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Dealers, Corporations, and Capital Gains -- Attributing the Trade or Business Activities of the Controlled Corporation to the Individual Shareholders

Edward A. Schrank

COMMENTS

DEALERS, CORPORATIONS, AND CAPITAL GAINS—ATTRIBUTING THE TRADE OR BUSINESS ACTIVITIES OF THE CONTROLLED CORPORATION TO THE INDIVIDUAL SHAREHOLDERS

EDWARD A. SCHRANK*

I. INTRODUCTION

> [T]he words of such an act as the Income Tax . . . merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport which it is my duty to extract. . . .[1]

The "purport" which the author herein will attempt to extract relates to the degree to which the controlled corporation can engage in a trade or business separate and apart from that of its controlling shareholders.

II. DEALERSHIP CONCEPT

"Capital Gain" may be defined simply as that gain derived from the sale or exchange of a capital asset. In defining "capital asset," Con-

* Assistant Editor, *University of Miami Law Review*.

1. Hand, *Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947).

gress has chosen to use a negative approach. It includes all "property" except that which is specifically excluded. By using the all-inclusive term "property," it is apparent that Congress intended to thrust upon the courts the task of giving that term a concrete definition.[2]

Was it also Congressional policy to grant to the courts the same broad discretionary authority in interpreting the specific exclusions? Section 1221(1) excludes from treatment as a capital asset any property "held by the taxpayer primarily[3] for sale to customers[4] in the ordinary course of his trade or business."[5] Although Congress has spoken in terms of the property itself and the manner and purpose for which it is held, case law has placed particular emphasis on the business activities and characterization of the individual by whom such property is held.[6]

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2. Zarky, *Capital Gain Concepts*, U. So. CAL. 1959 TAX INST. 357, 363.

> [T]he courts are undoubtedly influenced by their understanding of the overall Congressional purpose in attempting to differentiate between capital gain and ordinary income. Unfortunately . . . if one looks beyond the definition of section 1221 and attempts to discern some consistent pattern in all Code sections which deal with capital gains in specific areas, the consequence is one of bewildering confusion rather than a clarification of a basic legislative policy.

See generally Katcher, *What Is a Capital Asset?* 12 W. RES. L. REV. 256 (1961).

3. "Primarily" has generally been interpreted as meaning merely that the purpose of holding it for sale must be a "substantial" or "essential" one. Rollingwood Corp. v. Commissioner, 190 F.2d 263 (3d Cir. 1956); United States v. Bennett, 186 F.2d 407 (5th Cir. 1951). Thus, if taxpayer holds property for more than one purpose, and one such purpose is sale to customers in the ordinary course of his trade or business, ordinary income treatment may result. Recordak Corp. v. United States, 325 F.2d 460 (Ct. Cl. 1963); Hollywood Baseball Ass'n, 42 T.C. 234 (1964). *But see*, Municipal Bond Corp. v. Commissioner, 341 F.2d 683 (8th Cir. 1965), holding that the term requires it to be the "predominate" purpose. Author's Note—see also, Malat v. Riddell, 86 Sup. Ct. 1030 (1966). The ultimate effect of the Supreme Court's decision in Malat v. Riddell, which was rendered after this article was written, remains uncertain as of the date of publication. However, as there is a strong likelihood that it may substantially alter the law with respect to dealers and capital gains, hence it should be read in conjunction with the above article.

4. At least as applied to real estate transactions, any purchaser will be deemed to be a customer, Charles H. Black, 45 B.T.A. 204 (1941), *acq.*, 1941-2 CUM. BULL. 2, so that a sale to a single vendee will be one to a customer, Patterson v. Belcher, 302 F.2d 289 (5th Cir. 1962); Nielson v. United States, 333 F.2d 615 (6th Cir. 1964).

5. Before an activity can be classified as a business, there must be a devotion of time, attention, and effort with some regularity. Stern v. United States, 164 F. Supp. 847 (E.D. La. 1958), *aff'd per curium*, 262 F.2d 957 (5th Cir. 1959); Thomas v. Commissioner, 254 F.2d 233 (5th Cir. 1958).

Business means "busyness." Snell v. Commissioner, 97 F.2d 891 (5th Cir. 1958).

The fact that the taxpayer is engaged in other businesses and professions will not prevent him from being a dealer with regard to particular types of property. Gilford v. Commissioner, 201 F.2d 735 (2d Cir. 1953); Harvey v. Commissioner, 171 F.2d 620 (1st Cir. 1946); Reynolds v. Commissioner, 155 F.2d 620 (1st Cir. 1946).

Prior to the 1934 act, the words "customer" and "ordinary" were not found in the statutes. They were added in the middle of the depression when most sales produced losses. The reason for the inclusion was to increase the number of transactions qualifying as capital gain to make it "impossible to contend that a stock speculator trading on his own account is not subject to the provisions of § 117," H.R. Rep. No. 1385, 73d Cong., 2d Sess. 22 (1934). It is amusing that today, with most transactions resulting in gain, the Commissioner is allowed to use the same provisions, by bringing more and more transactions within the business category, to limit the number of transactions coming within the exclusion. Penell, *Capital Gains in Real Estate Transactions*, TUL. 8th TAX INST. 25 (1959).

Thus, through case law, the "dealership concept" has been brought to life.[7] This concept is founded upon the proposition that once one has had significant dealings with regard to a particular type of property, he should be found to be in the trade or business of dealing in that asset so that subsequent sales will be sales in the ordinary course of that trade or business.

The practical effect of this is to divide taxpayers into two groups: the first consists of those who have dealt substantially in this particular asset; the second consists of those whose dealings have not yet elevated them to this rather low-lying plateau. The former are to be denied capital gain treatment, the latter are to be afforded such treatment, at least until their activities become sufficient to change their status. That this concept does not conform to Congressional intent is obvious, since the statute makes no reference to the nature of the individual holding the property but merely refers to the purpose for which it was held.

This approach places a more severe handicap upon those who deal in real estate, than upon those who deal in securities.[8] Although each holds property "primarily for sale to customers," the Commissioner and the courts have given the term a more limited meaning with respect to security transactions. A dealer in securities is analogous to a retailer, "who purchased property for resale to customers he had or hoped to have for a price in excess of his cost, the premium representing his compensation as a middleman."[9] In security transactions, the dealer is distinguished from the trader, in whose hands securities are a capital asset. A trader is defined as "one who purchased property with the expectation of reselling it after a rise in the value during the interval of time he held it, and who performed no merchandising function for which he sought compensation since his source of supply was not significantly different from that of those to whom he eventually sold the property."[10] Regardless of the number of transactions into which a trader in securities enters, as long as he does not perform the mer-

6. Boomhower v. United States, 74 F. Supp. 997 (D.C. Iowa 1947); D. G. Bradley, 26 T.C. 970 (1956), *acq.*, 1957-1 CUM. BULL. 5; D. L. Phillips, 24 T.C. 435 (1955); Walter R. Crabtree, 20 T.C. 841 (1953), *acq.*, 1954-1, CUM. BULL. 4; Nelson A. Farry, 13 T.C. 8 (1949), *acq.*, 1950-2 CUM. BULL. 2. See generally Hertzbert, *Dealer or Investor*, 37 TAXES 155 (1959).

7. Emmanuel, *Capital Gains for Real Estate Operators*, 12 U. FLA. L. REV., 280, 282 (1959).

8. Not all the attributes of dealer statutes are disfavorable to the taxpayer. A dealer may deduct his expenses of sale as ordinary business expenses in the year in which they were paid or incurred. The investor must use his expenses to offset the purchase price, so that on an installment sale, he must amortize the selling expenses over the life of the installment contract. The dealer is also allowed an ordinary loss, while the investor is afforded the less precious capital loss. However, a dealer may not, while an investor may, take advantage of the tax-free exchange provisions of the code. ANDERSON, REAL ESTATE OPERATIONS 17 (2d ed. 1965).

9. 3B MERTENS, LAW OF FEDERAL INCOME TAXATION § 22:15 at 75 (1958).

10. *Ibid.*

chandising function necessary to be a dealer, he will be allowed to receive capital gain treatment.

For those who deal in real estate, the status upon which capital gain treatment depends is that of an investor. An investor is one who buys real estate, either for its income producing possibilities or for a possible future accretion in value. A dealer may be defined as one who buys real estate for the purpose of holding it for resale.[11] The frequency of sales itself may be sufficient to make one who sells real estate a dealer.[12]

Once one has achieved the dealership status, he is presumed to hold all such property in which he is a dealer for sale to customers in the ordinary course of his trade or business.[13] Although the presumption is rebuttable, the courts will be particularly exacting as to the quantum of proof required to rebut it.[14]

The stigma of dealership has been almost completely removed from those dealing in securities. As the result of a relief provision enacted in 1951, they have been allowed capital gain treatment on the sales of securities which, within thirty days of acquisition, were identified as being held for investment rather than for sale to customers.[15] Real estate dealers have not been so blessed. They have had to reconcile themselves to a code section which is in fact nothing more than an emaciated shadow of the other relief provision. It states that under very limited circumstances, an individual may not be found to be a dealer solely because of his activities with regard to a particular tract of land.[16] It provides no relief for one already a dealer.

11. Repetti, *What Constitutes a Dealer under Section 1237*, N.Y.U. 17TH INST. ON FED. TAX, 651, 656 (1959). *But see* James M. Fidler, 11 CCH TAX CT. MEM. 1128 (1952), *withdrawn and superseded by* 20 T.C. 1081 (1959) *aff'd*, 55-1 CCH U.S. TAX CAS. 9263 (9th Cir. 1955), *amended on other grounds*, 231 F.2d 138 (9th Cir. 1956); Philber Equip. Corp. v. Commissioner, 237 F.2d 129 (3d Cir. 1956), *reversing and remanding*, 25 T.C. 88 (1956). The Circuit Court held that "the mere fact of acquisition with the hope or expectation of selling it for a profit does not make the holding of it 'primarily for sale to customers.'"

12. Ehrman v. Commissioner, 120 F.2d 607, 610 (9th Cir. 1941), *cert. denied*, 314 U.S. 668 (1941).

13. Robert K. Fronk, 16 CCH TAX CT. MEM. 1103 (1957), *aff'd per curiam*, 265 F.2d 930 (6th Cir. 1959); Jones v. Commissioner, 209 F.2d 415 (9th Cir. 1954).

14. R. M. Clayton, 15 CCH TAX CT. MEM. 105 (1956), *aff'd*, 245 F.2d 238 (6th Cir. 1957).

15. INT. REV. CODE OF 1954, § 1236. The regulation requires only that a bookkeeping separation be made. Treas. Reg. § 1. 1236-1. A provision similar to § 1236 was proposed to give relief to real estate dealers. It was included in the House draft of the 1954 code but was eliminated by the Senate. See § 1237, H.R. Rep. No. 8300, 83d Cong., 2d Sess. (1954).

