18 T.C. 210 (1952)

When a taxpayer, rather than a corporation, purchases stock from a shareholder using a corporate loan and subsequently receives dividends and bonuses tied to that stock, those dividends and bonuses constitute taxable income to the taxpayer, not a corporate transaction.

Summary

George Hancock, a majority shareholder in Duff-Hancock Motors, arranged to purchase the remaining shares from Buford Duff using a corporate loan. The Tax Court addressed whether dividends and a bonus declared on these shares were taxable income to Hancock or a corporate transaction. The court held that because Hancock personally purchased the shares (even with a loan from the corporation), the dividends and bonus constituted taxable income to him, despite attempts to recharacterize the transaction as a corporate stock retirement via amended tax returns.

Facts

George Hancock (petitioner) owned 56 of 113 shares of Duff-Hancock Motors, Inc. Buford Duff, the president, owned a like number, and Jewell Winkle owned the remaining share. Duff wanted to retire. Hancock agreed to buy Duff's and Winkle's shares. The corporation lacked the capital for a direct purchase. The corporation's accountants devised a plan where the corporation would loan Hancock money to buy the shares. Hancock used this loan to purchase Duff's and Winkle's shares, which were then reissued with 56 shares to Hancock and 1 to his wife. Subsequently, a dividend was issued, and Hancock received a bonus tied to his position; these payments were intended to help him repay the corporate loan.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Hancock's income tax for 1948, arguing that the dividends and bonus were taxable income. Hancock contested this determination in the Tax Court.

Issue(s)

Whether dividends and a bonus, received by Hancock after purchasing stock from another shareholder with a corporate loan, constitute taxable income to Hancock or a non-taxable corporate transaction (i.e., a purchase of treasury stock).

Holding

No, the dividends and bonus constitute taxable income to Hancock because the evidence demonstrated that Hancock, and not the corporation, purchased the stock from Duff and Winkle.

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Court’s Reasoning

The court emphasized the clear language of the corporate resolution authorizing the loan to Hancock “for the sole purpose of George M. Hancock’s purchasing the 56 shares of common no par value stock from Buford Duff and 1 share from Jewell Winkle.” The court noted that Hancock deposited the loan into his personal account, wrote a personal check to Duff, and the stock was reissued in his and his wife’s names. The court found unpersuasive the amended corporate tax return which attempted to recharacterize the transaction. The court stated, “A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title.” The court also cited *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, stating that the corporation must be treated as an entity separate and distinct from its stockholders. The court reasoned that the corporation never actually acted to purchase the stock, and the adjusting bookkeeping entries were merely an attempt to avoid tax consequences after the fact.

Practical Implications

Hancock illustrates that the substance of a transaction, rather than its form, governs its tax treatment. Taxpayers cannot retroactively recharacterize completed transactions to minimize tax liability. This case underscores the importance of clear documentation and consistent treatment of transactions from the outset. It also serves as a reminder that a corporation is a separate legal entity from its shareholders, and transactions must respect that distinction to achieve desired tax outcomes. Subsequent cases cite *Hancock* for the principle that dividends are generally taxable to the shareholder who owns the stock when the dividend is declared.

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