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CAPITALIZATION OF THE CLOSE CORPORATION

*Wayne Hea**

Introduction

The subject of "capitalization of the close corporation" is much broader than the mere question of "thin" incorporation. I propose to treat the subject matter in the same order that I do when a client comes into the office for advice on how to capitalize a new corporation which he is bringing into existence at that time. Proper planning at this stage will result in many dollars of future tax saving and will also provide the ultimate in flexibility for later planning or transactions.[1]

Generally the matter of credit standing does not control in the case of a close corporation. This is so because in most cases the personal guarantee of the stockholders will be called for by the credit grantors where credit is an important item. For our discussion we will assume that the credit standing of the corporation is not an issue.

In the matter of capitalization we usually find one of two common fact patterns. Either an existing business is being incorporated or the corporation is being started with cash only. Where different treatment is required because of the difference between these two basic fact situations, it shall be set forth.

Ordinarily most tax savings will result and the most flexibility will be obtained where the new corporation is capitalized on the low side. High capitalization generally means that the stockholder's money or his accumulated wealth is tied up in the corporation and if he attempts to withdraw it from the corporation he must first pay an income tax to do so, either at ordinary rates or at capital gain rates, depending upon the circumstances. Low capitalization, therefore, will be our objective and this article will attempt to show methods used to obtain it. It will also attempt to show the pros and cons of the various methods presently being used by tax practitioners and outlined herein.

I. DETERMINING THE TOTAL CAPITAL AMOUNT

Where the client has an existing business to incorporate, many uninformed advisors have allowed their clients to capitalize their new corporations by placing all the business assets, including cash, inventory, fixed assets, intangibles, etc., in the corporate structure as a contribution to capital in one form or another. Tax advisors have long been aware of the disadvantages of this type of approach and, as a result, have started the "thinning" process right at this point. Since low capitalization is our objective, and flexibility always desirable, it is usually suggested that the real property or other major

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1 The matter of recapitalization of a close corporation is beyond the scope of this article.

fixed assets and sometimes important intangible assets be left out of the corporation and thus out of its capitalization. Since the use of such assets are many times required in the operation of the business their use can be obtained by the corporation renting them. Further, only the minimum amount of cash required to get the corporate business under way should be put in. The same should apply to inventory and other operating assets.

If the needs of the client dictate that assets of a considerable value must be incorporated though not necessarily in one corporate structure, consideration should be given at this point to the use of multiple corporations. Through later piece-meal liquidation of the separate corporations at intervals of time the owners could at least bail-out part of their capital at long-term capital gain rates.[2] The mechanics of setting up multiple corporations is, of course, beyond the scope of this article. But it is obvious that there is more flexibility if the total capital required is in separate corporate units, which corporate units may be liquidated at will, rather than being forced into a decision to liquidate the entire business just to get part of the capitalization into the hands of the stockholders at long term capital gains rates. A client might be able to stand a capital gains tax on part of the enterprise increment but not on all of the increment.

Even where the incorporation is an "all-cash" deal, consideration should be given to the use of multiple corporate entities to help solve our capitalization problem. The reasoning and liquidation bail-out procedure set forth in the preceding paragraph also applies where a large initial cash capitalization is dictated by business needs.

II. Liabilities at Time of Incorporation

Where an existing business which was on the accrual basis is being incorporated, all trade obligations of that business should be reflected on the books of the new corporation on the basis that the assets being contributed as capital of the corporation are being contributed subject to such indebtedness. This has the effect of lowering the net capital going into the corporation. It should be noted that under Section 357 of the 1954 Internal Revenue Code, the assumption of a liability of the transferor by the transferee in a section 351 exchange is not generally considered as "boot" received by the transferor.[3] However, where the assumption of a liability, or the transfer of property subject to a liability, in a section 351 transaction has no bona fide business purpose, or has as its principal purpose the avoidance of federal income tax, any

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2 Int. Rev. Code of 1954, §§ 331, 346.

