



Tax Reduction Letter

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Fisher v. Commissioner

54 T.C. 905 (T.C. 1970)

United States Tax Court.

Filed April 29, 1970.

Maurice Weinstein, for the petitioners.

Denis J. Conlon, for the respondent.

ATKINS, Judge:

The respondent determined deficiencies in income tax for the taxable years 1963, 1964, and 1965 in the respective amounts of \$926.97, \$2,488.38, and \$1,992.53, and additions to tax under section 6653(a) of the Internal Revenue Code of 1954 for the taxable years 1963, 1964, and 1965 in the respective amounts of \$46.35, \$124.42, and \$99.63. Some of the issues, including the issue with respect to the additions to tax, having been conceded by the petitioner, the only issue remaining for determination is whether certain amounts which petitioner purportedly borrowed from the corporation by which he was employed were in fact loans to petitioner or were taxable income to petitioner.

FINDINGS OF FACT

Some of the facts were stipulated and are incorporated herein by this reference. Petitioners Irving D. Fisher and Sylvia Fisher are husband and wife and were such during the taxable years 1963 through 1965, inclusive. At the time of the filing of the petition herein, they were residents of Milwaukee, Wis. They filed their joint Federal income tax returns for the taxable years 1963, 1964, and 1965 with the district director of internal revenue at Milwaukee, Wis. Sylvia Fisher is a party to this proceeding solely by virtue of having signed the joint returns, and as a matter of convenience Irving D. Fisher will hereinafter be referred to as the petitioner.

Since the early 1940's petitioner has been engaged in the business of buying and selling various types of scrap metal. Between 1940 and 1947 he was a partner in a partnership engaged in this business. The other partners were his father, Lewis Fisher, his mother, Dorothy Fisher, his brother, Edward Fisher, and his brother-in-law, Joseph Cohen. In 1947 a corporation, Fisher Iron & Steel Co., was organized and took over the business of the partnership. Petitioner was a stockholder in this corporation, as were the other partners of the partnership. Petitioner was a principal officer of both the partnership and the corporation, buying and selling scrap metal on their behalf.

During the years 1956 and 1957 petitioner, as a managing officer of Fisher Iron & Steel Co., received salaries of \$24,000 and \$27,000, respectively. Between 1952 and 1960, he also made substantial withdrawals from the corporation in addition to his salary.

For its fiscal year ended April 30, 1960, Fisher Iron & Steel Co. sustained a loss of \$15,304.96, which practically depleted its working capital. In view of its financial situation and past operations it was decided to cease operations, after which its only activity consisted of disposing of its merchandise, collecting accounts receivable, and paying liabilities. At about this time substantial Federal tax liabilities were assessed against Fisher Iron & Steel Co. It has continued to remain in existence but has ceased to carry on any active operations. Its balance sheet as of April 30, 1961, showed as its only assets accounts receivable from officers, a building on leased premises which had no value, and \$74.99 in cash. Its liabilities totaled \$11,019.44 which it has never been able to pay. Included among the accounts receivable from officers was an amount of \$24,248.12 due from petitioner. Fisher Iron & Steel Co. has never collected this amount from petitioner.

On July 29, 1960, Steel Trading, Inc. (hereinafter referred to as the corporation), was incorporated. It had an authorized capital stock of 5,000 shares of a par value of \$100 per share. On August 8, 1960, 300 shares were issued to Dorothy Fisher, petitioner's mother, for \$30,000. She paid for this stock by giving checks to the corporation for \$10,200 on August 5, 1960, and \$1,000 on August 11, 1960, and by transferring to it marketable securities valued at \$16,835.13 and U.S. series E savings bonds worth \$2,250, for a total payment of \$30,285.13. The balance of \$285.13 was carried by the corporation as a liability to Dorothy Fisher.

Dorothy Fisher continued to own the 300 shares until her death on August 9, 1961. Pursuant to the provisions of her will, these shares were transferred by her estate to Michael Fisher, petitioner's son, on October 1, 1963. Michael Fisher still owns these 300 shares. None of the other authorized shares was ever issued by the corporation and petitioner does not now own, and never has owned, any of its stock.

