***Schwartz v. Commissioner, 69 T. C. 877 (1978)***

Intercorporate transfers in a consolidated bankruptcy proceeding are not constructive dividends to the common shareholder if motivated by substantial business considerations.

**Summary**

In Schwartz v. Commissioner, the U. S. Tax Court ruled that intercorporate transfers made during a consolidated Chapter XI bankruptcy proceeding did not result in constructive dividends to Arthur P. Schwartz, the controlling shareholder of six related corporations. The corporations, facing financial distress, sold their assets to an unrelated party, and the proceeds were used to satisfy creditors, including those whose claims Schwartz had personally guaranteed. The court found that the transfers were motivated by business objectives, primarily to benefit the creditors as a whole, rather than for Schwartz's personal benefit. Additionally, the court disallowed Schwartz's claimed educational expense deductions due to insufficient evidence linking the expenses to his business activities.

**Facts**

Arthur P. Schwartz controlled six corporations that filed for Chapter XI bankruptcy in 1967. The corporations' assets were sold to Simon & Schuster, and the proceeds were distributed to satisfy creditors' claims, including those personally guaranteed by Schwartz. The corporations had been operating under a consolidated bankruptcy proceeding, and the asset sale was part of an arrangement to benefit all creditors. Schwartz also claimed educational expenses as business deductions for 1966, 1967, and 1968.

**Procedural History**

The corporations filed for Chapter XI bankruptcy in April 1967, and the proceedings were consolidated in June 1967. The asset sale to Simon & Schuster was negotiated and completed in early 1968. The Tax Court reviewed the case to determine whether Schwartz received constructive dividends from the intercorporate transfers and whether his educational expenses were deductible.

**Issue(s)**

1. Whether Arthur P. Schwartz received constructive dividends in 1968 from Alpha Study Aids, Inc. , Thor Publications, Inc. , and Barrister Publishing Co. , Inc.
2. Whether Arthur P. Schwartz is liable as a transferee for the income tax deficiencies of Thor Publications, Inc. , and Alpha Study Aids, Inc.
3. Whether certain amounts claimed as educational expenses by Arthur P. Schwartz are deductible as ordinary and necessary business expenses.

**Holding**

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1. No, because the intercorporate transfers were motivated by business objectives to benefit the creditors as a whole, not for Schwartz's personal benefit.
2. Yes, but only to the extent of the amounts Schwartz received in liquidation from Thor and Alpha, as the court found no constructive dividends.
3. No, because Schwartz failed to establish a sufficient nexus between the educational expenditures and his trade or business.

**Court's Reasoning**

The court emphasized that the consolidated bankruptcy proceeding and asset sale were driven by business considerations to benefit the creditors, not to provide personal benefit to Schwartz. The court noted that separate negotiations by each corporation could have led to less favorable terms for the creditors. The court also considered that Schwartz could have structured the sales for his benefit but chose not to, indicating a business purpose. Regarding the educational expenses, the court found that Schwartz did not provide sufficient evidence to show a direct correlation between the courses and his business activities.

**Practical Implications**

This decision clarifies that intercorporate transfers in bankruptcy, even if they indirectly benefit a shareholder, are not automatically treated as constructive dividends if they serve a valid business purpose. Attorneys should consider the broader context of bankruptcy proceedings when analyzing similar cases, focusing on the intent and primary beneficiaries of the transactions. The ruling also underscores the importance of clear documentation linking educational expenses to business activities for deduction purposes. Subsequent cases have cited Schwartz when addressing constructive dividends and bankruptcy-related transactions.

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