Aboussie v. Commissioner, 60 T. C. 549 (1973)

Investment tax credit recapture applies to a shareholder who disposes of their interest in a corporation before the end of the useful life of the underlying assets, even if the corporation continues to hold the assets.

Summary

Aboussie v. Commissioner addresses the recapture of investment tax credits under IRC section 47(a)(1) when a shareholder disposes of their interest in a corporation. Mitchell Aboussie, a partner in a business that converted to a corporation, sold his shares to his brothers in 1966. The Tax Court held that Aboussie's sale of shares triggered the recapture provisions because he ceased to retain a substantial interest in the business. The court also upheld the validity of the related Treasury Regulation, emphasizing that recapture liability remains with the shareholder, not the corporation, upon disposition of shares before the end of the asset's useful life.

Facts

Mitchell Aboussie and his brothers owned a partnership that converted to a corporation in 1966. Aboussie owned one-third of the corporation's stock. In September 1966, he agreed to sell his shares to his brothers for $75,000, with additional consideration tied to a future sale of the corporation's assets. The sale agreement was finalized on October 13, 1966. Aboussie had claimed investment tax credits for assets purchased by the partnership in 1965 and 1966. The corporation sold its assets to Sylvania in January 1967 and was liquidated, with proceeds distributed to Aboussie's brothers.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Aboussie's 1966 income tax, asserting that the sale of his shares triggered the recapture of investment tax credits. Aboussie petitioned the Tax Court for review. The court's decision focused on whether Aboussie retained a substantial interest in the corporation after the sale and the validity of the related Treasury Regulation.

Issue(s)

1. Whether Aboussie retained a substantial interest in the corporation after October 1966, thereby avoiding the recapture of investment tax credits under IRC section 47(a)(1)?
2. Whether Treasury Regulation section 1. 47-3(f)(5) is invalid because it is unreasonable and arbitrary?

Holding

1. No, because Aboussie sold his shares to his brothers, thereby ceasing to retain a

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substantial interest in the corporation, which triggered the recapture provisions under IRC section 47(a)(1).
2. No, because the regulation is consistent with the intent of Congress and therefore valid.

Court’s Reasoning

The court found that Aboussie’s sale of shares to his brothers in October 1966 constituted a disposition of his interest in the corporation, triggering the recapture provisions of IRC section 47(a)(1). The court rejected Aboussie’s argument that he retained an interest through an oral agreement to share in future profits, as this was not supported by the written agreement or the Fifth Circuit’s decision in a related case. The court also upheld the validity of Treasury Regulation section 1. 47-3(f)(5), noting that it aligns with Congressional intent that recapture liability remains with the shareholder upon early disposition of their interest. The court emphasized that the regulation’s requirement for continuous substantial interest in the business aligns with the statutory language and committee reports.

Practical Implications

This decision clarifies that shareholders must be cautious when disposing of their interest in a corporation, as it may trigger the recapture of previously claimed investment tax credits. Attorneys advising clients on business transactions should consider the potential tax consequences of such dispositions, particularly in relation to investment tax credits. The ruling reinforces the importance of maintaining a substantial interest in the business to avoid recapture liability. Subsequent cases, such as Charbonnet v. United States, have upheld similar regulations, indicating the continued application of this principle in tax law.

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