Complete Finance Corp. v. Commissioner, 80 T. C. 1062 (1983)

Constructive ownership rules under IRC § 1563(e) can be used to determine if corporations form a brother-sister controlled group, allowing indirect ownership to meet the statutory requirements.

Summary

Complete Finance Corp. , Lomas Warehouse, Inc. , and Sandia Auto Electric, Inc. were assessed tax deficiencies by the IRS, which determined they formed a brother-sister controlled group under IRC § 1563(a)(2). The Tax Court upheld this, using constructive ownership rules to attribute stock ownership across the corporations, meeting both the 80% and 50% ownership tests. Additionally, the court rejected inventory write-downs by Lomas and Sandia for lacking objective evidence, following the Thor Power Tool precedent.

Facts

Complete Finance Corp. , Lomas Warehouse, Inc. , and Sandia Auto Electric, Inc. were closely held corporations with overlapping stock ownership among a group of five shareholders. The IRS determined these corporations formed a brother-sister controlled group, leading to tax deficiencies. The corporations' stock ownership included direct and indirect holdings, with some shareholders owning stock constructively through their spouses or other corporations. Additionally, Lomas and Sandia claimed inventory write-downs for damaged goods without adjusting sales prices.

Procedural History

The IRS issued notices of deficiency to the corporations, which then petitioned the U. S. Tax Court. The Tax Court heard the case and issued its decision on May 25, 1983, upholding the IRS's determination on both the controlled group and inventory valuation issues.

Issue(s)

1. Whether Complete, Lomas, and Sandia constituted a brother-sister controlled group of corporations under IRC § 1563(a)(2), considering constructive ownership.
2. Whether Lomas and Sandia were entitled to write down their ending inventories to reflect an alleged loss of value due to damaged, shopworn, or imperfect items.

Holding

1. Yes, because the corporations satisfied the 80% and 50% ownership tests under IRC § 1563(a)(2) when constructive ownership was considered.
2. No, because the inventory write-downs did not clearly reflect income and lacked the required objective evidence as per Thor Power Tool Co. v. Commissioner.

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Court’s Reasoning

The court applied IRC § 1563(e) to attribute stock ownership constructively, finding that each shareholder owned stock in each corporation, either directly or indirectly, satisfying the requirements for a brother-sister controlled group. The court rejected the taxpayers’ reliance on United States v. Vogel Fertilizer Co. , clarifying that constructive ownership can meet the ownership requirement. The court also upheld the IRS’s use of repeated attribution under IRC § 1563(f)(2)(A), finding no violation of double family attribution rules. On the inventory issue, the court followed Thor Power Tool, requiring objective evidence for write-downs, which Lomas and Sandia lacked. The court noted that the Commissioner has discretion to change the taxpayer’s accounting method if it does not clearly reflect income.

Practical Implications

This decision clarifies that constructive ownership rules can be used to determine controlled group status, affecting how corporations with overlapping ownership are analyzed for tax purposes. Tax practitioners must carefully consider indirect ownership when assessing controlled group status. The ruling also reinforces the strict standards for inventory write-downs, requiring objective evidence of value decline, impacting how businesses account for damaged goods. Subsequent cases have followed this ruling, and it has influenced IRS guidance on controlled groups and inventory valuation.

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