Stein v. Commissioner, 65 T. C. 336 (1975)

For tax purposes, a distribution of money from a subchapter S corporation must be actual, not merely a bookkeeping entry, to be considered a distribution of undistributed taxable income.

Summary

In Stein v. Commissioner, the U. S. Tax Court ruled that the mere crediting of undistributed taxable income to a loans payable account did not constitute a distribution of money under section 1375(f) of the Internal Revenue Code. The case involved Shelley Stein, who sought to exclude withdrawals from a loans payable account from his taxable income, arguing they were distributions of previously taxed subchapter S income. The court held that the withdrawals were taxable dividends because they were not actual distributions within 2 1/2 months after the close of the tax year, emphasizing the requirement of a tangible distribution of money.

Facts

Shelley Stein owned 70% of Security Printing Co. , Inc. , which had elected subchapter S status from 1959 to 1968. On January 1, 1969, after the company lost its subchapter S status due to a new shareholder's failure to consent, the undistributed taxable income was credited to a loans payable account in the shareholders' names. Stein withdrew funds from this account in 1969 and 1970, which he did not report as income, claiming they were distributions of previously taxed income.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Stein's taxes for 1969 and 1970, treating the withdrawals as dividends. Stein petitioned the U. S. Tax Court for relief, arguing the withdrawals should not be taxed. The Tax Court upheld the Commissioner's determination, ruling that the withdrawals were taxable dividends.

Issue(s)

1. Whether the crediting of undistributed taxable income to a loans payable account on January 1, 1969, constituted a distribution of money under section 1375(f) of the Internal Revenue Code.

Holding

1. No, because the mere crediting of income to a loans payable account did not meet the requirement of an actual "distribution of money" as defined by section 1375(f) and the relevant regulations.

Court’s Reasoning

The court relied on the regulations interpreting section 1375(f), which require an actual distribution of money within 2 1/2 months after the close of the tax year to be considered a distribution of undistributed taxable income. The court noted that the mere bookkeeping entry of crediting the loans payable account did not meet this requirement. It cited previous cases and regulations that supported the necessity of an actual distribution, not just a constructive receipt or a bookkeeping entry. The court also pointed out that Stein failed to provide evidence of any formal declaration of dividends or agreements that would support his claim of a distribution. The court’s decision was influenced by the policy of ensuring that distributions are tangible and verifiable for tax purposes.

Practical Implications

This decision clarifies that for subchapter S corporations, distributions must be actual payments of money to be considered distributions of undistributed taxable income under section 1375(f). Legal practitioners advising clients with subchapter S corporations must ensure that any distributions intended to be treated as non-dividend distributions under this section are made in a timely and tangible manner. The ruling impacts how businesses manage their tax liabilities and plan their distributions, emphasizing the importance of formal procedures in corporate tax planning. Subsequent cases have continued to uphold this interpretation, reinforcing the need for clear documentation and actual payments in corporate tax strategies.