3 Section 357 provides that if —

(1) the taxpayer receives property which would be permitted to be received under section 351, 361, 371, or 374 without the recognition of gain if it were the sole consideration, and

(2) as part of the consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property subject to a liability,

then such assumption or acquisition shall not be treated as money or other property, and shall not prevent the exchange from being within the provisions of section 351, 361, 371, or 374, as the case may be.

obligation or liability of the transferor assumed by the transferee corporation constitutes "boot" to the transferor.[4]

When considering this means to reduce capitalization, the effect of section 357(c) should also be kept in mind. Under that section where there is an exchange under section 351, the transferor of property realizes a gain if the sum of the amount of liabilities assumed, plus the amount of the liabilities to which the property is subject, exceeds the total adjusted basis of the property exchanged. The gain realized is the amount of such excess, and may be either a capital gain or a noncapital gain. This provision does *not*, however, apply if the amount of the liabilities is treated as "boot" under section 357(b), because of a purpose to avoid tax, or the lack of a bona fide business purpose.

III. Notes vs. Stock to Reflect Ownership of Contributions by Stockholders

In almost all cases where a close corporation is involved, there will be additional tax advantages where the stockholders cast their contribution of money or property to the use of the corporation into a loan form rather than as a capital stock acquisition.

Where the stockholder-creditor casts his contributions in the form of a loan he will receive interest. Such interest will be income to him[5] but will be a deduction to the corporation.[6] Should the stockholder elect to make his contribution result in an investment in capital stock of the corporation, then any dividends paid on such investment will still be income to the stockholder but will *not* be a deduction from income to the corporation like an interest payment would be. Of course, the dividends paid would be subject to the dividend exclusion[7] and dividend credit.[8] In most cases such exclusions and credits are not enough to outweigh the advantage of the interest deduction to the corporation.

Another major advantage to the stockholder of the "loan route" is that at a later date there will be a tax free bail-out of funds. This results at the time the corporation pays back the loan to its stockholder-creditor. The payment of a true debt by a corporation, at face value, is merely a return of capital to the creditor.[9] If the stockholder had invested this same amount in the capital stock of the corporation, then a repayment of same to the stockholder at a time when the corporation had sufficient earnings would generally result in ordinary income to the stockholder on the theory that such payment is in reality an ordinary dividend. There are exceptions to this treatment but to come under such exceptions during the life of the corporation is generally

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4 INT. REV. CODE OF 1954, § 357(b).
5 § 61(a).
6 § 163.
7 § 116.
8 § 34.
9 The loan route must be handled with caution, however, as the courts in looking to the substance of the transaction may find the security to be a stock and not a debt. See Earle v. W. J. Jones & Son, Inc., 200 F.2d 846 (9th Cir. 1952); 1432 Broadway Corp. v. Commissioner, 4 T.C. 1158 (1945), *aff'd per curiam*, 160 F.2d 885 (2d Cir. 1947). *Cf.* Talbot Mills v. Commissioner, 146 F.2d 809 (1st Cir. 1944).

not practicable where the close-corporation stockholder is also a working executive of the corporation or where he wishes to remain either a controlling stockholder or a substantial one.[10]

The "loan route" provides certain additional and collateral advantages, one of which is that it helps eliminate a possible unreasonable accumulation of surplus problem at a later date. The existence of corporate debt is one of the factors in the taxpayer's favor when determining where surplus accumulation is truly for a corporate purpose or for a stockholder purpose. It would not necessarily be a controlling factor, however. Should the stock-acquisition route have been selected, then such stock would be a part of the corporation's net worth, and surplus would not ordinarily be required to be accumulated to retire same.[11]

A non-tax factor but one not to be overlooked arises if the corporation ever becomes insolvent and the creditors take over. The stockholder-creditor, to the extent of loans owed him by the corporation, will ordinarily stand on an equal basis with the creditors and will share in the corporate assets on a pro-rata basis with the other creditors.[12] Further, as a creditor he will suffer a bad debt rather than a long-term capital loss. This bad debt can either be a business or a non-business one depending upon the circumstances.[13]

IV. The Types of Capital Stock

It has been my observation that in the majority of incorporations there has been a singular lack of the use of imagination and creative thinking when determining what types of capital stock should be issued and their respective proportions one to the other, after the decision has been made as to the amount to be capitalized through the issuance of capital stock of the new corporation.

Tax planning of this phase of the capitalization of the close corporation generally revolves around customary types of stock, namely: common stock, with and without voting privileges, preferred stock, with and without voting privileges, and whether there should be cumulative or fixed dividends.

