2 T.C. 193 (1943)

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Advances made to a corporation are considered capital contributions, not debt, when the advances are made by a shareholder, without a fixed repayment schedule or interest, and are used to fund the corporation’s initial operations.

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Summary

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Joseph B. Thomas advanced funds to Pylac Products Co., a corporation formed to manufacture and market a car wash formula. Thomas deducted these advances as a bad debt when Pylac became insolvent. The Commissioner of Internal Revenue disallowed the deduction, arguing that the advances were a capital investment. The Tax Court agreed with the Commissioner, holding that the advances were contributions to capital because Thomas was a shareholder, no notes were issued, no interest was charged, and no fixed repayment schedule was established, making the loss a capital loss subject to statutory limitations.

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Facts

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In 1938, Joseph B. Thomas met H.W. McCulloch, who owned a car wash formula. They agreed to form Pylac Products Co. to develop and market the product. Thomas was to provide the financing, and they would split the company’s stock equally. Thomas advanced $18,661.90 to Pylac between February 1938 and January 1939. Thomas served as secretary and treasurer of Pylac until January 31, 1939. Pylac passed a resolution acknowledging the funds advanced by Thomas as an obligation. However, Thomas received no notes or other evidence of indebtedness, and no fixed repayment schedule or interest payments were established.

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Procedural History

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Thomas deducted the $18,661.90 as a bad debt on his 1939 income tax return. The Commissioner disallowed the deduction, determining that the advances were a capital investment. Thomas petitioned the Tax Court for review of the Commissioner's determination.

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Issue(s)

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Whether advances made by the petitioner to a corporation constitute a debt or a capital contribution for federal income tax purposes.

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Holding

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No, because the advances were made by a shareholder without a fixed repayment schedule, interest, or security, and were used to fund the corporation's initial operations; these factors indicate a capital contribution rather than a loan.

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Court's Reasoning

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The court noted that the distinction between loans and capital contributions depends on the specific facts of each case. While Pylac's books carried Thomas' advances as liabilities, this was not conclusive. The court emphasized that Thomas was a shareholder entitled to half of Pylac's stock, and the advances were used to fund the company's operations. The court also highlighted the absence of typical loan features, such as notes, interest, a fixed repayment schedule, and security. Given that Thomas was an

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