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Current Tax Problems

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Transactions Between Stockholder and His Wholly Owned Corporation

The effect of transactions between a stockholder and a wholly owned corporation has been the subject of much uncertainty. The following quotation from *Wilhelmina Doth v. Commissioner*, 42 B. T. A. 178, 11-14-40, seems to establish the rule that such transactions are recognized if the transaction "is carried out in the way that the ordinary parties to a business transaction would deal with each other" and are not recognized "when actual market prices play no part" in the transaction.

"The courts have held that a loss is deductible upon a bona fide sale by an individual to a wholly owned corporation. *Jones v. Helvering*, 71 Fed. (2d) 214; *Commissioner v. Eldridge*, 79 Fed. (2d) 629. Where there is a bona fide sale it may be made without a cash payment at the time and it may create an indebtedness. The mere fact that the purpose of the transaction may be to minimize taxes does not make the transaction ineffective if it is in all other respects a bona fide transaction. But if there is no real transfer of title, no complete relinquishment of dominion and control to the purchaser by the seller, the transaction is not effective to constitute a bona fide sale the consequences of which may be given effect for purposes of tax benefits by way of providing a basis for a deduction. *Wickwire v. United States*, 27 Fed. Supp. 724; *Pierre S. du Pont*, 37 B. T. A. 1198; *Shoenberg v. Commissioner*, *supra*; *Higgins v. Smith*, *supra*. The test to determine whether a transaction is a bona fide transaction is described by the term "arm's length," or, in other words, Was the transaction carried out in the way that the ordinary parties to a business transaction would deal with each other?

"When actual market prices play no part in a sale of stocks a question at once arises whether the transaction is bona fide. It is not reasonable that a seller is willing to sell property at less than its worth, or that a buyer is willing to buy for more than the reasonable worth of property. Where the facts show that the parties to a sale demonstrate such a lack of interest as to the price at which one sells to another that the buyer purportedly gives a sum greatly in excess of the worth of the property, such facts indicate that what was done was not a real business transaction and 'was not intended to have the usual results and significance of a bona fide business deal.' *Pierre S. du Pont*, *supra*, p. 1242. Here petitioners,

the sole stockholders of Unidauth, could establish an apparent loss to Unidauth by offering to sell and selling the stocks in question at cost to them at a time when Unidauth, selling the stocks on the market, would realize a loss. The effect was to give to their wholly owned corporation the benefit of a loss which, otherwise, they would be entitled to realize. It mattered not to petitioners, because they expected to receive reimbursement of the full cost of the securities to them from Unidauth from its earnings.

"Under such circumstances it must be held that the purported sale in 1929 was not a bona fide sale effective to create a valid debt from Unidauth in the amount of the agreed purchase price and effective later, in the taxable year, to support petitioner's claims that they sustained losses from their transactions with and investments in Unidauth."

Contributions to Corporations

In *Scanlan v. Commissioner*, 42 B. T. A. 146, 10-18-40, the Board of Tax Appeals held that a voluntary contribution by a taxpayer to a corporation of which he is the sole stockholder was not subject to the gift tax statute, and distinguished *Frank B. Thompson*, 42 B. T. A. No. 121, wherein it was held that a stockholder who makes a contribution to the capital of a corporation is subject to the gift tax, if there are other stockholders in the corporation, because they benefit proportionately from the receipt of the property by the corporation.

The above mentioned decisions are pertinent in connection with the question in mining states as to whether the donation to the corporation of 49% of the stock by the promoters is subject to gift tax. These decisions would seem to establish the rule that if all stockholders donate amounts proportionate to their respective holdings in the company, no stockholder has benefited by the act of any other and the transaction is not subject to gift tax.

Those who have attended the law institutes throughout the state will recall our discussion of this problem.

The El Paso County Bar Association, on November 19th, selected Roy A. Foard as president of the association to succeed Judge Willard T. Simmons, who passed away in October. G. Russell Miller was selected as vice-president to succeed Roy A. Foard.

In the absence of the new president, due to illness, Clyde H. Babcock, secretary of the association, presided. Thomas Burgess, a member of the local bar, made a brief survey of the wage and hour law, which proved of great interest to the local bar.

—Charles J. Simon, Correspondent.