16. INT. REV. CODE OF 1954, § 1237. If the individual has not held any part of the tract for sale to customers in the ordinary course of his trade or business, *and* in the same year held no other real estate for sale to customers, *and* if he has made no "substantial improvements" on the tract which "substantially increases" its value, *and* if he owned the land for over five years or acquired it by inheritance or devise, he will not be held to be holding such real estate primarily for sale to customers merely because he has subdivided the land into lots or parcels or has engaged in selling, promotion, advertising, or the use of sales agents in disposing of it. The section applies in favor of a corporate taxpayer only if the land was acquired by foreclosure. See generally Beck, *Some Tax Problems of the Investor*,

A. *The Test*

Whether one is a dealer in real estate or merely an investor is a question of fact.[17] The determination rests on all the circumstances in a particular case. No one fact is deemed to be determinative,[18] nor is any single factor entitled to the same weight in each case in which it may appear.[19] It is said that the total fact situation controls rather than the specific facts.[20] As with all questions of fact, the determination of the fact finder is well nigh impregnable, being subject to change only where "clearly erroneous."[21]

The factors which indicate a dealer status are: that there have been frequent sales by the taxpayer; that the owner's major source of income was derived from such sales; that the property was originally purchased for resale; that the property was not income producing; that the property was not used in the owner's trade or business; that the land was subdivided and improved prior to sale; that the property was listed or advertised for sale, that the sale was for the purpose of realizing appreciation; and that the proceeds were re-invested in new real estate.[22]

The inquiry is not limited to the taxpayer's activities with regard to this particular piece of property, but reaches all his real estate activities.[23] This form of investigation places the emphasis on the dealer-

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Subdivider, and Developer of Real Estate, N.Y.U. 15TH INST. OF FED. TAX 381 (1957); Benjamin, Jr., *Real Estate & Taxes: Acquisition of a Tract for Eventual Resale*, 18 BULL. ON TAX SECT. OF A.B.A. 8 (1965); Dean, *Tax Aspects of Real Estate Development*, N.Y.U. 18TH INST. OF FED. TAX 137 (1960); Croth, *Tax Problems in Real Estate*, 36 TAXES 267 (1958).

17. Raymond Bauschard, 31 T.C. 910, *aff'd*, 279 F.2d 115 (6th Cir. 1960); D. L. Phillips, *supra* note 6.

18. Tidwell v. Commissioner, 298 F.2d 864 (4th Cir. 1962); Ralph J. Oace, 39 T.C. 743 (1963). *But see*, Achong v. Commissioner, 246 F.2d 445 (9th Cir. 1957); Rollingwood Corp. v. Commissioner, *supra* note 3; Donald J. Lowrie, 36 T.C. 1117 (1961), stating the purpose for which it is held at time of sale is most significant.

19. John D. Riley, 37 T.C. 932, 938, *aff'd*, 328 F.2d 428 (5th Cir. 1964); C. E. Mauldin, 16 T.C. 698, 709, *aff'd*, 195 F.2d 714 (10th Cir. 1952).

20. The factors are not considered separately but only in relation to each other. Thomas v. Commissioner, *supra* note 5; Smith v. Commissioner, 232 F.2d 142 (5th Cir. 1956); Consolidated Naval Stores Co. v. Fahs, 227 F.2d 923 (5th Cir. 1956).

21. Thomas v. Commissioner, *ibid.;* Burgher v. Cambell, 244 F.2d 863 (5th Cir. 1957).

22. See ANDERSON, *supra* note 8. For instruction on how to avoid being classified as a dealer, see *Saunders, Trade or Business—Its Meaning under the Internal Revenue Code*, U. So. CAL. 1960 TAX INST. 710. For a general statement of the factors considered by the court, see Broughton v. Commissioner, 333 F.2d 492, 493 (6th Cir. 1964):

> Among the factors there pointed out to be considered are (1) the purpose for which the property was acquired; (2) the purpose for which the property was held; (3) the improvements and their extent, which were made to the property by the taxpayer; (4) the frequency, number, and continuity of sales; (5) the extent and substantiality of the transaction; (6) the nature and extent of the business of the taxpayer; (7) the extent of advertising to promote sales, or the lack of such advertising; (8) the listing, if any, of the property for sale directly or through brokers.

23. The court may consider the taxpayer's activity in both prior and subsequent years as well as the tax years in issue. Lockhart v. Commissioner, 258 F.2d 343 (3d Cir. 1958).

ship concept because the taxpayer's past real estate transactions, "like Banquo's ghost,"[24] constantly return to haunt him.

B. *Dealership Not Always Determinative*

Where the issue presented for determination is whether the taxpayer is entitled to capital gain treatment, generally the only function to be performed by the court is to decide whether the taxpayer is or is not a dealer, and, finding him to be a dealer, to rule that he receives ordinary income treatment. However, as the statutes require that the sale be in the *ordinary course* of his trade or business, the taxpayer may show either that he was not a dealer in this particular type of real estate, or that this particular sale was not in the ordinary course of his trade or business. The factors which must be shown to overcome the presumption attached to the dealer status are: the segregation of the property on the taxpayer's books and records, the lack of any improvements made to the property, the taxpayer's complete passiveness in disposing of the property, and the fact that this property differed in some substantial respect from that in which the taxpayer normally dealt.[25] The distinction referred to, above, has been made by the courts where the dealer sells income producing property,[26] a homesite,[27] or inherited property.[28] More significant is the recognition that one who is a tract developer may not also be a dealer in unimproved land.[29]

III. SEPARATE ENTITY CONCEPT

The "nature" of the corporation is a subject that has plagued legal philosophers for centuries. The attributes afforded by the courts to corporate existence depend upon the area of law involved and the par-

24. Apologies.

25. See Orem, *Capital Gains of Dealers in Real Property*, 33 TAXES 147 (1955). The author suggests there are, or should be, four classifications for individuals engaging in real estate transactions: (1) the real estate broker, who earns a commission for buying and selling real estate on behalf of others; (2) the tract developer; (3) dealers in real estate other than tract developers, and (4) the real estate investor.

26. Smith v. Commissioner, *supra* note 20; Nelson A. Farry, *supra* note 6, involving rental property; Jones v. Commissioner, *supra* note 3; Edward Butler, 19 CCH TAX CT. MEM. 1219 (1960), involving the sale of apartment houses; J. Kirby Reppell, 20 CCH TAX. CT. MEM. 295 (1961), involving the sale of a shopping center.

27. Walter Crabtree, *supra* note 6; Weyman Willingsham, 12 CCH TAX CT. MEM. 584 (1953).

28. Scott v. McCrory, 162 F. Supp. 535 (D.C. Neb. 1957).

29. "It has been held generally that unimproved or underdeveloped land in the hands of a taxpayer whose business is that of improvement and development of raw land and thereafter its sale is a capital asset and that its sale in that condition results in capital gain." Ponchartrain Park Homes, 22 CCH TAX CT. MEM. 437, 442 (1963), citing Eline Realty Co., 35 T.C. 1 (1960); Charles E. Mieg, 32 T.C. 1314 (1959); Nelson A. Farry, *supra* note 6.

The Internal Revenue Service has ruled that a taxpayer who sells the unsubdivided part of a tract of land, a part of which has been subdivided into lots for sale, is not in the trade or business of selling real estate as to the unsubdivided part and the sale thereof constitutes the sale of a capital asset. Rev. Rul. 57-565, 1957-2 CUM. BULL. 546.

ticular facts of the case. A corporation has been variously defined as: "A franchise," "An artificial person or being," "An intellectual body created by law," "A method" and "A collection of natural persons."[30]

A general rule, however, can be postulated that insofar as no equitable principle would require otherwise, the courts will treat the corporation as a separate entity.[31] The same general rule applies as well to the treatment of the corporation under the Internal Revenue Code.[32] The Supreme Court has stated:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an 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 . . . , the corporation remains a separate taxable entity.[33]

The corporation files its own return and pays its own tax. The income produced by the shareholders from their separate activities is not taxed to it nor that of the corporation taxed to the shareholders. This result is not affected by the fact that the corporation was formed with the intent to decrease the shareholder's tax burden,[34] for the taxpayer is under no duty to arrange his business affairs in a manner which will produce the most tax.[35]

On the other hand, the Supreme Court has stated that although the taxpayer may choose his own method of doing business:

> [T]he Government may not be required to acquiesce in the taxpayer's election of that form for doing business which is

30. BLACK, LAW DICTIONARY 409 (4th ed. 1951).

31. Burnet v. Clark, 287 U.S. 410 (1932); Metropolitan Holding Co. v. Snyder, 79 F.2d 263 (8th Cir. 1935).

32. New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1943). The separateness of the corporate entity will be recognized except "in exceptional situations where it otherwise would present an obstacle to the due protection or enforcement of public or private rights."

33. Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1941); *affirming* 131 F.2d 388 (5th Cir. 1942), *reversing* 45 B.T.A. 647 (1941).

For a full discussion of the corporate entity under the Internal Revenue Code, see generally: BITTKER, FEDERAL INTERNAL TAXATION OF CORPORATIONS & SHAREHOLDERS (1959); Anthoine, *Transactions Between Related Taxpayers*, 5th ANN. TAL. TAX INST. 269 (1956); Ballantine, *Corporate Personality in Income Taxation*, 34 HARV. L. REV. 573 (1921); Case, *Disregard of Corporate Entity in Federal Taxation—the Modern Approach*, 30 VA. L. REV. 398 (1944); Cleary, *Corporate Entity in Tax Cases*, N.Y.U. 4TH ANN. INST. ON FED. TAX., 772 (1946); Finkelstein, *The Corporate Entity and the Income Tax*, 44 YALE L.J. 436 (1935); Harrar, *The Function of the Entity in Federal Income Taxation*, 25 MINN. L. REV. 189 (1941); Stickler, *Corporate Entity & Taxation*, 29 B.U.L. REV. 486 (1949); Watts, *Corporate Entity*, N.Y.U. 20TH TAX. INST. 867 (1962); Whitted, *The Tax Exclusiveness of Corporate Identity*, 34 TAXES 613 (1956).

34. United States v. Isham, 84 U.S. 496, 506 (1873); Gregory v. Helvering, 293 U.S. 465 (1935); Bridges v. Commissioner, 325 F.2d 180 (4th Cir. 1963), *affirming* 39 T.C. 1064 (1963); Henry C. Beck Builders, Inc., 41 T.C. 616, 627 (1964).

35. Atchison, Topeka & S.F. Ry., 36 T.C. 584, 597-598 (1961); Palm Beach Aero Corp., 17 T.C. 1169, 1176 (1952).

> most advantageous to him. The Government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation.[36]

Therefore, to be a separate entity, the corporation must engage in some form of business, and the fact that it avoids taxes on the part of its shareholders will not be sufficient to find it so engaged.[37] The corporation for tax purposes will be disregarded if it is found to be a sham or unreal. However, even a minimal amount of activity on the part of and in the name of the corporation will be sufficient to support the contention that the corporation was an independent, viable and separate entity.[38]

A. *Corporate Transactions Disregarded*

The mere fact that the corporation will be recognized as a separate person does not mean, however, that the transactions entered into on behalf of the corporation will be recognized for purposes of determining the tax consequences which result therefrom. It has been held by the Supreme Court that:

> The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the

36. Higgins v. Smith, 308 U.S. 473 (1940).

37. National Inv. Corp. v. Hoey, 144 F.2d 466 (2d Cir. 1944), *reversing* 52 F. Supp. 556 (S.D.N.Y. 1943).

38. See National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949),

> When a corporation carries on business activity, the fact that the owner retains direction of its affairs down to the minutest detail, provides all the assets and takes all of its profits can make no difference tax-wise.

