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TAX PROBLEMS OF THE STRAW CORPORATION

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I. INTRODUCTION

Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.¹

JUDGE HAND'S OBSERVATION has been a polestar for tax practitioners in their attempt to chart courses which will further the business objectives of their clients without simultaneously producing adverse tax consequences. One of the tools available for achieving this goal is the straw or nominee corporation.²

A straw or nominee corporation holds legal title to real or personal property which is beneficially owned by another. Usually, the beneficial owners are the corporate shareholders, although they might be unrelated third parties. The use of a straw or nominee corporation is often prompted by sound business reasons not involving specific

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2. The term "straw corporation" is often used to describe any corporate entity to which legal or record title to property has been transferred, leaving beneficial ownership in another person or persons. However, for purposes of this article, the term "straw corporation" will denote a corporation whose shareholders desire its corporate identity, as a matter of fact, be ignored for tax purposes even though they concede that as a matter of form it is a corporation. The terms "nominee corporation" or "corporate nominee," will be used to identify a corporation that admits its corporate existence, both in fact as well as in form, but which relies on its status as an agent or trustee for its shareholders or other principals in order to avoid taxation. However, it should be noted that the terms "straw corporation" and "nominee corporation" are used indiscriminately by some courts and commentators.
tax goals, although, of course, if the corporation is treated as a straw
or nominee for tax purposes, instead of a viable corporation, beneficial
tax consequences will often result. Some of the major nontax reasons
for using a straw or nominee include: compliance with state usury or
investment laws;\(^3\) facilitation of the management or conveyance of
property;\(^4\) insulation of principals from liability;\(^5\) assistance in estate
planning;\(^6\) and insurance of anonymity of ownership.\(^7\)

In the typical situation, a corporate shell is first created in com-
pliance with all the requisite formalities. Legal or record title to the
real estate or other property involved is then transferred to the newly
created corporation while equitable or beneficial ownership is retained
by or transferred to the shareholders or other third parties. Although
the property involved is often real estate,\(^8\) it may also consist of an
operating business\(^9\) or any other property.\(^10\)

It is anticipated that for tax purposes the straw corporation's
existence will be ignored or the agency status of the nominee corpo-
ration recognized, and that the income, gain, or loss will be passed on
to the shareholders or other equitable owners of the property without
taxation at the corporate level. Thus, if the corporation is not only
characterized as a straw or nominee, but also treated as one, the non-
tax objectives can be obtained without adverse tax consequences.
However, if the corporation is treated in fact, as well as in form, as a
viable corporation, disaster may result.\(^11\) For example, if property was
conveyed to a straw corporation which is subsequently determined

3. See, e.g., David F. Bolger, 59 T.C. 7650 (1973); Dallas Downtown Dev. Co.,
   12 T.C. 114 (1949).

4. See, e.g., Harrison Property Mgmt. Co. v. United States, 475 F.2d 623 (Ct. Cl.
   1973), cert. denied, 414 U.S. 1130 (1974); Tomlinson v. Miles, 316 F.2d 710 (5th

5. See, e.g., Given v. Commissioner, 238 F.2d 579 (8th Cir. 1956); Love v.
   United States, 96 F. Supp. 919 (Ct. Cl. 1951); Sam Siegel, 45 T.C. 566 (1966).

6. See, e.g., Commissioner v. State-Adams Corp., 283 F.2d 395 (2d Cir. 1960),

7. See generally Kurtz & Kopp, Taxability of Straw Corporations in Real Estate

8. See, e.g., Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943);
   Given v. Commissioner, 238 F.2d 579 (8th Cir. 1956); David F. Bolger, 59 T.C.
   760 (1973).

9. See, e.g., National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949);
   Greer v. Commissioner, 334 F.2d 20 (5th Cir. 1964); Skarda v. Commissioner, 250
   F.2d 429 (10th Cir. 1957).

10. See, e.g., Harrison Property Mgmt. Co. v. United States, 475 F.2d 623 (Ct.
    Cl. 1973), cert. denied, 414 U.S. 1130 (1974) (oil leases); Jackson v. Commissioner,
    233 F.2d 289 (2d Cir. 1956) (shares of stock); Lloyd F. Noonan, 52 T.C. 907 (1969),
    aff'd per curiam. 451 F.2d 992 (9th Cir. 1971) (interest in partnership); Worth
    S.S. Corp., 7 T.C. 654 (1946) (steamship).

11. See generally Kronovet, Straw Corporations: When Will They Be Recogn-
to be viable, and thereafter that same property is transferred back to the beneficial owners, the latter may realize capital gains to the extent that the property appreciated in value while held by the corporation. Even if the corporation retains the property and distributes the income generated by the property to the beneficial owners, the income may initially be taxed to the corporation as ordinary corporate income and any distributions to the beneficial owners will be taxed as dividends, to the extent of the corporation’s earnings and profits. On the other hand, if the transfer of property to and from the straw corporation produces a loss, or if use of the property generates an operating loss, it is the corporation’s loss, and once the corporation is treated as viable the loss cannot be passed on to the shareholders for their tax benefit. In view of the adverse tax consequences which may result when the use of a straw or nominee corporation fails its intended purpose, the careful tax planner must effectively anticipate the approach that may be taken by the federal and state taxing authorities if they challenge the straw or nominee corporation. It is the purpose of this article to analyze the development of current judicial attitudes toward the use of straw and/or nominee corporations. Consideration will be given first to the legal development of the treatment of straw corporations, and thereafter, to that of nominee corporations. Although taxation is essentially statutory in nature, particular emphasis will be given to applicable court decisions since it is this judicial gloss which primarily concerns practitioners in the area. Finally, an approach will be suggested which, if utilized, should enhance the chances of simultaneously achieving satisfactory tax treatment and desired business objectives.

II. General Considerations

Traditionally, a distinction between a corporation and its owners has been recognized in the law of taxation: a corporation is a taxable entity, separate and independent of its shareholders. However, there

12. INT. REV. CODE OF 1954, §§ 301(c) (3) (A), 1001.
13. INT. REV. CODE OF 1954, § 301(c) (1).
14. Not only does this danger lurk at the federal level but it also exists at the state level. In the not too distant past, both state personal income taxes and corporate income or franchise taxes were generally regarded as mere nuisances in comparison to federal income taxes. However, as state tax rates have gradually increased, they have become serious factors with which taxplanners must contend. See, e.g., CAL. REV. & TAX. CODE § 17041 (West Supp. 1975) (maximum personal income tax rate of 11 percent); id. § 23151 (b) (maximum corporate income tax rate of 9 percent); PA. STAT. ANN. tit. 72, § 7302 (Supp. 1975) (maximum personal income tax rate of 2 percent); id. § 7502 (maximum corporate income tax rate of 9 percent).
15. Although some of the major weapons of the Internal Revenue Service (IRS) for maintaining this distinction are discussed briefly in this section, the discussion is

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are several statutory and judicial exceptions to this general rule. For example, it has been held that corporate existence, in form, will be disregarded if the alleged corporation is, in fact, a sham.\textsuperscript{16} Similarly, if the Internal Revenue Service (IRS) determines that a particular transaction between a corporation and its controlling shareholders lacks economic significance that transaction will be disregarded for tax purposes.\textsuperscript{17} A more subtle approach, employed with some success by the IRS is premised upon the judicial requirement that income be taxed to the one who “earns” it.\textsuperscript{18} Thus, if the IRS finds that the corporation was so inactive that it could not have earned the income, the income is attributed to the person or persons who actually earned it.\textsuperscript{19}

