***25 T.C. 458 (1955)***

Rental income received by a corporation from property used by a partnership in which the corporation's shareholders hold a significant ownership interest constitutes personal holding company income under Section 502(f) of the 1939 Internal Revenue Code.

**Summary**

The United States Tax Court addressed whether Fourth and Railroad Realty Co. qualified as a personal holding company, resulting in surtax liability and penalties for failure to file proper returns. The court determined that the company's rental income from property leased to a partnership, in which the same individuals owned all of the corporation's stock, constituted personal holding company income. Consequently, the company was deemed a personal holding company, thus rendering it liable for the surtax and penalties for failure to file timely and properly executed returns. The court further found that the company did not demonstrate reasonable cause for these filing failures.

**Facts**

Fourth and Railroad Realty Co. (Petitioner), a New Jersey corporation, derived its entire income in 1944 from rent paid by Mario G. Mirabelli & Co., a partnership operating a manufacturing business, for the use of the company's factory building. The two stockholders of Petitioner, Katherine and Emma Mirabelli, each owned 50% of the company's stock and were also partners in the lessee partnership, Mario G. Mirabelli & Co. Petitioner's personal holding company return for the year 1944 was filed late and was not signed by the treasurer, assistant treasurer, or chief accounting officer. The company's corporation income and declared value excess profits tax return was similarly signed only by the president.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies and penalties for the 1944 tax year. The Tax Court considered the issues of personal holding company status and the imposition of penalties for failing to file timely and properly executed returns.

**Issue(s)**

1. Whether the petitioner was a personal holding company in 1944 within the meaning of section 501 of the 1939 Internal Revenue Code.

2. If petitioner was a personal holding company, whether petitioner is liable for the statutory 25 per cent penalty under section 291 for failure to file a properly executed personal holding company return for said year.

© 2025 SCOTUSreports.com. All rights reserved. 

3. Whether petitioner is liable for the statutory 25 per cent penalty under section 291 for failure to file a properly executed income tax and declared value excess-profits tax return for the year 1944.

**Holding**

1. Yes, because the rental income qualified as personal holding company income under section 502(f) of the 1939 Internal Revenue Code.

2. Yes, because Petitioner's failure to file a timely personal holding company return was not due to reasonable cause, but to willful neglect.

3. Yes, because Petitioner did not file a proper return within the meaning of section 52 (a) of the 1939 Internal Revenue Code, and there was no reasonable cause for this omission.

**Court's Reasoning**

The court determined that the company met the ownership requirements of section 501(a)(1) because the same two stockholders owned all the stock of the petitioner and were members of the partnership that leased the petitioner's factory. Section 502(f) provides that personal holding company income includes amounts received as compensation for the use of a corporation's property where 25 percent or more of the stock is owned by an individual entitled to use the property. The court rejected Petitioner's argument that Section 502(f) should only apply to non-business use of non-business property, finding no support for such an interpretation in the statute or legislative history. The court also determined that since the company did not show reasonable cause for the late filing of the personal holding company return, and it failed to file a return signed by both the president and the treasurer, the penalties were appropriately applied.

**Practical Implications**

This case is crucial for understanding what constitutes personal holding company income and the consequences of failing to comply with tax filing requirements. It emphasizes that rental income can trigger personal holding company status, even if the property is used for a business purpose, if ownership structures align as described in the code. Attorneys advising businesses, particularly those structured with significant shareholder overlap between the corporation and its lessees, must be aware of how this case defines "personal holding company income". Careful attention to detail in tax return preparation, including proper signatures and timely filing, is essential to avoid penalties. Furthermore, the case underlines the importance of having and documenting reasonable cause to defend against penalties for late filings. Later cases would cite this case for the definition of what constitutes personal holding company income.

© 2025 SCOTUSreports.com. All rights reserved. 