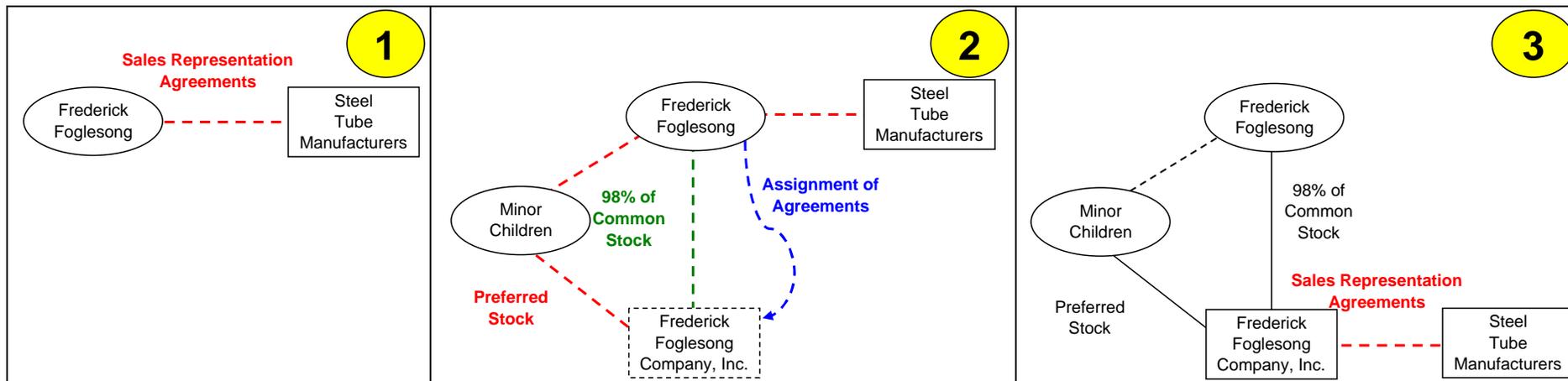


Initial Structure (1962/1963)

Incorporation (1966)

Ending Point



Frederick H. Foglesong, was a sales representative for two manufacturers of cold drawn steel tubing. On August 30, 1966, Foglesong incorporated his business as Frederick H. Foglesong Company, Inc. Foglesong held 98 shares and his wife and accountant held 1 share each. The Corporation paid no dividends on its common stock during the taxable years in question, 1966 through 1969. The Corporation also issued preferred stock to Foglesong's four minor children (for which the total subscription price was \$400). The four children received dividends totaling \$32,000 over the period beginning September 1, 1966 and ending December 31, 1969. At or about the time the Corporation was organized, Foglesong notified the steel tube manufacturers that the Corporation was being formed and asked that any commissions due under his agreements with them be paid to the Corporation.

Personal service corporation tax cases reveal a tension between the principle of a graduated income tax and the policy of recognizing the corporation as a taxable entity distinct from its shareholders in all but extreme cases. The impact of the graduated income tax is eroded when income is split artificially among several entities or over several tax years. The assignment of income doctrine under Section 61 (as formulated in *Lucas v. Earl*) seeks to recognize "economic reality" by cumulating income diffused among several recipients through "artificial" legal arrangements. The attribution of income to its "true earner" is simply a species of recognizing "substance" over "form." But, if the issue is one of attributing the income of a corporation to its sole stockholder-employee who "really" earned it, one encounters the important policy of the law favoring recognition of the corporation as a legal person and economic actor (*Moline Properties*).

In this case, the following circumstances, among others, were present:

- (1) the Corporation and not Foglesong is the party to the contracts under which services are performed,
- (2) the Corporation is recognized to be a viable, taxable entity and not a mere sham,
- (3) non-tax business purposes are present even though tax avoidance is apparently a major concern,
- (4) the Corporation has not been formed for the purpose of taking advantage of losses incurred by a separate trade or business,

- (5) the corporate form (and the status of the Corporation as an actual operating enterprise) has been consistently honored by Foglesong and other parties to the transactions giving rise to the income,
- (6) Foglesong does not render services as an employee to any entity other than the Corporation,
- (7) the Corporation is not disqualified from performing the services required of it by contract because the law requires these services to be performed by an individual,
- (8) the entities paying or providing the income are not controlled or dominated by Foglesong, and
- (9) other and more appropriate legal bases exist for attacking apparent tax avoidance than broad-scale disregard of the corporate form through application of assignment of income theory.

The Tax Court disregarded the corporate form under section 61 and the assignment of income doctrine, treating the bulk of the commission income as having been earned by, and taxable to, Foglesong. The appellate court, reversing the Tax Court, noted that the Tax Court did not find the Corporation to be a pure tax avoidance vehicle. Under the circumstances of this case, the appellate court found it inappropriate to attempt to weigh "business purposes" against "tax avoidance motives" in a determination whether the assignment of income doctrine of *Lucas v. Earl* should apply, in effect, to substantially disregard the corporate form. The appellate court found it inappropriate, in light of *Moline Properties* and *National Carbide*, except on more extreme facts, to achieve, through recourse to the assignment of income doctrine, essentially the same result as would follow from treating the Corporation as a "sham" for tax purposes. The appellate Court remanded the case to the Tax Court for consideration under section 482.

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