Federal Income Taxation and Real Estate Development: Death Knell for Shell Corporations?

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Commentary

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I. INTRODUCTION

The term "shell corporation" typically refers to a corporation which is used only for a limited purpose, and which hopefully will not be recognized or respected for other purposes such as taxation. Historically, shell corporations have been used to circumvent usury laws when adequate financing is not available at an interest rate permitted to individuals,\(^1\) to facilitate estate planning,\(^2\) to keep property out of the reach of creditors of its beneficial owners,\(^3\) to satisfy certain state and local laws that require publicly financed projects to be held by corporations,\(^4\) to avoid personal liability during liability-prone periods such as construction of a real estate development, and to serve many other purposes.\(^5\)

The use of a shell corporation presents a considerable dilemma to the beneficial owner of property in his role as taxpayer. The limited purpose for which a corporation is used is almost always to obtain a privilege which state law does not give to individuals, but corporate existence involves adverse federal income tax consequences. This dilemma flows from the fact that the corporation is a creature of legislative grace. The law permits individuals and other entities to join together and assume a favored legal status, but exacts a "fee" in exchange. On the state level, this "fee" re-

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3. See, e.g., Paymer v. Commissioner, 150 F.2d 334 (2d Cir. 1945).
5. See Kronovet, Straw Corporations: When will they be recognized; what can and should be done, 39 J. Tax. 54 (1973).
lates primarily to the regulation of the relationship between the parties to the agreement to incorporate as well as requiring organizational and operational formalities. The federal government influences the operation of a corporation by the taxation of its income. The corporation must pay a federal income tax as an entity separate from and in addition to the federal income tax paid by its shareholders.  

It may be more advantageous from a tax standpoint for the developer to hold property either individually or in a partnership rather than in a corporation. A partnership provides a flexible alternative. Liability may be limited by the use of a limited partnership, to the extent permitted under state law, thus providing a major advantage over individual ownership of the property. In addition, a partnership is not a taxable entity, so there is a pass-through of income and expense items to each partner and each may claim partnership losses to the extent of basis.

In spite of the advantages of using a noncorporate entity to hold property during the construction phase of a development, it is usually essential to assume the corporate form to obtain needed funds. The one statutory exception to double taxation which is allowed to certain classes of corporations, a Subchapter S election, may not be available to the real estate developer.

6. The corporation is generally subject to a federal income tax as an entity separate from and in addition to its shareholders. I.R.C. § 11.

Only certain corporations are able to take advantage of the pass through of corporate income and expense which is considerable under Subchapter S of the Internal Revenue Code. See notes 12-13 infra.

7. The developer incurs the following tax risks in his attempts to treat the corporate titleholder as a mere shell. The transfer of property between corporate and noncorporate entities solely for the purpose of obtaining financing may subject its beneficial owners to a capital gain tax on the retransfer of property which has appreciated in value during the period in which it was held by the corporation. This would be either a short term or long term capital gain, depending on the length of time that the corporation held the property. I.R.C. §§ 301(c)(3), 1001. The retransfer of property to its beneficial owner may result in double taxation, first to the corporation on its income, and then to the shareholder when he receives what may be construed as a dividend in kind. I.R.C. §§ 11, 301. In addition, any deductible item which is attributed to a corporation with no income will be lost. See also Kronovet, supra note 5, at 54.


13. In order to qualify for the pass through of corporate income and ex-
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The foregoing considerations have led many taxpayers to treat the corporations which they are forced to use as mere shells, with the hoped-for result that they will not be recognized for tax purposes. This commentary will examine the history and use of shell corporations in light of this problem, with special emphasis on the Tax Court's recent decision in *Strong v. Commissioner.*  

II. HISTORICAL BACKGROUND

Historically, taxpayers have attempted to avoid the taxation of shell corporations by resorting to two major doctrines. First, the "sham" approach urged disregard of the corporate entity for tax purposes if the corporation did not carry on a business activity. This approach was discussed in detail by the Supreme Court in *Moline Properties, Inc. v. Commissioner.*  

Second, the "agency" approach urged that if the corporation was a mere agent of the beneficial owners of the property, it was only entitled to a fee for serving in that capacity and was not charged with the tax consequences of beneficial ownership of property. This approach was discussed by the Court in *National Carbide Corp. v. Commissioner.*  

