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Tax Aspects of the Nominee Corporation: Roccaforte v. Commissioner of Internal Revenue

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NOTES AND COMMENTS

TAX ASPECTS OF THE NOMINEE CORPORATION: ROCCAForte v. COMMISSIONER OF INTERNAL REVENUE

I. INTRODUCTION

When a property owner uses a nominee corporation to hold title to property, the most significant tax question is whether the income generated by the property will be taxed to the corporation or to the beneficial owners of the property. The tax problem presented by the use of a nominee corporation is the structural problem of ownership of the property. Generally, it is the "owner" of the property who is entitled to the tax benefits and burdens of the property. When using a nominee corporation the taxpayer creates ownership problems by splitting ownership between the nominee corporation and the taxpayer. The nominee corporation holds naked legal title to property, while the taxpayer retains the tax consequences of the property.

The author thanks Professor Ljubomir Nacev for suggesting this topic and reviewing the manuscript.

1. A nominee is one who holds record title as an agent for the beneficial owner of property. The terms “nominee corporation,” “agent corporation,” “shell corporation,” or “straw corporation” typically refer to a corporation that is used for a limited purpose and will, hopefully, not be taxed on the income generated by the property to which it holds title. An individual, rather than a corporation, may serve as a nominee, however certain problems exist. One author, using the term “straw” rather than nominee, explained it as follows:

While an individual may serve as a straw, an individual straw presents these problems:
1. He is not immortal and, therefore, while he avoids title delays on the death of a beneficial owner, his own death may cause problems.
2. Although he may protect the beneficial owner from contract liability, he may incur it himself. Bachelorhood is also desirable, otherwise marital difficulties can cause considerable title problems.

These problems are eliminated if the straw is a corporation. A corporation is immortal. Separate straws can be used for each piece of property, thereby insulating each property from the liabilities of others. A corporation can be kept impecunious. Its officers can execute all documents, and officers can easily be changed if necessary.

Kurtz & Kopp, Taxability of Straw Corporations in Real Estate Transactions, 22 Tax Law. 647, 647-48 (1969). For an example of an individual serving as nominee see Estate of Smith, 36 T.C.M. 1770 (1977) (individual served as nominee of his wholly-owned corporation).


3. Id.
beneficial ownership. Because the Internal Revenue Code imposes a tax upon corporate income, the question is whether the corporation or the beneficial owner will be taxed on the income from the property. The beneficial owner usually asserts that the income should not be taxed to the corporation, but should be passed through to the beneficial owner. However, the structural problem remains; the corporation holds title to the property and therefore the income. The income, then, will be taxed once to the corporation and once when it is passed to the taxpayer. To avoid the corporate tax, the taxpayer must argue that the taxpayer, rather than the corporation owns the property. However, the taxpayer has chosen a corporation as the form in which to do business and, having chosen, is usually bound by the decision.

Taxpayers attempting to use nominee corporations have asserted two theories which allow the income to be attributed to the beneficial property owners rather than the corporation: the disregard theory and the nominee theory. Under the disregard theory the property owners, usually the shareholders, attempt to completely disregard the corporation for tax purposes. The disregard theory is often applied where the property owners wish to have their wholly-owned corporation disregarded for tax purposes. Under the nominee theory the corporation is recognized for tax purposes, but income from property to which it holds naked legal title is taxed to the beneficial owners of the property. The corporation asserts that the income is not taxable to it because the corporation has acted merely as the nominee of the property owners.

In Roccaforte v. Commissioner the Tax Court, and later the Fifth

4. Splitting of ownership is common, as in the law of trusts. However, the Internal Revenue Code is not equipped to deal with the split in ownership when a nominee corporation is created.

5. See Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 149 (1974) ("while the taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, and may not enjoy the benefit of some other route he might have chosen to follow but did not") (citations omitted); Higgins v. Smith, 308 U.S. 473, 477 (1940) ("having elected to do some business as a corporation, [the taxpayer] must accept the tax disadvantages").

6. Miller, The Nominee Conundrum: The Live Dummy Is Dead, but the Dead Dummy Should Live, 34 TAX L. REV. 213, 223 (1979) [hereinafter cited as Miller]. Miller's article presents an excellent analysis of the forms of ownership of dummy corporations. The identity of ownership is extremely important for tax purposes. Miller suggests the following distinctions: (1) record ownership; (2) title ownership; (3) substantive law ownership, i.e., an ownership claim enforceable in court; and (4) common speech ownership, or what a layperson would term ownership. Id. at 216-18. Although finer distinctions in types of ownership may be drawn, the terms "record title" and "beneficial ownership" will be used for simplicity when discussing Roccaforte v. Commissioner, 77 T.C. 263 (1981), rev'd, 708 F.2d 986 (5th Cir. 1983).

7. Miller at 221-23.

Circuit Court of Appeals, considered the application of these two theories. The Tax Court found that the corporation in *Roccaforte* was a true, nontaxable corporate nominee. The Fifth Circuit reversed the Tax Court and held that the corporation would be taxed on the income generated by the property which it held.

One year after *Roccaforte* the Tax Court considered the same issue in *Ourisman v. Commissioner*. The Tax Court found that the corporation in *Ourisman* was a true, nontaxable nominee. The Commissioner appealed to the Fourth Circuit Court of Appeals, and *Ourisman* was vacated and remanded.

This Note examines the current disagreement between the Tax Court and the Fourth and Fifth Courts of Appeals in light of *Roccaforte* and *Ourisman*. The purpose of this Note is to alert the practitioner to factors which determine whether a corporation is a true nominee.

### II. THE *ROCCAFORTE* TAX ISSUE

The taxpayers in *Roccaforte* formed a partnership to develop an apartment complex. To avoid state usury laws the partners formed a corporation to hold record title to the property. By written agreement, the corporation held only naked legal title to the property, while the ben-

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9. *Roccaforte*, 77 T.C. at 287-88. The court stated: "We believe that the entire substance of the arrangement was one of an agency relationship, and even the form (outside of the corporation's primary liability on the mortgages) indicated the agency relationship that was intended . . . [W]e will respect the status of the corporation as an agent of the partnership." *Id.* (citations omitted).

