10 T.C. 616 (1948)

A business operating under a revoked corporate charter, but owned and controlled by a single individual, is taxed as a sole proprietorship, not as an association taxable as a corporation.

Summary

Knoxville Truck Sales & Service, Inc. operated under a Tennessee corporate charter, selling and servicing vehicles. However, the charter was revoked in 1942 for nonpayment of taxes, unbeknownst to the sole owner, H.R. Thornton, who continued operating under the corporate name. The Tax Court addressed whether the business should be taxed as a corporation, an association taxable as a corporation, or a sole proprietorship for the years 1941-1944. The court held that until the charter revocation, it was a corporation; after revocation, it was a sole proprietorship taxable to Thornton individually, because a single-owner business cannot be an "association" taxable as a corporation. The court also found Thornton's compensation to be reasonable.

Facts

A corporate charter was issued to Knoxville Truck Sales & Service, Inc. in Tennessee on May 25, 1939. H.R. Thornton transferred real property and cash to the business. No stock was ever issued, and no formal corporate meetings were held. The business operated under the corporate name, selling and servicing vehicles under a General Motors agency contract, managed solely by H.R. Thornton. The corporate charter was revoked on April 23, 1942, for nonpayment of taxes, but Thornton was unaware of the revocation until November 1944 and continued to operate as before, filing corporate tax returns.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies in income tax, excess profits tax, and declared value excess profits tax against Knoxville Truck Sales & Service, Inc. for the years 1941-1944. The Tax Court consolidated the proceedings. The central issue was whether the business was a corporation, an association taxable as a corporation, or a sole proprietorship. The Commissioner argued that even after charter revocation, it was an association taxable as a corporation.

Issue(s)

1. Whether Knoxville Truck Sales & Service, Inc. should be taxed as a corporation or an association taxable as a corporation for the years 1941-1944.

2. If the business is a corporation, whether the compensation paid to H.R. Thornton in 1941 was reasonable.

Holding

1. No, in part. The business was taxable as a corporation until April 23, 1942 (the date of the charter revocation), but thereafter should be taxed as a sole proprietorship, because a business owned and controlled by a single individual cannot be an association taxable as a corporation.

2. Yes, because the amount paid to H.R. Thornton was not excessive considering the services he performed.

Court's Reasoning

The Tax Court reasoned that the business operated under a valid corporate charter until its revocation, meeting the requirements for corporate existence under Tennessee law. Citing *Burnet v. Commonwealth Improvement Co.* and *Moline Properties, Inc. v. Commissioner*, the court noted that taxpayers cannot disavow a corporate form they adopted for business advantages merely to gain tax benefits. However, after the charter revocation, the court considered whether the business was an "association" taxable as a corporation under 26 U.S.C. § 3797(a)(3). Referencing *Morrissey v. Commissioner*, the court emphasized that an association requires "associates" entering a "joint enterprise." Because H.R. Thornton was the sole owner and manager after the revocation, the court found the business lacked the essential characteristics of an association. The court distinguished the case from situations where multiple individuals continued a business after corporate charter expiration. The court also held that the compensation paid to H.R. Thornton was reasonable, and thus fully deductible.

Practical Implications

This case clarifies the tax treatment of a business after its corporate charter is revoked, especially when owned and controlled by a single individual. It emphasizes that a sole proprietorship cannot be classified as an association taxable as a corporation. This case informs legal reasoning by highlighting the importance of business structure and ownership in determining tax liability. For attorneys advising businesses, it underscores the need to understand the implications of corporate charter revocations and to advise clients on the appropriate tax treatment. It also reinforces the principle that taxpayers cannot easily disregard the chosen business form to avoid taxes, except in specific circumstances. This ruling has been applied in subsequent cases to distinguish between true corporations, associations, and sole proprietorships for tax purposes.