UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION

In re

Case No. 6:05-bk-05461-KSJ
Chapter 7

ARTHUR EUGENE WEST,

Debtor
_____/

ARTHUR EUGENE WEST,

Plaintiff,

vs.

Adversary No. 6:07-ap-100

UNITED STATES OF AMERICA,
INTERNAL REVENUE SERVICE,

Defendant.
_____/

ORDER DENYING PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT AND MOTION FOR RECONSIDERATION

On May 21, 2009, the Court heard and ruled upon the Motion by Plaintiff for Partial Summary Judgment (Doc. No. 35) and the Memorandum by Internal Revenue Service in Opposition to Plaintiff's Motion for Partial Summary Judgment (Doc. No. 39). Consistent with the findings of fact and conclusions of law stated orally and recorded in open court pursuant to F.R.B.P. 7052, the Court finds that factual disputes preclude entry of judgment as a matter of law, makes the following ruling and additional findings of fact and conclusions of law, and retains jurisdiction to issue further supplemental written findings of fact and conclusions of law to further explain the oral ruling, in the event an appeal is filed, pursuant to In re Mosley, 494 F.3d 1320 (11th Cir. 2007). Accordingly, it is

ORDERED:

1. The Motion for Partial Summary Judgment (Doc. No. 35) is denied.

2. In making this ruling, the Court makes the following supplemental findings of fact and conclusions of law:

   a. Plaintiff owned two "S" Corporations: 1) Florida Solar Distributors, Inc. ("Distributors") and 2) Solar Advantage, Inc. ("Advantage").

   b. In 1998, the United States of America, acting through the Internal Revenue Service (the "IRS") reallocated approximately $240,000 in expenses from Distributors to Advantage (reducing Distributors' 1998 loss and increasing Advantage's 1998 loss). Both companies, however, suffered losses in 1998, regardless of the IRS' reallocation of expenses. Because plaintiff did not have a sufficient basis in either S Corporation, he was unable to personally deduct either company's 1998 losses.

   c. In 1999, the IRS again reallocated approximately $200,000 in expenses from Distributors to Advantage (transforming Distributors' 1999 loss into a slight gain and increasing Advantage's 1999 loss). Because plaintiff still had an insufficient basis in Advantage, he again was unable to personally deduct Advantage's 1999 losses or Advantage's suspended 1998 losses.

   d. Plaintiff's Motion for Partial Summary Judgment (Doc. No. 35) seeks a determination that the expenses the IRS reallocated from Distributors to Advantage should be treated either as a loan or a capital contribution by plaintiff to Advantage. Either treatment would increase the plaintiff's basis in Advantage and would allow him to deduct Advantage's 1998 and 1999 losses on his personal income tax return. (Plaintiff's personal tax liability for 1998 and 1999 are at issue in this adversary proceeding.).

   e. "Under F.R.C.P. 56(c), made applicable to adversary proceedings and contested matters in bankruptcy cases by F.R.B.P. 7056 and 9014, summary judgment is proper 'if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and

that the moving party is entitled to judgment as a matter of law.'" In re Optical Technologies, Inc., 246 F.3d 1332, 1334 (11th Cir. 2001) (citing Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986)).

f. A shareholder of an S Corporation cannot take corporate losses and deductions into account on his personal income tax return to the extent that such items exceed the shareholder's basis in the corporation's stock and the shareholder's basis in the indebtedness of the corporation. 26 U.S.C. §1366(d). A shareholder can increase his basis by 1) the income of the corporation attributed to him, 2) making capital contributions, or 3) making loans to the corporation. 26 U.S.C. §§1366(d), 1367(a). In order to acquire basis in the debt of a corporation, a shareholder must make an actual economic outlay that renders him poorer in a material sense, and the indebtedness must run directly to the shareholder. Kerzner v. Comm'r, T.C. Memo. 2009-76 (2009); (citing Underwood v. Comm'r, 63 T.C. 468 (1975), affd. 535 F.2d 309 (5th Cir. 1976)).

