Greenberg v. Commissioner, 62 T. C. 331 (1974)

Distributions from sham corporations are treated as dividends from the surviving corporation, taxable as ordinary income.

Summary

Raymond Greenberg and his associates formed multiple corporations to develop and sell residential properties. The Tax Court found these corporations were shams, lacking independent business purpose, and treated them as a single entity. Distributions from the 'liquidated' corporations were deemed dividends from the surviving corporation, taxable as ordinary income to Greenberg. This ruling was based on the absence of real business activity in the separate corporations and the continuity of the underlying business through the surviving entity.

Facts

Greenberg, along with Sherman and Revitz, formed Gerasi Partnership and five Colt corporations to develop and sell homes in Burnt Mills Park and Foxhall subdivisions. Each partner held equal shares in the corporations. The corporations shared the same officers, office, and bookkeeping, and conducted no separate business. In 1966, Greenberg bought out Sherman and Revitz, and four of the five corporations were purportedly liquidated, distributing assets to Greenberg and Revitz. Greenberg reported these distributions as capital gains.

Procedural History

The IRS issued a notice of deficiency, asserting that the distributions should be treated as ordinary income. Greenberg petitioned the Tax Court, which heard the case and ruled in favor of the IRS.

Issue(s)

1. Whether the four liquidated Colt corporations were shams for tax purposes?
2. If so, whether the distributions to Greenberg from these corporations should be treated as dividends from the surviving corporation, taxable as ordinary income?

Holding

1. Yes, because the four liquidated Colt corporations lacked any separate or independent business purpose apart from the surviving corporation, Development.
2. Yes, because the distributions from the sham corporations constituted dividends from the surviving corporation, taxable as ordinary income to Greenberg.

Court's Reasoning

The Tax Court applied the sham doctrine, finding the four liquidated Colt

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corporations were mere shells without independent business operations or purpose. The court noted the shared officers, office, and bookkeeping, and the absence of separate business activities. The court rejected Greenberg's argument that the multiple corporations were necessary to limit liability, citing adequate insurance coverage and personal guarantees on loans. The court concluded that the distributions were either direct dividends from Development or redemptions of stock in Development, both taxable as ordinary income under IRC sections 301 and 302.

Practical Implications

This decision emphasizes the importance of demonstrating a legitimate business purpose for the formation and operation of multiple corporations. Taxpayers must show that each entity has a distinct business function beyond tax avoidance. The ruling impacts how the IRS and courts may scrutinize corporate structures, potentially reclassifying distributions from sham entities as dividends. This case influences legal practice in corporate tax planning, requiring careful consideration of the economic substance of corporate formations. Subsequent cases have applied this principle to challenge similar corporate structures, reinforcing the need for genuine business purpose in corporate organization.

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