Burnet v. Commissioner, 287 U.S. 415 (1932); Commissioner v. State-Adams Corp., 283 F.2d 395 (2d Cir. 1960), *cert. denied*, 365 U.S. 844 (1961), holding that corporation is a viable entity even though its activities are merely those of investing rather than an active business; Hagist Ranch, Inc., v. Commissioner, 295 F.2d 351 (7th Cir. 1961); O'Neill v. Commissioner, 271 F.2d 44 (9th Cir. 1959), recognizing that although a corporation will not be recognized as a separate entity if it holds legal title merely as nominee for its shareholders, if the corporation in its own name takes some significant action with regard to that property, it will be recognized as a separate entity. See also, *e.g.*, Paymer v. Commissioner, 150 F.2d 334 (8th Cir. 1945); Arthur J. Kobacker, 37 T.C. 882 (1962); Wage, Inc., 19 T.C. 249 (1952); A.B. & Container Corp., 14 T.C. 842 (1950); Alprosa Watch Corp., 11 T.C. 240 (1948). *Compare* United States v. Jelenko, 23 F.2d 511 (D.C.D. Md. 1927), "[T]here is nothing about the whole enterprise except the corporate charter to indicate a corporation . . . ." *with* Fontaine Fox, 37 B.T.A. 271 (1938), where the corporation's sole source of income was the services rendered by its sole shareholder.

> commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.[39]

The courts will not restrict themselves to the consideration of "refinement of title," but will view such transactions in reference to how they affect the flow of economic benefits.[40] The courts ascertain what was actually done rather than rely upon the disclosed purpose of the participants.[41] A transaction will be disregarded if it has no business purpose.[42]

However, the tax consequences of a transaction do not depend upon the motive or purpose in entering into the transaction but upon whether the transaction is what it appears to be.[43] The mere fact that the taxpayer engages in the transaction with a motive to avoid taxation will not alter the tax consequences.[44] The sole inquiry to be made by the courts is not what the purpose or the motive of the taxpayer is, but whether the transaction is in fact what it appears to be in form.[45]

Transactions between stockholders and their corporations are valid and enforceable if they are found to be both fair and reasonable when judged by standards applicable to parties dealing at arm's length.[46] The fact that the transaction between the related parties is motivated by the tax consequences which would result does not require the disregard of

39. Commissioner v. Court Holding Co., 324 U.S. 331 (1944), *reversing* 143 F.2d 823 (5th Cir. 1944), *reversing* 2 T.C. 531 (1943).

40. Griffith v. Helvering, 308 U.S. 355 (1939), *affirming* 103 F.2d 110 (7 Cir. 1939), *reversing* 37 B.T.A. 314 (1938), where the court disregarded the corporate entity where it was used as a conduit for the purpose of reporting gain on an installment basis.

41. Weiss v. Stearn, 265 U.S. 242 (1924).

42. See cases cited, *supra* note 34.

43. Fabreeka Prods. Co. v. Commissioner, 294 F.2d 876, 878 (1st Cir. 1961), *vacating and remanding*, 34 T.C. 290 (1960); Sun Properties v. United States, 220 F.2d 171, 174 (5th Cir. 1955); Chisholm v. Commissioner, 79 F.2d 14, 15 (2d Cir. 1935), *cert. denied*, 296 U.S. 641 (1935). See Frank W. Verito, 43 T.C. 429 (1965); H. L. McBride, 23 T.C. 901, 907 (1955).

44. United States v. Cumberland Publishing Serv. Co., 338 U.S. 451 (1950); Bullen v. Wisconsin, 240 U.S. 625 (1916); Arthur J. Kobacher, *supra* note 38, at 894; *contra*, Boyce v. Commissioner, 190 F. Supp. 950 (D.C. La. 1961), *aff'd*, 296 F.2d 731 (5th Cir. 1961).

45. Kraft Foods Co. v. Commissioner, 232 F.2d 118, 128 (2d Cir. 1956), *reversing on other grounds* 21 T.C. 513 (1954); Loewi v. Ryan, 229 F.2d 627, 629 (2d Cir. 1956); Chisholm v. Commissioner, *supra* note 43.

46. *Compare* Raymond Pearson Motor Co. v. Commissioner, 246 F.2d 509 (5th Cir. 1957); Stearns Magnetic Mfg. Co. v. Commissioner, 208 F.2d 849, 852 (7th Cir. 1954); Consolidated Apparel Corp. v. Commissioner, 207 F.2d 580 (7th Cir. 1953); Roy J. Champagne, 26 T.C. 634, 635 (1956); Joseph N. Neel Co., 22 T.C. 1083 (1954); George J. Staab, 20 T.C. 834 (1953); *with* Winters v. Dollman, 238 F.2d 912 (7th Cir. 1956); National Lead Co., 40 T.C. 282 (1963); Gladys Cheesman Evans, 30 T.C. 798 (1958).

the transaction, even though it does require that close scrutiny be given to determine if the substance is, in fact, identical to the form.[47]

B. *Statutory Exceptions*

The power to determine the attributes of corporate existence was not one Congress intended to leave exclusively to the courts. Congress has expressed its intent on a number of occasions by the enactment of several code provisions which limit or de-limit the corporation's separateness.[48]

As shown above, as long as the corporation engages in a substantial business enterprise and the transaction is the same in substance as it is in form, and no specific statutory provision applies, a shareholder is entitled to deal with his controlled corporation in the same manner with which he deals with third parties. The fact that a corporation can act only through its officers or employees, or that the controlling shareholder, through his corporate office and stock ownership actually owns, dominates, and controls the corporate activity down to its most minute details does not alter that result.

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47. Nassau Lens Co. v. Commissioner, 308 F.2d 39 (2d Cir. 1962), *remanding* 35 T.C. 268 (1960); Goldstein v. Commissioner, 298 F.2d 562 (9th Cir. 1962); Creston Corp., 40 T.C. 932, 936 (1963); see, *e.g.*, John F. Nutt, 39 T.C. 231 (1963), *acq.*, 1964-2 CUM. BULL. 5. Here the taxpayer conveyed the land, upon which he operated his farm, to a wholly-owned corporation, and conveyed his leases on other land to another controlled corporation. Both corporations owned bank accounts, borrowed money, employed laborers, filed their own tax returns, and dealt separately with the Department of Agriculture and the Commodity Credit Corporation. Although after the formation and the conveyance of the property, the business continued substantially the same as before, the court held that the corporation was not a sham and that the transfer was real. The court pointed to the fact that the title actively changed hands, the deed was recorded, the price was at fair market value, and secured by a mortgage.

48. Among these are: § 269, which authorizes the Commissioner to disallow a deduction, credit, or other allowance otherwise available, if the avoidance of income tax was the principal purpose for acquiring the corporate control; § 341 which makes the gain on liquidation or sale of stock of certain collapsible corporations ordinary income instead of capital gain; § 351 which provides that a tax free transfer (and not a sale) occurs upon the transfer of property to a controlled (80%) corporation solely in exchange for its stock or securities; § 382 which limits or disallows the net operating loss carryover in cases where stock ownership shifts in special ways; § 401 which provides that a stock bonus, pension, or profit-sharing plan will qualify for certain tax benefits only if it does not discriminate in favor of shareholders; § 482 which authorizes the Commissioner, in cases where two or more organizations are owned by the same interests, to allocate income among them if he determines that it is necessary to prevent tax evasion or clearly reflect income; § 531 which imposes an additional tax on a corporation that is formed or availed of for the purpose of avoiding the income tax on shareholders by accumulating rather than distributing its earnings; § 541 which imposes an additional tax on personal holding companies, which, in part, are defined by reference to the number of shareholders; § 1501 which permits the filing of a consolidated return by affiliated corporations; and § 1551 which denies the $25,000.00 corporate surtax exemption and the $100,000.00 exemption (in figuring the accumulated earnings tax) if a corporation transfers all or a part of its property (other than money) to a newly created or formerly inactive controlled corporation. See generally BITTKER, *supra* note 33.

Congress, however, has determined that the mere fact of control will be sufficient to alter the tax consequences of a sale of property to a corporation in certain respects.

Section 267 provides that no loss shall be recognized on the sale or exchange of property between either a corporation and a person who actually or constructively owns fifty per cent or more of the outstanding stock of such corporation, or between two corporations, if one was a personal holding company and if one person constructively owns more than fifty per cent of the outstanding stock of both. The effect of this provision is not that the transaction will be disregarded but that the mere fact of one party's control over the other is a sufficient basis to deny the deduction for the loss sustained.[49]

Section 1239 provides that any gain received from the sale or exchange (directly or indirectly) of depreciable property between an individual who (together with his wife, minor child and minor grandchild) owns eighty percent or more of the outstanding stock of the corporation to whom such property is sold, is ordinary income. The purpose of this section was to deny the seller a capital gain, while permitting a corporation which he controls to receive a stepped-up basis for depreciation deductions on the same property. Neither the sale nor the gain is disregarded. The shareholder is merely denied the right to have such gain taxed at the lower capital gains rate.[50]

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49. Note that preceding the passage of this code section, the Supreme Court had ruled that no loss was "sustained" upon the sale of property to a wholly-owned corporation. Higgins v. Smith, *supra* note 36, at 476,

> [I]ndeed this domination is so obvious in a wholly-owned corporation as to require a peremptory instruction that no loss in a statutory sense could occur upon a sale by a taxpayer to such entity.

See H. R. Rep. No. 1337, 83d Cong., 2d Sess., U.S. CODE CONG. & AD. NEWS 4017 (1954); H. R. Rep. No. 1546, 75 Cong., 1st Sess. 26 (1937). See also Estate of Johnson v. Commissioner, 42 T.C. 28 (1964), holding that the action applies to solve in the ordinary course of business as well as occasional sales. For attempts to circumvent the rule, see Moore v. Commissioner, 202 F.2d 45 (5th Cir. 1953); Drake v. Commissioner, 145 F.2d 365 (10th Cir. 1944); and Federal Cement Tile Co. v. Commissioner, 40 T.C. 114 (1963). Section 267 is applicable only if there is a bona fide sale to the corporation and a loss actually sustained. Otherwise the rule of *Higgens* will apply. See H. R. Rep. No. 1546, 75th Cong., 1st Sess. 26 (1937).

50. The history of this section is quite interesting. The House bill was much more extensive than the resulting statute. See H. R. Rep. No. 586, 87th Cong., 1st Sess. (1951-2 CUM. BULL. 357, 444). The Senate rejected the idea entirely. S. Rep. No. 781, 82d Cong., 1st Sess. (1951-2 CUM. BULL. 458, 507). The present bill is a compromise worked out by the Compromise Committee. H. R. Rep. No. 1213, 82d Cong., 1st Sess. (1951-2 CUM. BULL. 662). Two recent decisions have held the regulation invalid to the extent that they attempted to extend the section's coverage in attributing to the stockholder's stock beneficially owned by the designated relatives. See Mitchell v. Commissioner, 300 F.2d 533 (4th Cr. 1962); and Rothenberg v. United States, 233 F. Supp. 864 (D.C. Kan. 1964).

