Clinton Deckard v. Commissioner of Internal Revenue, 155 T. C. No. 8 (U. S. Tax Court 2020)

In Clinton Deckard v. Commissioner, the U. S. Tax Court ruled that Clinton Deckard, who was an officer and director of a Kentucky nonstock, nonprofit corporation, was not considered a shareholder for the purposes of subchapter S. The court emphasized that under Kentucky law, nonprofit corporations cannot have shareholders, and thus Deckard could not claim passthrough losses from the corporation on his individual income tax returns. This decision underscores the importance of corporate form and state law in determining shareholder status for tax purposes.

Parties

Clinton Deckard, the petitioner, was the president and one of the directors of Waterfront Fashion Week, Inc. (Waterfront), a Kentucky nonstock, nonprofit corporation. The respondent was the Commissioner of Internal Revenue.

Facts

Waterfront Fashion Week, Inc. was organized on May 8, 2012, under Kentucky law as a nonstock, nonprofit corporation. Its primary mission was to raise money for the conservation and maintenance of the Louisville Waterfront Park and to provide economic development opportunities in the fashion industry. Clinton Deckard was Waterfront's president and one of its three directors. In 2014, Deckard attempted to elect S corporation status for Waterfront retroactively to the date of its incorporation and claimed passthrough losses from Waterfront on his 2012 and 2013 individual income tax returns. The Commissioner disallowed these losses, leading to the present dispute.

Procedural History

The Commissioner issued a notice of deficiency disallowing the passthrough losses claimed by Deckard. Deckard filed a petition in the U. S. Tax Court challenging the deficiency. Both parties filed motions for partial summary judgment. The Tax Court granted the Commissioner's motion and denied Deckard's motions.

Issue(s)

Whether Clinton Deckard, as an officer and director of a Kentucky nonstock, nonprofit corporation, was a shareholder of the corporation for purposes of claiming passthrough losses under subchapter S of the Internal Revenue Code.

Rule(s) of Law

The court applied the rule that the determination of shareholder status for purposes of subchapter S is governed by federal law, which requires beneficial ownership of shares. However, state law determines whether a person is a beneficial owner. Under Kentucky law, a nonstock, nonprofit corporation cannot have shareholders or distribute profits to its members, directors, or officers.

Holding

The U. S. Tax Court held that Clinton Deckard was not a shareholder of Waterfront Fashion Week, Inc. for the purposes of subchapter S, and therefore, he was not entitled to claim passthrough losses from the corporation on his individual income tax returns.

Reasoning

The court's reasoning was grounded in the distinction between nonprofit and for-profit corporations under Kentucky law. The court found that Waterfront, as a nonstock, nonprofit corporation, could not issue stock and was prohibited from distributing profits to its officers or directors. Thus, Deckard, despite being president and a director, did not possess an ownership interest equivalent to that of a shareholder. The court also rejected Deckard's substance-over-form argument, stating that taxpayers are bound by the form of the transaction they choose. Furthermore, the court noted that Waterfront's lack of tax-exempt status did not change its status as a nonprofit corporation under state law. The court relied on federal regulations and case law that emphasize the need for beneficial ownership to be treated as a shareholder under subchapter S, which Deckard did not have under Kentucky law.

Disposition

The U. S. Tax Court granted the Commissioner's motion for partial summary judgment and denied Deckard's motions for partial summary judgment, affirming the disallowance of the claimed passthrough losses.

Significance/Impact

This case clarifies the application of subchapter S to nonprofit corporations and the importance of state law in determining shareholder status. It reinforces the principle that the form of a corporation, as dictated by state law, cannot be disregarded for federal tax purposes without clear evidence of abuse or misrepresentation. The decision impacts individuals who attempt to claim passthrough losses from nonprofit corporations on their personal tax returns, highlighting the need to understand the legal constraints of corporate form under state law.

