***Stipling Boats, Inc. v. Commissioner, 31 B.T.A. 1 (1944)***

A taxpayer cannot deduct interest expenses on indebtedness that it effectively repurchases through controlled agents or nominees, even if the formal legal title to the debt remains outstanding.

**Summary**

Stipling Boats, Inc. sought to deduct interest payments on a mortgage. The IRS disallowed the deduction, arguing that Stipling, through a series of transactions involving a shell corporation (Thurlim) and trusts, had indirectly purchased its own debt. The Board of Tax Appeals agreed with the IRS, finding that Thurlim and the trusts were acting as Stipling's agents. Since the substance of the transaction was a repurchase of debt, the interest payments were not considered true interest expenses but rather repayments of loans used to acquire the discounted debt.

**Facts**

Stipling Boats, Inc.'s subsidiary, Stiplate, issued a bond and mortgage for $1,717,500 in 1935. In 1937, Trinity, the holder of the mortgage, was willing to accept $600,000 for the obligation. Adler, the sole stockholder of Stipling, created Thurlim, a corporation with no assets or business activity. Thurlim offered to purchase the bond and mortgage from Trinity for $600,000, using funds ultimately sourced from Stipling. Simultaneously, trusts were created, and Thurlim's stock was issued to the trusts. Thurlim then agreed to sell the bond and mortgage to the trusts for $600,000, taking promissory notes from each trust. Adler arranged a loan for Thurlim, secured by his personal assets. Stipling then began making "interest" payments to the trusts, which passed the payments to Thurlim, which used the funds to pay off its obligations.

**Procedural History**

Stipling Boats, Inc. deducted interest payments on its tax return. The Commissioner of Internal Revenue disallowed a portion of the deduction. Stipling appealed to the Board of Tax Appeals, which upheld the Commissioner's determination.

**Issue(s)**

1. Whether Stipling Boats, Inc. could deduct interest payments made to trusts when the funds were ultimately used to repurchase its own debt through a controlled corporation.

**Holding**

1. No, because Thurlim and the trusts were acting as agents or nominees of Stipling Boats, Inc. in purchasing the company's outstanding indebtedness at a discount; thus, the payments to the trusts were not true interest payments.

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## Court’s Reasoning

The court reasoned that the substance of the transaction was a repurchase of Stipling’s own debt. The court emphasized that Thurlim was a shell corporation with no independent business purpose, and that the trusts were created solely to facilitate the repurchase. The court relied on precedent, including *Higgins v. Smith, 308 U.S. 473*, stating that “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 purpose of the tax statute.” The court concluded that the payments made by Stipling were not truly for the use of borrowed money, stating that “petitioner has not shown to our satisfaction that these payments by petitioner were in truth and substance compensation for the use of money.” The only deductible interest was the interest paid by Thurlim to Manufacturers Trust Co. on the loan used to finance the repurchase.

## Practical Implications

This case highlights the importance of substance over form in tax law. Taxpayers cannot use artificial structures or intermediaries to disguise the true nature of a transaction and obtain tax benefits that would not otherwise be available. The case establishes that the IRS can scrutinize transactions to determine their true economic substance and disregard the form if it is a sham. This principle is often applied in cases involving related parties and debt restructuring. Later cases cite *Stipling Boats* as an example of when a transaction lacks business purpose and should be disregarded for tax purposes. This case emphasizes the need for a legitimate business purpose beyond tax avoidance when structuring transactions.

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