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CURRENT DEVELOPMENTS IN TAXATION

BY ALBERT J. GOULD AND KENNETH L. SMITH

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PRESUMPTION OF CORRECTNESS OF COMMISSIONER'S DETERMINATION

In the *Federal National Bank of Shawnee* case, decided in our Tenth Circuit, where a taxpayer had acquired an insurance policy some twenty years previously with other assets of an insolvent bank, the Commissioner contended that the entire proceeds less collection expenses were taxable under Section 22 (b) (2) (A). The taxpayer contended, and the Court of Appeals so held, that the Commissioner should have found either the amount of consideration or cost basis or determined that it was not ascertainable from the taxpayer's records, and that the taxpayer was under no obligation to prove that the Commissioner's action was incorrect. Since the Commissioner's determination was excessive, the Court of Appeals held that the taxpayer did not have to show that he owed no tax or the correct amount of tax which he did owe. The case was remanded to the Tax Court to find the Commissioner's determination invalid unless on a further hearing he offered evidence of the correct amount of the tax owing.

LOANS TO CONTROLLED CORPORATIONS

Bona fide intention and business purpose doctrine gradually has been injected into loan transactions from stockholders to controlled corporations. In *Spreckles*, T. C. Memo, decided Dec. 27, 1949, the court held that a loan by the stockholder to the corporation was deductible as a bad debt and the Tax Court stated that "intention is the controlling factor and where the bona fides is not questioned (as here) the fact that the lender was the sole stockholder and the corporation's business was not prospering are not a basis for disregarding the true intention or the right of the parties to create debts".

In *Wilshire and Western Sandwiches*, 175 F. 2d 718, the Court of Appeals for the Ninth Circuit reversed the Tax Court, looking primarily to the intent of the parties and found that the parties had intended to create a debtor-creditor status between the stockholders and the corporation.

However, in the Eighth Circuit (*Wetterau Grocer Co.*, C.A. 8th, Jan. 17, 1950) it was decided that a corporation was paying dividends and not interest against its so-called debenture notes. The notes had been given to stockholders in exchange for preferred

stock which had previously been issued as a dividend on the common stock. The court found that there had been no money borrowed, that the notes had characteristics of preferred stock in that the interest depended upon earnings, that the debentures were non-negotiable and subordinate to general creditors' claims.

In *Lansing Community Hotel Corporation*, 14 T.C. 24, the directors declared a 100% dividend on the par value common stock payable in ten-year debentures, 5% cumulative interest payable only out of surplus, and the debentures were subordinate to creditors. The Commissioner argued that the debentures did not constitute a bona fide obligation and hence the interest was not deductible. The Tax Court held for the taxpayer, with six judges dissenting. Even though there was no borrowing of new money the Tax Court held that it is immaterial that interest was payable only out of income, that there was no discretion to pay or not to pay and that the interest was unqualifiedly payable at maturity. The dissent held there was no indebtedness because the debentures were merely substituted for an equity interest.

REMARKS: The cases in the Courts of Appeals have looked to the business purpose and the *Lansing Community Hotel Corporation* case is obviously slated for review. This line of cases should be watched with interest and all instances of loans to closely-held corporations should be created only where there is a bona fide intention to create an absolute indebtedness.

SALE OF PARTNERSHIP ASSETS

In *Hatch*, 14 T.C. 31, it was held that execution by the co-partners transacting business under the firm name, of a bill of sale for certain assets of the partnership was a sale by the partnership. Hence the gain or loss was an ordinary gain or loss, or a capital gain or loss, depending upon the nature of the assets sold, and not a sale of a partnership interest.

REMARKS: A distribution of the assets to the partnership and a sale by them may affect the tax savings.

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