8 T.C. 136 (1947)

A taxpayer's sale of stock is considered bona fide and dividends paid on the stock are not taxable to the seller, even if the sale was motivated in part by tax avoidance, so long as the sale is real, complete, and bona fide in every respect and the purchasers had a reasonable expectation of making a profit.

Summary

T.W. Rosborough sold stock in Caddo River Lumber Co. to a group including his wife and sisters, partly to alleviate his tax burden. The purchasers formed an investment partnership, Rosboro Investment Co., with Rosborough, pooling their Caddo and Rosboro Lumber Co. stock. The Tax Court held the sale was bona fide, and Rosborough was taxable only on the gain from the sale and his distributive share of partnership income, not on the dividends paid to the new owners of the Caddo stock. This case highlights the importance of proving a legitimate business purpose and a real change in economic position when a sale is challenged as a tax avoidance scheme.

Facts

Rosborough, facing a large tax bill from Caddo River Lumber Co. dividends, sold his 1,755 shares of Caddo stock at par to eight individuals, including his wife, sisters, and three non-relatives. He was heavily indebted, with the Caddo stock pledged as collateral. All dividends were being applied to his debt. Rosborough sold the stock to relieve himself from his difficult financial situation. The consideration for the sale included the buyers' assumption of $125,000 of Rosborough's debt and their personal notes to him for the remaining $50,500.

Procedural History

The Commissioner of Internal Revenue determined an income tax deficiency against Rosborough, arguing the stock sale and partnership were shams. Rosborough challenged the deficiency in the Tax Court. The Tax Court, after considering stipulated facts, documentary evidence, and testimony, ruled in favor of Rosborough, finding the sale and partnership to be bona fide.

Issue(s)

1. Whether the sale of Caddo stock by Rosborough to his eight vendees was a bona fide transaction, or a sham to be disregarded for federal income tax purposes?
2. Whether the subsequent formation of the Rosboro Investment Co. partnership by Rosborough and the eight vendees was a bona fide business association, or a sham to be disregarded for federal income tax purposes?

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. Yes, the sale of Caddo stock was a bona fide transaction because the sale was real, complete, and bona fide in every respect and the purchasers had a reasonable expectation of making a profit.
2. Yes, the Rosboro Investment Co. was a bona fide business association because the partners acted with the expectation of making profits, and the partnership was not merely a vehicle for tax avoidance.

Court's Reasoning

The Tax Court emphasized that a tax avoidance motive does not invalidate a transaction if it is "otherwise real, complete, and bona fide in every respect." The court noted the buyers were financially responsible individuals who understood their personal obligation to pay the notes. The court found that the purchasers had legitimate business reasons beyond tax avoidance, including the expectation of making profits on the Caddo stock and supporting Rosboro Lumber Co. The court distinguished the case from those where the taxpayer retains control or economic benefit, stating Rosborough's "control" was merely that of a secured creditor. The court further noted that all income was attributable entirely to the capital invested, not personal services, distinguishing it from family partnership cases. The court cited Allen v. Beazley, 157 Fed. (2d) 970, a similar case where the Fifth Circuit Court of Appeals found a similar transaction to be bona fide.

Practical Implications

This case provides guidance on when a sale of assets to family members will be respected for tax purposes. It illustrates that a sale will be upheld if it is a real transaction where the buyer assumes genuine economic risk and has a reasonable expectation of profit. The case also shows the importance of demonstrating that the transferor does not retain excessive control over the transferred assets. Later cases have cited Rosborough to support the principle that a tax motive, by itself, does not invalidate an otherwise legitimate business transaction. Legal practitioners should consider the factors outlined in Rosborough when structuring sales between related parties to ensure they are treated as bona fide for tax purposes.

© 2025 SCOTUSreports.com. All rights reserved.