Cooper v. Commissioner, 77 T. C. 621 (1981)

Section 482 of the Internal Revenue Code allows the Commissioner to allocate income among commonly controlled entities to prevent tax evasion and clearly reflect income.

Summary

In Cooper v. Commissioner, the Tax Court ruled that the IRS could allocate rental income from a corporation to its controlling shareholders under Section 482. The Coopers had transferred their construction business to a newly formed corporation but retained ownership of essential assets, allowing the corporation to use them without charge. The court found this arrangement constituted a business enterprise under Section 482, justifying the Commissioner's allocation of income to reflect an arm's length transaction. The decision underscores the IRS's authority to reallocate income to prevent tax evasion among related entities.

Facts

Revel D. and Josephine G. Cooper owned a construction firm which they incorporated in 1967 as R. D. Cooper Construction Co. , Inc. They transferred some assets to the corporation but retained ownership of essential depreciable assets like buildings and equipment, allowing the corporation to use these assets without charge on jobs it was contracted to perform. The corporation did not acquire its own depreciable assets and relied entirely on the Coopers' assets. The IRS sought to allocate rental income to the Coopers and allow the corporation a corresponding deduction under Section 482.

Procedural History

The IRS determined tax deficiencies for the Coopers and their corporation for several tax years. The Coopers contested these determinations, leading to a hearing before the Tax Court. The court's decision was to uphold the IRS's authority to allocate income under Section 482 based on the facts presented.

Issue(s)

1. Whether the Commissioner is authorized under Section 482 to allocate rental income from a corporation to its controlling shareholders when the shareholders have permitted the corporation to use their assets without charge?

Holding

1. Yes, because the Coopers' arrangement with the corporation constituted a business enterprise under Section 482, allowing the Commissioner to allocate income to reflect an arm's length transaction.

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Court’s Reasoning

The court reasoned that Section 482 authorizes the Commissioner to allocate income among commonly controlled entities to prevent tax evasion and ensure income is clearly reflected. The Coopers did not withdraw from active engagement in a trade or business when they incorporated; instead, they continued to participate by retaining ownership of essential assets used by the corporation. The court cited previous cases like Pauline W. Ach and Richard Rubin to support its conclusion that the Coopers’ arrangement with the corporation was a business enterprise subject to Section 482. The court applied the regulation’s definition of “true taxable income” to justify its decision, stating that the Commissioner could make allocations to reflect an arm’s length rental charge. The court also addressed the Coopers’ argument that the corporation lacked sufficient income to pay the imputed rentals, noting that the IRS had conceded additional business expense deductions to the Coopers, thus negating this objection.

Practical Implications

This decision reinforces the IRS’s authority to use Section 482 to allocate income between related entities to prevent tax evasion. Attorneys advising clients on corporate structuring must consider the potential tax implications of asset arrangements between shareholders and their corporations. Businesses should be cautious when using shareholder assets without proper compensation, as the IRS may impute income to shareholders to reflect an arm’s length transaction. Subsequent cases, such as Fitzgerald Motor Co. v. Commissioner, have upheld similar applications of Section 482. This ruling also highlights the importance of maintaining clear records and agreements regarding asset use to defend against IRS adjustments.

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