Miller v. Commissioner, 70 T. C. 448 (1978)

Interest incurred on loans used to purchase controlling interest in a corporation's stock can be classified as investment interest if the stock is held with a substantial investment intent.

Summary

In Miller v. Commissioner, the Tax Court ruled that interest paid on a loan used to acquire a controlling interest in a bank's stock was an investment interest expense under IRC sec. 57(b)(2)(D). The Millers, through their partnership Milbro, borrowed to buy Broadway National Bank (BNB) stock, with Harris Miller becoming BNB's president. Despite this business involvement, the court found that the stock was held predominantly for investment, due to the partnership's focus on capital growth and eventual resale, as evidenced by minimal dividends and significant capital gains upon sale. This case illustrates that even with operational control, stock can be considered an investment if held with a substantial profit motive.

Facts

In 1969, Harris and Earl Miller formed Milbro, a partnership, to purchase a controlling interest in Broadway National Bank (BNB) stock. Milbro borrowed approximately $900,000 for this purchase, using the stock and other assets as collateral. Harris Miller became BNB's president, spending most of his time at the bank, while also maintaining involvement with Miller Pontiac, another business. Milbro's 1970 partnership return showed minimal income from BNB and significant interest expenses. In 1973, Milbro sold the BNB stock at a substantial profit, which was reported as a long-term capital gain.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Millers' 1970 federal income tax, disallowing Harris Miller's deduction of his share of Milbro's interest expense as an investment interest expense. The Millers petitioned the Tax Court, which upheld the Commissioner's determination.

Issue(s)

1. Whether the interest expense incurred by Milbro on the loan used to purchase BNB stock constitutes an "investment interest expense" under IRC sec. 57(b)(2)(D).

Holding

1. Yes, because the BNB stock was held with a substantial investment intent, making the interest an investment interest expense subject to the minimum tax under IRC sec. 56.

© 2025 SCOTUSreports.com. All rights reserved.

Court’s Reasoning

The court applied a “substantial investment intent” test to determine whether the BNB stock was held for investment. It found that Milbro’s primary motive was investment, evidenced by its focus on capital growth and eventual resale rather than current income. Milbro reported the BNB stock sales as capital gains and the interest as an investment interest expense. The court noted that despite Harris Miller’s role as president, the partnership’s operations and the minimal dividends received indicated an investment rather than a business motive. The court rejected the argument that Milbro was in the banking business, emphasizing the distinction between stock ownership for investment and actual business operations. The court also dismissed the relevance of a legislative report suggesting difficulty in distinguishing investment and business interest, finding no statutory or legislative support for such an exception.

Practical Implications

This decision underscores the need for taxpayers to carefully consider the classification of interest expenses when borrowing to acquire corporate stock, even if it leads to operational control. Practitioners should assess the dominant motive behind stock purchases, focusing on whether the intent is primarily investment or business-oriented. The ruling suggests that if stock is held with a significant investment motive, interest on related loans will be treated as investment interest, potentially subjecting taxpayers to the minimum tax. This case has been cited in subsequent rulings to distinguish between investment and business interest, particularly in contexts where control over a corporation is acquired through stock purchases. Taxpayers and advisors should be cautious in structuring such transactions to ensure the desired tax treatment.

© 2025 SCOTUSreports.com. All rights reserved.