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STUDENT NOTES

Guaranteed Shareholder Loans and Thin Capitalization

Ideally, a revenue system should apportion the tax burden according to economic realities. Legal fictions may, however, interfere with the concept of economic reality. One example is corporate law. While there are innumerable decisions establishing the corporation as a separate entity, economically it is nothing more than a conglomerate group of individuals. And when this legal fiction is employed in the closely held corporation, irreconcilable results are to be expected.

Where widely held corporations are involved, the vast majority of cases recognize any debt instrument as genuine; but, at the other extreme where a corporation is closely held, and the debt is held in proportion to the equity interests, uncertainty prevails as to whether the debt is actually debt or equity. Corporations, however, are separate legal entities: be they owned by one indi-