In certain states the vote will pass from the common shares to preferred shares if dividends become in arrears on preferred shares in a certain amount, or time.[14] Because of this possibility of vote shifting from common shares and because in some states it is almost mandatory that the preferred shares have a fixed dividend rate, I have abandoned the use of preferred shares in the case of close corporations except where special business non-tax reasons require their use. I have found that with a combination of voting common and non-

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10 INT. REV. CODE OF 1954, §§ 301, 302.

11 §§ 531, 532.

12 Dean v. Kellogg, 394 Ill. 495, 68 N.E.2d 898 (1946); Bellaire Securities Corp. v. Brown, 124 Fla. 47, 168 So. 625 (1936). See also 13 FLETCHER, PRIVATE CORPORATIONS § 5756 (Supp. 1958). In bankruptcy the *Deep Rock* doctrine, Taylor v. Standard Gas & Elec. Co., 306 U.S. 307 (1939), would be applicable giving priority in the close corporation situation to non-shareholder creditors.

13 § 166(d).

14 Ellingwood v. Wolf's Head Oil Refining Co., Del., 33 A.2d 409 (1943), *aff'd*, 27 Del. Ch. 356, 38 A.2d 743 (1944); State v. Campbell, 135 Ohio St. 238, 20 N.E.2d 366 (1939); Pierce Oil Corp. v. Varon, 136 Va. 416, 118 S.E. 247 (1923). See also 11 FLETCHER, PRIVATE CORPORATIONS § 5301 (perm. ed. rev. repl. 1958).

voting common that one can get most of the advantages that preferred stock might have with almost none of its disadvantages. There are no differences in the rights or obligations of the voting and non-voting common shares except that of the right to vote. As an example: if a dividened is declared it must go equally to all shares, voting and non-voting alike.

In the great majority of cases I find it advisable to issue about ten percent of the amount which has been decided upon in common voting shares and the other ninety percent in non-voting common. This will generally result in the most flexibility for future employee, stockholder, corporate, estate and family planning purposes.

I feel that this above-mentioned equality of dividend payment is important where the non-voting shares are either placed in a trust or made the subject of a gift to parties closely related to the grantor or donor, and where at a later date the donor-owner of the common voting shares has used them to declare a dividend payable only to the non-voting common. Such an arrangement is open to attack in my opinion. Further, certain problems are raised under our short-term trust *Clifford* section of the Internal Revenue Code where voting shares of a close corporation are placed in such a trust.[15]

The non-voting common shares make a particularly suitable gift medium for a father to make annual gifts and secure the annual gift-tax exclusion.[16] He can do this without parting with his control, a factor which is usually very important to the client. Further, while the majority stockholder is developing young key executives he might be reluctant to sell voting shares to them at the start, whereas he will sell non-voting. Such a sale generally satisfies all concerned at that particular point of time. After the executive has been thoroughly tested, voting shares can be sold to him. The combination of shares means that the original owners can sell or dispose of up to ninety-four percent of the corporation and still retain control of the corporation, or can sell ninety percent of the non-voting shares and can retain absolute control.

When the net worth of the corporation has increased through retention of earnings and possible unrealized increment in assets the two-class common structure will facilitate the estate planning of the original stockholders or will allow them to realize on these corporate earnings but at capital gains rates. This latter can be done by selling the non-voting shares. Such a sale is not easy to make under ordinary conditions but in most close corporation situations conditions are not ordinary. For estate planning, generally gifts of the non-voting stocks, either to charity or to a related person, are in order. The original issue of non-voting common should obviate the necessity for a later non-taxable stock dividend. Such an original issue will *not* run afoul of section 306.

V. What Kind of Debt Instrument is Most Desirable for Thinning

Since many incorporations will involve a transfer of property as well as cash, especially those complying with section 351 so as to constitute what is

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15 Int. Rev. Code of 1954, §§ 671-75.
16 § 2503(b).

commonly known as a tax-free incorporation, we must know what constitutes a "security" if we want to make sure that our capitalization program does not involve us in a presently taxable situation. As yet there is no statutory definition of "securities" as used in connection with this problem. However, under court decisions, securities must evidence a continuity of interest in the corporation which is substantial as to time.[17] Therefore, short-term obligations, regardless of whether they are bonds, debentures or notes, do *not* meet this requirement. Courts have held that promissory notes with terms up to five years are *not* securities,[18] but that ten-year notes are.[19] Further, two and one-half year debentures have been rejected where they were shown to have been paid within ten months after issue.[20] On the other hand, serial bonds of a corporation with a maximum maturity of six years, have been held to be securities.[21]