10. 708 F.2d at 990.


12. *Id.* at 188. The *Ourisman* court relied on the *Roccaforte* Tax Court decision in holding that "the corporation was the agent of the partnership and that the losses generated by the project are attributable to the partnership and hence to the partners." *Id.*

13. 760 F.2d 541 (4th Cir. 1985). The Fourth Circuit decided *Frink v. Commissioner*, 798 F.2d 106 (4th Cir. 1986), on August 8, 1986. In *Frink*, the Fourth Circuit reversed the Tax Court's finding that a corporation created to avoid Mississippi usury laws was the agent of a real estate partnership.


15. 77 T.C. at 268.
eficial ownership of the property remained in the investors.\textsuperscript{16}

To finance development of the complex the landowners actively sought investors. The investors and landowners formed the “Glenmore Manor Apartments Partnership” and began seeking temporary and permanent financing for the project. The partnership obtained letters of commitment for interim financing and for permanent financing. The permanent financing, however, was contingent upon the project being structured through a corporation.\textsuperscript{17}

As required by the lender, the partnership formed a corporation to receive the permanent financing. On the date of incorporation of Glenmore, Inc., the corporation and all of the partners executed a nominee agreement in which Glenmore, Inc. agreed to act as nominee for the partnership.\textsuperscript{18} The nominee agreement gave Glenmore, Inc. the “authority to hold legal title to the real estate and to act with respect to the property in accordance with the owners' written authorization. . . .”\textsuperscript{19} The agreement also acknowledged that the beneficial or equitable interest in the property would remain in the partners.\textsuperscript{20} The corporation was not to receive any fee for acting as nominee for the partnership, but it was to receive reimbursement for actual expenses incurred in performing services for the partnership.\textsuperscript{21}

\begin{footnotes}
\item[16.] \textit{Id.}
\item[17.] \textit{Id.} at 266. The agreement provided that either a general partnership, a limited partnership, or a nominee corporation would be the vehicle for development of the project. \textit{Id.}
\item[18.] Roccaforte, 77 T.C. at 267.
\item[19.] \textit{Id.} at 268. The parties agreed that Glenmore, Inc. was to hold nothing more than naked legal title. According to the agreement and the intent of the partners, the equitable ownership never vested in the corporation. In part, the agreement stated that:
\begin{quote}
The nominee shall have no authority to and shall not take any action, sign any document, make any decisions, or do or perform any act whatsoever pertaining to owners' property, which involves the discretion or judgment of nominee, but shall act, at times, only upon written consent or authorization of owners expressed and provided in this agreement or any subsequent direction or authorization.
\end{quote}
\item[20.] \textit{Id.} at 268. The splitting of legal and equitable title is central to the nominee theory. The corporation holds only naked legal title to the property while the property owners retain equitable title.
\item[21.] \textit{Id.} Because the corporation performed services for its shareholders for no fee, the Fifth
\end{footnotes}
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The apartment complex had financial difficulties during subsequent years, creating net operating losses. After the shareholders claimed losses from the property on their tax returns, the Commissioner disallowed the losses, stating that the losses belonged to the corporation. To prevent the disallowance the shareholders petitioned the Tax Court.

The Commissioner argued that the losses belonged to the corporation because it owned the property in question. Therefore, the Commissioner contended, the taxpayers had incorrectly claimed the losses on their individual tax returns. The taxpayers argued that the corporation was a true, non-taxable nominee and that they could properly claim the losses.

The Tax Court determined that the corporation was a true, non-taxable nominee for the investors and allowed the losses to pass through the corporation to the shareholders. On appeal, the Fifth Circuit determined that the corporation was not a true nominee and reversed the Tax Court. Both courts examined two different views of nominee corporations: the disregard theory and the nominee theory. Because the courts reached opposite conclusions, a review of these theories is necessary to an understanding of the decisions.

III. HISTORICAL DEVELOPMENT OF THE NOMINEE THEORIES

A. The Disregard Theory

Under the disregard theory, the corporate entity is ignored for tax purposes and corporate income is passed through to the shareholders, bypassing the corporate income tax. Disregard of the corporate entity for tax purposes has usually come at the behest of the Commissioner of Internal Revenue to prevent some fraud by the shareholder. Taxpayers rarely argue for disregard of a corporation, but the nominee corporation is an exception to this rule. The Internal Revenue Service has, of course,
encouraged treatment of the nominee corporation as a separate entity and as the taxable owner of the property.

1. Moline Properties and the Business Activity Test

Although many cases dealing with nominee corporations were decided before 1943, the United States Supreme Court decision in *Moline Properties, Inc. v. Commissioner* is the controlling case concerning the disregard theory. In *Moline*, the corporation sought to have its existence completely ignored for tax purposes and to have the gain on sales of real property to which it held naked record title treated as the gain of its sole shareholder. The Supreme Court created a business activity test and determined that Moline Properties could not be disregarded. This business activity test remains the rule of law today when a taxpayer attempts to disregard a corporation.

The taxpayer organized Moline Properties, Inc. in 1928 at the suggestion of the second mortgagee of real estate owned by the taxpayer. Under the mortgagee's plan, the taxpayer conveyed the property and the mortgages to the corporation in exchange for all of the stock of the corporation. The taxpayer then transferred the stock to a voting trustee. The taxpayer remained at all times the sole shareholder of Moline Properties, Inc.

From 1928 until 1933, when the taxpayer paid the mortgage, a voting trustee controlled Moline Properties. During those five years, the corporation had only limited activity. It assumed a financial obligation that the taxpayer owed to the original creditor. It also defended a condemnation proceeding and instituted a suit to remove restrictions imposed on the property by a prior deed.

