John Stewart, Inc. v. Commissioner, 1948 Tax Ct. Memo LEXIS 136 (T.C. 1948)

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A corporation is not a personal service corporation if a substantial portion of its income is attributable to the services of non-shareholder employees, even if the shareholder-employees are highly qualified and essential to the corporation's success.

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Summary

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John Stewart, Inc. sought to be classified as a personal service corporation for tax purposes. The Tax Court denied this classification, finding that a substantial portion of the corporation's income was attributable to the services of its non-shareholder district managers and field men, not primarily to the activities of its shareholder-officers. The court emphasized that while the officers were crucial to the organization, the field men performed the majority of the income-producing work, specifically the management of farms, which required constant personal attention and specialized training.

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Facts

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John Stewart, Inc. managed farms for absentee owners. The corporation's three officer-stockholders were responsible for the overall organization and management of the company. However, the actual management of the farms was carried out by district managers and field men, who were not shareholders. These field men were carefully selected for their scientific training, character, and ability to take individual responsibility for managing the farms. A publication by the company's president stated that the success of the system was largely due to the selection of these field men.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in John Stewart, Inc.’s taxes, denying its claim to be a personal service corporation. John Stewart, Inc. petitioned the Tax Court for a redetermination. The Tax Court upheld the Commissioner’s determination.

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Issue(s)

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Whether John Stewart, Inc. qualifies as a personal service corporation under Section 725 of the Internal Revenue Code, where a substantial portion of its income is attributable to the activities of non-shareholder employees.

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Holding

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No, because the corporation’s income was not primarily attributable to the activities of its shareholders, but rather to the substantial services provided by its non-shareholder employees.

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Court’s Reasoning

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The court relied on Section 725 of the Internal Revenue Code, which defines a personal service corporation as one whose income is primarily ascribed to the activities of shareholders regularly engaged in the active conduct of the corporation’s affairs. The court also cited Treasury Regulations that state that a corporation is not a personal service corporation if employees other than shareholders contribute substantially to the services rendered, unless the value of those services is attributable primarily to the experience or skill of the shareholders and this is evidenced in a definite manner. The court found that the field men performed the greater part of the work which produced the income. This work required the constant personal attention of the field men and the application of their scientific training. Quoting from a prior case, Patterson-Andress Co., the court

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emphasized that the statute

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