14 T.C. 566 (1950)

Payments made by a stockholder to a corporation, ostensibly to cover operating losses, are generally treated as capital contributions that increase the cost basis of the stock, rather than as deductible ordinary business expenses or cost of goods sold.

Summary

Harry Sackstein and Louis Zlobin, partners in a kosher meat business, sought to deduct payments made to United Meat Company, Inc. (United) as either ordinary business expenses or as part of the cost of goods sold. These payments were made in addition to the ceiling price for meat during wartime price controls. The Tax Court held that these payments were capital contributions, increasing the basis of the petitioners' stock in United, and not deductible as business expenses or cost of goods sold. The court emphasized that the payments lacked a clear connection to the price of goods and were more akin to contributions to cover United's operating losses.

Facts

Sackstein and Zlobin operated a retail kosher meat business. Due to wartime price controls, they struggled to obtain enough meat at ceiling prices. To secure an additional supply, they purchased stock in United after being informed that United was organized for the convenience of stockholders and that they would likely be called upon to contribute to cover operating losses. They purchased a substantial amount of meat from United during 1945, paying O.P.A. ceiling prices. They also made additional payments to United to cover its losses.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax for 1945, disallowing deductions claimed for contributions to United. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether payments made by the petitioners, as stockholders, to United, in addition to the price paid for meat, constitute deductible ordinary and necessary business expenses or an adjustment to the cost of goods sold, or whether such payments are capital contributions.

Holding

No, because the payments were deemed capital contributions, increasing the basis of the petitioners' stock in United, rather than deductible business expenses or cost of goods sold.

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Court’s Reasoning

The court reasoned that contributions by stockholders to their corporation are generally treated as capital contributions, increasing the cost basis of the stock. The court found no evidence to suggest that these payments were directly related to the cost of the meat purchased. The court noted that if the payments were added to the cost of meat, the total cost would exceed lawful prices under O.P.A. regulations, suggesting a possible illegal

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