Even after the taxpayer regained control of the corporation its activity was minimal. The corporation's only activity consisted of the sale of the property in three parcels in 1934, 1935, and 1936. Although the tax-

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27. *See* Higgins v. Smith, 308 U.S. 473 (1940); Burnet v. Commonwealth Improvement Co., 287 U.S. 415 (1932); Palcar Real Estate Co. v. Commissioner, 131 F.2d 210 (8th Cir. 1942); United States v. Brager Bldg. & Land Corp., 124 F.2d 349 (4th Cir. 1941); Sheldon Bldg. Corp. v. Commissioner, 118 F.2d 835 (7th Cir. 1941); North Jersey Title Ins. Co. v. Commissioner, 84 F.2d 898 (3d Cir. 1936); 112 West 59th St. Corp. v. Helvering, 68 F.2d 397 (D.C. Cir. 1933); Abrams Sons' Realty Corp. v. Commissioner, 40 B.T.A. 653 (1939); Greenleaf Textile Corp. v. Commissioner, 26 B.T.A. 737 (1932), aff'd mem., 65 F.2d 1017 (2d Cir. 1933); Moro Realty Holding Corp. v. Commissioner, 25 B.T.A. 1135 (1932), aff'd mem., 65 F.2d 1013 (2d Cir. 1933); Stewart Forshay v. Commissioner, 25 B.T.A. 537 (1930).


29. *Id.* at 436.
payer did not liquidate the corporation, the corporation had no activity after the last sale in 1936.

In its opinion, the Supreme Court never directly discussed whether Moline Properties, Inc. or the taxpayer was the owner of the property, but instead it addressed whether the corporation was an entity which had a separate existence for tax purposes apart from its owner. The Court rejected Moline's contention that its existence should be ignored and formulated a "business activity" test to determine whether a corporation can be ignored for tax purposes. The Court stated that as long as the purpose of the corporation is equivalent to a business activity, the existence of the corporation will not be ignored for tax purposes. Because Moline existed to hold title to real estate, the Court refused to ignore its existence and determined that the corporation existed to conduct a valid business activity.

Moline also attempted to escape the tax by claiming that it was the taxpayer's agent. Moline based this claim solely on the taxpayer's 100 percent ownership of the corporate stock. The Court rejected this argument because no indication of agency existed other than the normal relationship between a corporation and its shareholder.

2. Post-Moline Business Activity Cases

The business activity test created by the Court in Moline has been widely applied in other tax cases. Post-Moline cases interpret Moline as providing that either a business purpose for the corporation's existence or a business activity by the corporation will result in recognition for tax

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30. Id. passim.
31. Id. at 438-39.
32. Id. The Court stated:
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.

Id. (citations omitted).
33. Id. at 439-40.
34. Id. The Court noted, "There was no actual contract of agency, nor the usual incidents of an agency relationship." Id.
purposes. The trend is clearly toward recognition of a corporation as a separate entity if the corporation exists for any business purpose or conducts any business activity.

Courts have not read Moline to mean that a valid state-law corporation can never be disregarded for tax purposes. The case of Paymer v. Commissioner illustrates the difficulties that sometimes come from following the Moline business activity approach. The Paymer court held that a single financing transaction met the Moline business activity test and prevented the disregard of the corporation for tax purposes.

In Paymer, to prevent attachment of the property by creditors, a partnership transferred two parcels of income-producing real estate to two newly organized corporations. The two partners each received one-half interest in the two corporations. The organizing minutes of the corporations expressly stated that the corporations received the properties as mere title holders and that beneficial interest remained in the two partners. After the transfer the corporations had no further meetings and had neither offices nor bank accounts.

Although the two corporations were virtually identical, the court disregarded one corporation for tax purposes, but not the other. Six years after incorporation, one of the corporations, Raymep, obtained a

37. See, e.g., Britt v. United States, 431 F.2d 227, 237 (5th Cir. 1970) ("Business activity is required for recognition of the corporation as a separate taxable entity; the activity may be minimal."); Harrison Property Mgmt. Co. v. United States, 475 F.2d 623, 626 (Ct. Cl. 1973), cert. denied, 414 U.S. 1130, reh'g denied, 415 U.S. 952 (1974) (holding that a corporation will not be ignored "if it is more than a pure sham and was created or acts for some business end"); Strong v. Commissioner, 66 T.C. 12, 24 (1976) (corporate activity must be "extremely low" for the corporation to be ignored).
38. Paymer v. Commissioner, 150 F.2d 334 (2d Cir. 1945). See also Red Carpet Car Wash, Inc. v. Commissioner, 73 T.C. 676 (1980); Minnesota Farm Bureau Securities, Inc. v. United States, 63-1 USTC ¶ 9138 (D.C. Minn. 1962).
39. 150 F.2d 334 (2d Cir. 1945). The court stated: "We think [the corporation] 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." Id. at 336.
40. Id.
41. Id.
42. Id. at 336. The corporate minutes stated:

The said conveyance was and is made with the express understanding that the corporation is only to hold title to the property, the beneficial interest and profits to be in the individual stockholders and the management and control of the property to be exclusively theirs. It is understood and agreed that this corporation was only organized for the convenience of the share-holders in the management thereof.

43. Id. at 336.
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loan secured by an assignment of all of the lessor's rights in two leases on the property. Raymep expressly covenanted that it was the sole lessor of the property. This single transaction was enough to satisfy the business activity test and prevented the disregard of Raymep. 44

The other corporation, Westrich, had no activity after it took title to the real estate. The Second Circuit held that Westrich was a "passive dummy" that should be disregarded for tax purposes. 45 The court ignored the minutes of both corporations which stated that the corporations were taking only record title to the property and that the beneficial ownership was to remain in the stockholders. 46

The distinction the court drew between Raymep and Westrich is an illogical application of the Moline business activity test. Functionally the two corporations were the same — they both served the stockholders by shielding assets from creditors. The single financing transaction by Raymep does not warrant different tax treatment because it did not affect the functioning of the corporation.

The distinction between the two corporations would be academic in a case today. Later courts have held that even a business purpose will meet the Moline test. Today, both corporations would be recognized because shielding assets from creditors is certainly a business purpose.