*Moline Properties* involved the use of a shell corporation as a security device for real property owned by its sole shareholder. The property was conveyed to the corporation which assumed the outstanding mortgages, and the shareholder received stock in exchange. The real property was the only asset held by the corporation. To the shareholders under these provisions, it is necessary that the corporation receive not more than 20% of its income from passive investments. I.R.C. § 1372(e)(5)(A). The construction phase of the development raises no problem in this regard. Although there is normally no income produced during the construction phase, net operating losses are generated which may pass through to the shareholders. I.R.C. § 1374. After construction has been completed, the major source of income becomes rental, which typically is classified as passive investment income. Treas. Reg. § 1.1372-4(b)(5) (1969). This prevents the corporation from continuing to utilize Subchapter S. I.R.C. § 1372(e)(5)(A).

In addition, the restrictions placed the corporation which elects under Subchapter S may make this option undesirable. Only individuals and estates, I.R.C. § 1371(a)(2), who have filed timely elections with the Service, I.R.C. § 1372(c)(1), may be shareholders and they may number no more than ten. I.R.C. § 1371(a)(1). If a partnership or another corporation invested in this venture, or if the developers broadened the investment base by admitting more shareholders, the Subchapter S election would terminate. *Id.*

15. 319 U.S. 436 (1943).
ration. The stock was subsequently transferred to a voting trustee appointed by the mortgagee, and served as security for an additional loan made to the shareholder. When the loan was paid off, the shareholder regained control of the stock, and paid off the mortgage liability by selling some of the real property. The rest of the property was sold later, and the proceeds were deposited in the individual account of the shareholder.

The Court held that gain from the sale of the property was chargeable to the corporation rather than its shareholder. The decision turned on the fact that during its existence the corporation conducted "business," which included: (1) the assumption of a certain obligation of its shareholder to a creditor; (2) the defense of certain condemnation proceedings and the institution of suit to remove restrictions imposed on the property by a prior owner, even though the expenses of the suit were paid by the shareholder; and (3) the leasing of a portion of its property as a parking lot. Neither books nor bank accounts were maintained. The Court stated:

The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity.17

This broad holding deflated many taxpayers' assertions that corporations they controlled were mere shams, to be disregarded for tax purposes.

The agency approach was briefly mentioned and rejected in the Moline Properties decision. The Board of Tax Appeals had found that the corporation "was a mere figmentary agent which should be disregarded in the assessment of taxes."18 The Supreme Court based its reversal of the Board on the fact that there was no agency contract and the lack of "the usual incidents of an agency relationship."19

The petitioners in National Carbide were three wholly-owned subsidiaries of Air Reduction Corporation (AIRCO). The Service asserted deficiencies against the corporation for income taxes and declared value excess profits taxes for the year 1938. Petitioners argued that they were agents of the parent corporation, and consequently that any tax on their income was property chargeable to the parent corporation.

18. 45 B.T.A. 647, 650 (1941).
19. 319 U.S. at 440.
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Petitioners were organized and used as operating companies in the four major fields of business of the parent company. Each subsidiary operated strictly as an agent of AIRCO and each was given responsibility to manage and operate plants and to market the products it manufactured. AIRCO supplied working capital, executive management and office facilities. Each subsidiary's fee for operation and management was limited by contract to six per cent on its outstanding stock, with all excess returning to the parent. During the year in question, the total amounts retained as income by the subsidiaries was $1,350, while AIRCO showed net earnings of nearly $4.5 million. AIRCO showed all appropriate amounts returned to it by the subsidiaries as income.

Petitioners contended that the Moline Properties holding of taxability where the corporate entity engaged in business activity was inapplicable where a corporation was the agent of its owner. They relied on an earlier Supreme Court holding in Southern Pacific Co. v. Lowe, but the Court distinguished the Southern

20. 336 U.S. at 424. The substance of the subsidiary-parent contract was as follows:

