20 T.C. 305 (1953)

A transfer of funds to a corporation by its stockholders is treated as a contribution to capital, not a loan, when factors such as inadequate capitalization, lack of a note or fixed repayment schedule, and proportional allocation to stockholdings suggest the funds were placed at the risk of the business.

Summary

Nelson v. Commissioner addressed whether a distribution to stockholders was a taxable dividend or repayment of a loan. The Tax Court held it was a dividend because the initial transfer of funds to the corporation was a contribution to capital, not a loan. The court emphasized the inadequate capitalization of the company without the funds, the lack of formal loan documentation, and the proportional allocation based on stock ownership. The reliance on an accountant's advice, however, excused penalties for failure to report the distribution as income.

Facts

In 1937, upon incorporating the Wood Company, R.E. Nelson, Gordon H. Wood, and W.H. Wood transferred $22,360.56 to the company. $2,000 was designated as capital stock, and the remaining $20,360.56 was recorded as Donated Surplus. Each received 20 shares of common stock. In 1946, the Wood Company distributed $17,960.49 to its stockholders. The taxpayers argued this was a repayment of the 1937 loan. The IRS contended it was a taxable dividend.

Procedural History

The Commissioner of Internal Revenue determined that the distribution was a taxable dividend and assessed deficiencies. The taxpayers petitioned the Tax Court for a redetermination, arguing the distribution was a repayment of a loan and that failure to file returns or report income was due to reasonable cause. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether the $20,360.56 transferred to the Wood Company in 1937 constituted a loan or a contribution to capital.
2. Whether the failure of some petitioners to file returns and the deficiency of others were due to reasonable cause and not willful neglect or negligence.

Holding

1. No, the transfer was a contribution to capital because the totality of circumstances indicated the funds were placed at the risk of the business and not intended as a debt.
2. Yes, the failure to file and the deficiency were due to reasonable cause because

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the petitioners relied on the advice of a qualified accountant.

Court’s Reasoning

The court reasoned that while the parties’ intent is relevant, it is not conclusive. The court stated, “an allegation that the parties intended a loan is not conclusive and must yield to the facts when they disclose a contrary intent.” Several factors indicated a capital contribution: inadequate capitalization if the transfer was a loan, lack of a note or fixed repayment schedule, the designation as

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