Note that the section applies only where the taxpayers would otherwise receive a capital gain and where depreciable property is involved. The section can easily be avoided by the issuance of twenty per cent in value of the stock to others, however, the recapture of depreciation rules of §§ 1245 and 1250 will still apply.

IV. SEPARATE TRADE OR BUSINESS

As has been seen, the dealership concept is an ominous cloud floating above the head of the taxpayer that follows him wherever he goes, precluding him from capital gain treatment. Upon the sale by him of a piece of property in which he is a dealer, other than in exceptional cases, ordinary income rains upon him. The issue to be discussed hereafter is: To what extent can the taxpayer use the corporate entity as an umbrella to shield himself from ordinary income treatment; to what extent can the taxpayer place the corporate structure between himself and the property in order to preclude the court from attributing dealer status to him, or, if already a dealer, to prevent the disadvantage attached thereto from applying to this particular transaction?

It must be remembered that the corporation is, at best, a "fictitious" person and can act only through its officers, employees and shareholders. Although the corporation is recognized as a separate entity and its transactions regarded as being of substance, to what extent can its activities be other than those of its officers and shareholders? How does the "separate entity" concept interrelate with the "dealership" concept? The answers are ones which the Congress has left almost entirely for the courts to decide.

An individual who is a member of a partnership, or joint venture which is actively engaged in selling property will be considered to be engaged in that trade or business even though he is *personally* passive with respect to the enterprise;[51] the mere fact of ownership or association is sufficient. Should the result be different merely because the corporation form of business is used?

The following example is illustrative of the position taken by the courts. The taxpayer was the controlling shareholder, officer, director and employee in a corporation manufacturing and selling steel wire. He purchased additional wire for investment, for appreciation in value due to the Korean War conflict. Although the wire was purchased out of a special investment account and separated from the corporate inventory, it was billed, shipped to and stored by the corporation. The court held

51. Rossiter v. United States, 60-1 CCH U.S. TAX CAS. ¶ 9170, *aff'd*, 282 F.2d 892 (7th Cir. 1960); Morris W. Zack, 25 T.C. 676 (1955), *aff'd*, 245 F.2d 235 (6th Cir. 1957); *cert. denied*, 355 U.S. 823 (1957); Joseph M. Philpin, 26 T.C. 1159 (1956); J. Roland Brady, 25 T.C. 682 (1956); *but see*, Blackburn v. Phiney (W.D. Tex. 1961), 61-2 CCH U.S. TAX CAS. ¶ 9599, holding that the fact that one member of a partnership is a dealer does not make the other partners dealers if the partnership itself is not actively engaged in that business.

The courts can always avoid these rules by simply finding that no partnership or joint venture exists. See Jacob L. Van Drunen, 23 CCH TAX CT. MEM. 903 (1964), where a doctor purchased land with one of his patients and agreed to let his co-owner subdivide and sell the land in lots. The co-owner was to receive a ten percent commission on each sale, however, the owner agreed to split all costs. The court found no partnership or joint venture existed.

that ordinary income treatment would result *only* if the purchase and sale of the wire were found to be, in fact, part of the activities of the corporation, or if the purchase and sale were in themselves sufficient to constitute a trade or business. The court found that these transactions bore no relation to his position in the corporation, "except to the extent such activities may have provided him with the training, experience, and knowledge of firms in the industry which enabled him to conceive the idea for and to carry out such investment."[52]

The trade or business of the corporation will not be attributed to its shareholders merely because of their control over the corporation, not even to its sole shareholder, who also maintains an office or position of employment with such firm. A significant factor is that a separation must be made between the activities and property of the corporation, and those of the shareholder. Otherwise the activities may be found to be those of the corporation, and performed in the ordinary course of its trade or business. The separation should be one both of a physical and of an accounting nature. Therefore, to the degree that the taxpayer is able to keep his transactions separate from those of the corporation, he is capable of realizing a capital gain on the same property as that sold by his controlled corporation.

In determining the frequency and continuity of sales by such a taxpayer, the sales by the corporation will not be attributable to him.

V. Inventory Received upon Liquidation

A different problem is presented where the transaction is not completely separated from the corporation, *i.e.*, where the corporate entity has had some relation to the property. The issue is not merely whether the trade or business of the corporation ought to be attributed to the shareholder, nor whether the mere fact of control and direction should determine the substance of the transaction, but whether the relationship of the corporation to the taxpayer with regard to a particular piece of property is sufficiently significant to cause the courts to look beyond the form of the transaction.

Upon the bona fide liquidation[53] by the corporation of the property which it has been holding either as inventory or for sale to its customers, will the shareholder receive a capital asset? Although the trade or busi-

52. Paul Nehring, 26 P-H Tax Ct. Mem. 191 (1957), at 196. This case was used only as an example of a general principle. It is significant because of the close physical relationship between the inventory of the corporation and the wire held for investment. The wire held for investment was not identical in all respects to that held by the corporation, although it was very similar. The taxpayer also sold some wire through a sole proprietorship formed for the purpose of experimenting with insulating materials. Such sales were not found to be in the trade or business of the proprietorship, but only ancillary to its main function, that of performing experiments.

53. If the liquidation is not bona fide, it will be disregarded for lack of substance.

ness of the corporation is not attributed to him, as to the identical assets which were held by the controlled corporation for sale to customers, should the courts recognize the separate entity concept, so as to find the shareholder holding them for a different purpose? In the leading case,[54] taxpayer and his sister each owned half of the stock of a corporation managed by the taxpayer and which engaged in the sale of industrial pipe. Sibling discord developed, and it was agreed that the corporation should be liquidated. Upon liquidation, the corporate inventory was sold by them as a partnership, sales being made to the customers of the old corporation in one hundred six relatively small transactions. Following the liquidation and during the time in which these sales were made, taxpayer and the sister's husband formed a new corporation which engaged in the same business as that of the one liquidated. The eighth circuit reversed the Tax Court, which had found that although the partnership was acquiring no new inventory, the new corporation was building up an inventory to carry on the business of the liquidated corporation, and therefore, because no bona fide liquidation was taking place, the sales were in the ordinary course of the taxpayer's trade or business. The circuit court held that there was a bona fide liquidation and the fact that a corporation largely owned by one of the liquidating agents was acquiring new stock was not relevant, since such a corporation was a separate entity. The taxpayers were, therefore, entitled to capital gain treatment on such sales.

The character of the assets received upon liquidation of a corporation does not depend upon the use made of them by the corporation, but rather, upon what the recipient does with them. The question to be determined by the court is whether the activities of the taxpayer in disposing of the assets were sufficient to make him a dealer; the courts have been prone to find the shareholder not to be engaged in the trade or business of selling the liquidated property.[55] Where the taxpayer re-

54. Greenspon v. Commissioner, 229 F.2d 947 (8th Cir. 1956). The Circuit Court held that there was no partnership intended but that the partnership returns were filed by mistake. A partnership has at times been successfully used to acquire capital gain treatment. *Compare* Altizer Coal Land Co., 31 T.C. 70 (1958), *acq.*, 1959-1, CUM. BULL. 3, where the two shareholders acquired the only corporate asset, an option right under the company lease to acquire the leased land and building. Unable to reach an agreement with the lessor, they formed a partnership and contracted with it to allow the partnership to sell these assets in return for forty per cent of the profits realized; *with* Pool v. Commissioner, 251 F.2d 23 (9th Cir. 1958); S. Kranz (D.C. 1955) 55-1 CCH U.S. TAX CAS. ¶ 9374. See also that the same rule, as expressed in *Greenspon*, applies where a parent corporation which receives the inventory, accounts receivable, and real estate of a subsidiary upon its liquidation. The Acro Mfg. Co. v. Commissioner, 334 F.2d 40 (6th Cir. 1964), *affirming* 39 T.C. 377 (1962). See also that the dealership activities of a dealer are not attributed to his estate or heirs, Garrett v. United States, 120 F. Supp. 193 (Ct. Cl. 1954); nor to his surviving partner. Austin v. United States, 116 F. Supp. 283 (S.D. Tex. 1953).

55. See, *e.g.*, cases holding that the activities of the controlling stockholder were not sufficient to find him to be a dealer: Powers v. United States (S.D. Ill.), 58-2 CCH U.S. TAX CAS. ¶ 9597, in which the court emphasized that the property was sold through agents, that no improvements were made, and that there were no personal efforts on the part of the

deemed his stock in a real estate corporation in exchange for real estate lots and subsequently sold some of the lots, a court held that the fact that the balance of the lots received were transferred to another real estate development corporation is not material.[56] Nor has it been determinative that the corporation acquired the title from the shareholder in the first place. Capital gain treatment has been given to the shareholder where he acquires an undeveloped tract of land and transfers it to his controlled corporation, which, in turn, plats, subdivides, and improves the land, sells a few lots, and then, in liquidation, transfers to him the same land, now in its developed form.[57] However, where the tract was very large, the land extensively improved by the corporation, and the corporation being liquidated within three years after only five houses were built thereon, the Court of Claims refused to recognize the corporation as a separate entity for the purpose of determining the shareholder's purpose in holding the property.[58]

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shareholder; King v. Jackson (W.D. Tex. 1956), 56-2 CCH U.S. TAX CAS. ¶ 9881, *on remand from* 223 F.2d 714 (5th Cir. 1955), emphasizing that the taxpayer had no real estate license, that sales resulted from unsolicited offers, and that no sign or advertising were used; Trapp v. United States, 79 F. Supp. 320 (W.D. Okla. 1958), *aff'd*, 177 F.2d 1 (10th Cir. 1949); George Peck, 19 B.T.A. 345 (1930), *acq.*, X-1 CUM. BULL. 50, holding that the shareholder sold all the land as soon as possible and that this was an attempt to dispose of his real estate holdings prior to his death; W. B. Leedy & Co., Inc., 184 F.2d 833 (5th Cir. 1956), capital gain being received even though taxpayer and its predecessor were in the real estate business; Chandler v. United States, 226 F.2d 403 (7th Cir. 1955), stating that had the land been sold as a single tract, there could have been no question as to its being a capital asset.

56. Thomas Wood, 16 T.C. 213, 227 (1951), *acq.*, 1951-2 CUM. BULL. 4, the court stating,

> We do not think the formation of the Wood Realty Company in the year following the taxable year in question is material under the facts in this case. While it is true that petitioner formed the Wood Realty Company in 1946, and, in exchange for the capital stock of that company, transferred to it, the undeveloped acreage he had received from the Lakewood Development Company, and that the Wood Realty Company built about 200 private dwellings on such acreage and engaged in the real estate business, these facts are not determinative of the present issue. They are merely some evidence tending to show a continuity of business transactions.