Airco hereby employs Sales as its agent to manage and operate, during the term of this contract, all plants for the production of oxygen, acetylene and other gases and for the manufacture of apparatus and containers for the utilization and transportation of such gases ...; and likewise employs Sales as its agent to market and sell, during the term of this contract, the output of all such plants .... Airco agrees (1) to give Sales the use of all cylinders, containers, motor trucks, equipment and shipping facilities, which it now owns or may hereafter acquire; (2) to supply such working capital as Sales may need; (3) to provide such executive management ... as may be necessary for the proper conduct of Sales business .... Sales agrees (1) to manage and operate ... all of said plants; (2) to maintain the same in first class condition ....; (3) to distribute, market and sell, the product manufactured in said plants as efficiently as possible ....; (4) to pay all expenses of such operation, maintenance and selling, and to discharge all expenses or liabilities incurred therein or thereby and to collect all accounts receivable or other proceeds resulting therefrom; (5) to credit monthly on its books to Airco all profits accruing to it from the operation of its entire business over and above an amount equal to six per cent (6%) per annum on its outstanding capital stock, which said amount it is hereby authorized to deduct and retain, and it hereby agrees to accept as full compensation for its services hereunder; and (6) to pay over to Airco upon demand any profits becoming due and credited to Airco as aforesaid.

Id. at 424 n.1.

21. Id. at 438.

22. 247 U.S. 330 (1918). Income earned by a wholly owned subsidiary prior to the effective date of the Income Tax Act of 1913 was attributed to the parent, owing to complete domination of the subsidiary by the parent. Id. at 337.
Pacific decision on the ground that the term "agent" as used in the earlier opinion was not intended in the technical sense of a principal-agent relationship, but as a means by which the Southern Pacific Court described its disregard of the corporate entity.\(^{23}\) As such, it was equivalent to the "sham" theory repudiated in the Moline Properties decision. The Court said that the relationship between AIRCO and its subsidiaries was the same as the relationship between Moline Properties, Inc., and its sole shareholder, and raised serious doubt as to whether a corporation could ever be considered an agent of its sole shareholder:

Undoubtedly the great majority of corporations owned by sole shareholders are "dummies" in the sense that their policies and day-to-day activities are determined not as decisions of the corporation but by their owners acting individually. . . . We reversed the Board of Tax Appeals in Moline Properties in the face of its finding that . . . [the sole shareholder retained full beneficial ownership of the underlying property].\(^{24}\)

The Court rejected petitioners' contentions of agency, but left the door open for "a true corporate agent . . . [to handle] the property and income of its owner-principal without being taxable therefor."\(^{25}\)

Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal by, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists.\(^{26}\)

Litigants attempting to create exceptions to the Moline Properties and the National Carbide decisions have not fared well in the courts.\(^{27}\) However, taxpayers did score a partial success in Paymer v. Commissioner,\(^ {28}\) which compared two corporations owned by the same shareholder. One corporation was deemed viable for tax purposes and the other a passive dummy which would not be taxed. In Paymer, a partnership transferred parcels of real estate to two corporations to prevent creditors of one of the partners from attaching partnership property. The minutes of the corporate meetings of each corporation stated: (1) that the corporation was intended only as a title holding device; (2) that the bene-

\(^{23}\) Id.
\(^{24}\) 336 U.S. at 433-34.
\(^{25}\) Id. at 437.
\(^{26}\) Id. (footnotes omitted).
\(^{27}\) The litigants have heretofore attempted to apply these doctrines to their fact situations rather than establish new principles. Kronovet, supra note 5, at 55 n.1.
\(^{28}\) 150 F.2d 334 (2d Cir. 1945).
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ficial interests of and the profits from the property were in the shareholders; and (3) that the corporation was organized solely for the convenience of the shareholders in the management of the property. The differing tax treatment was based on the fact that the leases on the property were never transferred to the corporation which was deemed passive while the viable corporation obtained a loan on a lease which was transferred to it. In order to obtain the loan, the latter corporation covenanted that the leases were in full force and effect and that it was the sole lessor. The court specifically noted that an absence of books, records, offices or a failure to hold corporate meetings is not decisive on the issue of business activity. A comparison of the taxable and nontaxable corporations in Paymer supports the proposition that the only time a corporation will be disregarded for tax purposes under the Moline Properties doctrine is when it serves no corporate business purpose with respect to the property it holds, but only takes and holds title to such property.

Paymer and subsequent decisions have been careful to note that the business purpose in question must be one which is germane to the functioning of the corporation. The Moline Properties test becomes: Is the corporation required to carry out any functions with respect to the property transferred to it in order to carry out the business purpose of the beneficial owners? If the answer is "yes" the corporation will, much more often than not, be charged with the beneficial ownership of the property and the consequent tax burdens.