g. Consistent with the findings of fact and conclusions of law stated orally and recorded in open court pursuant to F.R.B.P. 7052, the Court does not find persuasive either case cited by plaintiff in his Motion for Partial Summary Judgment (Doc. No. 35). The facts of both Culnen v. Commissioner, T.C. Memo 2000-139 (2000), and Rose v. Commissioner, 101 AFTR 2d 2008-1888 (11th Cir. 2008), are easily distinguishable from plaintiff's situation. In the instant case, plaintiff has not demonstrated any evidence of a loan transaction or a capital contribution on Distributors' or Advantage's books. Additionally, plaintiff has not demonstrated that he made any economic outlay that rendered him poorer in a material sense, or that Advantage was liable to him for the reallocated expenses. In the absence of such evidence, plaintiff's arguments based on Culnen and Rose fail.

h. In his Motion for Partial Summary Judgment (Doc. No. 35),[1] plaintiff alternatively argues that, when the IRS reallocated expenses from Distributors to Advantage, the IRS was obligated to make "collateral adjustments" pursuant to Section 482 of the Internal Revenue Code.[2] Plaintiff cites to Treasury Regulation 1.482-1(g)(2), which provides that whenever the IRS makes distributions, apportionments, or allocations to properly reflect the true income of one member of a group of controlled taxpayers (referred to as the primary allocation), it also must make an appropriate "correlative allocation" to the income of any other group member involved in the allocation. Treas. Reg. § 1.482-1(g)(2)(i); see also, Continental Equities, Inc. v. Comm'r, 551 F.2d 74 (5th Cir. 1977). Thus, if a reallocation increases the income of one group member, the income of the other group member must decrease. Id.

i. In the instant case, Treasury Regulation 1.482-1(g) requires no more than the following: if the IRS's imposed reallocation of expenses had the effect of increasing Distributors' income (the primary allocation), Advantage's income must be decreased correspondingly (the correlative allocation). Treasury

[1] The Court notes that plaintiff filed a Motion for Reconsideration of the Order Denying Plaintiff's Motion for Partial Summary Judgment or in the Alternative for Order Stating Controlling Issue of Law is in Question with Accompanying Memorandum of Law (Doc. No. 41) (the "Motion for Reconsideration") before the Court issued this Order Denying Motion for Partial Summary Judgment. Because the plaintiff's motion for reconsideration preceded the entry of this order, the motion is untimely and shall be denied. The ruling in this order, however, should address the issues raised in the untimely motion for reconsideration.

[2] Section 482 of the Internal Revenue Code authorizes the Secretary of the Treasury to allocate income, credits, and deductions between two or more organizations, trades or businesses owned or controlled, directly or indirectly, by the same interests, in order to prevent tax evasion or to clearly reflect income. Paccar, Inc. v. Comm'r, 849 F.2d 393 (9th Cir. 1988)

Regulation 1.482-1(g) contains no requirement that, if an individual owns two separate S corporations, such as here, the individual taxpayer's basis is increased to correspond with a correlative allocation. Indeed, given the requirement, discussed above, that basis increases only upon an "actual economic outlay" of some sort, it follows that correlative allocations between two sister S corporations will never result in a bump-up in basis to the individual taxpayer who owns them.

j. Plaintiff argues that if he is not given an increase in his basis in Advantage, he suffers real economic loss as a result of the shifting of expenses from Distributors to Advantage. He may well be correct. Section 482 of the Internal Revenue Code operates to prevent tax evasion and to clearly reflect ncome, not to protect taxpayers from potential economic loss. The IRS is not required to increase plaintiff's basis in Advantage pursuant to Treasury Regulation 1.482-1(g). The IRS made the appropriate correlative allocation by decreasing Advantage's income when it reallocated Distributor's expenses; that is all that is required by Treasury Regulation 1.482-1(g).

3. Plaintiff's Motion for Reconsideration (Doc. No. 41) is denied.

4. The parties are directed to exchange exhibits by **July 17, 2009**.

5. The parties are directed to meet and confer on factual and evidentiary stipulations by **July 29, 2009**.

6. Trial in this adversary proceeding is scheduled for **10:00 a.m. on July 30, 2009**, at the United States Bankruptcy Court, 5th Floor, Courtroom B, 135 W. Central Blvd., Orlando, Florida 32801.

DONE AND ORDERED in Orlando, Florida, on July 8, 2009.

/s/ Karen S. Jennemann
KAREN S. JENNEMANN
United States Bankruptcy Judge

Copies provided to:

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Defendant: United States of America, Internal Revenue Service, The Honorable Alberto R. Gonzales, 950 Pennsylvania Avenue, Attorney General of the United States, Washington, DC 20530-0001

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