On August 2, 1960, the corporation purchased for \$10,240 the assets of Fisher Iron & Steel Co., consisting of machinery, equipment, automobiles, and merchandise. It carried on the same general business of buying and selling scrap steel as had been carried on by Fisher Iron & Steel Co., except that the products were not handled physically. Rather, the trading was conducted on a brokerage basis, the corporation dealing only with shipping documents.

For the fiscal years ended July 31, 1963 through 1968, the directors of the corporation have been petitioner, his wife, and his son, Michael Fisher. Petitioner has continuously been president of the corporation. For fiscal years 1963 through 1967 petitioner's wife has been its vice president, and Michael Fisher has been its secretary-treasurer. Petitioner was its general manager. He ran the business. He had expert knowledge of the scrap steel business and did the buying and selling of the scrap steel. Such success as the corporation had was due to his skill in buying and selling scrap steel. Petitioner's son, Michael, was away from home from 1961 to 1964 attending law school at Madison, Wis. Thereafter he was engaged in the practice of law.

According to the corporation's books, petitioner was paid salaries for the corporation's taxable years ended July 31, 1963, 1964, and 1965, in the respective amounts of \$10,400, \$12,000, and \$12,000. Michael Fisher was paid \$3,000 for each of the corporation's fiscal years ended July 31, 1964 and 1965. During those 3 fiscal years no other business salaries were paid.

For Federal income tax purposes, the corporation reported total sales of about \$215,000 and taxable income of \$3,292.83 for the fiscal year ended July 31, 1963, total sales of about \$365,000 and taxable income of \$13,004.19 for the fiscal year ended July 31, 1964, total sales of about \$244,000 and a net loss of \$1,465.09 for the fiscal year ended July 31, 1965, and total sales of about \$272,000 and taxable income of \$5,843.56 for the fiscal year ended July 31, 1966.

The petitioner had authority to draw checks on the corporation's bank account. In his taxable years 1963, 1964, and 1965, petitioner by checks drawn on such account made total withdrawals from the corporation in the respective amounts of \$2,831.42, \$8,352.08, and \$7,230.47, in addition to his stated salary. The withdrawals were generally in relatively small amounts that were used for petitioner's personal living expenses consisting of payment of pharmacy bills, hotel bills, rent, and other expenses. For example, among the withdrawals in 1964 was an amount of \$1,650 which was used to pay the rent for an apartment in which petitioner resided. The petitioner's son, Michael, knew that petitioner was making withdrawals in excess of his stated salary.

These withdrawals were treated on the corporation's books as accounts receivable due from petitioner. On July 31, 1964, petitioner executed an unsecured demand note to the corporation for \$9,000, bearing interest of 4 percent per year, and on July 31, 1965, he executed a similar note for \$4,500, these amounts thereafter being carried as notes receivable instead of accounts receivable. The corporation continued to carry the excess of the withdrawals over the amount of these notes as accounts receivable. The withdrawals were never deducted by the corporation as expenses. It continued to treat the notes and accounts receivable as assets.

At the time these withdrawals were made Michael Fisher was generally aware of petitioner's financial condition. He knew that the only source of petitioner's income was his salary from the corporation. He also knew of some of his debts, including his outstanding obligations to Fisher Iron & Steel Co. He was also aware of the fact that in 1962 there had been a mortgage foreclosure on petitioner's residence.

On August 17, 1960, notices of Federal tax liens against petitioner were filed in the U.S. District Court, Eastern District of Wisconsin, in amounts totaling \$76,340.19 for the taxable years 1946 through 1950, inclusive, and 1952. In connection with these outstanding tax liabilities the petitioner, on February 12, 1962, submitted to the district director an offer in compromise. On February 12, 1964, he submitted an amended offer, which included such liability and an additional tax liability of about \$1,000 for the taxable years 1958 and 1959. Attached to these were statements showing petitioner's financial condition. The only assets listed are petitioner's furniture values at \$2,000 and cash varying from \$50 to \$200. Petitioner's only listed source of income was his salary from the corporation. The financial statements show that as of July 31, 1960, petitioner was indebted to Fisher Iron & Steel Co. in the amount of \$26,998.12 and that that liability remained unpaid. These statements indicate that the first mortgage on petitioner's residence was foreclosed in 1962 and that he was not able to redeem it.

With the offer in compromise in 1962 and the amended offer in 1964, there were proposed collateral agreements under which a percentage of petitioner's income would be applied in payment of his total outstanding tax liability.