57. See *Peck, supra* note 55, where the taxpayer, a barber, transferred land to his controlled development corporation, but subsequently became ill and in order to put his estate in a more liquid position, liquidated the corporation and sold off the real estate. In Goldstein v. United States (E.D. Wash. 1958), 58-1 CCH U.S. TAX CAS. ¶ 9365, both taxpayer and two others bought 220 acres of land at a tax sale and transferred the land to a corporation to hold title. The corporation filed a plat covering twenty acres, subdivided it, and was liquidated after it had sold thirteen lots, the property being conveyed to a trustee, possessing only ministerial power. The taxpayer bought out the other co-owner and sold the real estate over a period of years on which they realized a capital gain.

58. Boeing v. United States, 168 F. Supp. 762 (Ct. Cl. 1958); 2 Am. Fed. Tax R.2d 6214, at 6219 (1958).

> [P]laintiffs stress too greatly the corporate form of the Blue Ridge Land Company. Except for qualifying shares, the company was wholly owned by Mr. Boeing. He did not relinquish control over the property when he transferred it to the newly formed company in 1929. Mr. Boeing's ownership in the Blue Ridge Land Company also effectively brought within his control that additional property acquired by the corporation during its existence. The real estate development activities initiated in early 1929 by Mr. Boeing were thus continued by him under the *guise* of the Blue Ridge Land Company. . . . To speak of the transfer of the properties which immediately followed the demise of the corporation as involving an involuntary acquisition of the real estate by Mr. Boeing is to completely ignore the substance of what had preceded.

The fact that the inventory is not liquidated but purchased from the corporation and the proceeds liquidated does not alter the result, and the shareholder may receive a capital gain on the sale of such property.[59]

Finally, where the shareholder after the liquidation has remained as continuously active in his efforts to dispose of the property as he had been prior to the liquidation, he is not necessarily precluded from receiving capital gain on such sales, even though he may personally be a real estate broker. Whether such property will be a capital asset depends both upon the purpose for liquidation, and whether the court characterizes such activity on the part of the shareholder as an effort to continue the corporate trade or business in a non-corporate form.[60]

VI. USE OF CORPORATE EMPLOYMENT AS A GUISE FOR PERSONAL ACTIVITIES AS A BROKER-DEALER

An officer or employee of a corporation is not in the trade or business of that corporation. He is said to be in a trade or business in regard to that employment.[61] Therefore, if he, as an individual, buys and sells the same property in which he deals as an officer or employee on behalf of the corporation, the sales and other dealership activities of the corporation will not be attributed to him.[62] An exception to this general rule is found where the individual employee-shareholder or officer-shareholder purchases property, but thereafter tries to use his corporate office or employment to disguise his own personal efforts with regard to that property. The courts have been prone to characterize such activities as the taxpayer's personal activity; not as those of the corporation. In one instance, the taxpayer was a licensed real estate broker, president and controlling shareholder of a local real estate corporation. The taxpayer entered into a contract with his controlled real estate corporation wherein the corporation would sell his unimproved real estate, then he personally pursued an active course of conduct in selling it. The taxpayer argued that his sales activity could not be attributed to him, for

59. L. M. Graves, 11 CCH TAX CT. MEM. 467 (1952). *But see,* Reis v. Commissioner, 142 F.2d 900 (6th Cir. 1944), where the sales were made by circularizing a list of prospective customers.

60. *Compare* F. B. Tippens, Jr., 24 CCH TAX CT. MEM. 521 (1965), where taxpayer was a real estate broker and a half owner in a corporation engaged in the development and sale of development homes. Discord having developed with the heirs of his deceased co-owner, the corporation was liquidated and taxpayer received fifty-three lots which were sold through the existing advertising and sales facilities of the corporation. The court held there was no reason the taxpayer should not use the sales facilities available to him especially where the corporation was liquidated due to "fortuitous circumstances," *with* Beals v. United States, 91 F. Supp. 1013 (W.D. Mo. 1950), where the taxpayer hired sales agents, put up sales signs and maintained a sales office.

61. See Burnet v. Clark, 287 U.S. 410 (1932); James D. Jarvin, 32 T.C. 173 (1959).

62. See L. M. Graves, *supra* note 59.

purposes of determining the purpose for which such real estate was held, because such services were not performed by him individually, but as an employee of the corporation. The Tax Court disregarded that distinction and found the property to be held for sale to customers in the ordinary course of his trade or business.[63] For the above rule to apply, it is not necessary that the dealership status attached prior to the transaction in issue, as where the taxpayer, as co-trustee, entered into a contract with the trust providing that he would handle sales of the trust's real estate on a commission basis, formed a development corporation, and then sold the vast majority of lots to it. The taxpayer, as an employee of the corporation, was active in disposing of the property and dealt personally with each purchaser. The court rejected the arguments: that the taxpayer sold to only one purchaser, the corporation; that the eventual purchasers were customers of the corporation; and, that his personal activities in selling the properties were not performed as an individual but as a corporate employee. The court stated:

> Clearly, Building Company, even though a real taxable entity, was a mere business tool, whereby the joint adventurers . . . made their stock in trade (the vacant lots) more attractive for sales purposes. They, not Building Company, held the lots for sale to customers as surely as though the company had not existed. There was no real business purpose or necessity for title being held by Building Company during the time for construction of a house for a purchaser.[64]

The Tax Court has also disregarded the separate entity concept where the taxpayer is found personally to be a "package builder," one who designs, arranges the financing, selects the location, and eventually constructs the building. The court has taken the position that the taxpayer's trade or business is both that of providing the finished product and performing each intermediate step necessary to produce the finished result. Thus, the taxpayer, by having part of the operation performed by a corporation, could not receive capital gain on the acquisition and sale of the real estate involved.[65]

In transactions involving the sale of securities, the court has been equally observant, so that taxpayers were denied capital gains on the

63. Harry A. Worth, 30 P-H TAX CT. MEM. 235 (1961).

For the practical purpose of determining whether the lots were held primarily for the purpose of sale to customers in the ordinary course of business, the question of whether the company or petitioner himself made the sale is not here significant.

64. Samuel Broughten, 21 CCH TAX CT. MEM. 1448, 1453 (1962), *aff'd*, 333 F.2d 492 (6th Cir. 1964).

65. George K. Heebner, Jr., 280 F.2d 228, 233 (3d Cir. 1960), *affirming* 32 T.C. 1162, stating, "[T]he sale of real estate was an aspect of the prime business inextricably interwoven for the purpose of furthering the prime or main activity, the sale of real estate here was but one aspect of the entire transaction."

sale, by them, of the same corporation's securities which, as officers and employees of their controlled corporations, they had marketed to the public.[66]

VII. SALES TO A CONTROLLED DEVELOPMENT CORPORATION

As shown above, the shareholder is entitled to deal with his controlled corporation as if it were an independent person, provided the transaction is one of substance. He is, therefore, entitled to realize a gain on the sale of property to it. As long as there is a bona fide sale for a fair and adequate consideration, the subsequent activity of the corporation with regard to the property is not material.

Should this general rule be applied in the case of a shareholder who acquires a piece of real estate, and then conveys it to his controlled corporation which subsequently subdivides, improves, develops, constructs homes thereon, and sells the same to purchasers in the ordinary course of its trade or business? Should the activities of the controlled corporation subsequent to the sale be attributed to the shareholder for the purpose of determining the purpose for which it was held? Does the shareholder hold it any-the-less for sale to customers, if he intends to sell to a controlled corporation for development and sale, than if the development and sales were to be personally made? Or is the difference in form so significant so as to constitute a difference in substance?

A. *Is the Mere Fact of Control Sufficient to Attribute the Activities of the Corporation to the Individual?*

The idea of attributing the activities of a corporation to the individual is not one foreign to the Internal Revenue Code, especially in regard to real estate transactions. Section 2037 has several provisions which attribute the activities of a shareholder to a controlled corporation, and the activities of a controlled corporation to the individual shareholder, for the purpose of determining whether the relief provision is applicable.[67]

The history of the proposition—that mere ownership of a controlled development corporation to whom realty is transferred is sufficient to attribute the trade or business activities of such corporation to the shareholder—is quite interesting. It was first asserted by the Commissioner in

66. Frank v. Commissioner, 321 F.2d 143 (8th Cir. 1963), *affirming* 21 CCH TAX CT. MEM. 542 (1962).

67. *Supra* note 16. The section applies to a corporation only if no shareholder, directly or indirectly, holds real property for sale to customers in the ordinary course of his trade or business. An individual taxpayer is considered as holding real property for sale to customers if he holds a controlling interest in any corporation which holds real estate for sale to customers or would so hold but for the fact that it qualifies under § 1237. Improvements are deemed made by the taxpayer if made by a corporation in which he actually or constructively owns more than fifty per cent of the voting stock.

1935.[68] The taxpayers, engineers, president and vice president of a bridge construction corporation, were induced by the secretary of the corporation to invest in a land syndicate arranged by him. A corporation was formed and the land conveyed to it, along with the full power to handle all dealings with respect to such property. Although the taxpayers were president and vice president of the corporation, and constituted a majority of its Board of Directors, the corporation was managed by the secretary. It was agreed that the corporation handle the subdivision and sale of the real estate in return for a one-third interest in the syndicate. The Tax Court found that taxpayers were engaged in the trade or business of dealing in real estate through the activities of the corporation; it relied on their control over the corporation through their offices, board membership, and stock ownership.[69] The sixth circuit reversed, stating the issue to be, "Whether a director and officer of a corporation, owning a substantial amount of its stock but not active in its affairs, is engaged in the business in which the corporation is engaged."[70] The court held that because of their personal inactivity, the activity of the corporation could not be attributed to them so to put them in the real estate business. The court, however, implied that the decision would be different if the actual manager of the corporation were before the court.

Twenty-two years later, the Tax Court reached the position set out in the dicta of the prior case, holding that the mere fact of control over the development corporation is sufficient to attribute the activities of the corporation to the controlling shareholder who is also responsible for the management of the corporation.[71] The court held that the case before it was indistinguishable from *Walter H. & Irene Kaltreider*.[72] There, after extensive and costly improvements, the shareholders had transferred the real estate to the corporation for purposes of constructing houses thereon, and conveyed the land directly to the purchaser (the corporation never taking title), the sales price being apportioned between the corporation and the shareholders in relation to the value of the land to the building; here there was a bona fide sale

68. Willard Pope, 28 B.T.A. 1255 (1935), *rev'd*, 77 F.2d 599 (6th Cir. 1935).

69. *Id.* at 1260.

It is axiomatic that one may confide the management of his business to another; but it still remains the business of the owner. . . . They, together, with Miller, held the important executive offices of the company and they with Miller constituted a majority of its board of directors. Thus they, and the syndicate through them, were in absolute control of their agent.

70. 16 Am. Fed. Tax R. 126, 127 (1935).

71. August Engasser, 28 T.C. 1178 (1957).

72. 28 T.C. 121 (1957), *aff'd*, 255 F.2d 823, 1 Am. Fed. Tax R.2d 1766, 1768 (3d Cir. 1958).

Taxpayers were not licensed real estate brokers nor did they hold themselves out to be such, they did not list the lots in their two developments with any real estate agents; they placed no signs on the lots, nor did they advertise in newspapers. Contracts for sales of the houses in their developments were made—never by taxpayers alone.

of unimproved land. The court held that the distinction was insignificant, and that the shareholders were engaged in the trade or business of selling real estate through the activities of the controlled corporation which they actively managed.

