

Commissioner v. Fink
483 U.S. 89 (1987)

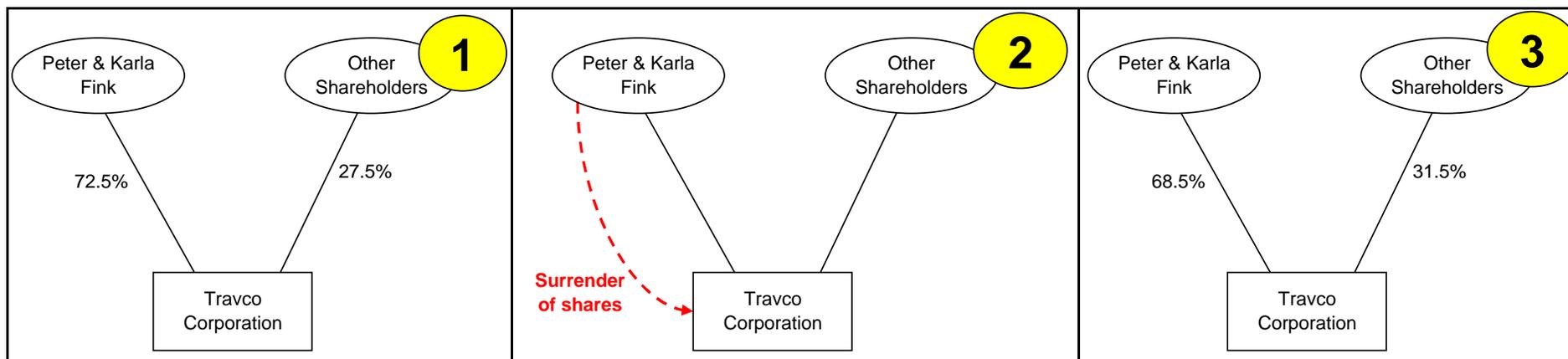
**No Deduction for Voluntary
Surrender of Stock to a Corporation**

Copyright © 2006 Andrew Mitchel LLC
International Tax Services
www.andrewmitchel.com

Initial Structure

Surrender of Shares

Ending Point



Peter and Karla Fink were the principal shareholders of Travco Corporation. The Finks owned 72.5% of the outstanding shares. Travco urgently needed new capital as a result of financial difficulties it encountered. The Finks voluntarily surrendered some of their shares to Travco in an effort to "increase the attractiveness of the corporation to outside investors." As a result, the Finks' combined percentage ownership of Travco was reduced from 72.5% to 68.5%. The Finks received no consideration for the surrendered shares, and no other shareholder surrendered any stock. The effort to attract new investors was unsuccessful, and the corporation eventually was liquidated. On their tax returns, the Finks claimed ordinary loss deductions for the full amount of their adjusted basis in the surrendered shares. The Commissioner disallowed the deductions.

It is settled that a shareholder's voluntary contribution to the capital of the corporation has no immediate tax consequences. Reg. 1.263(a)-2(f). Instead, the shareholder is entitled to increase the basis of his shares by the amount of his basis in the property transferred to the corporation. Sec. 1016(a)(1). When the shareholder later disposes of his shares, his contribution is reflected as a smaller taxable gain or a larger deductible loss. This rule applies not only to transfers of cash or tangible property, but also to a shareholder's forgiveness of a debt owed to him by the corporation. Reg. 1.61-12(a). Such transfers are treated as contributions to capital even if the other shareholders make proportionately smaller contributions, or no contribution at all. The rules governing contributions to capital reflect the general principle that a shareholder may not claim an immediate loss for outlays made to benefit the corporation.

The court held that:

a dominant shareholder who voluntarily surrenders a portion of his shares to the corporation, but retains control, does not sustain an immediate loss deductible from taxable income. Rather, the surrendering shareholder must reallocate his basis in the surrendered shares to the shares he retains. The shareholder's loss, if any, will be recognized when he disposes of his remaining shares. A reallocation of basis is consistent with the general principle that "[p]ayments made by a stockholder of a corporation for the purpose of protecting his interest therein must be regarded as [an] additional cost of his stock," and so cannot be deducted immediately.