T. J. Henry Associates, Inc. v. Commissioner, 80 T. C. 886 (1983)

A bona fide transfer of stock to a custodian under the Uniform Gifts to Minors Act can terminate a Subchapter S election if the custodian does not consent to the election.

Summary

T. J. Henry Associates, Inc. , a Subchapter S corporation, faced a dispute over the tax status of its 1976 and 1977 fiscal years after its controlling shareholder, Thomas J. Henry, transferred one share of stock to himself as custodian for his minor children under the Pennsylvania Uniform Gifts to Minors Act. The transfer aimed to terminate the Subchapter S status due to the new shareholder's failure to consent to the election. The Tax Court held that the transfer was bona fide and effective for tax purposes, resulting in the termination of the Subchapter S election. This decision emphasized the formal ownership over economic substance in determining shareholder status for Subchapter S elections.

Facts

T. J. Henry Associates, Inc. was a Pennsylvania corporation engaged in commercial printing and had elected Subchapter S status. Thomas J. Henry, the controlling shareholder, owned 900 of the 1,000 issued shares. On September 22, 1976, he transferred one share to himself as custodian for his four minor children under the Pennsylvania Uniform Gifts to Minors Act. The transfer was recorded in the corporate books, and no consent to the Subchapter S election was filed by Henry in his capacity as custodian or as the children's guardian. The corporation then filed its tax returns as a regular corporation for the fiscal years ending September 30, 1976, and September 30, 1977.

Procedural History

The Commissioner of Internal Revenue determined deficiencies for the years 1976 and 1977 against the corporation and Henry's estate. The case was submitted to the U. S. Tax Court fully stipulated. The court's decision was to be entered under Rule 155 of the Tax Court Rules of Practice and Procedure, focusing on whether the corporation should be taxed as a Subchapter S corporation for the years in question.

Issue(s)

1. Whether the transfer of one share of stock by Thomas J. Henry to himself as custodian for his minor children under the Pennsylvania Uniform Gifts to Minors Act was a bona fide transfer recognized for federal tax purposes.
2. Whether the failure of the new shareholder (the custodian) to consent to the Subchapter S election terminated the election.

Holding

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1. Yes, because the transfer was treated as effective by all parties involved and was not merely a paper transfer, showing it was bona fide and valid under the Uniform Gifts to Minors Act.
2. Yes, because a bona fide transfer to a new shareholder who does not consent to the Subchapter S election triggers termination of the election under the relevant tax regulations.

Court's Reasoning

The court applied the regulations that require recognition of a shareholder if the stock was acquired in a bona fide transaction and the donee is the real owner. The court found that the transfer to the custodian was valid and effective, thus creating a new shareholder. The court emphasized that the circumstances surrounding the transfer, including actions before and after it, supported its bona fide nature. The court rejected the Commissioner's argument that the transfer lacked economic substance, noting that beneficial ownership was vested in the children and that the value of the stock was irrelevant to the validity of the transfer. The court also drew parallels to grantor trust cases, where formal ownership rather than economic substance governs Subchapter S status. The decision was supported by prior case law and the legislative intent to apply Subchapter S rules based on formal ownership.

Practical Implications

This decision clarifies that a transfer of stock under the Uniform Gifts to Minors Act can be recognized for tax purposes, affecting the Subchapter S status of a corporation if the custodian does not consent to the election. Practitioners must ensure that such transfers are bona fide and not merely on paper to effect a change in tax status. The ruling also underscores the importance of formal ownership over economic substance in tax law, which could influence how corporations manage their shareholder structure and Subchapter S elections. Subsequent cases may cite this decision when addressing similar issues of shareholder consent and the validity of transfers under state gift statutes.

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