In 1961, the Tax Court made the "full swing" back to the general rule of separate entities.[73] The taxpayer owned sixty per cent of the stock in a construction company, the balance being owned by his sister and brother-in-law. He acquired a one-half interest in an option to purchase eighty-four acres of land. The option contract provided that the property was to be subdivided into building lots. The option was sold to the construction corporation for a fixed amount, at the time it was to be exercised, and a fixed fee per lot, as each home was built. The taxpayer also sold to another controlled corporation a one-half interest in another large tract, allegedly purchased for the construction of a dog track, but which proved to be an impossible objective, as dog racing was not legalized. However, an option acquired by the taxpayer on a small piece of adjoining land, also transferred to the corporation, provided that a fence would be built "when home construction on said tract shall begin." The taxpayer was the officer and controlling shareholder of eight other real estate development corporations, and had some other personal dealings in real estate and option contracts. The court held these sales to be merely two "isolated transactions" and that there was no evidence upon which to find the taxpayer engaged in the trade or business of dealing in real estate, stating:

> Respondent's argument ignores the corporate entities of which petitioner was merely an executive officer. It attributes the corporation's sales of lots to individual purchasers, to petitioner. Respondent recognizes no distinction between a taxpayer holding property for sale to his customers and a taxpayer holding property for sale to his controlled corporation engaged in selling such property to its customers. Petitioner's business was that of a corporate executive. There is no justification for imputing the real estate activities of the many corporations which he owns, or controls, to him.[74]

In 1964, the Commissioner acquieced to this decision. However, in 1965, the Tax Court, in a memorandum decision, held that the broad statement—that the separateness of the corporate entity must be recognized upon the sale to a controlled corporation engaged in selling such

73. Ralph E. Gordy, 36 T.C. 855 (1961), *acq.*, 1964-3 CUM. BULL. 6. The court tried to partially distinguish this case on the fact that one of the assets was an option and not real estate. *But see* INT. REV. CODE OF 1954, § 1234, and Treas. Reg. § 1. 1234-1(a)(1), a gain or loss attributable to the sale or exchange of an option to buy or sell property is a capital gain or loss *if* the option property would be, if acquired, a capital asset in the hands of the taxpayer.

74. *Id.* at 859.

property to customers—should not be taken literally.[75] A distinction is made where the taxpayer is personally a dealer. The activities of a controlled corporation may not be attributed to the shareholder for purposes of determining whether he is engaged in the trade or business of selling real estate. However, once he is engaged in that trade or business, the real estate corporations which he controls will be viewed not as being separate entities, but merely as other entities through which the taxpayer carries on his trade or business. How far the exception to the statement in *R. E. Gordy* will be taken is not yet known. Under the particular facts in this case it has not been taken very far, for this taxpayer admitted on his return that he was a real estate dealer. However, the dealership concept appears almost irresistible to the court, and it will probably be applied in any case where, independent of the corporate activities, the activities of the taxpayer personally are sufficient to make him a dealer.

Other uncertainties present themselves: Are only the activities of the corporation to whom such property was sold attributable to the controlling shareholder or do you attribute to him all the activities of all the real estate corporations which he owns? Upon finding the taxpayer independently to be a dealer, *must* the court attribute those activities to him?

The court apparently felt that this was merely a restatement of the law prior to *R. E. Gordy*, but there are numerous cases in which the court has, in order to determine the trade or business of the taxpayer, looked not only at his personal activities, but at those of his controlled corporations as well.[76]

The significance of the case lies in the fact that the statute requires more than the mere fact that the taxpayer was a dealer in order to deny

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75. Thomas W. Nevin, 24 CCH TAX CT. MEM. 294 (1965).

76. See Richmond v. United States (S.D. Ga. 1965), 65-1, CCH U.S. TAX CAS. ¶ 9329, where the court instructed the jury that to determine why the taxpayer held property, they could consider the activities of his controlled corporation even though he personally was not a dealer. Dobson v. United States (W.D. Tenn. 1953), 44 Am. Fed. Tax R. 1285, the court held that to determine the purpose for which taxpayer was holding the land, it is necessary to consider the activities of his controlled corporation. Jerome S. Murray, 24 CCH TAX CT. MEM. (1965), where the petitioner's objection to the testimony with regard to the activities of his controlled corporation for purposes of determining his trade or business was overruled. The court held that the conclusion that he was a dealer was buttressed by the activities of his controlled corporation. August Engasser, *supra* note 71, at 1177.

> [T]he clear unrebutted inference from the record is that the numerous real estate transactions to which he, the partnerships, and the corporation were a party were more than sufficient to place him individually in the business of buying and selling real estate.

But see, Carruth v. United States, 167 F. Supp. 294 (D.C. Texas 1957), where the taxpayer received capital gain on the sale of realty to a controlled corporation on the basis that he had never personally entered the real estate business. The court felt this result should be unaffected by the fact that prior to the conveyance, the taxpayer had the land cleared, platted, and sewers installed.

capital gain treatment. Although he may be in the trade or business of dealing in that asset, the particular sale must be in the ordinary course of that trade or business. It is accepted that a tract developer whose trade or business is that of selling improved lots will not be denied capital gain treatment on the sale of an undeveloped tract.[77] The effect of this decision is that he will not receive capital gain treatment on the sale of even this property, if it is sold to a corporation controlled by him which holds this property for sale to customers in the ordinary course of its trade or business. On the other hand, a taxpayer may develop as much realty as he wishes and still realize capital gain on the sale of real estate, provided that he is careful to conduct all of his real estate development business through the use of controlled corporations. This decision puts a premium on form rather than on substance.

The court, in its decision, relied on a fifth circuit case[78] which had held not that the activities of the real estate corporation would be attributed to its controlling shareholder, who was personally a dealer, but that, the fact that it was sold to a controlled corporation, subdivided and sold by it to customers afforded ample evidence that it was purchased and held by plaintiff for the purpose of subdivision and development.

The latter approach, although it may not lead to a different result in a particular case, is quite different from that taken by the Tax Court. The latter inquiry is one into the purpose for which the property is being held, which in fact is what the statute requires; the Tax Court inquiry is one into the status of the taxpayer, and it will deny or grant capital gain treatment according to that status, regardless of the taxpayer's purpose in holding the property. The effect of the Tax Court approach is that if the court wishes to deny the taxpayer capital gain on the sale of property to his controlled development corporation, it will find him to be a dealer. If the court feels he should be entitled to capital gain treatment, it will find him not to be a dealer.[79]

77. See *supra* note 29.

78. Burgher v. Cambell, 244 F.2d 863 (5th Cir. 1957).

79. See Gardens of Faith, Inc., 23 CCH TAX CT. MEM. 1045 (1964), *aff'd*, 345 F.2d 180 (4th Cir. 1965), where the court citing *R. E. Gordy* found only an "isolated sale" by a shareholder not personally a dealer. Here taxpayer had been in the cemetery business for twenty-five years. He had been a salesman for cemetery companies and then purchased, developed, and operated his own cemetery company in partnership with his wife. At the time of the transfer to his controlled corporation, consisting of the partnership business now incorporated, the taxpayer held proprietary interests in four cemetery companies. The taxpayer was also a member of a joint venture which held real estate transferring it to the cemetery companies as required by their needs. In return, the joint venture received certificates of indebtedness, which the court determined constituted securities. *Compare* this with the statement in Burgher v. Cambell, *ibid.*, where the court stated that the taxpayer had spent his entire business life in one phase or another of the real estate business. A distinction can be made between the cases for here the burial lots were acquired from the corporation itself due to its inability to pay the salary owed to the taxpayer and held for eventual resale to the corporation. Here the taxpayer was not "feeding" the corporation the land it needed

The rationale for the rule expressed here is that one who engages in real estate dealings only through controlled corporations has expressed that he personally does not wish to enter into that business and that were it not for the separateness of the corporate entity, would not engage in it at all. He is unwilling personally to take on the risks and liabilities connected with that trade or business. He prefers to remain a mere investor. The taxpayer who has engaged personally in the real estate business has not demonstrated this reluctance. The courts conclude, almost as a matter of law, that the use of the controlled corporation to which land is sold by such a taxpayer is merely a guise, that the *only* reason that the taxpayer himself does not develop the land is to acquire a capital gain on the appreciation.

The better rule would appear to be that if the facts show that the taxpayer actually acquired the property for investment, held it for investment, and sold it to realize a profit on his investment, the mere fact that it was sold to his controlled corporation should not be determinative. Because the taxpayer has personally developed other real estate, but prefers to have a corporation, though one controlled by him, develop this property does not require the finding that the sole reason for doing so is as a guise.

The real test should be whether in purchasing and holding the property, the taxpayer was acting as the purchasing agent of the corporation. The distinction to be made is whether the taxpayer acquired this property and held it for investment (for appreciation), intending to eventually sell it to his controlled corporation or third parties for the best, but fair, market price he could get, or whether he acquired the property and held it in the ordinary course of the corporation's trade or business, planning to transfer it to his controlled corporation whenever it needed the additional land. Where the controlling shareholder acts more or less as a supplier of real property to the corporation, he should be denied capital gain treatment.[80]

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to engage in business. The corporation had already owned the real estate. The sale was not one in the ordinary course of the corporation's trade or business in acquiring and selling burial plots. See also Randolf D. Rouse, 39 T.C. 70 (1962), *acq.*, 63-2 CUM. BULL. 5.

80. The court has not accepted this position and will not determine that the taxpayer should be denied capital gain because he acted as the purchasing agent for the corporation. See Glaslow Village Dev. Corp. 36 T.C. 691 (1961). Here C & W planned a real estate development which was to include the land owned by Conant. C & W each acquired a fifty percent interest in a dormant development corporation. W later bought out C's interest. An agreement to purchase the adjoining land included a provision that the corporation would acquire the Conant property at the same terms, a fixed fee per lot as each home was built. Later W acquired title to the Conant property as trustee for himself and some associates. He paid the taxes on it and tried to farm it. The property was later sold to the corporation for two hundred fifty thousand dollars. The Commissioner argued that the taxpayer was acting as the agent for the corporation and therefore the corporation acquired the property at W's cost so that any gain realized on the sale was a dividend to the shareholder. The tax court rejected this argument, stating: that the facts showed that W acted for himself and his associates and not on behalf of the corporation; that it was his

This distinction, although very narrow, is one which the courts should at least attempt to make. It is consistent with the statutory approach taken by Congress. By searching for dealership activities and determining the case upon that limited issue, the courts have settled upon a poor substitute, whose only virtue is that it simplifies the problem before the court.