B. The Nominee Theory

Even though Moline drastically limited the use of the disregard theory, the nominee theory remains an alternative. Under the nominee theory, the tax impact upon the shareholder and the corporation is the same as the tax impact under the disregard theory. Under the nominee theory, the corporation is recognized as a separate taxable entity, but corporate

44. Id. at 337.
45. Id. The corporate minutes did not appear to be mere self-serving documents. The activity of the corporations was consistent with the purpose stated in minutes. In its discussion of the difference between the two corporations, the court stated:

The petitioners now contend that Raymep and Westrich were mere 'dummies' which held legal title to property owned by the two individual petitioners and that both corporations are to be disregarded for income tax purposes. As a general rule a corporation is a taxpayer separate and distinct from its stockholders . . . . [T]he treasury may disregard the separate corporate entity where it serves but as a shield against taxation and treat the one who actually may take the benefit of the income as the owner of the property which produces it and tax him accordingly . . . . 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 . . . . It was but a sham to be disregarded for tax purposes.

Id. at 336-37 (citations omitted).
46. Id. at 336.
income attributable to the property flows through the corporation to be included in the net income of the taxpayer. The income is not attributed to the corporation because the corporation has merely acted as a nominee for the beneficial owner of the property. In National Carbide Corporation v. Commissioner the Supreme Court created six tests to determine whether a corporation is a true nominee of the beneficial owners of the property. Instead of using the term nominee the Court used the term "agent," but the concept is still the same.

In National Carbide the Air Reduction Corporation (Airco) owned four operating subsidiaries. Airco financed the operations of three of these subsidiaries under agreements which provided that the subsidiaries were employed as its agents. In the agreements, Airco promised to provide the subsidiaries with certain assets, executive management, and working capital. The subsidiaries were to pay to Airco all profits in excess of a six percent return on their corporate stock. The subsidiaries held only record title to the assets. Airco retained the beneficial ownership of the property.

Airco argued that the subsidiaries were merely acting as its agents and that it, not the subsidiaries, was taxable on the amount in excess of the six percent on the subsidiaries' stock. The Commissioner contended that the subsidiaries were taxable on all of the income. In rejecting Airco's argument, the Court determined that the relationship between Airco and its subsidiaries was merely the result of the shareholder-corporation relationship and that the subsidiaries were not Airco's non-taxable agents.

When reviewing Airco's relationship with its subsidiaries, the Court found that "[t]he entire earnings of [the subsidiaries] except for trifling amounts, [were] turned over to Airco not because [Airco] could command this income if [the subsidiaries] were owned by third persons," but because Airco dominated the subsidiaries. Airco had not acted at arm's length with the subsidiaries. The subsidiaries would have commanded a much greater fee for the services performed for Airco if they

47. 336 U.S. 422 (1949).
48. Id. at 437.
49. Id. at 424.
50. Id. at 424-25 n.1.
51. Id. at 425.
52. Id. at 426.
53. Id.
54. Id. at 433.
55. Id. at 438.
had been independent corporations. Although Airco received inexpensive services from its subsidiaries, the small fees prevented the tax treatment that Airco had expected.

However, the opinion did not eliminate the possibility that a corporation could avoid taxation by acting as the nominee of another. The Court said: “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 therefor.” The Court stated that the following factors must be considered to determine whether the corporation is taxable on income generated by the property for which it acts as agent:

1. whether the corporation operates in the name and for the account of the principal;
2. binds the principal by its actions;
3. transmits money received to the principal;
4. 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. The court went on to say that
5. 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. [6] Its business purpose must be carrying on the normal activities of an agent.

This language became the six factors for determining whether a corporation is a valid nominee corporation.

IV. ANALYSIS OF ROCCAFORTE v. COMMISSIONER

A. The Tax Court Decision

In Roccaforte v. Commissioner the Tax Court reviewed the claims of individuals who alleged that a nominee corporation had acted as their agent with respect to property beneficially owned by them. The court reviewed the Supreme Court opinion in National Carbide and the six factors that the Court suggested for determining whether a corporate agency exists.

The Tax Court began its analysis in Roccaforte with a review of the

56. Id. at 437.
57. Id. (emphasis added). It must be very clear that the taxpayer and the nominee are dealing at arm’s length to ensure the tax treatment desired. Because of the uncertainties caused by Roccaforte and Ourisman in the nominee corporation arena, one author has emphasized the importance of using an uncontrolled agent. See Falk, Nominees, Dummies and Agents: Is It Time for the Supreme Court to Take Another Look?, 63 TAXES 725, 729 (1985).
59. Id.
corporate entity doctrine and its relation to the ability of a taxpayer to disregard the corporate entity and pass income and expenses through a corporation to the beneficial owner of property. The court reviewed the doctrine even though the taxpayers had conceded that the corporation should not be disregarded. The court noted that the Supreme Court had reaffirmed the corporate entity doctrine in Moline Properties which precluded the ability of most taxpayers to use the disregard theory. This review served the court by quashing any notion that the court was attempting to disregard the corporation and it allowed the court to present its analysis of the National Carbide tests.

The Tax Court determined that an agency relationship existed between Glenmore, Inc. and the partnership because Glenmore, Inc. met four of the six National Carbide factors. Glenmore, Inc. operated in the name of the partnership; the actions of Glenmore, Inc. bound the partnership; income received by Glenmore, Inc. was attributable to assets of the partnership; and, the activities of Glenmore, Inc. were consistent with the normal duties of an agent. The Tax Court did not consider the third factor, whether the corporation had transmitted the monies that it received to the partnership, because it was not applicable due to the ongoing nature of operating an apartment complex.

