Bush Bros. & Co. v. Commissioner, 73 T. C. 424, 1979 U. S. Tax Ct. LEXIS 8 (1979)

A corporation's income can be imputed when it distributes appreciated property as dividends in kind with the primary purpose of tax avoidance and no substantial business purpose.

Summary

Bush Bros. & Co. , a family-owned corporation, distributed navy beans as dividends in kind to its shareholders, who immediately sold them back to the supplier, Michigan Bean. The Tax Court held that the income from these sales should be imputed to Bush Bros. because the distributions lacked a substantial business purpose and were primarily motivated by tax avoidance. The court determined that Bush Bros. expected and influenced the shareholders' immediate sales, thus the income was attributable to the corporation. This ruling emphasizes the scrutiny applied to corporate distributions aimed at tax avoidance.

Facts

Bush Bros. & Co. , a family-owned food processing business, distributed navy beans as dividends in kind to its shareholders on five occasions between 1971 and 1973. These beans were sourced from Michigan Bean under open contracts. Upon distribution, the shareholders immediately sold the beans back to Michigan Bean at a profit. The transactions were facilitated by preprinted assignment clauses on the bills of sale, and the sales were completed rapidly, often on the same day. Bush Bros. maintained that these distributions were necessary to reduce excess inventory, but the court found that the primary motivation was tax avoidance.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Bush Bros. ' federal income taxes for the fiscal years ending April 30, 1972, and April 30, 1974, and issued a statutory notice of deficiency. Bush Bros. petitioned the U. S. Tax Court, which held that the income from the sales of the navy beans should be imputed to the corporation. The court's decision was split, with dissenting opinions arguing that the shareholders' sales should not be imputed to the corporation without direct corporate participation in the sales.

Issue(s)

1. Whether the income from the shareholders' sales of the distributed navy beans should be imputed to Bush Bros. & Co. ?
2. Whether the distributions of navy beans were anticipatory assignments of income?
3. Whether Bush Bros. properly evaluated the cost of the distributions of navy beans?

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4. Whether the statute of limitations barred consideration of the distribution declared on April 20, 1971?

Holding

1. Yes, because the distributions were primarily motivated by tax avoidance, lacked a substantial business purpose, and Bush Bros. expected and influenced the immediate sale of the beans by the shareholders.
2. The court did not reach this issue due to the decision on the first issue.
3. The court did not reach this issue due to the decision on the first issue.
4. No, because the income from the distribution was imputed to the fiscal year in which it was distributed, not declared.

Court's Reasoning

The Tax Court applied the principles from *Commissioner v. Court Holding Co.* and *United States v. Cumberland Public Service Co.* , which allow for income imputation when a corporation uses dividends in kind to disguise sales for tax avoidance. The court emphasized that while tax avoidance is permissible, the steps taken must be within the intent of the statute. The court found that Bush Bros. lacked a substantial business purpose for the distributions, as evidenced by the increasing frequency of such dividends and the immediate resale of the beans. The court also noted the control exerted by family leaders over both the corporation and the shareholders, facilitating the sales. The court rejected the relevance of the absence of direct corporate participation in the sales, citing the informal understanding with Michigan Bean that ensured the beans would be sold back to them. The court's decision was supported by a concurring opinion, which emphasized the need for corporate participation in the sales, while dissenting opinions argued that without direct corporate involvement, the income should not be imputed.

Practical Implications

This decision impacts how corporations should structure distributions of appreciated property to avoid imputation of income. Corporations must ensure that such distributions have a substantial business purpose and are not primarily motivated by tax avoidance. The ruling suggests that even without direct corporate involvement in the sale, if a corporation expects and influences shareholders to sell distributed property immediately, the income may be imputed. This case has influenced later decisions and underscores the importance of documenting a legitimate business purpose for in-kind distributions. Practitioners should advise clients to carefully consider the timing and purpose of such distributions, ensuring they align with business needs rather than tax strategies. The case also highlights the need for clear corporate governance and separation of roles between shareholders and corporate officers to avoid the perception of control and influence over shareholder actions.

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