Achiro v. Commissioner, 77 T. C. 881 (1981)

A personal service corporation formed primarily to obtain benefits from corporate retirement plans must be recognized as a separate entity for tax purposes if it conducts business and respects its corporate form.

Summary

Achiro and Rossi formed A & R Enterprises to provide management services to their waste disposal companies, Tahoe City Disposal and Kings Beach Disposal. The IRS challenged A & R's corporate status, arguing it was a sham formed solely to gain tax advantages from retirement plans. The Tax Court recognized A & R as a valid corporation, ruling that its income and deductions could not be reallocated to the disposal companies under Sections 482, 269, or 61. The court found that A & R conducted business and its shareholders respected its corporate form. However, the court held that A & R's retirement plans were discriminatory when aggregating employees with Tahoe City Disposal under Section 414(b).

Facts

Achiro and Rossi owned waste disposal businesses, Tahoe City Disposal and Kings Beach Disposal. In 1974, they formed A & R Enterprises, with Achiro's brother Renato owning 52% of the stock. A & R entered management service agreements with the disposal companies and employed Achiro and Rossi exclusively. A & R's primary purpose was to obtain benefits from its retirement plans, but it conducted business and respected its corporate form. The IRS challenged A & R's corporate status and sought to reallocate its income and deductions to the disposal companies.

Procedural History

The IRS issued deficiency notices to Achiro and Rossi, disallowing management fees paid to A & R as deductions and reallocating A & R's income and deductions to the disposal companies. The taxpayers petitioned the U. S. Tax Court. At trial, the IRS amended its answer to assert additional theories under Sections 482, 269, and 61. The court granted the taxpayers' motion to shift the burden of proof to the IRS on these new matters.

Issue(s)

1. Whether the IRS properly allocated A & R's income and deductions to Tahoe City Disposal and Kings Beach Disposal under Section 482, Section 269, or Section 61?
2. Whether the management fees paid by Tahoe City Disposal to A & R were expended for the purpose designated and were ordinary and necessary business expenses?
3. Whether the employees of A & R should be aggregated with the employees of Tahoe City Disposal under Section 414(b) for purposes of applying the antidiscrimination provisions of Section 401 to A & R's pension and profit-sharing

plans?

Holding

1. No, because A & R conducted business and its shareholders respected its corporate form, making it a valid corporation for tax purposes.
2. Yes, because the management fees were reasonable in amount and expended for the purpose designated.
3. Yes, because A & R and Tahoe City Disposal constituted a brother-sister controlled group under Section 1563(a), requiring aggregation of employees under Section 414(b).

Court's Reasoning

The court recognized A & R as a separate entity under Moline Properties, Inc. v. Commissioner, because it conducted business by entering management service contracts and employing Achiro and Rossi. The court rejected the IRS's arguments under Sections 482, 269, and 61, finding no basis to disregard A & R's corporate existence or reallocate its income and deductions. The court noted that while A & R was formed primarily to obtain retirement plan benefits, this purpose alone did not justify disregarding its corporate status. The court found the management fees were ordinary and necessary expenses, as the IRS conceded they were reasonable if treated as salary deductions. However, the court held that A & R's retirement plans were discriminatory when aggregating employees with Tahoe City Disposal under Section 414(b), as Renato's voting rights in A & R were attributable to Achiro, making the companies a brother-sister controlled group.

Practical Implications

This decision reinforces that personal service corporations formed primarily to obtain retirement plan benefits will be recognized for tax purposes if they conduct business and respect their corporate form. Taxpayers must ensure their corporations are not mere shells but engage in bona fide business activities. The IRS cannot reallocate income and deductions among related entities under Sections 482, 269, or 61 without specific circumstances justifying such action. However, taxpayers must be cautious of Section 414(b), as it may require aggregating employees among related corporations for purposes of applying the antidiscrimination provisions of qualified retirement plans. This case highlights the importance of carefully structuring ownership and voting rights to avoid unintended controlled group status under Section 1563(a).

