"'UNIFIED BUSINESS ENTERPRISE" THEORY

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Under Code §183, individuals and S corporations desiring deductions for their business activities must be engaged in the activity "for profit." Activities which consistently generate losses may be presumed to be not for profit.

A recent case illustrates a seldom-discussed theory or concept, known as the "unified business enterprise" theory. Under this theory, a taxpayer conducting activities in isolation which generate losses and thus may be considered not to be "for profit" under Code §183, may be able to aggregate that activity with other activities conducted either individually or through other commonly controlled entities to come up with a profit motive for an aggregate, or "unified business" enterprise that will avoid the limits of Code §183.

The cases tend to arise where property, such as an airplane or land, is owned and leased to a related business venture, with losses arising in the owning entity. In the current case, the taxpayer was a principal in the Hard Rock Café chain. The taxpayer owned several aircraft in one or more entities, which aircraft were used by the taxpayer and/or other entities. The IRS asserted that deductions relating to the aircraft should be disallowed because the owning entities were not operated for profit. The taxpayer countered with the unified business enterprise theory.

The Court of Claims sustained the application of the unified business enterprise theory to the taxpayer's situation, and ruled against the IRS (although IRS issues of substantiation of expenses were allowed to go forward). The IRS raised the cases of Deputy v. du Pont, 308 U.S. 488 (1940) and Moline Properties, Inc. v. Comm., 319 U.S. 436 (1943) to show that corporations and their shareholders should be treated as separate and distinct for tax purposes. However, the court noted that in those older cases, S corporations were not involved, and did not involve overlapping businesses that essentially treated the S corporations as alter-egos for the taxpayer owner.

Thus, the unified business enterprise theory is alive and well, at least for pass-through entity situations such as S corporation and partnerships. Situations involving C corporations should expect greater resistance, if not outright rejection, of the theory by the IRS and courts.

Morton v. U.S., 107 AFTGR 2d 2011-xxxx (Ct Fed Cl), April 27, 2011

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