An obvious exception to this rule surfaces in situations where the corporation is deemed a true agent of the beneficial titleholders. Another safe harbor for taxpayers is the situation where

29. Id. at 336.
30. Id.
31. Id.
32. Id. at 337.
33. Harrison Property Management Co. v. United States, 475 F.2d 623, 626 (Ct. Cl. 1973); Jackson v. Commissioner, 233 F.2d 289 (2d Cir. 1956).
34. Carver v. United States, 412 F.2d 233, 239 (Ct. Cl. 1969). But see Commissioner v. State-Adams Corp., 283 F.2d 395 (2d Cir. 1960); Harrison Property Management Co. v. United States, 475 F.2d 623, 627 (Ct. Cl. 1973). The distinction is whether the corporation is governed by the principal-agent relationship with the beneficial owner of the property or whether the corporate acts are the usual incidents of a close corporation-shareholder relationship. For a discussion of National Carbide, see text accompanying notes 20-26 supra. In connection with this issue, the clear implication is that it is the very rare case where a close corporation will be deemed to be the agent of its shareholders, but may act on behalf of an independent third party.
the intended business purpose is not effected.\textsuperscript{35} The result is the same as that of the nontaxable corporation in Paymer—the corporation merely holds title to the property in question and is not charged with beneficial ownership.

Assuming that a shell corporation is found to have a "business purpose" within the meaning of the Moline Properties doctrine, how much activity will be necessary to charge it with beneficial ownership of property? Mere taking and holding of title to property, without more, usually will not result in a tax being assessed on the corporation. \textit{Britt v. United States}\textsuperscript{36} stated that "[b]usiness activity is required for recognition of the corporation as a separate taxable entity; the activity may be minimal."\textsuperscript{37} Although courts have not consistently held that a corporation which engages in any business activity will be deemed a taxable entity,\textsuperscript{38} there have been enough cases to dissuade many taxpayers from using a shell corporation if other alternatives are available.

A related doctrine stated in \textit{Higgins v. Smith},\textsuperscript{39} pervades the entire area of the taxation of shell corporations. The Service need not always accept the taxpayer's characterization of the transaction or entity in question:

A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax advantages.

On the other hand, the Government may not be required to acquiesce in the taxpayer's election of that form for doing business which is most advantageous to him. The Government may look at actualities and upon determination that the form employed for doing business ... is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute.\textsuperscript{40}

Thus, a taxpayer is stuck with his decision regardless of whether it best suits all of his business purposes, while the Service is af-

\textsuperscript{35} In National Investors Corp. v. Hoey, 144 F.2d 466 (2d Cir. 1944), a corporate taxpayer transferred securities to a shell corporation solely for the effectuation of a plan of reorganization that was rejected. The corporation performed no function with respect to such property except to hold it and return title to the beneficial owner after the failure of the plan. The Second Circuit found that the loss accruing with respect to the securities belonged to the beneficial owner of the property. The corporate owner had attempted to place the loss on the shell, but the court disallowed this action, holding that escaping taxation was not business in the ordinary sense of the word. \textit{Id.} at 468.

\textsuperscript{36} 431 F.2d 227 (5th Cir. 1970).

\textsuperscript{37} \textit{Id.} at 237.

\textsuperscript{38} \textit{See} note 43 and accompanying text infra.

\textsuperscript{39} 308 U.S. 473 (1940).

\textsuperscript{40} \textit{Id.} at 477.
forded flexibility in the enforcement of the revenue laws. This treatment is consistent with the previously discussed decisions regarding the sham and agency approaches. "It is command of income and its benefits which marks the real owner of property."41 When considered in light of the anticipatory assignment of income doctrine42 this rule makes perfect sense. When applied to taxation of shell corporations, however, it leaves the door open for the taxpayers to assert that shareholders and not the corporation should be taxable on the income which nominally rests in the shell corporation. *Higgins* was overruled on this point by *Moline Properties*.

A recent case, *Bolger v. Commissioner*43 was decided in favor of the taxpayer, however, and seemed to rely to a great degree on *Higgins*. In *Bolger*, the taxpayer organized corporations to acquire title to properties, issue promissory notes secured by mortgages, and execute leases on the properties. Immediately upon completion of the foregoing steps, usually within one day, the properties were conveyed to individuals, subject to the leases and debts. The Tax Court held specifically that the corporations were viable taxable entities and were not true agents, citing *Moline Properties* and *National Carbide*.44 But the court went on, without citing *Higgins*, to hold that the transferees of the properties were the true owners, and thus were entitled to the depreciation deductions.