On November 29, 1965, the district director accepted petitioner's offer in compromise of \$10,000 payable as follows: "\$2,000 payable within 30 days from the date of this letter, the balance of \$8,000 payable in quarterly installments of \$400 commencing with March 15, 1966 and thereafter on the 15th day of every third succeeding month until paid in full."

A collateral agreement was also executed which provided that in addition to the payment of the \$10,000 the petitioner, from his annual income during the period 1966 to 1975, would pay on his total tax liability 20 percent of his income exceeding \$6,000 but less than \$8,000, 30 percent exceeding \$8,000 but less than \$10,000, and 50 percent of his annual income in excess of \$10,000.

On March 17, 1958, petitioner was convicted in the U.S. District Court for the Eastern District of Wisconsin, upon his plea of nolo contendere, of the offense of "attempting to evade and defeat Income Tax due and owing to the United States, by filing with the Collector of Internal Revenue a false and fraudulent income tax return, etc. in violation of Section 145(b), Int. Rev. Code; 26 U.S.C., Section 145(b)" for the taxable year 1950.

In their joint income tax returns for the taxable years 1963, 1964, and 1965 the petitioner reported as his only income the amounts of \$10,400, \$12,000, and \$12,000, respectively, received as salary from the corporation.

In the notice of deficiency the respondent recomputed petitioner's taxable income for the taxable years 1963, 1964, and 1965 by including therein, as salary income from the corporation, the withdrawals in the respective amounts of \$2,831.42, \$8,352.08, and \$7,230.47.

There was no bona fide intention on the part of either the petitioner or the corporation that the amounts withdrawn by the petitioner from the corporation in excess of his stated salary in the taxable years 1963, 1964, and 1965 should be repaid and therefore the withdrawals did not give rise to a bona fide debtor-creditor relationship. The amounts withdrawn constituted taxable compensation to the petitioner.

OPINION

The issue presented is whether amounts totaling \$18,413.97 withdrawn by petitioner from the corporation in excess of his stated compensation in 1963, 1964, and 1965 constituted amounts borrowed from the corporation as contended by petitioner or whether they constituted additional compensation to petitioner as determined by the respondent. On brief the respondent contends that there was no bona fide debtor-creditor relationship between petitioner and the corporation and that these withdrawals, irrespective of any formal obligation to repay, are income to the petitioner within the meaning of section 61(a) of the Internal Revenue Code of 1954.[1]

Whether a bona fide debtor-creditor relationship exists is a question of fact to be determined upon a consideration of all the pertinent facts in the case. See *Jack Haber*, 52 T.C. 255, *affd.* (C.A. 5) 422 F. 2d 198 (1970). An essential element is whether there exists a good-faith intent on the part of the recipient of the funds to make repayment and a good-faith intent on the part of the person advancing the funds to enforce repayment. See *Chism's Estate v. Commissioner*, (C.A. 9) 322 F. 2d. 956, *affirming a Memorandum Opinion of this Court*, and *C. M. Gooch Lumber Sales Co.*, 49 T.C. 649.

Here the amounts which the petitioner withdrew from the corporation were recorded in the corporation's books as accounts receivable and thereafter \$13,500 of the withdrawals was made the subject of two unsecured demand notes providing for interest at 4 percent. At the trial the petitioner testified that his son Michael, who owned all the stock of the corporation, knew of the withdrawals and that both he and his son expected the amounts to be repaid when he was able to make repayment. Michael testified that he knew of these withdrawals and that he expected the petitioner would repay these amounts, and that there was no understanding between them that the amounts would not have to be repaid.

