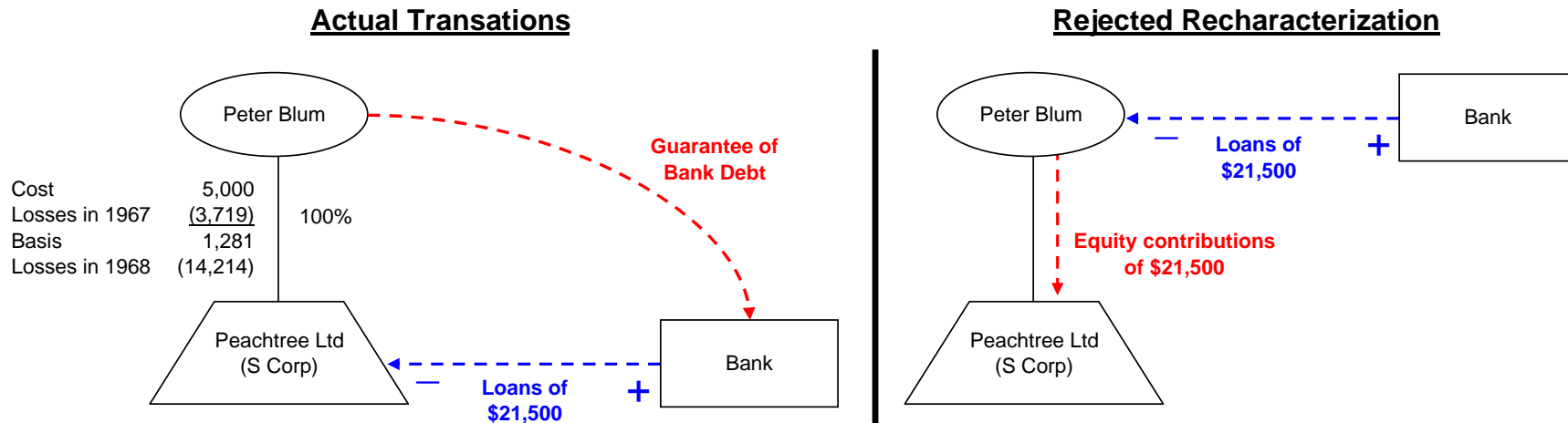


Blum v. Commissioner
59 T.C. 436 (1972)

**Guaranteed Loans Not Treated
As Equity Investments**

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In this case, the taxpayer was trying to argue that a loan from a bank directly to an S corporation should have been treated as a bank loan to the shareholder, followed by a capital contribution into the S corporation (similar to Plantation Patterns). The S corporation had incurred losses and the shareholder wanted additional tax basis in the S corporation shares to be able to deduct the losses. The Tax Court stated:

It is true that the [I.R.S.] on numerous occasions has attempted to apply the “substance over form” doctrine and recharacterize guaranteed loans as equity investments. It is also true that at least on one occasion this Court has permitted the taxpayer to successfully challenge the form of his own choosing and claim that guaranteed loans were in substance an equity contribution by the taxpayer. * * * As we stated in *Santa Anita Consolidated, Inc.*, “Whether such debt [guaranteed debt] is to be treated as an indirect capital contribution must be resolved by an investigation of the facts in light of traditional debt-equity principles.” In the present fully stipulated case, after applying many of those traditional principles, we find that petitioner simply has not carried his burden of proof and has not convinced this Court that the guaranteed loans should properly be characterized as equity investments.

In determining whether a debt in form is to be considered an equity interest for tax purposes, no single factor is controlling and each case must be decided upon its own peculiar facts, with the taxpayer bearing the burden of proof. Thin capitalization is only one of many factors indicative of an equity investment, and often not one of prime importance. See for example *Sun Properties v. United States* and *Baker Commodities, Inc.*, where equity ratios of 310:1 and 692:1, respectively, did not compel a finding of an equity contribution. Certainly a corporation's purported insolvency at the time of a loan is evidence that the lender may be relying on the guarantor for repayment. However, an unexplained guaranteed loan to an insolvent corporation does not require a finding that the loan was in fact made to the guarantor and not his corporation. One factor which stands out in the case at bar is that there is absolutely no evidence to refute the fact that the bank expected repayment of its loan from the corporation and not the petitioner. To find that petitioner made a capital contribution of the guaranteed loans we must find that the bank in substance loaned the sums to petitioner, not the corporation, and that petitioner then proceeded to advance such funds to the corporation. Based on the evidence presented we cannot make such a finding. [citations omitted]