Section 482\textsuperscript{20} of the Internal Revenue Code (Code) is a major tool which the IRS can employ to adjust or set aside transactions between related taxpayers. Basically, the section authorizes the Commissioner to reallocate gross income, deductions, credits, or other allowances of related taxpayers in order to prevent the evasion of taxes or to reflect more accurately the income of the parties. Section 482 is specifically directed towards artificial transactions which distort true income, and the regulations point out that good faith transactions entered into without a tax avoidance motive, but which in fact distort income, nevertheless invite application of this section.\textsuperscript{21} The thrust of other Code sections, such as section 269,\textsuperscript{22} which permits the Commissioner to challenge corporations formed to avoid taxes by securing multiple surtax exemptions, has been blunted by relevant provisions of the Tax Reform Act of 1969 which substantially reduced the multiple corporation tax savings and thus the inducement to use multiple corporations as a device to avoid tax.\textsuperscript{23}

\begin{footnotes}
\item[17] See, e.g., Shaw Constr. Co. v. Commissioner, 35 T.C. 1102 (1961), aff’d, 323 F.2d 316 (9th Cir. 1963); Aldon Homes, Inc., 33 T.C. 582 (1959).
\item[21] Treas. Reg. § 1.482–1(c) (1968).
\item[22] Int. Rev. Code of 1954, § 269.
\end{footnotes}
The final preliminary consideration involves the question of whether the taxpayer encounters the same problems in attempting to successfully disregard the corporate entity as does the IRS. The Commissioner has considerable power to disregard or recognize a purported corporate entity. In fact, it has been suggested that the Commissioner may disregard or recognize the corporate entity at his discretion. In *Higgins v. Smith*, the Supreme Court stated:

A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages.

On the other hand, the Government may not be required to acquiesce in the taxpayer’s election of that form for doing business which is most advantageous to him. The Government may look at actualities and upon determination that the form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purpose of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation.

In a more recent case, it has been asserted that in order to prevent unfair tax avoidance, the Commissioner has not only great freedom in this respect, but also the duty to disregard the corporate entity under appropriate circumstances. Conversely, taxpayers usually cannot complain that corporations of their own creation, which may have served their purposes are shams and should be disregarded.

One commentator has indicated that a study of cases decided after 1960 indicates that contrary to prior statements, the Commissioner apparently does not have a decided edge over the taxpayers in contesting these issues. However, despite this observation, others believe that the taxpayer is at a disadvantage when he attempts to disregard his own creation. The taxpayer challenging the existence of

27. Id. at 477 (footnote omitted).
30. For example, it has been stated:

I think there is no merit in the taxpayer’s theory that the Commissioner and the Commissioner is not required to disregard the Taxpayer’s Theory. That is, it is not the Commissioner’s own creation, but it creates
a corporate entity must controvert, qualify, or requalify his prior actions in order to succeed, and accordingly, some adverse inferences will exist even in the most meritorious cases. The Commissioner is not similarly burdened, and, in addition, he is aided by the judicial presumption of correctness which attaches to his factual determinations. Yet, regardless of the position of the parties with respect to factual determinations, the applicable principles of law remain the same.

III. THE STRAW CORPORATION

A. Preliminary Considerations

The logical starting point for a discussion of straw or nominee corporations is the 1943 decision of the United States Supreme Court in *Moline Properties, Inc. v. Commissioner.*\(^\text{31}\) However, before the seminal decision in *Moline* is considered, an examination of earlier judicial approaches to the issue raised in *Moline* is helpful. The typical approach is perhaps best illustrated by *United States v. Brager Building and Land Co.*\(^\text{32}\)

In *Brager*, two partners who owned a mortgaged building leased the property to an unrelated corporation. Thereafter, the senior partner died, but under the terms of the partnership agreement the partnership was not dissolved by his death. The surviving partner then organized a corporation and conveyed the building to it in return from its stock. It was stipulated that there was no tax avoidance motive behind the transfer. The sole purpose was to provide an entity to hold legal title to the property in order to avoid complications when the surviving partner died. The partnership retained complete control of the property. The corporation engaged in no business activities, had no salaried officers or employees, and served no purpose other than to passively hold title to the building. Moreover, it had no actual capital, no bank account, no office, no books of account, no cash flow, and it did not assume the mortgage debt. Notwithstanding this factual pattern, the Commis-

and uses a corporation, he cannot require the Commissioner to say it isn't there. Interstate Transit Lines v. Commissioner, 319 U.S. 590, 596 (1943) (Jackson, J., dissenting).

32. 124 F.2d 349 (4th Cir. 1941). For similar approaches, see Inland Dev. Co. v. Commissioner, 120 F.2d 986 (10th Cir. 1941); North Jersey Title Ins. Co. v. Commissioner, 84 F.2d 858 (3d Cir. 1936); 112 W. 59th St. Corp. v. Helvering, 68 F.2d 397 (D.C. Cir. 1933); Carling Holding Co., 41 B.T.A. 493 (1940); Mark A. Mayer, 36 B.T.A. 117 (1937); Moro Realty Holding Corp., 25 B.T.A. 1135 (1932), aff'd per curiam, 65 F.2d 1013 (2d Cir. 1933). See generally Case, Disregard of Corporate Entity in Federal Taxation: The Modern Approach, 30 Va. L. Rev. 1085 (1944) (see note 7, at 649).
sioner assessed a deficiency against the corporation, charging it with income consisting of a portion of the rental receipts paid directly by the tenant to the mortgage trustee. The Fourth Circuit, however, disregarded the corporate fiction and held that the entity should be ignored for tax purposes. Although the holding was based upon the fact that the corporation had not been formed for a useful business purpose—a precursor of the test later adopted in *Moline*—the court emphasized that the corporation had no beneficial ownership of the property and was unable to exercise control over the property.

The *Brager* court recognized the general rule that although a corporation is an entity distinct from its shareholders for tax as well as other purposes, this technical separateness may be disregarded under appropriate circumstances. The court then drew the critical distinction:

But it is going too far to say that if a taxpayer forms a corporation for his convenience, he is thereafter estopped from disclosing the true nature of the arrangement, whenever it is of advantage to the government to recognize only the corporate form. The advantage of the taxpayer has been served by many decisions in which the identity of the corporation and its sole stockholder has been adjudicated, and we do not understand that this body of the law has now for practical purposes ceased to exist. In a number of these cases... under circumstances quite similar to those found in the case at bar, it has been held that when a corporation has been formed merely as an agency to hold title to real estate for the convenience of the owner, and has served this purpose with little or no independent activity on its part, the property and the income therefrom should be regarded as belonging to the stockholder.

Thus, the primary considerations which concerned most courts prior to *Moline* were beneficial ownership of the income producing property and the ability to exercise control over the corporate property. However, in *Moline* the Court removed this requirement that the corporation be given the beneficial ownership of the property, under the proper circumstances, mere legal title would be considered a sufficient basis

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33. 124 F.2d at 352.

34. *Id.* at 351–52. See generally *Kurtz & Kopp*, *supra* note 7, at 648–49. The current viability of *Brager* is questionable. In *Joseph Rothafel*, 24 CCH Tax. Ct. Mem. 1524 (1965), the court maintained that *Brager* had been tacitly overruled by *Moline*. This view is supported by one commentator who points out that the *Moline* Court had ample opportunity to decide the case on the "equitable ownership" theory, but did not do so, positing its own rule instead. *Case, supra* note 32, at 432–33. Nevertheless, *Brager* has never been expressly overruled and as recently as 1971, was cited with approval in *Taylor v. Commissioner*, 445 F.2d 455, 457 n.2 (1st Cir. 1971).

