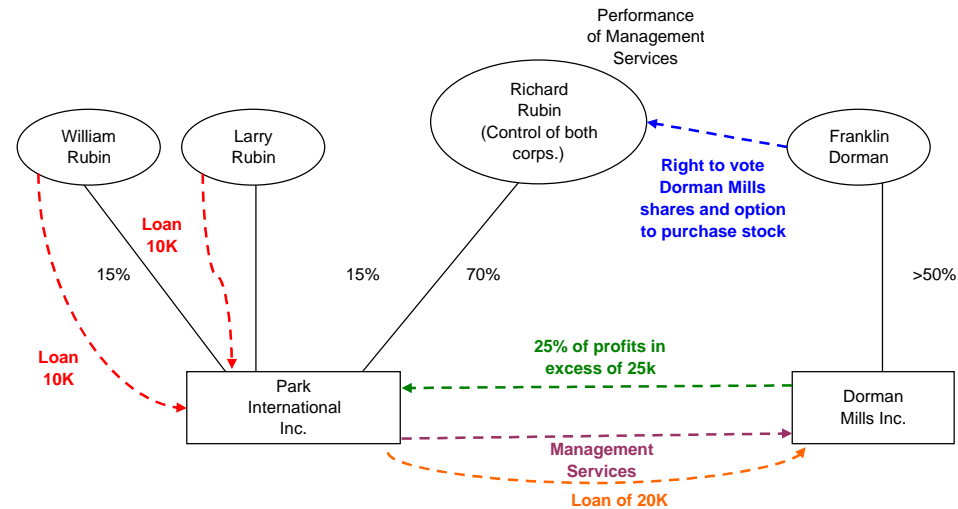


**Rubin v. Commissioner**  
**429 F.2d 650 (2d Cir. 1970)**

**AOID: Corporate Management Services**  
**Taxable to Controlling Shareholder**

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Richard Rubin and his two brothers, William and Larry, formed Park International, Inc. (Park). Richard took 70% of the stock; the remaining 30% was held equally by the two brothers. The stock was issued for a nominal consideration but William and Larry each made a \$10,000 loan to the corporation. Park then entered into a contract with Dorman Mills, Inc., and its principal stockholder, Franklin Dorman. This provided that Park would lend Dorman Mills the \$20,000 it had received from William and Larry, this to be subordinated to additional financing of not to exceed \$150,000 which Dorman Mills, Inc. would seek to obtain, and would furnish management services in return for 25% of the annual net profits of Dorman Mills, Inc. in excess of \$25,000. In a simultaneous agreement, Richard was granted a four-year option on Franklin Dorman's controlling block of stock and obtained the right to vote it. Although the contracts did not explicitly say so, all parties understood that Richard would perform the management services Park was obliged to furnish. The Commissioner asserted deficiencies against Richard Rubin for the years 1960 and 1961, on the theory that Park's receipts under the Dorman Mills contract, less related expenses, constituted income to him. The Tax Court sustained the Commissioner.



"Loaned employee" cases such as this reveal a tension between competing policies of the tax law. On one side is the principle of a graduated income tax, which is undercut when individuals are permitted to split their income with others or to spread it over several years. *Lucas v. Earl*, 281 U. S. 111 (1930). Opposing this is the policy of recognizing the corporation as a taxable entity distinct from its shareholders in all but extreme cases. *Moline Properties, Inc. v. Commissioner*, 319 U. S. 436 (1943). Complicating matters are the personal holding company provision, I. R. C. §§ 541-47, and the accumulated earnings tax provisions, I. R. C. §§ 531-37, which may or may not afford a helpful insight into the extent to which Congress wants the policy of the graduated income tax to prevail over that of recognizing the corporate entity. The personal holding company provisions deal with the problem of the loaned employee by imposing a prohibitive tax on corporate income from personal service contracts, but only when 80% of the corporation's income is derived from such sources, a condition not here fulfilled. The accumulated earnings tax is imposed when, with intent to avoid the income tax on shareholders, a corporation accumulates surplus beyond the reasonable needs of the business, another condition apparently not satisfied here. Also lurking in the background is §482. Confronted with this welter of doctrines and statutory provisions, the Tax Court fell back on the general provisions of §61 and *Lucas v. Earl*, that "income is taxed to the true earner thereof," and on the many cases holding that tax consequences depend on substance rather than form. Holding that Ruben rather than Park was the "true earner" of the Dorman Mills payments, and that "in substance" Richard had worked directly for Dorman Mills, and turned part of his salary over to Park as a contribution to capital, the court sustained the Commissioner.

The Second Circuit held that the broad sweep of §61 may occasionally be useful in connection with "transactions heavily freighted with tax motives" which cannot be satisfactorily handled in other ways, but they have no place where, as here, there is a statutory provision adequate to deal with the problem presented. Section 482 allows the Commissioner to "distribute, apportion, or allocate gross income, deductions, credits or allowances" between or among "two or more organizations, trades or businesses . . . owned or controlled directly or indirectly by the same interests" if he determines that such action is "necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses." Resort to section 482 is clearly superior to the blunt tool employed by the Tax Court. References to "substance over form" and the "true earner" of income merely restate the issue in cases like this: Who is the "true earner"? What is substance and what is form? Moreover, they do so in a way which makes it appear that these questions can be answered simply by viewing the facts with appropriate suspicion. The language of §482 more clearly commands analysis of the facts in terms of the competing policies outlined above. Section 482 has other advantages. It provides greater flexibility than the all-or-nothing approach used by the Tax Court. The Court emphasized, however, that having found it unnecessary to consider this question, it did not hold that employment status constitutes, in and of itself, a trade or business within the meaning of section 482. On remand, the Tax Court held that section 482 applied to allocate income from Park to Richard.