Because of the "blue-sky" legal restrictions on the issuance of bonds and debentures and because of the usually large cost of their issuance, bonds and debentures are generally not used for thinning purposes in the truly close corporation type situation. Instead of their use I recommend that there be issued for this purpose negotiable promissory notes (secured or unsecured) payable not sooner or later than ten years from date of issuance.[22] These promissory notes should comply with all the legal requirements of a true debt instrument, such as were set forth by the Tax Court in *Ruspyn Corp. v. Commissioner*:[23]

> [T]hat there was a good business reason for the issuance of debt securities, that the securities have a fixed maturity date at which time the principal becomes payable in all events, that reasonable interest is payable in all events without regard to earnings, that the holders of the securities may enforce payment in the event of default, that the securities have no voting rights, that the security is called a bond [or promissory note] and is reflected on the books and financial statements as an indebtedness, ...

The very early "thin-incorporation" cases were generally decided based upon a determination of the parties' intent as shown by a large number of more or less formalistic criteria, such as the court has outlined above.

VI. Debt Ratio Allowable for Federal Tax Purposes

After we have decided upon the total amount to be contributed by the stockholders, we are then faced with the really tough question under the present uncertain status of the law. Namely, what should be the ratio of capital stock investment to debt owed to the creditor-stockholders at incorporation?

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17 Le Tulle v. Scofield, 308 U.S. 415 (1940); Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U.S. 462 (1933).

18 Neville Coke & Chemical Co. v. Commissioner, 148 F.2d 599 (3d Cir. 1945).

19 Burnham v. Commissioner, 86 F.2d 776 (7th Cir. 1936), *cert. denied,* 300 U.S. 683 (1937).

20 L. & E. Stirn, Inc. v. Commissioner, 107 F.2d 390 (2d Cir. 1939).

21 Commissioner v. Freund, 98 F.2d 201 (3d Cir. 1938).

22 See Burnham v. Commissioner, 86 F.2d 776 (7th Cir. 1936), *cert. denied,* 300 U.S. 683 (1937). 300 U.S. 683 (1937).

23 18 T.C. 769, 777 (1952).

The last few years the courts have been struggling with this question and have attempted to arrive at a solution to the problem upon various theories. It is believed that a brief review of some of these theories will best point up the problem and the difficulties which now beset the tax practitioner should he attempt to "thin" the close corporation through the use of true debt securities running back to stockholder-creditors at the time of incorporation.

A. The Debt-Ratio Solution

Tax practitioners originally felt they were safe on the question of "thin" incorporation if they complied with two originally leading cases on the subject, namely *Kelly v. Commissioner*[24] and *Ruspyn Corp. v. Commissioner.*[25] In *Kelly* a debt to stock ratio of 4 to 1 was held to be proper and in the *Ruspyn* case that of 3½ to 1. As a result of these two cases many practitioners were using ratios of 3 to 1 or less and felt they were secure. Later court decisions have caused tax practitioners to abandon the ratio test as the sole test.

Later court decisions have helped the taxpayer in the computation of what his actual debt to stock ratio is. This has been done by allowing in the computation of the equity investment, the fair market value of assets contributed rather than their book value. Further, there has been allowed to be included in the computation, the value of contributed assets even though they are not necessarily shown on the books of the corporation using them. These include such assets as unrealized appreciation, goodwill and other intangible assets.[26] The courts have assumed that the values at the time the alleged indebtedness was incurred are controlling. This would be true without regard to the corporation's later financial success or failure. In other words, a later financial improvement in the corporation's equity would not cure an inadequacy existing at the time of issuance of the debt.

B. The Criterion of Adequate or Sufficient Capitalization

In a recent case the Tax Court took a new approach to the thin incorporation problem. In *Gooding Amusement Co.*,[27] it found that the persons holding both the stock and the notes were essentially interested in the corporation as stockholders and they never intended to enforce their rights as creditors to the detriment of their interests as stockholders. The court reached its result where there was a debt-to-equity ratio of four and one-half to one without consideration of any goodwill of the predecessor partnership. However, there were bad factors from the taxpayers' standpoint, namely a subordination of the stockholder loans to other creditors plus a failure to pay the notes at their maturity due to lack of corporate funds. From the above the court concluded that the stockholder loans were in effect equivalent to capital stock

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24 326 U.S. 521 (1946).