The judicial ascertainment of someone's subjective intent or purpose motivating actions on his part is frequently difficult, and his true intention is to be determined not only from the direct testimony as to intent but from a consideration of all the evidence. *Army Times Sales Co.*, 35 T.C. 688, and *American Properties, Inc.*, 28 T.C. 1100, *affd.* (C.A. 9) 262 F. 2d 150. In determining such question an essential consideration is whether under all the particular facts and circumstances there was a reasonable expectation of repayment in light of the economic realities of the situation. *C. M. Gooch Lumber Sales Co.*, *supra*. In *American Properties, Inc.*, *supra*, we stated:

The statement of an interested party of his intention and purpose is not necessarily conclusive. *Helvering v. National Grocery Co.*, 304 U.S. 282, *affirming* 35 B.T.A. 163. In *R. L. Blaffer & Co.*, 37 B.T.A. 851 *affd.* (C.A. 5) 103 F. 2d 487, *certiorari denied* 308 U.S. 576, we stated that one's categorical statement may be of less weight than the facts and circumstances which affect it and that "[t]o be skeptical of the weight to be accorded an interested witness' statement in view of other evidence is not the same as wholly to reject the statement as if it were dishonest." * * *

Upon a consideration of the whole record, it is our conclusion that the withdrawals here in question did not give rise to a bona fide debtor-creditor relationship. At the time of the withdrawals the petitioner was in fact, if not in law, insolvent. Federal tax liens totaling \$76,340.19 were outstanding against him during the years 1963, 1964, and 1965. Since 1960 the petitioner had also been indebted to Fisher Iron & Steel Co. in the amount of \$26,998.12. This obligation has never been discharged. Prior to the withdrawals the mortgage on petitioner's home had been foreclosed and he had been unable to redeem it. The petitioner's assets consisted of only his furniture valued at \$2,000 and an insubstantial amount of cash. His only source of income was the salary that he received from the corporation. The petitioner's son Michael was aware of the petitioner's financial condition. The petitioner testified in effect that he expected to expand the corporation's operations and increase its earnings and thereby enable it to pay him a larger salary out of which he could repay his indebtedness, including the withdrawals in question. However, even if he had been able to obtain an increase in his stated salary, we fail to see how he could have expected to repay his indebtedness, including the withdrawals, from any such increase. In 1962 the petitioner had commenced negotiations with the Internal Revenue Service looking toward a compromise of his large tax liability and was aware that as a condition to a compromise it would be necessary to enter into a collateral agreement requiring that a substantial portion of his future income be applied in payment of the total tax liability over and above any amount agreed upon in compromise. As shown by the facts, the petitioner in 1965 did enter into a compromise agreement and a collateral agreement which provided for such application over a period of 10 years to the extent of 20 percent of income between \$6,000 and \$8,000, 30 percent of income between \$8,000 and \$10,000, and 50 percent of all income in excess of \$10,000. We think the conclusion is inescapable that there was no reasonable expectation, at the time the amounts in question were withdrawn from the corporation, that they

would be repaid. Under all the circumstances it is our conclusion that there was no bona fide intention on the part of either the petitioner or the corporation that the amounts in question should be repaid. It should be added that, insofar as the record shows, no part of the withdrawals has been repaid and that, although the demand notes called for the payment of interest, no interest has ever been paid.

We are not here presented with the question which often arises as to whether a withdrawal from a closely held corporation constitutes a dividend rather than a bona fide loan. All the stock of the corporation was owned by the petitioner's son Michael, and there could be no basis for holding that the petitioner was in receipt of a dividend. However, we have held that where no bona fide indebtedness existed withdrawals by an officer may constitute taxable compensation. See *Jack Haber*, supra. Here the respondent determined that the withdrawals constituted salary income, and on this record we cannot conclude that such determination was erroneous. On the contrary, the evidence supports that determination. Petitioner ran the corporation and he apparently was the only one who rendered services that produced any income for it. Michael apparently devoted little or no time to the corporation, having been away at school for 2 of the years in question and having been occupied in his own profession during the remaining year. Apparently the petitioner was rendering to the corporation substantially the same services as he had rendered to the corporation by which he had been previously employed, which was a corporation owned by himself and his family. During the years 1956 and 1957 he had drawn from that corporation salaries in the respective amounts of \$24,000 and \$27,000. Under the circumstances, we think it reasonable to conclude that the petitioner's services were worth more than his stated salary and that the corporation permitted the petitioner to make withdrawals only in connection with the rendition of such services. There is no intimation that the amounts withdrawn constituted gifts to petitioner from the corporation or from his son Michael. We therefore hold that the withdrawals in question constituted taxable compensation to petitioner.

Decision will be entered for the respondent.

[1] Sec. 61(a) of the Internal Revenue Code of 1954 states:

SEC. 61. GROSS INCOME DEFINED.

(a) GENERAL DEFINITION. — Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items; * * *