9 T.C. 1060 (1947)

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A trust company is not considered a “bank” for purposes of exemption from personal holding company status under Section 501 of the Internal Revenue Code unless a substantial part of its business consists of receiving deposits, making loans, or exercising fiduciary powers for profit.

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Summary

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Palm Beach Trust Company sought a redetermination of a deficiency in personal holding company surtax and a penalty for failure to file a personal holding company return. The Tax Court addressed whether the Trust Company qualified as a “bank” under Section 104 of the Internal Revenue Code, whether income from the sale of municipal certificates was tax-exempt, and whether the penalty for failure to file was justified. The court held the Trust Company was not a “bank,” the income from the certificates was tax-exempt interest, but the penalty was appropriate due to a lack of reasonable cause for failing to file the return.

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Facts

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Palm Beach Trust Company, a Florida-chartered trust company, did not accept deposits from the general public or make loans/discounts. Its primary activity consisted of acting as trustee for mortgages held for the benefit of its stockholders’ families. It collected principal and interest payments on these mortgages, but did not bill or receive any income for these services. The company’s income was primarily derived from interest, dividends and gains on the sale of securities. It failed to file a personal holding company return for 1941.

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Procedural History

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The Commissioner of Internal Revenue assessed a deficiency in personal holding company surtax against Palm Beach Trust Company, along with a penalty for failing to file a personal holding company return. The Trust Company petitioned the Tax Court for a redetermination of the deficiency and penalty.

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Issue(s)

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1. Whether Palm Beach Trust Company qualified as a “bank” under Section 104 of the Internal Revenue Code, thus exempting it from personal holding company status.

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2. Whether the income from the sale of Miami certificates of indebtedness, received in lieu of tax-exempt interest, was taxable as capital gain.

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3. Whether the penalty for failure to file a personal holding company return was properly imposed.

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Holding

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1. No, because a substantial part of the Trust Company’s business did not consist of receiving deposits, making loans, or exercising fiduciary powers for profit.

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2. No, because the proceeds from the sale of the certificates represented tax-exempt interest.

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3. Yes, because the Trust Company failed to demonstrate reasonable cause for its failure to file the return.

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Court’s Reasoning

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The court reasoned that to qualify as a “bank” under Section 104, a substantial part of the trust company’s business must consist of receiving deposits, making loans, or exercising fiduciary powers similar to those permitted to national banks. The court found that the Trust Company’s fiduciary activities, while present, were restricted, informal, and not conducted for profit. The court emphasized the lack of billing and collection of fees, indicating the absence of a true business purpose. The court stated, “The pursuit of an activity for profit is indispensably associated with the concept of ‘business.'” Regarding the tax-exempt status of the Miami certificates, the court reasoned that the proceeds retained their character as tax-exempt interest, even when collected through a sale. The court noted, “Collection from the purchaser upon a transfer of tax-exempt interest does not deprive the receipt of its original character.” Finally, regarding the penalty, the court held that the Trust Company failed to provide sufficient evidence to demonstrate reasonable cause for its failure to file a personal holding company return. “The present petitioner does not seem to us to have sustained its burden of showing, as the statute requires, that the failure to file the personal holding company return was due to reasonable cause and not to willful neglect.” A dissenting opinion argued that the Trust Company met the literal definition of a bank under Florida law and that the penalty was inappropriate given the doubt surrounding its classification.

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Practical Implications

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This case clarifies the definition of a

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