B. *Agency*

The mere fact that the taxpayer is found not to be personally a dealer in real estate does not guarantee that the activities of the corporation will not be attributed to him. Although the mere fact of control over the corporate management and ownership will not be sufficient to accomplish this, the activities of the corporation with regard to the transferred property will be attributed to the taxpayer if the corporation is found, in fact, to be his *agent*.[81] It has long been held that the activities of an agent are attributable to the principal.[82] However, an agency relationship cannot result from a transaction which is in fact a bona fide sale.[83]

The rule as stated by the Tax Court is that:

> A taxpayer cannot insulate himself from the acts of those persons whose efforts are combined with his in a mutual endeavor to make a profit, no matter how the endeavor is denominated. . . . But this does not mean that because the agent is in the real estate business, and would be considered as holding the property primarily for sale in the ordinary course of its business, that the agent's *business* can be imputed to the taxpayer. The question is whether the activities of the taxpayer, including

money with which the property was acquired and not the corporation's; that he and his associates paid the expenses and taxes for keeping up and farming the property, and that the sales price was the fair market value of the property. *Cf.*, Wagner v. Dudley, 1 Am. Fed. Tax R.2d 1991 (D.C. Pa. 1958). Here the president of a corporation convinced his attorney and doctor to purchase a certain undeveloped tract, develop it, and give the corporation an option to purchase the lots. The corporation selected the contractors and engineers, dealt directly with them and paid them either directly or indirectly through advisers to the taxpayer. Customers of the corporation received title directly from the taxpayer. The court held that the taxpayers were not agents of the corporation because the taxpayers' only interest in the project was to make a profit for himself and not to aid the corporation. If the project would have failed, they would have personally incurred a loss and whether the corporation itself would have incurred a loss was of no concern to the taxpayers.

81. The first case to hold that a corporation could be an agent for its shareholders from whom it purchased property was Walter H. Kaltreider, *supra* note 72, at 1770, stating, "[C]onsidering the activities of the taxpayer, the rule is settled that a person may engage in business via an agent, and the sales activity of an agent for the benefit of the principal will be imputed to the principal."

82. Achong v. Commissioner, 246 F.2d 445 (9th Cir. 1957); Ehrman v. Commissioner, 120 F.2d 607 (9th Cir. 1941); Solomon v. Welch, 99 F.2d 41 (9th Cir. 1938); Richards v. Commissioner, 81 F.2d 369 (9th Cir. 1936); Brown v. Commissioner, 143 F.2d 468 (5th Cir. 1944); Snell v. Commissioner, 97 F.2d 891 (5th Cir. 1932).

83. See RESTATEMENT (SECOND) AGENCY, § 14J (1957).

the activities of an agent that can properly be imputed to him, taken together with all the other relevant factors pertaining to the taxpayer's relationship to the property, place the taxpayer in the real estate business. . . .[84]

"Agency is the relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."[85] The mere fact that one contracts with a real estate "agent" to subdivide, improve, and sell his property does not make the real estate or sales "agent" his agent, as the term is used here. If the dealer was acting independently of the taxpayer, for his own benefit and profit and not to benefit the taxpayer, his activity in disposing of the property will not be attributed to the taxpayer.[86]

The test for determining this independence is the presence, or lack of the retention by the taxpayer, of control over the acts of the other party.[87] This is not the internal control discussed above, but external control—the ability as a separate entity to effect and control the act of another. Nor is it the mere right to control; it is actual control.[88] The test may be stated to be whether the business function and risks of the enterprise remained with the taxpayer.[89] Some of the factors which have been found to be significant in determining that an agency arrangement exists are that: the "agent" had to submit a proposed plan for the subdivision and improvements for the taxpayer's approval, or a budget of his expenses for approval; the taxpayer retained the power to determine the price to be charged; the taxpayer retained the right to cancel the contract at short notice; all essential points were not agreed upon prior to the active development of the land, taxpayer paid some of the expenses or costs involved, reimbursed the agent, or loaned money to the agent so that he could pay those expenses; the taxpayer performed some ministerial functions such as collecting the purchase price from customers of the agent, signed or counter-signed checks to pay expenses, or signed or counter-signed contracts; and that the agent received a commission on the sale of the lots.[90]

84. Estate of William D. Mundy, 36 T.C. 703, 712 (1961).

85. RESTATEMENT (SECOND) AGENCY, § 1 (1957).

86. Voss v. United States, 329 F.2d 164 (7th Cir. 1964); Smith v. Dunn, 224 F.2d 353 (5th Cir. 1955); Dunlap v. Oldham Lumber Co., 178 F.2d 781 (5th Cir. 1950); Fahs v. Crawford, 161 F.2d 315 (5th Cir. 1947); Boomhouser v. United States, 74 F. Supp. (N.D. Iowa 1948).

87. See cases cited, *supra* notes 82 & 86; Wagner v. Dudley, *supra* note 80. See Martin Ex'r. v. United States, 230 F.2d 106 (7th Cir. 1956), *affirming* 128 F. Supp. 576 (E.D. Ill. 1954), where, lacking sufficient evidence of control, the government contended that a joint venture existed.

88. Voss v. United States, *supra* note 86.

89. Johnson v. United States, 188 F. Supp. 939 (D.C. Calif. 1960).

90. See Achong v. Commissioner, *supra* note 82; United States v. Beard, 260 F.2d 81 (9th Cir. 1954); Johnson v. United States, *ibid.;* Boeing, Ex'r. v. United States, 168 F.

1. CONTROLLED CORPORATION AS AGENT

When a taxpayer transfers property to his controlled corporation, there is little need of retaining any external controls over its operation due to his complete internal control. Therefore, the above-mentioned factor will not be influential here. The courts, however, have been prone to find an agency relationship between the controlled corporation and the shareholder by relying on two basic factors, the lack of a bona fide sale and the lack of either arm's length dealings or the formalities of separateness.

a. Lack of Bona Fide Sale

The effect of having a bona fide sale is to preclude a finding of agency.[91] The effect of not having a bona fide sale does not require, but merely permits, such a finding. In situations where the alleged agent is not a controlled corporation, the courts have been lenient in finding a bona fide sale.[92] However, where controlled corporations are involved, they have not been so lenient.

An agency relationship has been found to exist where the taxpayer, pursuant to a contract with the corporation, conveyed title directly to the customer after the corporation had built houses thereon;[93] where the taxpayer transferred title to a trustee to hold while houses were being constructed and then by him conveyed directly to the customers;[94] and, where the title to each lot was conveyed to the corporation but only after it had found a purchaser for that lot.[95] The court has rejected the argument that the granting of an option to a corporation, to acquire the prop-

Supp. 762 (Ct. Cl. 1958); Wagner v. Dudley, *supra* note 80; also H. H. Ranch, Inc., 24 CCH TAX CT. MEM. 626 (1965), where the contract provided that the vendor would make improvements if for some reason the construction corporation could not; that no purchase price was to be paid in all events; that the corporation was entitled to retain any subdivided lot if it was unable to sell it within a stated period; and that petitioner paid some of the expenses of having the land platted.

91. See Gardens of Faith, Inc., *supra* note 79; P. Carruth, *supra* note 76; R. E. Gordy, *supra* note 73; *but see*, August Engasser, *supra* note 71, where the court found the corporation to be the taxpayer's agent but relied on the mere fact that it was internally controlled. *Cf.* Burgher v. Cambell, *supra* note 21; here the court did not rely on any agency principle.

92. See Frederick Flato, 14 CCH TAX CT. MEM. 853 (1955), *rev'd on other grounds*, 245 F.2d 413 (5th Cir. 1957). After repeated efforts on the part of P, a real estate agent who had sold off a large part of the tract, to get taxpayer to subdivide and sell the balance, the taxpayers agreed to *sell* him the land. It was agreed that P would subdivide the land and sell upon his own account. P agreed to assign purchase deposits to them and sale contracts to a partnership owned by them to be applied to the purchase price. A deed to the balance was not conveyed until the requisite amount of payments was received by the taxpayers. The court found a bona fide sale.

93. Walter H. Kaltrieder, *supra* note 72, the sales price being apportioned between the house and the lot.

94. Ackerman v. United States, 215 F. Supp. 867 (D.C. Tex. 1963), *aff'd*, 335 F.2d 521 (5th Cir. 1964), here the corporation had an option to acquire all lots at a fixed fee per lot but never took title. It merely notified the trustee to convey title to its purchaser and then paid him for lots.

95. Samuel S. Broughton, *supra* note 64.

erty at a fixed price per lot, was a bona fide sale of the whole tract so that the receipt of the fixed fee per lot could be characterized as merely a partial payment of the total purchase price.[96] The court has characterized such transactions as a contract providing for the piecemeal sale of lots, disregarding the fact that the corporation was entitled pursuant to such option to acquire the whole tract for the price established by such contract. The court has, however, found a bona fide sale where the option provided for the sale of the whole tract, but that the purchase price was to be paid in the form of a fixed fee per lot, as each lot is sold.[97]

b. Lack of Arm's Length Dealings

Where the court has found the taxpayer to be engaged in the trade or business of dealing in real estate through his controlled corporation acting as his agent, in every case there has been a lack of either arm's length dealings or those formalities which indicate the separateness of the two entities. An agency relationship has been found where: the taxpayer reported the gains on the sales by the corporation on his own tax return;[98] the taxpayer's books showed no notes or accounts receivable although the taxpayer had made several sales to the corporation on account, nor any deductions for the interest paid to the corporation;[99] the sales price was below the fair market value;[100] an option given to the corporation had a renewal agreement whereby the option could be renewed if a specific number of lots were purchased prior to a specific date and the taxpayer extended the option even though the requirement was not met;[101] an option was given to purchase lots at a fixed price for a year and, for no good business purpose, the agreement was modified a month later, providing that a higher price be paid;[102] the taxpayers subordinated their rights as beneficiaries under a trust so that the corporation could acquire financing;[103] and, where the taxpayer prior to the conveyance to the corporation negotiated on behalf of the corporation for its sale.[104]

In one instance, the taxpayer, an architect, entered into a contract

96. See Raymond Bauschard v. Commissioner, 31 T.C. 910 (1959), *aff'd*, 279 F.2d 115 (6th Cir. 1960). Here the corporation acquired, concurrently with the option, a lease to the whole tract so that it could subdivide and improve the whole tract prior to the actual conveyance. See also, Estate of Peter Finder, 37 T.C. 411 (1961).

97. Ralph E. Gordy, *supra* note 73; Abe Pickus, 22 CCH Tax Ct. Mem. 1791 (1963), where the whole tract was actually transferred and the purchase price paid as each lot was sold.

98. Walter H. Kaltrieder, *supra* note 72.

99. H-H Ranch, Inc., *supra* note 90.

100. *Ibid.*

101. Estate of Peter Finder, *supra* note 96.

102. Ackerman v. United States, *supra* note 94; *but see*, Charles E. Rosebrook v. United States, 191 F. Supp. 356 (N.D. Cal. 1961), *aff'd*, 318 F.2d 316 (9th Cir. 1963), holding that not all participants in a joint venture need have the same intent or purpose in holding the property.

103. *Ibid.*

104. Thomas Nevin, *supra* note 75.

with others to form a construction corporation to engage in the real estate development business.[105] It was agreed that the taxpayer, as an individual, would acquire options on the tract of land to be developed in order to hold for and subsequently convey to those controlled corporations. The taxpayer agreed to hold any gain realized on such sales as trustee for all participants. The court found that the agreement was an agreement to enter into the real estate business through the use of controlled corporations as agents, and that the agreement to share gains realized on the sale of the options showed an intent that such gains were to be part of the profits from the business.