35. 124 F.2d at 351.
for treating the corporation as a viable entity.36 Furthermore, the ability or inability of a corporation to exercise control over the property or the income therefrom likewise ceased to be a dominant factor in the resolution of this issue. Nevertheless, these two concepts still have some support37 and might even have been determinative in several post-Moline Tax Court decisions.38

B. The Moline Case

In 1928, at the instigation of his creditors, Uly Thompson organized a corporation to serve as a security device in connection with certain realty which he owned. Thompson conveyed the property to the corporation which assumed the outstanding mortgages. In return, Thompson received all the outstanding stock, less qualifying shares, which he transferred to a voting trust controlled by his creditors. In 1933, the original loans were repaid and control of the corporation reverted to Thompson. The property held by the corporation was sold in several parcels between 1933 and 1936. The proceeds from the sales were received by Thompson and deposited in his account. Until 1933 the only business in which the corporation had engaged consisted of the assumption of Thompson's obligation to the original creditors, the defense of certain condemnation proceedings and the institution of a suit to remove some prior restrictions on the property. Thompson personally paid these litigation expenses. In 1934, part of the property was leased as a parking lot. The corporation did not transact any business after the sale of the last parcel in 1936. It kept no books, had no bank account and owned no other assets.

Although the corporation initially reported the sales of the property on its income tax returns, Thompson filed a claim for refund on the corporation's behalf and reported the gain on his individual return. The issue, simply stated, was whether the gain from the sales was income taxable to the corporation or taxable to Thompson. Implicit in this inquiry was the fundamental issue of whether the corporate


37. See generally Kurtz & Kopp, supra note 7, at 649. But see Case, supra note 32, at 428.

entity should be disregarded. The Board of Tax Appeals resolved the question in favor of the corporation, holding that it was a mere agent whose corporate existence should be disregarded for tax purposes. 39 The Court of Appeals for the Fifth Circuit reversed on the basis that once the corporation was formed by Thompson — regardless of motive — it must be recognized as a separate taxable entity. 40

In oral argument before the United States Supreme Court, the corporation maintained that it was the mere agent or fiduciary of Thompson, its creator. Therefore, it concluded that the gain from the sales must be Thompson's, not its own. Conversely, the Commissioner argued that a court can never disregard the corporate entity at the request of the taxpayer. 41 The Court, although finding for the Commissioner, rejected its absolute theory and instead based its decision on the theory that a corporation should be recognized as a separate entity for tax purposes when the purpose for which it was created is the equivalent of business activity or when it subsequently engages in business activity. 42 The Court expressed the rule as follows:

The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. 43

In refusing to disregard the corporate entity, the Court noted that when a taxpayer adopts the corporate form for his own purposes and accepts the advantages of such a business entity, he must also accept the tax disadvantages. 44 This particular corporation had been created by Thompson for his own advantage and had a special function from its

41. It had been the Commissioner's traditional position that, as a general rule, any wholly owned corporate entity might be disregarded by the IRS in furtherance of its revenue collection function, but that it could never be disregarded by its creators to reduce or avoid tax. Case, supra note 32, at 419 n.78.
42. 319 U.S. at 438-39.
43. Id. (footnotes omitted); accord, Taylor v. Commissioner, 445 F.2d 455 (1st Cir. 1971); Tomlinson v. Miles, 316 F.2d 710 (5th Cir.), cert. denied, 375 U.S. 828 (1963); Hagist Ranch, Inc. v. Commissioner, 295 F.2d 351 (7th Cir. 1961); Skarda v. Commissioner, 250 F.2d 429 (10th Cir. 1957); Payner v. Commissioner, 150 F.2d 334 (2d Cir. 1945); Carver v. United States, 412 F.2d 233 (Cl. Ct. 1969); Perry R. Bass, 50 T.C. 595 (1968). See also National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949); Harrison Property Mgmt. Co. v. United States, 475 F.2d 623 (Cl. Ct. 1973), cert. denied, 414 U.S. 1130 (1974).
inception. At the time of its formation, the corporation was clearly not the taxpayer’s alter ego in that it had been dominated and controlled by the members of the voting trust which had interests antithetical to those of the taxpayer. At that time the corporation had been a separate entity just as though its outstanding stock had been owned by third parties.

In an attempt to require the Commissioner to disregard the corporate entity, the taxpayer had offered the alternative argument that the corporation was a mere agent for its sole shareholder. The Court, however, refused to accept this argument, pointing out that there was no contract of agency and that the usual incidents of an agency relationship were not present. Unfortunately, the Court did not detail what might compose the usual incidents of an agency relationship. The Court did maintain, however, that the mere existence of a close corporation would not make the corporation the agent of its stockholders. The Court concluded that the issue of agency depended upon the same legal principles as did the question of corporate identity. Presumably, therefore, when the purpose for which the corporation is created is the equivalent of business activity, or when the corporation subsequently engages in business activity on its own accord, it is not the agent of its sole shareholder.

It is interesting to note, however, that the *Moline* Court did not completely foreclose the possibility that a straw corporation would be disregarded in certain circumstances. Unfortunately, however, the Court did not give any concrete suggestion of what those circumstances might be. The Court was satisfied merely to assert that the corporate form might be disregarded when it is a sham or a fiction. The result of this indefiniteness has been a series of cases in which courts have attempted to specify those appropriate circumstances to which *Moline* had alluded. It should also be noted that implicit in the Court’s opinion was the proposition that in certain instances, a corporation could be an agent for its stockholders or other parties. Again, however, the Court failed to provide specific examples of those necessary circumstances, other than to intimate that the “usual incidents of an agency relationship,” whatever they might be, and a contract of agency, must be present.

45. *Id.* at 440.

46. *Id.* at 440-41.

47. *Id.* at 439.

48. *Id.* at 440. See text accompanying notes 79-106 infra; cf. Carver v. United States, 412 F.2d 233, 239-40 (Cl.Ct. 1969), where the court found that a true agency or trusteeship existed when a wholly owned corporation acted on behalf of an independent third party to the same end as it did for its owner.
C. Evolution and Application of the Moline Test

Consideration of the application of the Moline test raises several preliminary questions. The first and most obvious problem is the meaning of "business activity." Shortly after the Moline decision, the Court of Appeals for the Second Circuit faced that question. In defining "business activity," Judge Learned Hand added the following gloss to the Moline rule:

[T]o be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial, or other activity besides avoiding taxation: in other words . . . the term "corporation" will be interpreted to mean a corporation which does some "business" in the ordinary meaning; and . . . escaping taxation is not "business" in the ordinary meaning.

Thus, it should be concluded that the corporation must actually do something in order to be engaged in business activity. A mere passive existence, even if its purpose is to hold title to property, is insufficient.

Another question is whether the first prong of the Moline rule is worthy of literal application. On its face, the test directs that if a corporation is created for a purpose which is the equivalent of business activity, that corporation is to be considered a separate taxable entity, even if the corporation does not engage in any business activity. Although this position appears questionable, the Second Circuit, in Jackson v. Commissioner, has indicated that the test should be literally applied.

In Jackson, the court reiterated that a corporation may not be disregarded for tax purposes if one of the shareholders' intentions in creating it was that the corporation itself should have a substantial business function. The court emphasized that it is the intended business function of the corporation itself and not the incorporator's reason for incorporating which is determinative. Nevertheless, based on the facts of the case, the court applied the second prong of the Moline rule and held that the corporate entities involved should be disregarded.

