971); *Alamo Broadcasting Co., Inc.* 15 T.C. 534 (1950).

190. Richard R. Riss, Sr., 56 T.C. 388, 416 (1971).

incurred in a "transaction entered into for profit."¹⁹¹ Although offering the property for rent is sufficient for purposes of establishing that the property was "held for the production of income" under sections 167 and 212, to establish a loss under section 165(c)(2) as a "transaction entered into for profit" there must be an actual renting of the property.¹⁹² It is not clear whether there should be two separate conversion rules for corporations as there are for individuals, one for expenses and depreciation and one for losses.¹⁹³ There appears to be no reason to have a different set of rules once the corporation has made a proper conversion.

A somewhat more risky alternative is to argue that the corporate property is being held for long-range profit.¹⁹⁴ By arguing an economic profit motive the corporation would in effect be attempting to prove that the property was acquired with a view toward realizing a profit from the expected appreciation, thereby meeting the "trade or business" test of sections 162 and 167 and any implied "trade or business test" that may be created by the courts. The economic profit motive test was approved in *Blake v. Commissioner*.¹⁹⁵ In *Blake* the taxpayer, although sustaining losses in operating a horse farm for twelve consecutive years, was able to prove his economic profit intent by showing that his losses were incurred as a result of the unrealized appreciation in the value of his real estate and horses. The court in allowing the loss deduction placed great weight on the fact that the property had substantially appreciated in value. It is questionable whether the test would be accepted where the property had depreciated in value and the taxpayer was claiming a loss.

Lodging furnished to a shareholder-employee for the convenience of the employer is excludible from the gross income of the shareholder-employee if the employee is required to accept the

191. I.R.C. § 165(c)(2).

192. William C. Horrmann, 17 T.C. 903 (1951); Theodore H. Cowles, Jr., 39 T.C.M. (P-H) 970 (1970).

193. The difference between the two conversion rules as to individuals arises as a result of different language in sections 167(a)(2), 212(1) and 165(c)(2).

194. See Richard R. Riss, Sr., 56 T.C. 388 (1971); Comment, *supra* note 11, at 1653. It is important to note at this point that as amended, section 274's entertainment facility rules would deny any expenses, losses, or depreciation, notwithstanding the fact that they are incurred in connection with the corporation's trade or business.

195. 38 B.T.A. 1457 (1938). For a case in which it has been held applicable to corporations, see Hillcone S.S. Co., 32 T.C.M. (P-H) 1246 (1963). Most of the cases concerning this test arise under the "hobby loss" cases of section 183. See Treas. Reg. §§ 1.183-1(d), -2(b)(4) (1972) (profit includes the expectation that assets may appreciate in value). For a further discussion of section 183, see notes 125-40 & accompanying text *supra*.

lodging on the business premises as a condition of employment.¹⁹⁶ Lodging is required as a condition of employment where the employee is required

to accept the lodging in order to enable him properly to perform the duties of his employment. Lodging will be regarded as furnished to enable the employee properly to perform the duties of his employment when, for example, the lodging is furnished because the employee is required to be available for duty at all times or because the employee could not perform the services required of him unless he is furnished such lodging.¹⁹⁷

The business premises of the employer means the place of employment of the employee.¹⁹⁸ For example, a shareholder-employee was not required to include in gross income the value of lodging furnished him by the corporation where the shareholder resided on the ranch for the convenience of the employer, since there was no other available housing within eighty miles of the ranch.¹⁹⁹

The exclusion should apply irrespective of whether the employer makes a charge for the lodging, or the employment agreement or a statute fixing the terms of employment requires it to be furnished as compensation.²⁰⁰

Finally, the shareholder-employee and corporation may agree to treat the employee's use of the corporate asset as compensation for services rendered to the corporation. Where compensation is paid other than in cash the Regulations provide that the fair market value of the property taken in payment must be included in income as compensation.²⁰¹ The test of deductibility in the case of compensation payments is that they be compensation for services in fact and reasonable in amount.²⁰² One key factor is that the

196. There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him . . . on behalf of his employer for the convenience of the employer, but only if—

(1) in the case of meals, the meals are furnished on the business premises of the employer, or

(2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

In determining whether meals or lodging are furnished for the convenience of the employer, the provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether the meals or lodging are intended as compensation.

I.R.C. § 119.

