17 T.C. 1562 (1952)

Corporate withdrawals are treated as loans rather than dividends when there is evidence of intent to repay, even in the absence of formal loan documentation.

Summary

Carl White, a minority shareholder and president of a lumber company, withdrew funds exceeding his salary, bonus, and travel allowance. The IRS argued these withdrawals were dividends, taxable as income, or a return of capital. The Tax Court held that the withdrawals were loans, not dividends, because both White and the company intended them as such, supported by consistent accounting treatment and White's ongoing repayments, despite the lack of formal notes or interest. This case underscores the importance of intent and consistent treatment in classifying corporate distributions.

Facts

Carl White was the president and a 40% shareholder of Breece-White Manufacturing Company. White and another shareholder, Vaughters, could independently draw checks on company funds. The company maintained personal accounts for White and Vaughters, charging withdrawals and crediting salary, bonuses, and expenses. White's withdrawals exceeded his credits in 1942-1944, resulting in a significant debit balance. White lost much of the withdrawn money gambling, a fact known to Vaughters, who objected but initially took no action. White eventually pledged his stock to the company as security for the debt.

Procedural History

The IRS determined that White's withdrawals were taxable dividends to the extent of the company's surplus, and the excess was a return of capital resulting in a long-term capital gain. White petitioned the Tax Court, contesting the IRS's determination. Prior to the Tax Court case, the company sued White in Arkansas state court and obtained a judgment against him for the excessive withdrawals. The Tax Court then reviewed the IRS determination.

Issue(s)

Whether withdrawals by a shareholder-officer from a corporation constitute dividend distributions, taxable as income, or loans from the corporation to the shareholder.

Holding

No, because the withdrawals were intended as loans by both the corporation and the shareholder, as evidenced by consistent accounting treatment and ongoing repayments, despite the lack of formal loan documentation.

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Court’s Reasoning

The court emphasized that the critical factor is whether the withdrawals were intended as loans when they were made. The court found that White’s intent, as well as the company’s intent, was for the withdrawals to be loans. This was supported by: (1) the company’s consistent treatment of the withdrawals as debits in White’s personal account; (2) White’s regular repayments through salary, bonuses, and expense allowances; (3) the absence of a formal agreement among stockholders to authorize the withdrawals as dividends; and (4) Vaughters forcing the issue and the company acquiring White’s stock as collateral for the debt in a later year, obtaining a judgment against him. The court distinguished this case from others where withdrawals were considered dividends because there was no intent to repay or the withdrawals were formally authorized as dividends.

The court quoted Vaughters testimony: “and when you know that sickness is there, you try to get along the best you can with it without getting out of bounds.”

Practical Implications

This case provides guidance on how to classify corporate distributions to shareholder-officers for tax purposes. It clarifies that the presence of formal loan documentation (notes, interest) is not the sole determinant. Intent to repay, consistent accounting treatment, and actual repayment activity are critical factors. Later cases have cited White v. Commissioner to support the argument that shareholder withdrawals should be treated as loans when there is evidence of intent and ability to repay. Businesses and legal practitioners must carefully document the intent and treatment of such withdrawals to ensure accurate tax reporting. It also highlights the potential for conflict among shareholders when one shareholder engages in excessive withdrawals, and the need for clear corporate governance policies to address such situations.

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