49. National Investors Corp. v. Hoey, 144 F.2d 466 (2d Cir. 1944).
50. Id. at 468.
51. 233 F.2d 289, 290 (2d Cir. 1956); accord, Carver v. United States, 412 F.2d 233, 236 (Ct. Cl. 1969); cf. Caswal Corp., 19 CCH Tax Ct. Mem. 757 (1960). But see Kronovet, supra note 11, at 59, where the author maintains that corporations which engage in a single activity over a minimal time period have not been challenged by the Commissioner.
52. 233 F.2d at 290.
53. Id. But see Tomlinson v. Miles, 316 F.2d 710 (5th Cir.), cert. denied, 375 U.S. 628 (1963); 556 F.2d 1287 (5th Cir. 1977); 61 Tax Ct. 509 (1963).
since they engaged in only negligible business activities. Implicit in this holding is the conclusion that the corporations were not created for the purpose of exercising any substantial business function.

It would appear that, based on the facts, the holding in Jackson is correct. However, the implication of Jackson that any corporation should be treated as a taxable entity merely because it can be proven that it was created for the purpose of performing a substantial business function would seem to impair the power of the IRS to disregard the corporation. An examination of the cases indicates otherwise. It is submitted that formation for a business purpose combined with minimal, rather than substantial, activity will result in the disregard of the corporation for tax purposes. Most courts, when considering this question, primarily direct their attention to whether the corporation has engaged in any substantial business activity. In fact, it may be presumed that unless a corporation engages in more than a single activity over a period of time, the straw status of a corporation will not be challenged, regardless of the purposes for which it was created.

This conclusion is further supported by the many cases in which it has been held that the mere fact that a corporation is regarded by its owners as a "dummy," a "straw," or a "phantom" bears no weight. In fact, the Supreme Court has recognized that although most corporations owned by sole shareholders are "dummies" in the sense that the determination of their policies and day-to-day activities are decisions of the individual stockholders and not corporate decisions, that single fact is meaningless for disposition of the tax issue.

This attitude is reflected in the case of Love v. United States, where the taxpayers were members of a partnership or joint venture whose primary business concern was the operation and sale of real

54. Two corporations, Dumelle and Belgrade, were owned and controlled by the individual taxpayers. Dumelle's only activity was the receipt of stock from a corporation in which the taxpayers owned a one-third interest. Thereafter, Dumelle purported to sell the stock to Belgrade which exchanged the shares for stock in a fourth corporation. Belgrade continued merely to hold the stock in the fourth corporation. 233 F.2d at 289-90.

55. See, e.g., Sam Siegel, 45 T.C. 566 (1966).

56. See cases cited in note 58 infra.

57. See David F. Bolger, 59 T.C. 760 (1973); Shaw Constr. Co., 35 T.C. 1102, 1166 (1961); Kronovet, supra note 11, at 59.


60. 96 F. Supp. 919 (Ct. Cl. 1951).
property. Legal title to the venture's income-producing property was held by the Leado Investment Company (Leado), a corporation owned by the taxpayers. The Commissioner proposed deficiency assessments against the corporation on the grounds that certain income reported by the individual taxpayers should have been reported as corporate income, and that the individuals should have treated their income as dividends. The taxpayers maintained that Leado was merely a dummy or phantom corporation used to hold legal title to the property conveniently, and that it had never engaged in active operations. The Commissioner argued that the corporation's business activities were sufficient to require it to be recognized as a separate taxable entity. Leado held legal title to approximately 100 parcels of real estate, the annual income from which exceeded $50,000. The income did not flow through the corporation, but was collected and disbursed by an agent of the interested parties. The court noted, however, that any of the interested parties could have insisted that the money flow through the corporation and be distributed by it rather than by the agent. The corporation, acting through its officers, executed leases and deeds of trust, entered into agreements to sell, purchased and held insurance policies on the property, sued and was sued in its corporate name on matters involving the property, employed at least 10 employees, and paid the applicable payroll taxes. The fact that the corporation was used for so many business purposes and was available at all times for such use precluded the court from finding that it was a mere phantom organization. Noting that the parties could have elected to conduct their business in other ways, but had elected to utilize the corporate form as insulation against potential personal liability, the court concluded that the taxpayers could not avoid the resulting tax consequences. The court stated:

That a corporation is regarded as a "straw," a "dummy," a "phantom," in itself proves nothing. The concept of the corporation is itself a fiction. A corporation is an artificial person. It operates under a charter granted it by the state, conferring certain rights, and also conferring certain privileges and exemptions in return for complying with certain rules or conditions. The decision to recognize or not to recognize the tax identity of a corporation depends upon what the corporation does, not what it is called, how many or how few own it, or how they regard it. Whether much or little use was made by plaintiffs of the Leado corporation, it was available to them at all times, like the musket

61. Id. at 920.
62. Id. at 922.
behind the door, for use when needed or when occasion should arise. We hold that they did in fact use it to such an extent that its separate identity must be recognized.63

Thus, if a corporation engages in some business activity in the ordinarily accepted meaning of that term, it will be recognized as a taxable entity separate and distinct from its creators. Although the proposition is not entirely free from doubt,64 recent caselaw indicates that the quantum of business activity is not determinative. Therefore, it is safe to conclude that the business activity sufficient to permit the Commissioner to recognize a corporation as a separate taxable entity may be minimal.65

Certain functions may exist which, though performed in the normal course of a corporation's business, are not deemed to be business activities. For example, many courts have held that tax avoidance is not a business activity.66 Furthermore, since straw corporations are often formed for the sole purpose of holding title to real property such corporations, by necessity, are required to perform certain ministerial acts involving the receipt and transfer of title. Such corporations might also be required to perform similar activities in connection with income from the property. However, it is precisely the latter types of transactions which often form the basis for a determination that the corporation is no longer the alter ego of its creators but is a viable and taxable entity. Nevertheless, the mere execution of documents of title and related papers should not deny the corporation its straw status, so long as it makes no contrary representations to outsiders in such transactions.67 However, extreme caution should be taken in such situations to ensure that the corporation remains merely a straw and does not participate in its own right in any negotiations or other activities, since those actions are sufficient cause to treat the corporation as a taxable entity.

63. Id.


66. See, e.g., National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949); National Investors Corp. v. Hoy, 144 F.2d 466 (2d Cir. 1944); Lloyd F. Noonan, 52 T.C. 907 (1969), aff'd per curiam, 451 F.2d 992 (9th Cir. 1971).

67. See Taylor v. Commissioner, 445 F.2d 455, 457 (1st Cir. 1971) (dictum). See also Watts, supra note 24, at 877. But see Kronovet, supra note 11, at 55.
This reasoning has been developed in a line of cases involving real estate holding companies which held record title to real estate, beneficial ownership of which remained in certain individuals pursuant to written agreement. In Stewart Forshay, the first of these cases, certain real property was transferred by three individuals to a corporation organized to hold title for their benefit. The individuals entered into a written agreement which specifically provided that the corporation existed solely to hold record title. Thereafter, the property was sold at a gain. The Board of Tax Appeals determined that although record title was held by the corporation, both legal and equitable title was retained by the individuals. Therefore, the gain from the sale was taxable to them instead of the corporation. The Board held that since the corporation did not engage in business, hold directors' meetings, declare dividends, or perform acts other than the execution of deeds, as the record title holder, it should be disregarded for tax purposes.

Thus, the Moline test as evolved can be summarized as follows: where a corporation engages in business activity, in the ordinary meaning of that term, even if such activity is minimal, its corporate existence will not be disregarded for tax purposes unless its sole activity consists of those ministerial tasks necessary to receive and transfer title.