60. The corporate entity doctrine simply recognized that the corporation has a separate legal existence from its shareholder.
61. Id.
62. Id. at 279. Despite the fact that Moline is applicable to the facts in Roccaforte, the Tax Court was careful to avoid indiscriminate application of Moline. The court stated: The Moline decision is not conclusive with respect to the facts in the instant case. Factual differences between the two require us to consider further the agency argument. For instance, in Moline, there was neither an agency contract nor did any of the usual incidents of an agency relationship exist . . . . However, in the instant case, the agency issue is presented clearly.
Id. (citations omitted).
63. 77 T.C. at 292-93. Even after the court explained that it was not attempting to disregard the corporation, the dissent still appeared to confuse the disregard theory with the nominee theory. Id. (Nims, J., dissenting). The dissent stated: "I find it inappropriate to here sanction an end-run around Moline Properties and its holding that so long as the purpose of incorporation 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." Id. at 291-92. Judge Nims' dissent was misplaced because the Tax Court clearly was not disregarding the corporation. The Moline business activity test cited by Nims is applicable only when the corporation is to be disregarded as a separate taxable entity. The Tax Court's holding that the corporation was the nominee of the beneficial owners is inconsistent with Nims' dissent. The Tax Court could not have found that the corporation was a nominee unless it also recognized that the corporation had a separate existence.
64. Id. at 283-88.
65. Id. at 283-85.
66. Id. at 285-86.
67. Id. at 286.
68. Id. at 287.
The critical point in the analysis, and the point upon which the Tax Court was later reversed, was that the Tax Court found Glenmore, Inc. failed the fifth factor. The agency of Glenmore, Inc. depended upon the partner’s ownership of the corporation. The partnership clearly controlled and dominated the corporation. However, because an agent is always controlled by the principal, that factor alone should not be determinative of whether a true corporate agency exists for tax purposes. The investors in the partnership were also the shareholders in the corporation. Still, the partners’ ownership of the corporation did not prevent Glenmore, Inc. from meeting the fifth test. It was the manner in which the partners dealt with the corporation that made the agency dependent on ownership by the partners.

The Tax Court noted that the partnership had not dealt with the corporation at arm’s length. Agents do not normally perform services gratuitously for their principals. Because the partners had not compensated Glenmore, Inc. for the services that it had performed, the dealings between the two were not at arm’s length. The partners presented no explanation for the free services other than the ownership of the corporation. Thus, the court concluded that Glenmore, Inc. served as agent for the partners only because the partners owned it.

Although the corporation failed to meet the fifth part of the nominee/agency test, the Tax Court determined that the corporation was a true non-taxable nominee because the “entire substance” of the arrangement was one of an agency relationship. The dealings of the corporation with outside parties indicated the corporation intended that an agency relationship exist between the corporation and the partnership. All of the parties that dealt with Glenmore, Inc. were aware that it was merely acting as agent for the partnership. The court also noted that the partners remained primarily liable on all of the mortgages and liabilities arising out of the apartment project and did not avail themselves of the limited liability of the corporate form.

69. Id. at 286-87.
70. Id. at 287.
71. Id. at 288. The taxpayers in Roccaforte “were careful to endow the corporation with specific indicia of an agency relationship.” Id. at 287. Among the factors which the Tax Court considered was that the investors represented to creditors that they, rather than the corporation, were the true obligors. Id.
72. Id. at 287.
73. Id.
74. Id. 287-88.
75. Id.
In deciding that the corporation was the non-taxable agent/nominee of the partnership, the Tax Court considered the reason that the partners had formed the corporation. The shareholders had incorporated only to comply with the state’s usury laws. The partners claimed none of the traditional benefits available to a corporate shareholder and had not formed the corporation as a scheme to avoid taxes or liability.

By considering these additional factors, the Tax Court added an additional step in the National Carbide analysis; the court looked at the transaction as a whole. In substance, the partners were the economic owners of the property with all of the risks and benefits of ownership. The relationship between Glenmore, Inc. and the partners appeared as if the partners intended a valid agency to exist. Because the transaction as a whole seemed to be a proper agency relationship, the court recognized the agency relationship which the partners had intended. The court noted that when the indicia of agency are present and the corporation is formed solely to comply with state usury laws, it would respect the status of the corporation as agent of the beneficial owners of the property.

B. Roccaforte in the Fifth Circuit

On appeal by the Commissioner, the Fifth Circuit reversed the decision of the Tax Court in Roccaforte. Although the Tax Court looked at the substance of the entire relationship, the Fifth Circuit determined that before a corporation can be considered a “true, nontaxable agent” of its principal, it must meet the fifth and sixth factors of the National Carbide test. The Fifth Circuit found the fifth factor, that relations with the corporation’s principal must not be dependent on the fact that it is owned by the principal, and the sixth factor, that the business purpose of the corporation must be the carrying on of the normal duties of an agent, were mandatory. The Tax Court had already determined that the agency relationship between the corporation and its principal was dependent upon the ownership by the principal. All that remained for the Fifth Circuit to do was to determine whether the Tax Court had properly applied the law.

The Fifth Circuit Court noted that the Tax Court had interjected a new idea into the nominee/agent corporation arena by treating all six of

76. See supra note 14.
77. 708 F.2d 986.
78. 77 T.C. at 287.
the factors as having equal weight. In *National Carbide*, the Supreme Court stated that "[i]f 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 . . . [and its] business purpose must be the carrying on of the normal duties of an agent." The Fifth Circuit interpreted this language as making these factors mandatory. By treating all of the factors equally and then looking at the "entire substance" of the transaction, the Tax Court had inserted a new factor of chance into an already confusing area.

The Fifth Circuit rejected the notion of looking at the "entire substance" of the transaction when it determined that the fifth and sixth factors were mandatory. The court based its holding on prior case law. In *Collins v. United States*, individuals formed a corporation for the same purpose as in *Roccaforte*, to avoid state usury laws. The Fifth Circuit noted that in *Collins* it had affirmed the decision of the district court when the district court did not even mention the first four tests of *National Carbide*. Similarly, in *Jones v. Commissioner*, the Fifth Circuit determined no corporate agency existed when the taxpayers failed to produce evidence on the fifth and sixth "crucial" factors. In the words of the *Roccaforte* court, "[t]he fifth and sixth conditions of *National Carbide* are ‘crucial’ precisely because they are mandatory."

