B & M Investors Corp. v. Commissioner, 78 T. C. 165 (1982)

Common ownership is required for the 80% test when determining a brother-sister controlled group of corporations.

Summary

In B & M Investors Corp. v. Commissioner, the IRS included the stock of a shareholder who did not own stock in all corporations within the alleged controlled group to calculate the 80% ownership test required for a brother-sister controlled group under Section 1563(a)(2)(A) of the Internal Revenue Code. The Tax Court, relying on the Supreme Court's decision in United States v. Vogel Fertilizer Co. , ruled that such inclusion was improper because the 80% test mandates common ownership across all corporations in the group. The court invalidated the IRS regulation that allowed otherwise, confirming that only shareholders with stock in every corporation can be considered for the 80% test. This decision resulted in the petitioners not being classified as a controlled group, allowing them to claim full surtax exemptions.

Facts

The case involved B & M Investors Corp. , Hi-Way Dispatch, Inc. , and Kem Mart Investors, Inc. , which were alleged to form a brother-sister controlled group. The IRS determined deficiencies in petitioners' federal income taxes for 1973 and 1974, asserting they were part of a controlled group and thus limited in their surtax exemptions. The IRS included Frank Bove's 15% ownership in Hi-Way Dispatch in its 80% ownership calculation, despite Bove not owning stock in the other two corporations. The petitioners contested this, arguing that only shareholders with stock in all corporations should be considered for the 80% test.

Procedural History

The IRS issued notices of deficiency to B & M Investors and Hi-Way Dispatch for the tax years 1973 and 1974. The petitioners filed a case with the U. S. Tax Court, which was submitted under Rule 122. The court considered the issue of whether the corporations formed a controlled group based on the IRS's calculation method, ultimately deciding in favor of the petitioners after following the Supreme Court's ruling in United States v. Vogel Fertilizer Co.

Issue(s)

1. Whether the stock of a shareholder who does not own stock in all corporations within the alleged controlled group should be included in the 80% ownership test under Section 1563(a)(2)(A) of the Internal Revenue Code?

Holding

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1. No, because the Supreme Court in United States v. Vogel Fertilizer Co. held that the 80% test requires common ownership across all corporations in the group, invalidating the IRS regulation that allowed otherwise.

Court's Reasoning

The Tax Court relied on the Supreme Court's decision in United States v. Vogel Fertilizer Co. , which clarified that the 80% test under Section 1563(a)(2)(A) necessitates that each member of the stockholder group owns stock in each corporation considered for the test. The court emphasized the common ownership requirement, rejecting the IRS's interpretation that allowed inclusion of shareholders not owning stock in all corporations. The court cited its earlier decision in Fairfax Auto Parts of No. Va. , Inc. v. Commissioner, which had taken a similar stance and was affirmed by the Supreme Court's ruling. This reasoning led to the invalidation of the IRS regulation, confirming that Frank Bove's stock should not have been included in the 80% test, as he did not own stock in all three corporations.

Practical Implications

This decision clarifies that for the purpose of determining a brother-sister controlled group under Section 1563(a)(2)(A), only shareholders with stock in every corporation can be included in the 80% ownership test. This ruling impacts how tax practitioners and corporations should analyze and structure their ownership to avoid unintended controlled group status, which could affect their tax liabilities. It also underscores the importance of understanding and adhering to the common ownership requirement when planning corporate structures. Subsequent cases have followed this precedent, and businesses must ensure compliance to avoid misclassification and potential tax penalties.

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