Although this test is easily stated, its application is extremely difficult. The fine line separating corporate recognition from corporate disregard is very tenuous. This is illustrated by the Second Circuit's resolution of the problem in Paymer v. Commissioner, where the corporate status of one close corporation was disregarded while a second member of the same corporate family was held to be a separate taxable entity.

In Paymer, one of two brothers, who were business partners, had personally guaranteed the payment of a substantial matured debt. In an attempt to thwart the attachment of any partnership property in satisfaction of the personal debt, the partners formed two corporations, Raymep Realty (Raymep) and Westrich Realty (Westrich). Both corporations were given broad powers in their articles of incorporation to own, manage, and dispose of real property. The partnership con-


70. 150 F.2d 334 (2d Cir. 1945) criticized in Kurtz & Kopp, supra note 11, at 152. See also Raymep Realty Corp., 7 CCH Tax Ct. Mem. 269 (1948).
veyed a parcel of income-producing property to each corporation for
which each partner received one-half of the stock. The corporations'
minutes provided that the conveyance was made with the express
understanding that the corporation was only to hold title to the prop-
erty and that the beneficial interest, profits and the exclusive right to
manage and control the property were to be retained by the partners. The
minutes also provided that the corporations were organized solely for
the convenience of the shareholders in the management of the property.

The two partners managed the property, collected the income,
paid the expenses, deposited the cash receipts in the partnership bank
account, and used the net proceeds for their own purposes, treating the
property exactly the same as they had when it had been partnership
property. The existing leases on the properties were not assigned to
either corporation. Westrich did nothing with respect to the property
held in its name. The only activity Raymep engaged in was to secure
a $50,000 loan — the security consisting of an assignment to the
lender of all the corporation's rights, profits and interests in the two
leases on the property to which it held title. Raymep also covenanted
that the leases were in full force and effect and that it was the sole
lessor. During 1938, the partners received approximately $19,000
in gross rental income from the property to which Raymep held title
and $3,300 from the property to which Westrich held title.

In drawing a fine line between the activities of the two corpora-
tions the Second Circuit, applying the Moline test, stated:

We think that Raymep was active enough to justify holding
that it did engage in business in 1938. The absence of books,
records and offices and the failure to hold corporate meetings are
not decisive on that question. Though Raymep was organized
solely to deter creditors of one of the partners, it apparently was
impossible or impractical to use it solely for that purpose when it
became necessary or desirable to secure the above mentioned loan
in a substantial amount. . . .

Westrich, however, was at all times but a passive dummy
which did nothing but take and hold the title to the real estate
conveyed to it. It served no business purpose in connection with
the property and was intended to serve only as a blind to deter the
creditors of one of the partners. It was but a sham to be disre-
garded for tax purposes.71

In so holding, the court apparently attached little or no significance
to the corporate resolutions which had declared that the corporations had
no beneficial interest in the properties. With the possible exception of Raymep's declaration that it was the sole lessor at the time it obtained the loan, it would appear that the corporation did no more than perform those ministerial acts\textsuperscript{72} inherent to a straw corporation which have been held not to constitute business activity. Thus, the distinction drawn by the Paymer court is questionable. However, it is illustrative of the problems encountered in this area by courts applying the Moline test. It is also an example of the strict application of the principle that a corporation holding title to property is treated as a taxable entity if it engages in any significant nontax activity with respect to the property it holds.

A second example of the potential danger permeating this area is the recent Tax Court decision in David F. Bolger.\textsuperscript{73} Bolger concerned the typical 1-day real estate transaction for which most practitioners would expect the corporate entities to be disregarded.\textsuperscript{74} However, the decision in Bolger that the corporations were taxable entities mandates a reexamination of that expectation.

In Bolger the taxpayer formed 10 financing corporations, each with an initial capitalization of $1,000. The stockholders were the same individuals who would ultimately take title to the property. After formation, the corporations purchased buildings which other enterprises desired to lease, although occasionally, the seller would also become the lessee. Usually, each particular transaction was completed in 1 day: the seller conveyed the property to the financing corporation and the financing corporation leased it to the user; the financing corporation then sold its negotiable interest-bearing corporate notes, in an amount equal to the purchase price, to institutional lenders pursuant to a note purchase agreement. The notes were secured by a first mortgage on the properties and by an assignment of the lease. Following the completion of these transactions, the financing corporation conveyed its property to its shareholders subject to the lease and mortgage. At that time, the shareholders assumed the financing corporation's obligations under the lease and mortgage except that they assumed no personal financial obligation for the mortgage payments. Liability on the assumption was thus limited to the transferred property. The corporations agreed to continue in existence and to refrain from any business activity not associated with the ownership and leasing of the property. Rental payments in an amount equal to the mortgage pay-

\textsuperscript{72} See text accompanying note 62 supra.

\textsuperscript{73} 59 T.C. 760 (1973).

\textsuperscript{74} See Kronovet, supra note 58, at 54.
ments were made directly to the mortgagee, and the financing corporation only kept the additional portion of the rent.

The ultimate issue before the Tax Court was whether the shareholders were the owners of the property and entitled to the depreciation deductions thereon. Even though the matter was not decisive, the court went to great lengths to determine that the corporations were separate entities for tax purposes, both before and after the transfer of the properties to the shareholders, although the taxpayers prevailed on the depreciation issue.

Applying the *Moline* test, the *Bolger* court found that the corporations had initially engaged in substantial business activities and were viable entities whose separate existence could not be ignored for tax purposes. The court determined that the corporations were formed for three business purposes: to enable the transactions to produce maximum financing by avoiding state restrictions on loans to individuals, to limit personal liability, and to facilitate multiple-lender financing. To accomplish these purposes the corporations purchased and leased property, issued corporate obligations and executed mortgages. The court also held that the corporations should be recognized as separate entities even after they transferred their properties and contracted to refrain from engaging in any other business activity. The court based this determination on the facts that the corporations remained liable on the mortgages, had contracted to remain in existence and had promised to preserve their powers to own property and to engage in business.

IV. THE NOMINEE CORPORATION

A. Preliminary Considerations

The second major device for accomplishing taxpayers’ business objectives without causing adverse tax consequences is the corporate nominee. Such corporations freely admit their separate existence, yet maintain that they are either agents or trustees of the beneficial

75. 59 T.C. at 766. The Tax Court distinguished *Jackson v. Commissioner*, 233 F.2d 289 (2d Cir. 1956), *O’Neill v. Commissioner*, 170 F.2d 596 (2d Cir. 1948) and *Dallas Downtown Dev. Co.*, 12 T.C. 114 (1949), on the basis of the quantum of activity, noting that the activities conducted by the corporations in *Bolger* were far greater.

76. 59 T.C. at 766.

77. *Id.* Although in some of the transactions there were words in the pertinent documents connoting nominee rather than straw status the court rejected the taxpayer’s argument that the corporations were mere agents or nominees, primarily on the authority of *National Carbide Corp. v. Commissioner*, 336 U.S. 422 (1949). See text accompanying notes 86-106 infra.
owners of the property. The critical question in disputes involving the
validity of corporate nominee status is not whether the corporation is
engaged in business activity, but rather whether it is acting in its own
behalf or as an agent or trustee for the beneficial owners of the income-
producing property.