While consistency in following the interpretation of prior Fifth Circuit cases was an adequate reason for the Fifth Circuit to overturn the Tax Court in *Roccaforte*, the final comments of the court provide the true rationale for its holding. The court noted that its holding was based on strong policy considerations concerning closely held corporations. The

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79. *Roccaforte*, 708 F.2d at 989. The court stated, "While we agree with the Tax Court's factual determination as to each separate condition, we are forced to reject both its overall assessment of their relative weights, and its conclusion that GMA was a true corporate agent as that term is defined in *National Carbide*." *Id.*
80. 336 U.S. at 437 (emphasis added).
81. *Roccaforte*, 708 F.2d at 989.
82. *Id.* at 990.
84. *Id.* at 18-19.
85. *Roccaforte*, 708 F.2d at 990.
87. *Id.* at 754-55.
88. 708 F.2d at 990. The facts of *Collins* are very similar to those of *Roccaforte* and *Ourisman*. In *Collins*, a corporation was formed to hold title to an apartment complex. The corporation became entitled to depreciation allowances, which were claimed by the individual investors. Note, however, that the facts will never be exactly the same. One court has observed that "it is highly unlikely that in any two situations the activities and conduct in the name of the corporation will be the same . . . ." *Tomlinson v. Miles*, 316 F.2d 710, 714 (5th Cir. 1963).
89. 708 F.2d at 990.
Fifth Circuit noted that, while *Moline* established that a closely held corporation has a separate taxable existence, such corporations frequently function as agents for their owners. The shareholders should not be allowed to rely on characteristics common to all corporations in order to avoid income tax. The court reasoned that to prevent abuse and to maintain the integrity of the corporate entity, more than the normal attributes of agency must be shown. The court decided that the "mandatory" fifth factor concerning relations with the principal prevents abuse of the corporate entity and helps to maintain its integrity.

C. The Tax Court After Roccaforte

One year after *Roccaforte*, in *Ourisman v. Commissioner*, the Tax Court reaffirmed its position on the *National Carbide* indicia of agency. The Tax Court disagreed with the analysis of the Fifth Circuit in *Roccaforte* interpreting the fifth factor as mandatory. On facts which were almost indistinguishable from *Roccaforte*, the court determined that the *Ourisman* corporation was a non-taxable agent for its principals. As in *Roccaforte*, the decision of the Tax Court was overruled; this time the Tax Court decision was vacated by the Fourth Circuit Court of Appeals.

The Tax Court applied the *National Carbide* factors to the facts of *Ourisman* as if they were of equal weight, just as it had in *Roccaforte*. As in *Roccaforte*, the court found that the corporation met all of the factors except the fifth, because the stockholders of the nominee corporation were also the beneficial owners of the property. The court determined that the corporation was the non-taxable agent/nominee of the beneficial owners because a majority of the indicia of corporate agency was present.

The Tax Court disagreed with the way the Fifth Circuit had interpreted *National Carbide*, holding that *National Carbide* did not create a "factor checklist" and it did not believe the fifth factor was

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90. Id.
92. Id. at 185.
93. Id. at 187.
94. 760 F.2d at 549.
95. 82 T.C. at 181-85.
96. Because venue for appeal of *Ourisman* was in either the Fourth Circuit or the District of Columbia Circuit, the Tax Court was not required to follow the decision of the Fifth Circuit in *Roccaforte*. Id. at 185. See Golsen v. Commissioner, 54 T.C. 742 (1970), aff'd, 445 F.2d 985 (10th Cir.), cert. denied, 404 U.S. 940 (1971).
97. 82 T.C. at 187.
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mandatory. The Tax Court also found nothing in *National Carbide* to indicate that the United States Supreme Court intended that the fifth factor deny a corporation the status of agent/nominee merely because the beneficial owners of the property were also the stockholders of the corporation. The Tax Court stated that the fifth factor simply affirmed the *Moline Properties* principle that the agency relationship must be proved by evidence other than the control which shareholders automatically possess over the corporation. In *Ourisman*, the taxpayers had presented other evidence sufficient to convince the Tax Court that the corporation was the agent of the beneficial owners. As in *Roccaforte*, the court noted that all parties to the transaction were aware that the corporation was acting as a nominee for the property owners and that the owners had not used the corporation to avoid the responsibilities of property ownership.

Even though both the Fourth and Fifth Circuits focused on the lack of compensation to the corporation, the Tax Court was not concerned with the lack of compensation and refused to treat the corporation as the taxable owner of the property. The Fifth Circuit saw the lack of compensation from the stockholders as proof of the lack of arm's length dealing between the corporation and the property owners. According to the Fifth Circuit the lack of arm's length dealing was the main indication that the corporation could not be considered a non-taxable agent.

The Fourth Circuit vacated *Ourisman* on the same basis as the Fifth Circuit reversed *Roccaforte*. It gave a literal construction to the language in *National Carbide*. The Fourth Circuit also found that the fifth factor was mandatory. As long as the agency relationship depended upon control of the agent by the principal, the corporation was not considered the non-taxable agent of the taxpayer, regardless of the presence of other indicia of agency.

The court noted that it would be difficult for controlled corporations to satisfy the independence requirement, but that it would not be impossible. The main concern of the court was that the relationship be at

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98. *Id.* at 185.
99. *Id.* at 186.
100. *Id.*
101. *Id.*
102. *Id.* at 173.
103. *Id.*
104. *Id.* at 186-87.
106. *Id.* at 548.
arm's length. The court did not specify the amount of evidence required to make a showing that the agency was at arm's length, but it did provide a list of criteria that it considered important. One item is the identity of ownership interest of the principal and agent. The remaining factors are whether the articles of incorporation or the first corporate resolution specifically limits the corporate purpose to acting only as an agent for third parties, whether the agent acts for more than one principal, whether the agent has entered into a written agency contract which provides for specific duties and for a reasonable fee, and whether the agent actually collects a reasonable fee. As a matter of law, the court was unable to determine that any of these factors were present and it held that the Ourisman corporation was a not a non-taxable agent.