197. Treas. Reg. § 1.119-1(b)(3) (1960), *amended*, T.D. 6745, 1964-2 C.B. 42.

198. Treas. Reg. § 1.119-1(c) (1960), *amended*, T.D. 6745, 1964-2 C.B. 42.

199. See F.R. McDowell, 43 T.C.M. (P-H) 345, 350 (1974).

200. Treas. Reg. § 1.119-1(b)(3) (1960), *amended*, T.D. 6745, 1964-2 C.B. 42.

201. Treas. Reg. § 1.61-2(d)(1) (1957), *amended*, T.D. 6696, 1963-2 C.B. 23; T.D. 7554, 1978-36 I.R.B. 5.

202. Treas. Reg. § 1.162-7(a) (1960).

amount be what would ordinarily be paid for like services by like enterprises under like circumstances.²⁰³

While the Service may not demand formal documentation to support corporate compensation deductions, it may be advisable to support a claim for a deduction with a formal corporate resolution.²⁰⁴ Where the payment is recognized as deductible compensation, the corporation obtains a deduction representing the value of the expenses incurred in providing the shareholder-employee with the use of the asset and the shareholder-employee includes in income the fair rental value of the use.²⁰⁵ The advantage with structuring the use of the asset as compensation is that it may avoid the constructive dividend income problem. However, the Service may contend that salaries paid to shareholder-employees are excessive and are in reality a distribution of a dividend.²⁰⁶ In those cases where the salary is found to be unreasonable, the corporation loses the deduction but the shareholder remains taxable on what is now considered dividend income.

For those taxpayers who would not have taken the salary if it was not deductible by the corporation, there is a way to hedge against this result. This is accomplished by having the shareholder-employee enter into a "hedge" agreement with the corporation whereby the shareholder agrees to repay any sums which are held to be nondeductible by the corporation. In Revenue Ruling 69-115,²⁰⁷ the Service stated that officer-shareholders of a closely held corporation are entitled to business expense deductions for repayments of excessive salary to the corporation, which are made under a legal obligation to repay, enforceable under the applicable state law.²⁰⁸ If the deduction is denied, the corporation will not have taxable income upon receiving the refund since the original

203. *Id.*

204. *See* *Annabelle Candy Co.*, 30 T.C.M. (P-H) 953, 954-56 (1961). In *Annabelle Candy Co.*, the court allowed the corporation to deduct compensation of \$1,000 to its shareholders, while disallowing as deductible compensation the transfer of corporate automobiles to the shareholders. Although the \$1,000 cash payment was documented in a corporate resolution, while the transfer of the automobiles was not, the court made no reference in its opinion to the resolution as a factor in its decision.

205. *International Artists, Ltd.*, 55 T.C. 94, 106 (1970); *C.A. White Trucking Co.*, 46 T.C.M. (P-H) 18, 29 (1977). *Cf.* *Estate of William F. Runnels*, 54 T.C. 762, 767 (1970) (amount of constructive dividend income is measured by the combined cost of operating the automobile and its depreciation).

206. *Charles McCandless Tile Service v. United States*, 422 F.2d 1336 (Ct. Cl. 1970).
207. 1969-1 C.B. 50, 51.

208. *Id.* Although the taxpayers used corporate resolutions to document their agreement, it may be advisable to ensure deductibility by spelling out the shareholder-employee's obligation in the employment contract. The agreement must also be entered into prior to payment of the salary. *John G. Pahl*, 67 T.C. 286 (1976).

disallowance of the deduction created a debt due from the shareholder-employee. Use of a "hedge" agreement provides the basis for avoiding dividend income problems. However, some courts have denied officer-stockholders deductions for repayment because the "hedge" agreements "may reflect a pre-existing knowledge on the part of the taxpayers that the payments would not be reasonable for tax purposes."²⁰⁹

IV. CONCLUSION

Although the corporate mechanism is a vehicle which may be used by the taxpayer to acquire tax benefits from nonbusiness assets not available to the individual, frequently it creates unexpected and often adverse tax consequences to shareholders. Whether this is because of reliance on the presumption that all corporate expenditures are deductible, unwise tax advice or merely a desire to save taxes, taxpayers in their attempt to circumvent the tax rules applicable to individuals have created dividend income without receiving a corresponding tax benefit from assets which would not have otherwise produced income in their hands. The ability of sophisticated taxpayers to avoid the Code limitations by proper compliance and structuring has reduced the purpose of the "trade or business" deduction limitation to a trap for the unwary, rather than an effective barrier against tax avoidance.

The 1978 Revenue Act amendment to section 274 has closed many avenues of tax abuse through which corporations attempted to deduct, as business expenses, items that essentially represented nondeductible personal expenditures. The new rule appears to take away most of the tax advantages associated with incorporating nonbusiness assets. But, the new rule may have collateral benefits. Under prior law the entertainment deduction provisions were extremely complex, which made uniform application hard to predict. Consequently, a number of taxpayers fell into the trap for the unwary by failing to properly substantiate claimed deductions. By closing the door on deductions for entertainment facilities the new law does not mislead the blind, but encourages effective tax planning which will take account of and structure around the risks involved in incorporating nonbusiness assets.²¹⁰

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209. *Charles Schneider & Co., v. Commissioner*, 500 F.2d 148, 155 (8th Cir. 1974), *aff'g* 42 T.C.M. (P-H) 537 (1973); *Castle Ford, Inc.*, 47 T.C.M. (P-H) 684 (1978); *Saia Electric, Inc.*, 43 T.C.M. (P-H) 1284, 1288 (1974), *court order* (5th Cir. July 16, 1976), *cert. denied*, 429 U.S. 979 (1976).

210. See notes 41-58 & accompanying text *supra*.