14 T.C. 776 (1950)

A corporation formed by an individual to hold title to real estate and engage in business activities related to that real estate is a separate taxable entity, even if all stock is owned by that individual.

Summary

L.B. Whitfield formed Whitfield Realty Co. to hold title to his Florida real estate and avoid administration expenses. The corporation filed income tax returns, reported rental income and expenses, and sold property. The IRS argued the gain from the sale should be taxed to the corporation, while Whitfield's estate claimed it should be taxed to him. The Tax Court held that the corporation was a separate taxable entity because it engaged in sufficient business activity, including renewing leases, paying expenses, and selling property.

Facts

L.B. Whitfield, indebted to Alabama-Georgia Syrup Co. (Syrup Co.), conveyed Florida real estate to Whitfield Realty Co. (Realty Co.) in 1938. Realty Co. was formed upon advice to avoid ancillary administration proceedings in Florida. Whitfield owned nearly all the stock. The properties were rental properties subject to yearly leases producing monthly rentals. Rent checks were endorsed by Whitfield and delivered to Syrup Co. to reduce his debt. Realty Co. filed income tax returns, reporting rental income and various expenses. In 1942, Realty Co. sold a property in Pensacola, Florida.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Whitfield's income tax and asserted transferee liability against his estate for deficiencies of the Realty Co. The Tax Court consolidated the proceedings and considered whether the gain from the sale of the Pensacola property was taxable to the Realty Co. or to Whitfield's estate.

Issue(s)

Whether the Whitfield Realty Co. should be recognized as a separate taxable entity for federal income tax purposes, or whether its income and activities should be attributed to its controlling shareholder, L.B. Whitfield.

Holding

Yes, because the Realty Co. was formed with a business purpose and engaged in sufficient business activity to be recognized as a separate taxable entity.

Court's Reasoning

The court applied the general rule that a corporation is a separate taxpayer from its stockholders, citing *Moline Properties, Inc. v. Commissioner*. The court recognized an exception to this rule where a corporation is a sham or unreal, or where it merely holds bare title to property without engaging in business. However, the court found that Realty Co. had a business purpose (acquiring, owning, selling real estate) and engaged in sufficient activities, including acquiring property via deed, renewing leases, collecting rent, paying expenses (legal, travel, auditing, commissions), and selling property. The court noted that the corporation filed income tax returns, paid franchise taxes, and recognized rental receipts as income taxable to it. The court distinguished cases like *Glenn v. Commissioner* and *Paymer v. Commissioner*, where corporations were found to be mere passive holders of title without business activities.

Practical Implications

This case reinforces the principle that a corporation formed for a legitimate business purpose and engaging in business activities will be recognized as a separate taxable entity, even if closely held. Attorneys advising clients on forming corporations to hold real estate must consider the level of business activity the corporation will undertake. Mere passive holding of title may allow income to be taxed to the individual, but active management, leasing, and sales will likely result in taxation at the corporate level. Taxpayers cannot disregard the corporate entity they create merely because it suits their tax objectives at a later date.