7 T.C. 1129 (1946)

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When a corporation pays excessive rent to its majority stockholder, and the Commissioner determines that a portion of such payments constitutes a disguised dividend, the Tax Court can review the disallowance and determine what part, if any, was actually a distribution of profits.

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Summary

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Limericks, Inc. paid rent to its president and majority stockholder, G.L. Limerick, for a building the corporation used. The Commissioner disallowed a portion of the rent deduction, arguing it was a disguised dividend. The Tax Court considered whether the rental payments were excessive and, if so, whether they constituted a distribution of profits. The court held that a portion of the rent was indeed a disguised dividend, considering the close relationship between Limerick and the corporation and the disparity between the rent paid and the property's value.

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Facts

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G.L. Limerick owned a furniture business and the building it occupied. He transferred the business to B&B Furniture Co. (later Limericks, Inc.), a corporation owned by his wife, daughter and son-in-law, while continuing to own the building. He leased the building to the corporation. Later, Limerick acquired 190 of 250 shares of the corporation, becoming president. The corporation moved to a new building Limerick purchased and immediately rented to the company for $18,000 per year. The Commissioner later disallowed a portion of the rent paid as a business expense deduction.

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Procedural History

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The Commissioner determined deficiencies in Limericks, Inc.’s income, declared value excess profits, and excess profits taxes for 1940-1943, disallowing portions of the rent deduction. Limericks, Inc. petitioned the Tax Court for redetermination. The Tax Court consolidated the cases for trial.

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Issue(s)

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Whether amounts paid by Limericks, Inc. to its president and principal stockholder as rent for a building used by the corporation constituted a distribution of profits.

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Holding

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No, a portion of the amounts paid as rent constituted a disguised dividend because the payments were excessive considering the property’s value and the relationship between the corporation and the landlord.

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Court’s Reasoning

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The court emphasized the close relationship between Limerick and the corporation. Limerick owned the majority of the stock, and his wife owned the remainder (except for qualifying shares), making them the primary beneficiaries of both dividends and rental payments. The Court considered that the money used to purchase the real estate owned by G. L. Limerick was acquired after marriage from the joint efforts of Limerick and his wife, and the real estate is community property. The stock owned by Mrs. Limerick in the B & B Furniture Co. and Limericks, Inc., was also community property. Because of the personal nature of the transactions, the court found the rental agreement was not at arm’s length. The court noted the high rent compared to the property’s cost and market value. It cited 26 U.S.C. §23, allowing deductions for “rentals or other payments required to be made as a condition to the continued use or possession…of property to which the taxpayer has not taken or is not taking title or in which he has no equity.” The court determined that a portion of the payments was not

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