T.C. Memo. 1968-3

A foreign corporation will be recognized as a separate taxable entity from its shareholder if it is formed for a substantial business purpose or engages in substantive business activity, even if tax avoidance is a motive for its creation.

Summary

Perry Bass, a U.S. citizen, formed Stantus A.G., a Swiss corporation, and transferred a portion of his oil and gas interests to it. The Commissioner sought to disregard Stantus A.G. for tax purposes, arguing it was solely created for tax avoidance. The Tax Court held that Stantus A.G. was a valid corporate entity for tax purposes because it engaged in substantive business activities, including managing oil and gas interests, maintaining its own books and records, and operating independently, despite Bass's control and potential tax benefits.

Facts

Petitioner Perry Bass, a U.S. citizen, formed Stantus A.G. in Switzerland and was its sole shareholder, with nominal shares held by Swiss directors. Stantus A.G. was formally organized under Swiss law, maintained a Swiss bank account, and hired Swiss auditors.

Prior to forming Stantus A.G., Bass owned a significant interest in Texas oil and gas leases. Bass sold a 25% working interest in these leases to Stantus A.G. for $21,000. Stantus A.G. received income from oil and gas production, paid its share of operating expenses, and invested some funds in securities.

Stantus A.G. maintained its own books, held annual shareholder meetings in Switzerland, filed Swiss tax returns, and U.S. information returns, claiming exemption from U.S. income tax under the U.S.-Swiss Tax Treaty. The IRS argued that Stantus A.G. should be disregarded as a sham corporation, and its income should be attributed to Bass.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Perry Bass's federal income tax for 1963, arguing that the income and losses of Stantus A.G. should be attributed to Bass. Bass petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether Stantus A.G., a wholly-owned foreign corporation of the petitioners, should be disregarded for U.S. tax purposes, such that its income and losses are attributed to the petitioners.

Holding

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1. No. The Tax Court held that Stantus A.G. should not be disregarded for tax purposes because it was formed for a substantial business purpose and engaged in substantive business activity.

Court's Reasoning

The court relied on the principle that a taxpayer may choose any form to conduct business, and that form will generally be respected for tax purposes if it is a viable business entity. Referencing *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436 (1943) and *National Carbide Corp. v. Commissioner*, 336 U.S. 422 (1949), the court stated that a corporation must have a substantial business purpose or engage in substantive business activity to be recognized for tax purposes.

The court found that Stantus A.G. exhibited corporate formalities: it was duly organized in Switzerland, had articles of incorporation, issued stock, maintained corporate records, and was subject to Swiss taxes. More importantly, Stantus A.G. engaged in substantive business activities. It held title to oil and gas lease interests, paid operating expenses, executed division orders, collected income, maintained bank accounts, and invested funds. The court noted, "Stantus not only looked like a viable corporation, it also acted like a viable corporation."

The Commissioner argued that Bass controlled Stantus A.G. and that its activities were merely to avoid taxes. However, the court stated that even if Bass directed Stantus A.G.'s affairs, this did not negate its corporate existence, citing *National Carbide Corp. v. Commissioner*: "Undoubtedly the great majority of corporations owned by sole stockholders are 'dummies' in the sense that their policies and day-to-day activities are determined not as decisions of the corporation but by their owners acting individually."

Regarding tax avoidance as a motive, the court acknowledged the possibility but emphasized that "the test, however, is not the personal purpose of a taxpayer in creating a corporation. Rather, it is whether that purpose is intended to be accomplished through a corporation carrying out substantive business functions. If the purpose of the corporation is to carry out substantive business functions, or if it in fact engages in substantive business activity, it will not be disregarded for Federal tax purposes." The court concluded that Stantus A.G. met this test, distinguishing it from "mere skeletons" in cases like *Gregory v. Helvering*, 293 U.S. 465 (1935). As explained in *National Investors Corp. v. Hoey*, 144 F. 2d 466, 468, a corporation must do some "business" in the ordinary meaning to be recognized.

Practical Implications

Bass v. Commissioner reinforces the principle that while taxpayers may structure their affairs to minimize taxes, the chosen form, particularly a corporate form, must have economic substance beyond mere tax avoidance. It clarifies that a foreign corporation, even wholly-owned and potentially established with tax benefits in

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mind, will be recognized for U.S. tax purposes if it conducts genuine business activities. This case is important for understanding the “business purpose” and “economic substance” doctrines in corporate tax law. It demonstrates that engaging in real business operations, even if directed by the shareholder, is sufficient to establish a corporation as a separate taxable entity, preventing the IRS from simply disregarding it. Later cases applying this principle often focus on the degree and nature of the corporation’s business activities to determine if it is a viable entity for tax purposes.

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