Notwithstanding a favorable decision for the shareholder transferees, *Bolger* solidified the Service's position regarding the sham and agency theories. Prior to *Bolger*, most tax practitioners believed that a transaction of this type which was completed within one day was an unwritten exception to the *Moline Properties* and *National Carbide* doctrines.45 It is now clear that this exception does not exist.

**III. THE FACTS OF STRONG**

The facts of *Strong v. Commissioner*46 present a common attempt by individuals to avoid New York's usury statute.47 Seeking to obtain adequate financing for the construction of an apartment complex, they used the medium of a corporate borrower, while trying to retain beneficial ownership of the underlying real property in a partnership.

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41. *Id.* at 478 (footnote omitted).
43. 59 T.C. 760 (1973).
44. *Id.* at 766.
Prior to September, 1967, the petitioner and other individuals formed a partnership to develop an apartment complex. Financing was unavailable at the maximum rate of interest which could legally be charged to natural persons, and the partnership was not a separate entity exempt from the usury laws. Corporations were exempt.

The decision to form a corporation owned by the partnership to obtain financing was reached in September, 1967. The intention of the parties at all times was to retain beneficial ownership of the apartment complex and the underlying realty in the partnership. The parties entered into a formal partnership agreement on December 18, 1967. The agreement provided that certain of the partners were to transfer a parcel of real property "to the partnership or its nominee" and stated further that:

It is agreed that title to the aforesaid Parcel [of land] be held by a corporate nominee for the benefit of the partnership, it being the intention of the parties hereto that at all times the real and beneficial owner of the said Parcel shall be the partnership.

The partners also agreed that the partnership would enter into a construction agreement with the nominee corporation, for which the plans and specifications would be prepared on behalf of the partnership. A second agreement between the parties, substantially similar in its terms to the first, was executed on the same day, and provided for the transfer of two additional parcels of real estate to the partnership.

The first parcel was deeded to the corporation on December 27, 1967. Two days later, a building loan agreement and mortgage on this parcel was entered into between the corporation as mortgagor and Chemical Bank New York Trust Company as mortgagee. The corporation represented that (1) it was a corporation in good standing; (2) it had been duly authorized to enter into the loan agreement; and (3) it owned the property and that any assignment of the property by it without the consent of the lender was an event of default.

Upon completion of the apartments on the first parcel, they were leased to tenants and the partnership was named as landlord.

48. 66 T.C. at 14.
49. See note 1 supra.
50. Id.
51. 66 T.C. at 15.
52. Id.
53. Id. at 15-16.
54. Id.
55. Id. at 17.
Assurance was obtained to guard against destruction of the buildings and loss of rents in December, 1968, with the corporation as the named insured. One year later, the policy was amended to include the partnership as a named insured. One last loan was made to the corporation in February, 1969 to facilitate the completion of construction on the first parcel.

Similar arrangements were made with respect to the financing of the development of apartments on the second and third parcels.

In December, 1969, the situation changed. A memorandum by one of the partners directed that “the only time the title will rest in the Corporation will be at the moment an advance is made.” All three parcels were to be conveyed immediately to the partnership, deeded to the corporation only for the purpose of securing advances, and immediately reconveyed to the partnership. “IRS considerations” were stated as the motivation for such actions. Since the original conveyances from the partnership, legal title to the three parcels had rested continuously in the corporation.

This conveyance-reconveyance arrangement continued until May, 1970, when the parcels were conveyed to the partnership by warranty deed with full covenants, which was recorded promptly.