These factors reflect concern by the courts over preserving the integrity of the corporate entity doctrine. In order to preserve the doctrine of corporate entity, the courts have required the taxpayer to make a greater showing of agency than that which usually exists between a corporation and its shareholders. The courts will not give a non-taxable effect to an agency which is merely consistent with the normal relationship between the shareholder and corporation. If this greater showing is not required, the corporate entity becomes only the pocketbook of the shareholder.

The latest decision regarding nominee corporations is Frink v. Commissioner. Because there was incomplete identity of ownership of the nominee corporation and a real estate partnership which was the beneficial property owner, the Tax Court distinguished Frink from Ourisman. On appeal, the Fourth Circuit reversed the Tax Court. The Fourth Circuit found that the lack of identity of ownership interests provided an insufficient basis for distinguishing Ourisman, and that “[t]he

107. Id.
108. The Fifth Circuit held in Moncrief v. United States, 730 F.2d 276 (5th Cir. 1984), that a corporation was the true non-taxable agent of the principal when only twenty-five percent of the corporation was owned by the principal.
109. The articles of incorporation of the corporations in Roccaforte and Ourisman allowed the corporations to engage in any lawful activity. Roccaforte, 77 T.C. at 267; Ourisman, 82 T.C. at 173-74. Although the function of the corporation was more narrowly delineated in Ourisman, than in Roccaforte, the corporation could engage in any business activity related to real estate.
110. Id.
111. Id.
113. 1984 T.C.M. (P-H) § 84,669 at 2724-25. It is interesting that the Tax Court's decision is a memorandum decision since memorandum decisions generally apply well-settled legal principles to the facts. Apparently, the Tax Court will continue its argument until the Supreme Court rules on the issue.
114. 798 F.2d at 111.
principles explained in Ourisman govern this case." Applying Ourisman and the mandatory fifth factor from National Carbide, the Fourth Circuit reversed the Tax Court's judgment allowing the taxpayers to deduct a portion of the corporation's losses. The Fourth Circuit indicated in its opinion that the tax treatment desired by the taxpayer could have been achieved through proper planning.

V. TAX PLANNING

Until the United States Supreme Court speaks once again on the nominee corporation issue, taxpayers should plan the use of nominee corporations in light of Roccaforte and Ourisman. Even though the Tax Court may continue to assert its position that the National Carbide criteria should be viewed as a whole, other circuits will likely follow the lead of the Fourth and Fifth Circuits. Unwarranted or not, the question of whether the agency relationship is dependent upon the ownership of the principal has become a "super-factor." Under Roccaforte and Ourisman, the agency relationship question is virtually outcome determinative; it will overshadow all tax planning.

Ideally, the taxpayer should choose a nominee corporation that is completely independent of the taxpayer. The further the taxpayer is removed from the ownership of the corporation, the more likely it is that a court will find that the agency is not dependent upon the ownership of the principal. One commentator has noted that it is possible to vest ownership of the corporation's stock in a law firm or a holding company organized by the law firm to hold the stock of several nominee corporations as a service to different clients. Any individual could also own the stock as long as the individual is completely independent of the taxpayer.

115. Id. at 109.
116. Id. at 111.
117. See B. BITTKER, M. EMORY & W. STRENG, 1 FEDERAL INCOME TAXATION OF CORPORATIONS & SHAREHOLDERS: FORMS, at 2-230 (rev. ed. 1982) [hereinafter cited as BITTKER]. Because the Bittker forms book was written before Roccaforte, it notes that some taxpayers might wish to own all of the stock of the nominee corporation. Id. These suggestions should be disregarded. The authors did note that "absent extremely limited activity, the use of a dummy corporation should probably be avoided." Id. See also, Falk, Nominees, Dummies & Agents: Is it Time for the Supreme Court to Take Another Look?, 63 TAXES 725 (1985).
118. The taxpayer's family members, partnerships, and trusts should not hold the stock because of possible attribution to the taxpayer. Although no section of the Internal Revenue Code specifically attributes ownership of a nominee corporation's stock to the beneficial property owner, the principles of attribution are well-recognized in the Code. See, e.g., I.R.C. § 318 (for specified I.R.C. sections, ownership of stock is attributed to a taxpayer if stock is held by certain family members, partnerships, trusts, and closely held corporations). A court would have little trouble attributing
If an independent nominee corporation cannot be found, the taxpayer could form a new corporation. As the Ourisman court suggested, the articles of incorporation should limit the purposes of the corporation to acting as a nominee for others. Although National Carbide does not actually prohibit the beneficial owners from being the stockholders of the new corporation, as Roccaforte demonstrates, a corporation that is owned by the beneficial property owners must be dealt with at arm's length. The nominee corporation must act on behalf of a non-owner in the same way it acts for its individual owners. The quantum of proof required to prove arm's length independence is greater when the taxpayer is also the shareholder.

Regardless of the ownership of the nominee corporation, the taxpayer should prepare a written agency agreement that specifies the duties of each party. Although an agency can arise from an oral agreement, a written document is essential, as a practical matter, to a nominee corporation. Still, formal designations in an agency agreement are not conclusive. The agreement must provide for an arm's length fee to the corporation — the same fee an independent agent would receive.

Not only should the taxpayer consider the Roccaforte and Ourisman decisions in tax planning, but the taxpayer should also consider the impact of recent tax legislation on nominee corporations. The Tax Reform

ownership of stock to a taxpayer if the stock were held by the taxpayer's spouse, partnership, or a controlled corporation.

119. The Bittker forms book offers the following language for the articles of incorporation:

The purpose or purposes for which the corporation is organized are: To take and hold title to real estate, as nominee, on behalf of other corporations, associations, partnerships, or individuals and not on its own behalf, and to convey the same and perform any incidental transactions in connection therewith for and on behalf of the corporations, associations, partnerships and individuals for whom it shall hold title.

Bittker at 2-231.