As previously noted,79 the Moline Court suggested that under
certain unarticulated circumstances a corporation could be an agent of
its stockholders or other parties. The Court merely stated that the
prerequisite for such status was the existence of the "usual incidents of
an agency relationship."80 This dicta foreshadowed the result reached
by the Court six years later in National Carbide Corp. v. Commis-
sioner.81 However, even before the National Carbide decision, the
Tax Court had held that a corporation could function as the trustee
or agent of its principal.82 A review of the approach taken by the Tax
Court prior to the National Carbide decision provides helpful insights
into the background of that case.

For example, in Worth Steamship Corporation,83 two of three
participants in a joint venture operated a steamship for the joint ven-
ture's account at a monthly fee. The two individuals organized a steam-
ship corporation of which they were sole shareholders for this purpose.
The corporation received the monthly management fee which it re-
ported as taxable income. Record title to the ship was transferred to
the corporation with the understanding that it was merely to operate
the vessel, collect the income, pay the expenses, and transmit the excess
to the three joint venturers who had retained the beneficial ownership
of the vessel. All the business transactions were carried out in accord-
ance with the terms of a written joint venture agreement, an operating
agreement, and a declaration of trust. The Tax Court agreed with the
taxpayers that the basic test to determine who was responsible for the
tax was one of ownership. The court held that the corporation was an
agent of the joint venture, and, except for the monthly management fee,
was not the owner of, and was not taxable on, the income generated by
the use of the ship.

In light of other authority, the ownership test applied by the Tax
Court is somewhat suspect.84 Nevertheless, the case illustrates three

79. See text accompanying note 48 supra.
80. 319 U.S. at 440.
82. Worth Steamship Corp., 7 T.C. 654 (1946); Industrial Union Oil Co., 5
83. 7 T.C. 654 (1946).
84. See National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949); Moline
Properties, Inc. v. Commissioner, 339 U.S. 436 (1949); Harrison Property Mgmt.
recurring factors in cases in which taxpayers prove the existence of a corporate agency or trust: existence of written agency or trust agreements, scrupulous adherence to the terms of those agreements, and the lack of absolute identity between the corporate shareholders and the beneficial owners of the income-producing property. Although the existence of these three factors does not guarantee judicial recognition of a corporate nominee, their absence substantially reduces the likelihood of such recognition.85

B. National Carbide Corporation v. Commissioner

In National Carbide, three wholly owned subsidiaries of Airco contended that they were corporate agents of the parent. Their written contracts with Airco, with which they operated in strict accordance, provided that the subsidiaries were employed as agents to manage and operate certain production plants and to sell the output for their principal. Airco agreed to furnish working capital, executive management and office facilities. The subsidiaries agreed to pay Airco all profits in excess of 6 percent on their nominal outstanding capital stock. The subsidiaries held title to their assets and the amounts advanced by Airco for working capital were carried on the subsidiaries' books as accounts payable. The chief officers of Airco were also officers of the subsidiaries. The directors of the subsidiaries met only to ratify the actions of Airco's top management. Airco treated the profits from the subsidiaries as its own income and reported it as such for tax purposes, whereas the subsidiaries reported only the 6-percent return on their capital. The Commissioner proposed that the subsidiaries were taxable on all the income from their operations.

The issue, as phrased by the Supreme Court, was whether the "usual incidents of an agency relationship," mentioned by the Moline Court, were present.86 Accepting the rule of Moline, the Court noted that "[o]wnership of a corporation and the control incident thereto can have no different tax consequences when clothed in the garb of agency than when worn as a removable corporate veil."87 The Court found no distinction between the control exercised by Airco over the three subsidiaries and that exercised by the sole stockholder in Moline.


86. 336 U.S. at 427 (1949).
The Court held that no agency relationship existed because the subsidiaries' earnings were turned over to Airco, which owned and completely dominated the subsidiaries — a result which would not have been possible if the subsidiaries had been owned by third parties. The Court also emphasized that all the subsidiaries' assets had been transferred to them by the parent, and that no real consideration had passed from the subsidiaries to Airco in return for these assets. Nevertheless, the Court suggested the scope of its decision:

What we have said does not foreclose a true corporate agent or trustee from handling the property and income of its owner-principal without being taxable thereafter. Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purpose must be the carrying on of the normal duties of an agent.

Thus, the National Carbide decision details some of the characteristics of the true corporate nominee. The nominee corporation must operate in the name of, and for the account of its principal; it must have the power to bind the principal by its actions; money received by it must be transmitted to its principal; the principals must not be the owners of the corporation; and the agency relationship must be the result of an arm's length transaction and not the shareholders' ownership of the purported agent. However, these attributes are merely descriptive and were not intended as an all-inclusive guide. The importance of a written agreement setting forth the details of the relationship between the principal and the corporate agent, as well as the scrupul-

88. Id. at 438.
89. Id. at 434–35.
91. See, e.g., Given v. Commissioner, 238 F.2d 579 (8th Cir. 1956), in which the absence of an agency agreement or trust instrument negated taxpayer's argument that the corporation was a mere agent of the shareholders.
ous adherence to these details cannot be overemphasized. However, the mere presence of a properly drafted agency agreement is insufficient; the written agreement must be based on an authentic agency relationship, since the Court stressed that the "usual incidents of an agency relationship" are not satisfied by the identity of ownership and control disclosed by the facts in National Carboide.

C. Application of the National Carboide Test

The case of Given v. Commissioner provides a prime example of a procedure guaranteed to be regarded by the IRS and the courts as not constituting a creation of a corporate nominee. In Given, five individual associates in the purchase, repair, operation, and profitable sale of a commercial building, utilized an existing corporation in order to avoid the complications of death, litigation, and other hazards of personal ownership. Each associate contributed a proportionate share of the needed cash into the corporate treasury, each receiving one-fifth of the corporate stock in return. The corporation then assumed the obligation for the balance of the purchase price by executing the necessary notes and mortgage. No other agreements were executed among the individuals or with the corporation establishing any trust or agency relationship. The corporation, after leasing the building to various tenants, made the necessary repairs and improvements to the building and was reimbursed by the individual associates. Three of the associates terminated their interest in the venture by transferring their stock to the two who remained. Thereafter, the corporation executed the necessary instruments to sell the building.

The Commissioner proposed a tax at the corporate level on the rental income and the proceeds of the sale. The taxpayers, liable for the corporate tax as transferees of its corporate assets, insisted that the income was received by the corporation as their agent and not in its own right. The Court of Appeals for the Eighth Circuit rejected this theory on the authority of Moline and National Carboide, holding that the corporation had engaged in substantial business activities in its own behalf. The court emphasized the fact that the individuals had entered into no agreements with the corporation or each other establishing any status, relationship, or right in the property other than that inherent in their capacity as stockholders. There was no foundation

92. 336 U.S. at 439. See generally Rev. Rul. 59-247, 1959-2 CUM. BULL. 14, in which the IRS proposes its method for establishing a corporate agency relationship, although reserving the right to reallocate the combined income of the corporate group annually, if the yearly factual situation so warrants.

93. 238 F.2d 579 (8th Cir. 1956).
for the claim that the corporation was an agent, conduit, or other straw; therefore, it had no basis for escaping tax liability.  

The outcome of this case might have been different had the individuals given more attention to the details of the transaction. It is conceivable that if the parties had entered into a specific contract of agency with the corporation, adhered closely to its terms, provided for payment to the corporation of a reasonable management fee, and not maintained identity of corporate ownership, the resulting tax consequences would have been quite different.