During the development period, the corporation was involved only in the financing of the projects. The partnership took all material actions with respect to the development of the complexes. Permits were issued to the partnership, it granted necessary easements, and handled all other details. Advances from lenders were credited to the corporation’s account, and transferred by check to the partnership. The only departures from this procedure occurred when time was of the essence and it was necessary to transfer the advances directly to the contractor. All other receipts and disbursements were by the partnership, and so reflected on its books. The corporation kept no books other than the ones which pertained to its advance accounts. No capital stock was issued by the corporation, and it held no meetings and maintained no minutes. Federal income tax returns were filed which listed its business as “nominee corporation”; but no income, loss, assets or liabilities were reported. With the exception of the real property, no other partnership assets ever were transferred to the corporation. It was dissolved in 1973. Net operating losses with respect to the development of the apart-

56. Id.
57. Id. at 19.
58. Parcel 2 was deeded to the corporation in May 1969, and Parcel 3 was deeded in June 1969. Id. at 18.
59. Id. at 19.
ment complexes were sustained in 1965, 1966, 1968 and 1969. The losses were reported on the tax returns of the partnership and the individual returns of the partners as distributive shares. The Service disallowed the losses to the partnership and the partners. Litigation followed in the Tax Court and the Service's position was affirmed in all respects.

IV. THE STRONG OPINION

The Tax Court's opinion in *Strong* represented a logical step in a progressively broadened view by the Service toward the taxation of shell corporations. Petitioners made two allegations. First, they argued that the corporation was a sham whose ownership of the real property should have been disregarded for tax purposes. Second, they argued that the corporation was a nominee of its shareholders. The nominee approach was reminiscent of the agency doctrine, but had little support in the facts.

The Tax Court first dealt briefly with the accepted practice in New York of using shell corporations to avoid usury laws, citing

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60. The sources of the losses in the two earlier years were not discussed in the opinion.
61. See notes 15-19 and accompanying text *supra*.
62. The only indications that the corporation was intended as an "agent" of its shareholders as that term was used in National Carbide v. Commissioner, 336 U.S. 442 (1949), are the following: (1) the partnership agreement of December 18, 1967 stated that title to Parcel 1 "may be held by a corporate nominee for the benefit of the partnership" 66 T.C. at 15; and (2) similar statements reaffirming the intention of the parties to treat the corporation as a nominee upon conveyance of Parcels 2 and 3 to the partnership. *Id.* at 9.

This is far different from the observations of one commentator who suggested the following procedure in order to assure "agency" treatment by the Internal Revenue Service where the corporation is organized to circumvent usury laws: (1) form a shell corporation, but no beneficial owners of the property should act as incorporators, or be shareholders, officers or directors; (2) have the articles of incorporation state a limited purpose—that of a corporate agent; (3) do not observe corporate formalities, i.e., hold no meetings, adopt no by-laws, etc.; (4) file tax returns but show no income other than an agent's fee; and (5) draft a detailed agency agreement which includes the following elements: (a) the beneficial owners are the true owners of the property and the corporate agent's only purpose is to obtain a loan (or the like); (b) the corporation shall only perform ministerial functions with the beneficial owners retaining full control of the property; (c) the loan obtained shall be placed in an account for the benefit of the beneficial owner who shall have exclusive control over it; (d) the property shall be reconveyed to the beneficial owners on demand. Tilley, *Dummy Corporations for Real Estate Holding Purposes: Taxation and Technique*, 33 Tex. B.J. 445, 451-52 (1970).
Hoffman v. Lee Nasham Motors and Leader v. Dinkler Management Corp., two decisions of that state's highest court. In the Leader decision, the New York Court of Appeals denied the usury defense in spite of a finding by the lower court that "the loan . . . was made to appellant . . . individually, though in form to a corporation in order to hide the fact that . . . [the lender] exacted an illegal rate of interest." The test in Leader focused on whether the loan was in form made to a corporation, ignoring the substance of the transaction.

The Tax Court's response was a half-hearted acceptance of the reality of the situation: "There is no doubt that petitioners sought to do business in partnership form and that the corporation was, at least in their eyes, a mere tool or conduit. Their argument is not without some appeal, but . . . it should not be accepted."

The Moline Properties doctrine set the parameters for the discussion in Strong. The court found that the avoidance of state usury laws was a "business purpose" within the meaning of Moline Properties. The doctrine was restated in dictum, when the Tax Court found that income from property was taxable to its corporate owner "unless the corporation is a purely passive dummy." The line of cases cited to support this statement gives some indication of the types of activities which are considered to constitute a "business purpose" and thus result in taxation to the corporation. Use of a corporation (1) for efficient management of property in the event of the death of one of its beneficial owners, (2) to mask the identity of a beneficial owner, or (3) to avoid usury laws constitutes a business purpose. On the other hand, the mere hold-