25 18 T.C. 769 (1952).

26 Kraft Foods Co. v. Commissioner, 232 F.2d 118 (2d Cir. 1956).

27 23 T.C. 408 (1954), *aff'd*, 236 F.2d 159 (2d Cir. 1956), *cert. denied*, 352 U.S. 1031 (1957).

and therefore the interest and principal payments were deemed to be distributions of earnings, non-deductible as interest to the corporation payor and were to be taxed to the stockholder-creditors as dividends.

Subsequently the Tax Court applied the above theory in deciding the case of *Ryan Contracting Corp.*[28] In this case it based its decision on the lack of evident intention on the part of the stockholder-creditors to demand repayment of the amounts advanced and the admitted fact that it would have been impossible to operate the corporate business as it was without the funds in question. There was also similarity of interest of stockholders in capital stock and loans. The court in holding that the debts though in proper form, were not true debts but essentially equivalent to capital stock, expressly stated that it did not decide whether or not the corporation was a "thin" corporation because whether it was or not is only one of the many facts to be considered.

At the present time we have not had enough cases decided under this most recent theory of "adequate or sufficient" capitalization to be able to tell the exact limits of its application. Whether it will be applied only in the situation of close family groups, like in the *Gooding Amusement Co.* case, or in the situation of very small groups owning a corporation, like in the *Ryan Contracting Corp.*, where there was an incorporation of a three-man partnership, is not presently determinable. Pending the time when the courts have shown the exact limits of this new theory I can only recommend one solution. In the truly close group ownership situation, no debt instruments should be issued to the group at the time of incorporation, except where the instruments are in proper debt form as hereinbefore set forth, bear a modest rate of interest, are in a ratio of three to one or less, have a maturity date as close to ten years from date of issuance as possible, and last, but most important, is that the client understands that you are doing this on a purely speculative basis awaiting the outcome of the development of the law. During this waiting period no payments of principal will be made, only modest interest payments. The interest payments will be enough to smoke out the Service's opinion on your particular client's situation or you will wait without principal payments being made until the law has developed sufficiently for you to make your own determination. If the law develops against your particular situation, the notes can be made a "contribution" to capital without any tax detriment to your client. If the law develops in your favor you have not been too timid, but have on the contrary placed your client in a position to save tax money. If the clients are working stockholders and did not need the interest income you could merely reduce their salaries to the amount of the interest they are receiving during this waiting period.

Certain other methods have been devised by tax practitioners to avoid the issuance of debt instruments at the time of incorporation in a tax-free exchange for assets (either cash or property), to the owners of the corporation. Most of these alternate methods have not been passed upon by the

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28 15 T.C.M. 999 (1956).

courts and as a result we are presently not always certain of the outcome, but they are worth exploring and I do so in the following sections.

VII. ADVANCES BY STOCKHOLDERS SHORTLY AFTER INCORPORATION

Taxpayers on occasion when setting up their corporations have deliberately undercapitalized them with the idea that in a few months after incorporation they would commence making cash advances to such corporations to keep them going, knowing full well that they should have put more capital into them in the first place. These cash advances are shown on the corporate books as monies owed to stockholders. These same taxpayers feel that the repayments of these advances should be treated the same as any other liability payment, merely as a return of capital and as such not a taxable event.

I personally feel that the Commissioner could successfully attack this type of approach on the "step-transaction" theory.[29] The courts have on several occasions held that the incorporation period covers several months and that the various steps taken, where they were part of a planned series, must be put together to make a whole and the end result is what the tax result should be based on.

VIII. LOANS BY THIRD PARTIES TO THE CORPORATION GUARANTEED BY STOCKHOLDERS

Probably the latest alternate method gaining favor is that of "loans by third parties to the corporation but guaranteed by the close corporation stockholders." Under this method the new corporation, right after incorporation, borrows money from a bank or other outside lender. Obviously, since the corporation was incorporated on a weak financial basis, the lender requires the personal guarantee of the stockholders. The tax result hoped for is, of course, a true debt and a corresponding deductible interest, this being supported on the theory that the loan is from independent third parties, and not from interested stockholders.