Yet it is possible that a corporation can attain nominee or agency status within the scope of the National Carbine test. For example, in K-C Land Co., a corporation contended that it was merely a title-holding entity and that a deficiency assessed against it was computed on income from the purchases and sales of land, an oil and gas lease, and corporate stock, all of which belonged beneficially to others. The stock of the corporation had been issued to three individuals, although no money had been paid to the corporation. The properties involved, some of which were income-producing, had been acquired by the corporation at various times. Upon each acquisition, the corporation agreed with the joint venturers that it had no beneficial interest in the property and that it held record title only as trustee for the joint venture. The parties involved — the three stockholders, other individuals who did not own stock in the petitioner corporation, and another corporation — executed a joint venture agreement which provided that the profits and losses were to be shared equally, that all proceeds should first be applied to payment of costs and expenses, and thereafter, be divided in accordance with the profit-sharing ratio, that the proceeds should be transferred to the corporation solely for convenience and management purposes, and finally that taxes and other expenses should be paid by the corporation only for operational convenience. The parties also executed a management agreement which provided that the corporation was to retain possession of the property, and operate and manage it for the joint venturers at their direction and control. The corporation performed no managerial functions and received no managerial fees.

The Commissioner argued that the corporation was organized for a business purpose and had engaged in substantial business activities.

95. Id.
96. 19 CCH Tax Ct. Mem. 183 (1960); accord, Caswal Corp., 19 CCH Tax Ct. Mem. 757 (1960). The current status of K-C Land is questionable since it relied, in part, upon State-Adams Corp., 32 T.C. 365 (1959), which was reversed on appeal, 283 F.2d 395 (2d Cir. 1960), cert. denied, 365 U.S. 844 (1961). See also Kronovet, supra note 11, at 56, where it is suggested that neither K-C Land nor Caswal Corp.
It was the Commissioner's position that the corporation had been created to provide central control for various transactions and had engaged in substantial business activities in furtherance of that purpose.

In rejecting the Commissioner's contentions, the court held that the net profits distributed to the joint venturers were not corporate distributions to shareholders. The court emphasized that the corporate shareholders and the joint venturers were not identical, and asserted that the joint venturers did not intend to do business as a corporation. The court concluded that the corporation held title to the property in trust, had no beneficial interest in the properties, and did not engage in substantial business activities. Therefore, the income derived from the properties belonged to the joint venture and was not taxable to the petitioner corporation.97

A recent and informative application of the National Carbide rationale is the decision in Harrison Property Management Co. v. United States.98 The critical issue was whether profits derived from oil leases, the record title to which was held by the management corporation, were taxable to that corporation, or to the beneficial owners who had transferred record title to the corporation of which they were the sole incorporators, stockholders, officers and directors.99 The corporation had been formed for the express purpose of providing efficient management if any one of the individuals died. The corporate charter strictly limited the rights, powers, and authority of the corporation to conduct business affecting the property. The property was transferred to the corporation solely for the purpose of management and administration. The individuals executed an agreement with the corporation whereby the transfer was made "solely and only as a matter of convenience and accommodation and without consideration whatsoever."100 The agreement identified the individuals as the beneficial owners of the property and provided that the corporation disclaimed any right, title, or interest in the property other than the right to manage and administer it. The corporation complied with the terms of the agreement, deducting from corporate income all expenses and crediting the balance in appropriate proportions to the accounts of the individuals.

The Court of Claims initially analyzed the facts without considering the contract of agency and concluded that, if the contract was not capable of recognition for tax purposes, the corporation was a taxable entity. The paramount principle was that the stockholders of a closely

99. 475 F.2d at 624.
100. Id. at 625.
held corporation could not demand that their corporation be ignored for federal income tax purposes.

Where individuals adopt the corporate form for purposes of their own, the choice of the advantages of incorporation to do business requires "the acceptance of the tax disadvantages." It is immaterial that the shareholders remain the beneficial owners of the property transferred to the company, or that the latter's policies and day-to-day activities are determined, not as decisions of the corporation, but by the owners acting individually. . . . The controlling tests, ignoring the fact that the corporation is substantially the alter ego of the stockholders, concentrate on the reasons why the "dummy" was created, and what it actually does.\(^{101}\)

In applying these tests, the court found that the corporation had been formed for acceptable business purposes and that the corporation had performed those business functions. The court concluded, therefore, that the corporation had been neither dormant nor inert.\(^{102}\)

The court next considered the taxpayers' major argument that the agency agreement brought the matter within the exception recognized by the Supreme Court in National Carbide. However, the court held that National Carbide did not make the formal designation of a document as an "agency agreement" a conclusive factor. The significant criteria were

whether the so-called 'agent' would have made the agreement if the so-called 'principals' were not its owners, and conversely whether the 'principals' would have undertaken the arrangement if the 'agent' were not their corporate creature.\(^{103}\)

The court reasoned that it would be inconceivable that a corporation would have entered into the alleged agency contract with property owners who were not shareholders or that the shareholders would have agreed to such an arrangement with the corporation if they had controlled it. The efficacy of the corporation's relations with the beneficial owners of the managed property depended on their position as the sole shareholders. The court concluded that the corporation was, in fact, a taxable entity, and not a mere agent of the shareholders.\(^{104}\)

The Harrison Court stated that the Moline-National Carbide tests defining the taxability of close corporations cannot be circumvented by a simple agency agreement device if the actual operations of the corporation indicate otherwise. Rather, the National Carbide Court, which had previously disposed of that postulate, required a more substantial

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\(^{101}\) Id. at 626 (citations omitted).

\(^{102}\) Id. at 626-27.

\(^{103}\) Id. at 627.

\(^{104}\) Id. at 629.
showing that the connection between the self-designated principal and agent was independent of the principal's ownership and control of the agent.\textsuperscript{106}

In closing, the court rendered a telling observation on the significance of adherence to the \textit{National Carbide} test in cases involving small, closely held corporations:

In Subchapter \textit{S}, sections 1371–1379 of the 1954 Code, Congress has provided, in defined circumstances, for the treatment of such companies as partnerships, with the stockholders rather than the corporation paying the income tax on the profits. It appears highly probable that [the corporation in this case], though a small business corporation, could not qualify for Subchapter \textit{S} benefits because more than 20 percent of its receipts in the taxable years was "passive investment income" from rents — a specific exception contained in Section 1372(e)(5). This limitation is still an integral part of the Congressional design for lifting the tax from the corporation — an existing legislative restriction which would be thwarted if non-eligible companies could attain the same result by the simple procedure of a surficial "principal" — "agent" agreement which is not in essence divorced from the owner-corporation relationship.\textsuperscript{106}

At first glance, the holding in \textit{Harrison} might be considered indicative of a judicial trend toward strict limitation on the use of a nominee corporation. However, closer analysis reveals that it is merely a literal and balanced application of the \textit{National Carbide} test. The critical flaw which prevented the taxpayers in \textit{Harrison} from achieving the desired tax treatment was the identity of interests between the shareholders who dominated and controlled the corporation while retaining beneficial ownership of the income-producing property. Conceivably, had this identity of interest been severed through the use of a separate corporate agent owned and controlled by unrelated third parties, the result might have been different. On the other hand, the court suggested that if the corporation had been controlled by unrelated third parties the taxpayers might not have been able to achieve their desired business objectives.