64. 20 N.Y.2d 393, 230 N.E.2d 120, 283 N.Y.S.2d 281 (1967).
65. Id. at 398, 230 N.E.2d at 122, 283 N.Y.S.2d at 284.
66. Id. at 399, 230 N.E.2d at 122, 283 N.Y.S.2d at 284.
67. 66 T.C. at 21.
68. See notes 15-19 and accompanying text supra.
69. 66 T.C. at 24. The court relied on the Moline Properties and Bolger cases and the decision in Collins v. United States, 386 F. Supp. 17 (S.D. Ga. 1974), aff'd per curiam, 514 F.2d 1282 (5th Cir. 1975), to establish this point. The Collins case was the only one which directly stated that the avoidance of state usury laws constituted a "business purpose" within the meaning of Moline Properties. 386 F. Supp. at 21.
70. 66 T.C. at 22.
72. Taylor v. Commissioner, 445 F.2d 455 (1st Cir. 1971).
ing of title to securities as part of a plan of reorganization which eventually fails does not constitute a business purpose.\textsuperscript{74}

In light of the authorities that have followed \textit{Moline Properties}, the Tax Court's treatment of shell corporations is typical. As far as the "business purpose" doctrine is concerned, \textit{Strong} added nothing new.

The Tax Court did state that a claim of nontaxability of the entity by the shareholders of a close corporation would be subject to close scrutiny.\textsuperscript{75} This follows directly from the \textit{National Carbide} decision,\textsuperscript{76} which stated that although it is often difficult to determine whether a close corporation is the agent or the alter ego of its shareholders, the corporation will be taxed as a separate entity\textsuperscript{77} unless strong evidence of a true corporate agency is present.\textsuperscript{78} An even stronger case for the Service's position exists in the situation where there is no claim of corporate agency.

The court considered and rejected the suggestion of one commentator that the "situs of real beneficial or economic ownership," rather than the viability of the corporate entity should be controlling.\textsuperscript{79} This recommendation comports with the view expressed in \textit{Higgins}\textsuperscript{80} and \textit{Bolger}.\textsuperscript{81}

The apparently significant difference between the \textit{Strong} case of nontaxability and the \textit{Bolger} decision is difficult to see. \textit{Bolger} expressly stated that the \textit{Moline Properties}\textsuperscript{82} and \textit{National Carbide}\textsuperscript{83} doctrines were applicable in a case where all of the corporate functions were performed within a short period of time followed by an immediate reconveyance of the properties to the shareholders/beneficial owners. But the determination that the shareholders were the beneficial owners of the property seems to have rested on the same grounds. The only differences in the present case are (1) the fact that the principals in the \textit{Bolger} case were actively engaged in real estate investment and finance,\textsuperscript{84} while in the present case the corporation was only used to finance one project, and (2) the fact that the corporate dealings throughout the

\textsuperscript{74} National Investors Corp. v. Hoey, 144 F.2d 466 (2d Cir. 1944).
\textsuperscript{75} 66 T.C. at 22.
\textsuperscript{76} See notes 20-26 and accompanying text \textit{supra}.
\textsuperscript{77} 336 U.S. at 434.
\textsuperscript{78} \textit{Id}. at 437. See note 63 \textit{supra}.
\textsuperscript{79} 66 T.C. at 22.
\textsuperscript{80} See notes 39-41 and accompanying text \textit{supra}.
\textsuperscript{81} See notes 43-45 and accompanying text \textit{supra}.
\textsuperscript{82} See notes 15-19 and accompanying text \textit{supra}.
\textsuperscript{83} See notes 20-26 and accompanying text \textit{supra}.
\textsuperscript{84} 59 T.C. at 761.
history of the Bolger transactions consisted almost entirely of one-
day-in-one-day-out conveyances to and from the corporations, \(^85\) while the petitioners in Strong decided to resort to this approach
only late during the last tax year in issue after it was determined
that it might be critical for tax purposes. \(^86\) The major difference
in the two cases relates to the second issue, concerning beneficial
ownership of property.

The role approach to corporate financing transactions, discussed
in the foregoing paragraph has received some support from com-
mentators but not by courts. \(^87\) For example, one writer has sug-
gested discarding the present determinative factors \(^88\) in favor of
such a role approach. Rather than asking whether a corporation
is a shell for tax purposes, the question would be posed in terms
of "whether a corporation's formal relationship to a particular prop-
erty or transactions should be disregarded as dummy ownership or
as a sham transaction." \(^89\) Although this restructured analysis of
the problem initially would create a new issue for taxpayers to
litigate, the impact on the Service and the courts could be lessened
through codification of this approach with a consequent analysis
by the Service through treasury regulations and revenue rulings.

