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### TAX CONSEQUENCES OF SHAREHOLDER GUARANTEES: THERE'S STILL HAY IN *TULIA* *FEEDLOT*

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Out in Swisher County in the Texas Panhandle lies a heavy concentration of feedlot operations, where the 45,000 head of feeder cattle in just one feedlot far outnumbers the whole county's population of 8,378 people.<sup>1</sup> One of these feedlot operations is conducted by Tulia Feedlot, Inc.<sup>2</sup> This feedlot operation is located in the South Tule Draw of the Red River Basin,<sup>3</sup> about five miles south of Tulia, the county seat of Swisher County. From that feedlot operation arose a tax case, *Tulia Feedlot, Incorporated v. United States* ("*Tulia I*"),<sup>4</sup> which continues to provide a platform for the Internal Revenue Service to attack the structure and operation of shareholders' guaranteeing the obligations of privately-owned corporations.<sup>5</sup> Yet, properly

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1. Total population of Swisher County, Texas, based on census for year 2000. U.S. Census Bureau, Fact Finder. <http://quickfacts.census.gov/qfd/states/48/48437.html> (last visited May 11, 2004).

2. The Tulia Feedlot operation spreads over 225 acres. Cattle are fed two or three times a day and will eat about twenty-two to twenty-eight pounds per day. Letter from John Van Pelt, Manager of Tulia Feedlot, Inc., to Merle F. Wilberding (April 4, 2004) (on file with the author).

3. Red River Authority of Texas, <http://www.rra.dst.tx.us/misc/aboutbasin.cfm> (last visited August 25, 2004). The Red River Basin has a total drainage area of 94,450 square miles, of which 24,463 square miles lie within Texas. *Id.* (The remaining drainage areas are in Oklahoma, New Mexico, Arkansas and Louisiana where it discharges into the Mississippi River.)

4. *Tulia Feedlot Inc. v. U.S.*, 513 F.2d 800 (5th Cir. 1975), *cert. denied*, 423 U.S. 947 (1975).

5. *See, e.g.*, I.R.S. Priv. Ltr. Rul. 82-11-005 (Nov. 27, 1981); I.R.S. Priv. Ltr. Rul. 86-10-009 (Nov. 14, 1985); I.R.S. Priv. Ltr. Rul. 86-10-010 (Nov. 14, 1985).

implemented *Tulia I* and its progeny<sup>6</sup> can provide taxpayers a structure and procedure for compensating shareholders for the risk they assume in guaranteeing corporate obligations.

For most privately-owned corporations, shareholder guarantees of corporate obligations are a way of life, and shareholder guarantees are often an integral part of the ability of many corporations to conduct business. More attention needs to be given to the corporate and tax aspects of shareholder guarantees to insure that shareholders are properly compensated for the risks they assume and to insure that corporations are properly entitled to deductions as ordinary and necessary business expenses under Section 162 of the Internal Revenue Code (the "Code").<sup>7</sup>

Tulia Feedlot, Inc. was incorporated in the State of Texas on March 29, 1963, with its business address in Tulia, Texas.<sup>8</sup> Its purpose was to conduct cattle feeding operations which it established on land located about five miles south of the town of Tulia, Texas. In 1967, the Red River Authority of Texas created the Tulia Feedlot Reservoir by impounding the waters of the South Tule Draw with an earthen dam seventeen feet tall, with a crest length of 2,190 feet.<sup>9</sup> Tulia Feedlot was one of many feedlot operations which were established in the 1950s and 1960s to take advantage of the abundant grain crops and other agricultural resources in that county.<sup>10</sup> From its inception, the Tulia Feedlot operation grew rapidly and by 1970 it had reached its capacity of 28,000 head of cattle.<sup>11</sup>

The nature of its operations was twofold. Primarily, it fed cattle owned by its customers.<sup>12</sup> To keep the feedlot running at maximum efficiency, it also purchased and fed cattle for its own account.<sup>13</sup> Feeding cattle for its own account required large amounts of credit to carry the acquisition and feeding costs of this part of the operation.<sup>14</sup> To satisfy the financial in-

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6. See, e.g., *Tulia Feedlot, Inc. v. United States*, 231 Ct. Cl. 971 (1982); *Tulia Feedlot, Inc. v. United States*, 3 Cl. Ct. 364 (1983); *Olton Feed Yard, Inc. v. United States*, 592 F.2d 272 (5th Cir. 1979); *Stewart v. Comm'r*, 84 TCM (CCH) 175 (2002); *Seminole Thriftway, Inc. v. United States*, 42 Fed. Cl. 584 (1998); *Harris v. United States*, 902 F.2d 439 (5th Cir. 1990); *Sleiman v. Comm'r*, 187 F.3d 1352 (11th Cir. 1999); *Harrison and Sons, Inc. v. United States*, 86 TCM (CCH) 240 (2003).

7. I.R.C. § 162 (2005).

8. The articles of incorporation were filed on March 29, 1963. This information was found in the Public Records in the office of the Texas Secretary of State, available in LEXISNEXIS Library (last visited March 29, 2004).

9. Red River Authority of Texas, [http://www.rra.dst.tx.us/survice\\_w/swisher/tulia\\_feedlot\\_reservoir.cfm](http://www.rra.dst.tx.us/survice_w/swisher/tulia_feedlot_reservoir.cfm) (last visited March 27, 2004).

10. Red River Authority of Texas, [http://www.rra.dst.tx.us/c\\_t/history/SWISHER/default1.cfm](http://www.rra.dst.tx.us/c_t/history/SWISHER/default1.cfm) (last visited March 27, 2004).

11. *Tulia Feedlot Inc. v. United States*, 513 F.2d 800, 802 (5th Cir. 1975).

12. *Id.* at 803.

13. *Id.*

14. *Id.*

