Kenyatta Corp. v. Commissioner, 90 T. C. 740 (1988)

Income from personal service contracts is considered personal holding company income if the contract designates a 25% shareholder by name or description to perform the services.

Summary

Kenyatta Corp. , owned by William F. Russell, was assessed a personal holding company tax deficiency for 1978. The key issue was whether Kenyatta's income from various contracts qualified as personal holding company income under section 543(a)(7). The Tax Court found that contracts with the Seattle SuperSonics, ABC Sports, the Seattle Times, and Cole & Weber designated Russell by name or description, thus meeting the statutory definition. Kenyatta's adjusted ordinary gross income for 1978 was $138,895, with 67. 5% ($93,728. 35) derived from these personal service contracts, exceeding the 60% threshold required to classify Kenyatta as a personal holding company subject to the tax.

Facts

Kenyatta Corp. was a Washington corporation formed to provide the personal services of William F. Russell, a former professional basketball player. During its fiscal year ending January 31, 1978, Kenyatta received income from various sources, including contracts with the Seattle SuperSonics for public relations services, ABC Sports for television commentary, the Seattle Times for a weekly column, and Cole & Weber for television commercials. Russell owned 100% of Kenyatta's voting stock during this period. The Internal Revenue Service assessed a deficiency in Kenyatta's personal holding company tax, arguing that the income from these contracts constituted personal holding company income under section 543(a)(7).

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Kenyatta Corp. 's personal holding company tax for its 1978 fiscal year. Kenyatta petitioned the U. S. Tax Court for a redetermination of this deficiency. The Tax Court reviewed the evidence presented and issued its opinion on the issue of whether Kenyatta was a personal holding company during the relevant period.

Issue(s)

1. Whether Kenyatta Corp. was a personal holding company under section 542(a) during its 1978 fiscal year, based on the stock ownership test and the tainted income test.
2. Whether the income Kenyatta received from contracts with the Seattle SuperSonics, ABC Sports, the Seattle Times, and Cole & Weber constituted personal holding company income under section 543(a)(7).

Holding

1. Yes, because Kenyatta met both the stock ownership test (Russell owned 100% of the voting stock) and the tainted income test (more than 60% of its adjusted ordinary gross income was personal holding company income).
2. Yes, because the contracts with the Seattle SuperSonics, ABC Sports, the Seattle Times, and Cole & Weber designated Russell by name or description to perform the services, satisfying the requirements of section 543(a)(7).

Court's Reasoning

The court applied the statutory tests for personal holding company status under sections 542(a) and 543(a)(7). The stock ownership test was easily met, as Russell owned 100% of Kenyatta's voting stock during the relevant period. For the tainted income test, the court examined each contract to determine if it met the designation test, requiring that the individual performing the services be designated by name or description in the contract. The court found that the contracts with the Seattle SuperSonics, ABC Sports, the Seattle Times, and Cole & Weber all designated Russell as the performer, thus qualifying as personal service contracts under section 543(a)(7). The court rejected Kenyatta's arguments that the contracts were not final or that other individuals' services were essential, emphasizing the clear language of the contracts and the lack of evidence supporting Kenyatta's claims. The court also noted that the burden of proof rested with Kenyatta to disprove the Commissioner's determination, which it failed to do.

Practical Implications

This decision clarifies that income from personal service contracts will be treated as personal holding company income if the contract designates a 25% shareholder to perform the services, even if other individuals assist in the performance. Corporations engaging in similar arrangements should carefully structure their contracts to avoid unintended personal holding company status and the associated tax. The ruling may prompt corporations to reconsider the use of personal service contracts, especially when involving majority shareholders, to minimize the risk of personal holding company tax. Subsequent cases have followed this interpretation, reinforcing the importance of clear contract language in determining the nature of corporate income.