Bond v. Commissioner, 14 T.C. 478 (1950)

A corporation's separate legal existence will be respected for tax purposes if it engages in substantial business activities, even if it is closely held and its operations benefit its shareholders.

Summary

Allan Bond sought to deduct a capital loss carry-over in 1944, claiming his stock in a corporation became worthless in 1943. The Tax Court addressed whether the corporation should be recognized as a separate entity for tax purposes, or if it was merely the alter ego of Bond. The court held that the corporation was a distinct entity because it engaged in substantial business activities, including owning property, filing tax returns, borrowing money, and managing a building. Therefore, Bond was entitled to the capital loss carry-over.

Facts

In 1926, a corporation was formed and acquired title to two properties. The corporation held title to the properties until 1943. During that time, it filed income tax returns annually, borrowed money, erected a 16-story building, executed a mortgage, hired a commercial managing agent, and leased office space. In 1943, the corporation contracted to sell the property and subsequently delivered the deed to the purchasers. Allan Bond was a bona fide owner of the corporation's stock, with a cost basis exceeding $191,000. When the corporation was stripped of its assets, Bond claimed his stock became worthless.

Procedural History

Bond initially claimed a business loss, but abandoned that argument based on precedent. He then argued for a capital loss carry-over. The Commissioner disallowed the carry-over, contending that the corporation was merely Bond's alter ego and should not be recognized as a separate entity for tax purposes. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether the corporation should be recognized as a separate entity for tax purposes, or whether it should be disregarded as the alter ego of Allan Bond, thus precluding him from claiming a capital loss carry-over based on the worthlessness of the corporate stock.

Holding

No, the corporation should be recognized as a separate entity because the corporation engaged in sufficient business activity to warrant its recognition as a separate entity for tax purposes.

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Court’s Reasoning

The court relied on the principle articulated in *Moline Properties, Inc. v. Commissioner, 319 U. S. 436*, stating that “in matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal. In such situations the form is a bald and mischievous fiction.” The court found that the corporation was not a sham. It was formed to acquire property, held title to the properties for many years, filed tax returns, borrowed money, erected a building, hired a managing agent, and leased office space. These activities demonstrated that the corporation was a viable entity and not merely Bond’s alter ego. The court also referenced a letter from the Deputy Commissioner that recognized the corporation’s separate entity and required it to file its own tax return. Based on this evidence, the Tax Court concluded that the corporate entity should be respected, and Bond was entitled to the capital loss carry-over.

Practical Implications

This case reinforces the principle that a corporation’s separate legal existence will generally be respected for tax purposes as long as it conducts meaningful business activities. It clarifies that simply being a closely held corporation or benefiting its shareholders does not automatically justify disregarding the corporate entity. Legal professionals should consider the extent of a corporation’s business activities when determining whether to challenge its separate existence for tax purposes. This case is often cited when the IRS attempts to disregard a corporate entity to prevent tax avoidance. Tax advisors should advise clients to maintain proper corporate formalities to ensure that the corporate entity is respected.

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