Note that in Paymer the organizing minutes stated that the corporations were taking only record title. The Paymer court ignored the minutes. Where the function of a corporation is expressly limited to that of a nominee, courts will probably respect the articles of incorporation rather than ignore them as the Paymer court did. See supra notes 37-44 and accompanying text.

120. The Bittker forms book contains a "Nominal Titleholder Agreement." The agreement is adequate except for the fee of $100.00. Bittker at 2-233. As Roccaforte and Ourisman illustrate, the fees which a nominee corporation receives for its services must represent arm's length dealing; a nominal fee will not be sufficient.

In Frink v. Commissioner, 798 F.2d 106 (4th Cir. 1986), an attorney for the lender had suggested that a corporation owned by him hold legal title to the partnership's property for a fee of $1,000.00. If this course had been followed, there would have been a factual question as to whether the $1,000.00 represented an arm's length fee. Instead of following this route, the lender insisted that a separate corporation be formed. The nominee agreement with the corporation did not provide for compensation. Thus, when the Fourth Circuit applied Ourisman, it found that the corporation did not meet the fifth National Carbide criterion. Id. at 109.

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Act of 1986 will affect virtually all taxpayers, including nominee corporations. The Bill passed by the Senate added limitations on the ability of taxpayers to use losses and credits from passive activities. Although the Senate included these provisions to curb certain investments in tax shelters, the provisions will affect the deductability of losses and availability of credits passed from a nominee corporation to beneficial owners of property.

Generally, the Act provides that deductions from passive trade or business activities may not be deducted against income from nonpassive activities, and that credits from passive activities are limited by the tax allocable to passive activities. An activity is passive if it involves the conduct of any trade or business where the taxpayer does not materially participate in the activity. The provision applies to individuals, estates, trusts, and personal service corporations. Except for a special rule which limits the use of passive activity losses against portfolio income of closely held corporations, the provision does not apply to regular C corporations.

As a beneficial owner of property held by a nominee corporation, a taxpayer will be subject to the passive activity rule on losses and credits passed from the nominee. If the beneficial owner of the property does not materially participate in the management of the property, then any losses or credits may only be used to offset income from other passive activities. The owner may not use the losses to offset ordinary income such as salary or dividend income. The losses and credits are not lost, but may only be used against income from other passive activities.

The Act contains exceptions to the passive activity rule that will affect some nominee corporations. The Act implements these exceptions by defining certain activities as passive or nonpassive without regard for the material participation of the taxpayer. The term "passive activity" excludes oil and gas working interests. Owners of working interests may deduct losses and use credits from the working interests to offset

123. SENATE COMM. ON FINANCE, TAX REFORM BILL OF 1986, REPORT ON H.R. 3838 at 713-18 [hereinafter cited as SENATE COMM. REP.]. "[T]he purpose of tax preferences to function as intended, their benefit must be directed primarily to taxpayers with a substantial and bona fide involvement in the activity to which the preferences relate."
124. SENATE COMM. REP. at 719.
125. Of course, these provisions will not affect the pass through of income, only losses and credits.
126. To be codified at I.R.C. § 469(d)(3). "The term 'passive activity' shall not include any

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nonpassive income even though the owners do not materially participate in the operation of the properties. This exception should apply to oil and gas working interests held by a nominee corporation. The beneficial owner should be able to deduct all losses and use all credits passed from the nominee without regard to the other type of income of the owner. While the term "passive activity" excludes oil and gas working interests, it includes any rental activity whether or not the taxpayer participates in the activity. Thus, rental losses and credits will always be subject to the passive activity rules, even when a nominee corporation holds the properties.

As with any tax act, this Act contains exceptions to the exceptions. Under the Act, an individual may deduct up to $25,000 per year of passive activity losses attributable to real estate activities in which the taxpayer actively participates, regardless of the identity of the offsetting income. This exception is only available to taxpayers who actively participate in the rental activity. Taxpayers using a nominee corporation to hold title to real estate should be able to use this exception. Nothing prohibits the beneficial owners from managing the property and thereby actively participating in the activity. In fact, the nominee only holds title to the property, and management by the beneficial owners is perfectly in line with the relationship between the beneficial owners and the nominee.

The Senate excluded oil and gas working interests because of the current state of the oil and gas industry which was caused by the world-wide collapse of oil prices. SENATE COMM. REP. at 717.

The exception is available only to taxpayers who hold the interest directly or through an entity which does not limit the liability of the taxpayer. A nominee corporation will not limit the liability of the taxpayer and should be adequate in that respect. Of course, one entity that allows the pass through losses is the S corporation. Besides being limited by the basis rules in the amount of loss that may be passed through, the S corporation may not be the entity of choice for oil and gas interests because of these new rules regarding limited liability. A nominee corporation may be superior to an S corporation for oil and gas interests with respect to this limited liability question.

The language of the Bill states that the exception applies to an entity which "does not limit the liability of the taxpayer with respect to such interest." Id. The Report of the Senate Finance Committee indicates that the language refers to "financial risk proportionate to . . . ownership." SENATE COMM. REP. at 718. Although this language uses the term "risk," the provision probably does not refer to the at-risk rules. The report states that the passive activity provision bear no relation to whether a taxpayer is at-risk. Id. at 717. The language may refer to potential civil liability arising from acts associated with the oil and gas property. Although a discussion of whether an S corporation would protect a shareholder from civil liability is outside the scope of this Note, a nominee corporation would not protect the owners and appears to be the superior choice between the two entities.

To be codified at I.R.C. § 469(d)(1)(B).

To be codified at I.R.C. § 469(f).
VI. CONCLUSION

The Tax Court is firmly convinced that its position on the *National Carbide* criteria is correct. The court will likely continue the same argument in other circuits. Because the Tax Court’s position may not be any more successful in other circuits than in the Fourth and Fifth Circuits, taxpayers should assume that the fifth *National Carbide* factor, that relations with the principal are not dependent on the principal’s ownership of the corporation, is mandatory and order the relationship between the property owners and the corporation accordingly.

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