VIII. OTHER ASPECTS OF ATTRIBUTION

A. *Extent of Attribution*

As already stated, the activities of one's agents, partners, and joint adventurers are attributable to him. One interesting aspect of these attribution rules appears where the activities of the corporation are attributed to third parties through the controlling shareholder. If one were to sell property to a real estate corporation controlled by one of the co-owners of such property and the activities of the corporation were attributable to the co-owner, those activities could be attributed to him as well. This is so regardless of the fact that his only motive in acquiring and holding the property was that of realizing a profit upon an investment, and that he personally did not actively participate in the subdivision and sale or have control over the corporation.[106] The same result has been reached where the corporation, which developed and sold the property, was controlled by a real estate dealer who induced the taxpayer to acquire the property on the premise that he would receive a profitable return on his investment. The court held a joint venture existed between the real estate dealer and the taxpayer.[107] A passive investor could also be found to be in the trade or business of dealing in real estate because of the activity of his agent's agents.[108] Where the courts wish to avoid the corporate activities being attributed through

105. Norman A. Grant, 22 CCH TAX CT. MEM. 771 (1963), *aff'd*, 333 F.2d 810 (4th Cir. 1964).

106. See Ackerman v. United States, *supra* note 94, where the court found the activities of the corporation to be attributable to the taxpayer, a one quarter owner of the property, because he and his co-owners, *together*, held control over the corporation to whom it was sold. The taxpayer's purpose here was simply that of obtaining a good investment.

107. See Raymond Bauschard, *supra* note 96. Although the court did not discuss this aspect in order to find the taxpayer holding the property in the ordinary course of his trade or business, it would be necessary to find some business activity with regard to this property to attribute to him.

108. See Samuel S. Broughton, *supra* note 64; *but see*, Estate of William D. Mundy, *supra* note 84, where the court held that the activity of the taxpayer's agent would not be attributed to them. He was the partial owner of a development corporation building a subdivision adjacent to their land, and had their land developed by another realty company and made a part of the same subdivision.

the real estate dealer to the investor, they may do so by merely finding no agency, partnership, or joint venture relationship existing between them.[109]

B. *Sale of Property Purchased from Corporation*

Where the controlling shareholder purchases property from his controlled corporation which has been held by it primarily for sale to customers in the ordinary course of its trade or business, whether or not he will receive a capital gain on its sale, here, as elsewhere, depends upon his status as an investor or dealer.[110] Where the taxpayer purchases houses from his real estate corporation, holds them for rental purposes, and subsequently sells them, the court will not attribute the activities of the corporation nor its purpose for holding the property unless dealership status is found.[111] If he is found to be a dealer, the corporation is his agent and he holds the rental property for sale in the ordinary course of his trade or business. This is so even though he subsequently sells the property to another controlled corporation.[112]

C. *Attribution Between Controlled Corporations*

In an action to determine whether a corporation held property in the ordinary course of its trade or business, the Tax Court allowed testimony as to the real estate activities of the other corporations controlled by taxpayer's principal shareholder and chief executive. The eighth circuit, reversing, held this was error.

> We do observe that under the record here it appears that taxpayer is a separate and distinct corporate entity and no basis

109. See Charles E. Tibbals, 17 CCH TAX CT. MEM. 228 (1958). Here taxpayer acquired with his brother, who dealt extensively in real estate, 439 unimproved lots. Title was taken in his brother's name as trustee. The brother was given the power to contract for the improvement and sale of the lots. All of the lots were sold to a corporation controlled by the brother. The court found that taxpayer was entitled to capital gain treatment. The activities of his brother were not attributable to him for he was engaged in neither a partnership nor joint venture with him.

110. See *supra* note 59.

111. It is obvious that where the court feels the taxpayer is entitled to capital gain treatment because he actually acquired the property for rental purposes and not to hold it for sale, the court will find him not to be a dealer. *Compare* Randolf D. Rouse, *supra* note 79, at 76, where, although the taxpayer's corporation represented the partnership business now carried on in the corporate form, he was not found to be a dealer, the court stating: "It is true, as respondent contends, that petitioner's corporations were also in the business of building and selling houses . . . but . . . this court has repeatedly recognized the dual roles of taxpayer in comparable situations," *with* Howard F. Smith, 22 CCH TAX CT. MEM. 1146 (1963), which distinguished *Rouse* mainly on the basis that here taxpayer was a dealer. See also J. V. Rylander (D.C. Cal. 1956), 56-2 CCH U.S. TAX CAS. ¶ 9863.

112. Robert Binda, 22 CCH TAX CT. MEM. 1195 (1963). Here, the taxpayer bought several lots bordering on a main highway from his controlled development corporation, had the property zoned commercial, and sold some of the lots to a controlled construction corporation for purposes of erecting thereon an office building. The court stated it is of no importance whether or not the taxpayer contemplated the construction of the office building prior to the sale, for the petitioner's only trade or business was that of an employee and officer of the corporation.

> has been shown for piercing the corporate veil. Hence, it is our view that the operations of the other corporations would have no probative force in establishing taxpayer's purpose of holding real estate except to the extent it might be shown that the other corporations were acting as an agent for the taxpayer.[113]

Indeed, where the agency relation has been shown, the activities of the related corporations have been attributed to the principal.[114]

D. *E. Aldine Lakin Rule*[115]

Both the facts and the rule in this case are unique, but the potential impact of the *E. Aldine Lakin* case, on both the dealership and separate entity concept, is enormous. The taxpayers were the principal officers and shareholders of a lumber company which also sold millware, building supplies, home appliances, and "practically everything that goes into a house." The taxpayers purchased, as tenants in common, a number of lots in existing developments plus two tracts of land which they subsequently subdivided. A building corporation was formed as an outlet of the lumber company's products. The majority of lots sold by the taxpayer were sold to the building company, the balance being sold to private builders upon the condition that they purchase their building supplies from the lumber company. The taxpayers relied upon this complete lack of dealership activity with respect to the property, their complete passiveness.[116] The court stated that, "Although we agree petitioners were not engaged in the real estate business as it is sometimes conducted, we still think the record shows that they were engaged in that business, . . . ,"[117] and "they [the lots] were being held primarily for sale to customers, including model homes, in the ordinary course of their business of promoting their interests in the lumber company."[118]

That the property was found to be held for sale in the ordinary course of their trade or business is clear; what is unclear is, in the ordinary course of *what* business? The quote above would indicate they held such property in the ordinary course of their business as share-

113. Municipal Bond Corp. v. United States, 341 F.2d 683, 15 Am. Fed. Tax R.2d 408, 414 (8th Cir. 1965), *reversing and remanding* 41 T.C. 20 (1963).

114. H-H Ranch, Inc., *supra* note 90.

115. 28 T.C. 462 (1957), *aff'd*, 249 F.2d 781 (4th Cir. 1957).

116. *Id.* at 468:

> Neither Lakin nor Mullendore had ever had or applied for a license to sell real estate, or been a member of a real estate board, or had an office from which he conducted a real estate business, or had his name listed in a telephone directory as being in the real estate business, or otherwise publicized himself as being in the real estate business. Petitioners did not employ any salesmen, or advertise the properties for sale, or have any sales office, or list the properties with brokers, or pay commissions to brokers. Inquiries about the properties were unsolicited. Neither Lakin nor Mullendore spent any significant amount of time on real estate transactions.

117. *Id.* at 469.

118. *Id.* at 470.

holders, employees, and officers of the lumber company. In another part of the decision, the court indicates that the sale of the real estate itself constituted a business, not because of their activities but because of their purpose of promoting the lumber company's sales.[119] There is no precedent for either of these views.

The logic behind, and effect of, this decision is to extend the rule of *Corn Prods. Ref. Co.*[120] to the shareholders and officers of that corporation. Even though the asset would ordinarily be a capital asset in the hands of the corporate officers or shareholders, the fact that it was acquired or held as an "integral part" of the corporation's business will be sufficient to deny him capital gain on its sale. It will also deny him capital gain on any property which, if acquired by the corporation, would be considered a "tiein purchase."[121] Thus, if the corporation would be denied capital gain on the sale because it was acquired as an "integral part" of its businesses or as a "tiein purchase," the corporate officers, director or controlling shareholder will be denied capital gain treatment as well.

IX. Conclusion

Whether or not the taxpayer holds property primarily for sale to customers in the ordinary course of his trade or business is a question of fact. As with all questions of fact, the finding of the trial court will be undisturbed unless it is found to be clearly erroneous. In deciding this question, the tax court has placed particular emphasis on the frequency and continuity of the taxpayer's real estate dealings, thus giving impetus to the dealership concept. The standards to be applied are so flexible that, unless the trial court misstates what those standards are, its decision will not, and generally cannot, be said to be clearly erroneous. The trial court has therefore an almost absolute discretion in deciding this issue.

The courts have read the dealer concept into section 1221(1) of the Internal Revenue Code. In almost all cases involving this code provision, whether the property is excluded from being a capital asset will depend upon the status given to the taxpayer. The courts have made nearly all correlative issues dependent upon this status, including the separateness accorded the activities of his controlled corporations. One exception is whether the activities performed by the taxpayer as an officer or em-

119. *Id.* at 469, "The record, we think, shows they entered into business activities having in mind the promotion of their interests in their principal business, the lumber company."

120. 350 U.S. 46 (1955).

121. For the law applicable to "tie in purchases," see Mansfield Journal Co. v. Commissioner, 274 F.2d 284 (6th Cir. 1960); Commissioner v. Bagley & Sewall Co., 221 F.2d 944 (2d Cir. 1955); Exposition Souvenir Corp. v. Commissioner, 163 F.2d 283 (2d Cir. 1947); Edwards v. Hogg, 214 F.2d 640 (5th Cir. 1954); Gulftex Drug Co., 29 T.C. 118 (1957), *aff'd per curiam*, 261 F.2d 238 (5th Cir. 1958); Tulane Hardware Lumber Co., 24 T.C. 1146 (1955); Western Wine & Liquor Co., 18 T.C. 1090 (1952), *acq.*, 1958-2 Cum. Bull. 8; Rev. Rul. 58-40, 1958-1 Cum. Bull. 275.

ployee of his controlled corporation, but with regard to his own property, can be attributed to him as an individual. Although in all cases, the court bases its opinion in terms of dealership, it is apparent that in many cases, the actual decision was based upon other factors.

The dealership concept has been particularly harsh with relation to dealers in real estate, but quite lenient with relation to security dealers. This distinction cannot be justified by the language of section 1221(1); but it can be based on public policy. The security dealer performs a vital function in the industrial society. The effect of inducing people into "dealing" in securities by offering them capital gain treatment is to create an active and ready market for new and previously issued securities, which results in an increase in capital funds available to corporations which, in turn, results in the purchase of additional equipment and the hiring of additional labor. The effect is to eventually raise the standard of living. Real estate dealers, no matter how hard they try, cannot place one additional foot of real estate on the earth. The only effect of having a more active market is to have the price increase. Therefore, the Tax Court, with the Commissioner holding the reins, has been headed in the direction of limiting capital gain treatment on the sale of real estate to only "passive" investors.