V. \textbf{Summary and Suggested Approach}

It has been shown that a corporation, created for business purposes, or thereafter engaging in business activities in the ordinary meaning of that term, is to be regarded as a separate taxable entity.\textsuperscript{107}
The conduct necessary to constitute sufficient business activity in order to compel recognition of the corporation as a separate entity has not been expressly delineated. However, it can reasonably be concluded that in most instances minimal business activity on the part of the corporation is a sufficient basis to label it a taxable entity.\textsuperscript{108} The business activity test has been applied quite literally and strictly by the courts.\textsuperscript{109} Moreover, recent decisions have cast suspicion upon formerly safe transactions involving straw corporations.\textsuperscript{110} Nevertheless, if a corporation engages in no transactions in its own behalf and exhibits only a passive existence, it has been treated as a straw and thus has escaped taxation at the corporate level.\textsuperscript{111}

It has also been demonstrated that, under certain circumstances, a corporate agent or trustee may hold, manage, or operate the property of its principal without being subject to tax on the operating income.\textsuperscript{112} Although most of the factors have been exhibited in situations where the taxpayer failed to prove an agency or trust relationship, the absence of these factors will result in a decision adverse to the taxpayer. Thus, although the presence of certain criteria will not guarantee a beneficial result for the taxpayer, the cases indicate that the "usual incidents of an agency relationship" must be present.\textsuperscript{113} The corporate agent must \textit{inter alia}, operate in the name of the principal, have the power to bind the principal by its action, and transmit all funds to the principal.\textsuperscript{114} Moreover, the agency or trust relationship must result from an arm's length transaction and must not depend upon the principal's ownership or control of the corporate agent. The factor which the cases stress most is the requirement of a lack of identity between the corporate owners and the beneficial owners of the income-producing property.\textsuperscript{115} In other words, the corporate shareholders should not be the beneficial owners of the income-producing property, nor should they be subject to the control, either direct or indirect, of the beneficial owners. Finally,

\textsuperscript{108} See, \textit{e.g.}, Britt v. United States, 431 F.2d 227 (5th Cir. 1970); Herbert v. Riddell, 103 F. Supp. 369 (S.D. Cal. 1952).

\textsuperscript{109} See, \textit{e.g.}, Paymer v. Commissioner, 150 F.2d 334 (2d Cir. 1945).


\textsuperscript{111} See, \textit{e.g.}, Jackson v. Commissioner, 233 F.2d 289 (2d Cir. 1956). \textit{See also} text accompanying notes 66--67 supra.

\textsuperscript{112} See text accompanying notes 79--92 supra.

\textsuperscript{113} See, \textit{e.g.}, National Carbide Corp. v. Commissioner, 336 U.S. 422, 427 (1949); Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 439 (1943).

\textsuperscript{114} National Carbide Corp. v. Commissioner, 336 U.S. 422, 437 (1949).

\textsuperscript{115} See, \textit{e.g.}, id. at 422; Harrison Property Mgmt. Co. v. United States, 475 F.2d 623 (Ct. Cl. 1973); 475 U.S. 108, 110 (1975).
the terms of the agency or trust relationship must be in writing, and the parties must strictly adhere to those terms.\footnote{116}{See, e.g., Given v. Commissioner, 238 F.2d 579 (8th Cir. 1956).}

Not unexpectedly, the doctrine developed by \textit{Moline, National Carbide}, and their progeny has not escaped criticism. One approach suggests that any corporation properly formed and in good standing should be considered a taxable entity.\footnote{117}{See, e.g., Kurtz & Kopp, supra note 7, at 656-57.} However, the question should be what amount of the income, if any, should be taxable to that entity. If a properly structured corporation states in its articles of incorporation that its specific purpose is to function as a straw or nominee, and it scrupulously complies with this description in its business dealings, any income generated by the property to which it holds legal, but not beneficial, title should be taxed to the true owner of the income-producing property. Any other income, including fees or management charges, would otherwise, of course, be taxable to the corporation since it earned that income. Any abuse of such an arrangement could still be prevented by invoking the general doctrines of sham corporation, reallocation of income, and the attack on transactions lacking economic significance.

Although this approach achieves the desired result by a less circuitous route — taxing income to the beneficial owner of the income-producing property — it has not received judicial acceptance. The courts continue to phrase the issue in terms of disregard of the corporate entity, purpose of incorporation, and quantum of business activities. Since the courts, including the Supreme Court, have applied the \textit{Moline} and \textit{National Carbide} tests for more than thirty years, it is highly unlikely that they would accept a surrogate at this late date. Therefore, it is necessary to tailor the corporate vehicle to satisfy the prevailing tests.

It is submitted that, with the exception of the true real estate holding company, the greatest risk is encountered when the taxpayer attempts to comply with the \textit{Moline} test for straw corporations. In those instances, minimal activity by the corporation — for example, obtaining a loan or executing a lease or mortgage — might be sufficient to render the corporation a separate entity for tax purposes. On the other hand, it has been suggested that the taxpayer has a better chance of complying with the \textit{National Carbide} test for nominee corporations, although there are contrary opinions.\footnote{118}{Compare id. at 657 (taxpayer should be successful in accomplishing business objectives of a nominee corporation without incurring adverse tax consequences) \textit{with} \textit{Kurtz} supra note 14, at 85-86 (the agency approach involves too many risks).}

The foregoing difficulties suggest that in order to secure certain business objectives, straw or nominee corporations should be utilized...
only as a last resort. The client should be advised that the likelihood is slight that either corporate form might avoid the additional separate tax burden. If the decision is nonetheless made to use one of these corporate forms, the following recommendations should be carefully considered.\textsuperscript{119}

The initial concern should be compliance with local requirements concerning incorporation and related legal formalities. It is also important that the corporation be adequately financed for its intended purpose. The articles of incorporation should be carefully drafted in order to limit the corporate purposes and powers to either holding, or managing and operating property on behalf of others and not on the corporation's own behalf. Standard boilerplate clauses enabling the corporation to engage in any legal business activity should be avoided. Appropriate agreements should be executed between the parties setting forth the true status of the corporation and its relationship to the beneficial owners of the property. Specific provisions in such agreements should include: 1) that the corporation has no discretionary authority to act without the express written direction of the beneficial owners; 2) that the corporation will terminate the agency or straw relationship upon notice from the beneficial owners and will retransfer legal title to the property to such beneficial owners upon their notice and demand; 3) that the corporation will receive an appropriate fee for services rendered; 4) that all income generated by, and all expenses incurred for the benefit of the property should be paid through the beneficial owners' bank account; and 5) that the only funds deposited into the corporation's account should be its own earned fees, and the only checks drawn on the corporate account should be payment of those non-reimbursable expenses incurred in performing these services.

The importance of the appropriate documents outlining the relationship between the corporation and the beneficial owners of the property cannot be overemphasized. Their existence is critical for a satisfactory resolution should any challenge be made by the federal or state tax authorities. Directors' and shareholders' resolutions expressly detailing the corporation's passive role should be reflected in the appropriate minutes prior to each transaction. All books, records, statements, reports, and returns should evidence in meticulous detail the relationship between the corporation and the beneficial owners, stressing the fact that the latter are the true owners of the property. The corporation's financial statements and tax returns should reflect only the fees it receives for services rendered and the expenses incurred.

\textsuperscript{119} See generally Kronovet, \textit{supra} note 11, at 59–60; Kurtz & Kopp, \textit{supra} note 7, at 656–67; Watts, \textit{supra} note 24, at 883–88.
in performing those services. Similarly, all leases, contracts, and other documents should be executed by the beneficial owners and not by officers or employees of the corporation. Of course, even the most carefully drafted instruments are of no assistance if their provisions do not accurately reflect the facts. Thus, all the concerned parties must comply with the specific provisions of all agreements. Most importantly, the corporation's officers, directors, employees and shareholders should be different from, and independent of, the beneficial owners of the property.

Yet, even though it is believed that adherence to these recommendations will enhance the likelihood of a corporation maintaining straw or nominee status, no assurance can ever be given that the corporation will not be treated as a taxable entity.