The Tax Court did address this alternative in Strong, however,
stating briefly that the door is open for a corporation to argue that
it is a mere straw with respect to a particular transaction. \(^90\) Its
shallow approach to this alternative leaves at least two questions
unanswered. First, in the area of real estate investment and fi-
nance, the corporation is often obligated to represent that it is the
beneficial owner of the land in question, as well as to pledge leases
executed to it as additional security for advances. Assuming that
a lender will demand such representations and actions when large
sums of money are borrowed, the shell corporation nearly always
will be considered more than a "dummy" with respect to transac-

85. Id.
86. 66 T.C. at 18.
87. See Watts, Tax Problems of Regard for the Corporate Entity, 20 N.Y.U.
88. The major stakes in present litigation turn on whether the corporation
is a viable entity or whether it is a true agent.
89. Watts, supra note 87, at 868.
90. The adoption of this approach would necessarily change one of the
basic premises inherent in the tax treatment that the Internal Revenue
Code accords to corporations. With a few exceptions in statute (i.e.,
the Subchapter S election) and in practice (corporations may be disre-
garded for tax purposes if the motive of the shareholders is tax avoid-
ance) the Corporation and its shareholders are viewed exclusively
from the standpoint that they are separate taxable entities. Watts,
supra note 87, at 868.
tions such as occurred in Strong. Second, while the court in the present case reasonably accurately represents that corporate activity will be a determinative factor in deciding whether to tax the corporation or the beneficial owners on the property, several decisions have inexplicably held for the taxpayer where a good deal of corporate activity exists.\footnote{91}{See Kronovet, supra note 5, at 55-56.}

V. CONCLUSION

The doctrines developed in case law since Moline Properties have been, for the most part, well reasoned and consistent. The Tax Court's decision in Strong was no exception. If Strong added anything to the case law, it extended Bolger\footnote{92}{See K-C Land Company, Inc., 29 T.C.M. (P-H) 209 (1960). In this case a corporation acquired title to numerous properties, transferred title, issued stock, kept corporate records, executed mortgages, borrowed and repaid money, paid operating expenses and was disregarded for tax purposes. Alan S. Davis, 39 T.C.M. (P-H) 825 (1970) and Noonan v. Commissioner, 52 T.C. 907 (1969) both allowed a disregard of the corporate entity where the purpose was essentially one of tax avoidance. See also Kronovet, supra note 5, at 55.} by taxing a corporation when title to real estate was vested therein for only a short period of time.\footnote{93}{Kronovet would probably dispute the importance and possibly the accuracy of this conclusion. He states: "Experience indicates that the avoidance of usury may be the single most important reason for using a straw corporation. Accordingly, an inference is possible that the Commissioner is not prone to challenge situations in which a corporation is used for this purpose." Kronovet, supra note 5, at 56.}

Taxpayers have been apprised of the possible, if not probable, consequence of using shell corporations to serve functions that only corporations can serve, if those functions constitute a "business purpose." Taxation at the corporate level is likely to result. This knowledge does not solve the taxpayers' problem, however, because state usury laws still exist.

The Treasury should take steps to remedy what has heretofore been the inequitable treatment of the taxpayer who is forced to use the shell corporation. Congress could enact legislation which would allow for some type of election by taxpayers so that they could retain the beneficial ownership of property and its consequent tax burdens and benefits which must be transferred to a shell corporation. The proposed election would be available only where state law expressly or in effect requires a corporate entity and where there is no good reason to require the use of such an entity. An alternative would be for the Treasury Department to issue
regulations, revenue rulings or revenue procedures providing that corporations will not be taxed or favorable ruling issued if the beneficial owners of property follow stated procedures with respect to their financing transactions. Finally, a mass repeal of state usury statutes would solve the problem and the need for any action by the Service. Although this would be the cleanest alternative from the standpoint of corporate financing, it would create some degree of hardship on the small individual borrower. A related solution would be to repeal usury statutes where the amount in question is higher than a stated dollar figure, thus avoiding the hardship.

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