My personal feeling is that if the courts go "all out" to stop thin-incorporation practices by adopting their latest concept of a "permanent capital requirement" to its full extent, they can easily devise theories upon which to strike down this guaranteed loan approach. I will say, however, that I feel that the courts will be reluctant to go after this approach because it will be extremely difficult to determine when there is a purely tax motive and when there is a purely business motive generating the loan. In the past, in a different situation, the Tax Court refused to recognize a guaranteed loan as such.[30]

It would appear to me that a taxpayer who wanted to use the guaranteed-loan approach would have a much stronger case where he had to use personal assets of a type not ordinarily put into a corporation, to back up his

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29 See *e.g.*, Heller v. Commissioner, 2 T.C. 371 (1943), *aff'd*, 147 F.2d 376 (9th Cir.), *cert. denied*, 325 U.S. 868 (1944).

30 E. J. Ellisberg, 9 T.C. 463 (1947).

guarantee of the loan to the corporation. In other words, if he were to use merely his personal signature or a cash time deposit to back up the guarantee, it would appear that this could be challenged successfully on the theory that either he should have borrowed the money personally and put it into the corporation as a capital stock contribution, or that if he is using a time deposit to back up the guarantee, said funds should have been put into the corporation as an equity investment.

In summary, on this method it should be pointed out that short-term lenders usually want their money back in three years or less. Therefore the taxpayer will not have an opportunity to "wait out" the development of the thin corporation law as he would where he has notes issued to himself. This makes for a hard choice since as yet there are no cases directly in point on the guaranteed-loan method. I, personally, would be willing to recommend either the guaranteed-loan approach or the use of ten-year notes to a "sophisticated" taxpayer where all the safeguards which have been recommended in this article can be used, where the client makes the decision after hearing all the pros and cons and understands the unsettled state of the law at present.

IX. Stockholders Sale of Assets Shortly After Incorporation

On a section 351 tax-free exchange there is no change in tax basis of the assets being contributed by the stockholders to the corporation in exchange for stocks and securities (including therein qualified debt instruments). On the other hand, where there is a sale of assets to a close corporation by its stockholders there can and probably will be a change in tax basis of the assets thus sold. The sale also can be on the installment basis. If the sale does not run afoul of section 1239, there can thus be a step-up in tax basis of depreciable assets with at most only a capital gain to the sellers. Further, if the sale holds up, we have a nice method with which to do some corporate "thinning." First a corporation is created, but is undercapitalized. Then the stockholders sell assets to the corporation on an installment sale basis. The notes bear interest which is deductible. When the notes mature they provide a means of bailing out cash from the corporation tax-free.

The problem here arises where the sale takes place at or shortly after incorporation. The courts may then deem that the separate transactions, namely the incorporation and the sale of assets, were merely separate steps in a planned result and should, therefore, be put together into one to determine the tax result. If the courts do this and deem it to be a section 351 transaction (which is entirely possible in many cases) then we have our usual thin incorporation fact situation with all of its attendant problems.

If a taxpayer is going to use this method I suggest for consideration *Ainslie Perrault*,[31] a Tax Court case recently acquiesced in by the Commissioner. Briefly, the facts of the case were that two brothers were equal partners. Each subscribed and paid $1,000 in cash for all the capital stock of

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31 25 T.C. 439 (1955).

a new corporation. They then transferred partnership assets valued at about $1,000,000 to the corporation which assumed partnership liabilities of some $50,000 and also agreed to pay the partners some $970,000 in four installments with interest. Also at this time they transferred to the new corporation, without consideration, other assets to a value of several hundred thousand dollars. These latter assets were not recorded in the books of account of the corporation.

The court held that this was not a thin corporation and that there had been a bona-fide sale to the corporation. It deemed that the corporation was adequately capitalized due to the transfer without consideration of the additional assets. Since the sale was bona-fide the payments by the corporation on the purchase price represented payments of proceeds of a sale rather than dividends. Interest on the deferred purchase price was deductible as true interest. Finally, the basis of the depreciable assets sold was the price fixed in the purchase agreement.[32]

One additional recommendation should be made if the sales approach is pursued. The assets should be leased to the corporation for over one year and then sold at the end of that time if the conditions of the *Perrault* case cannot be satisfied.

Conclusion

An attempt has been made in this article to outline most of the tax-saving methods presently being used in tax planning the capitalization of a close corporation, with their pros and cons. I feel that though the courts are narrowing the scope of "thinning" possibilities, there are still enough methods remaining to do the client considerable good if such methods are studied thoroughly and carefully applied.

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32 See also Warren H. Brown, 27 T.C. 27 (1956).