

1 STATE OF ALASKA  
DEPARTMENT OF ADMINISTRATION  
2 OFFICE OF TAX APPEALS  
PO Box 110200  
3 Juneau, Alaska 99811-0200  
(907) 465-1886; Fax (907) 465-2280

BEFORE THE OFFICE OF TAX APPEALS

STATE OF ALASKA

6  
7 IN THE MATTER OF: )

Case No. 31-OTA-99

8 NORTHWEST MEDICAL IMAGING, INC. )  
9 Corporate Income Tax )  
10 9112-9512 )

Memorandum and Order Abating Corporate  
Income Tax Assessment

11 This memorandum addresses opposing motions by the taxpayer, Northwest Medical Imaging  
12 (NWMI), and the Department of Revenue (DOR). NWMI initiated the motion battle by filing a  
13 Motion to Prohibit Assessment<sup>1</sup> of corporate income tax on the grounds that NWMI was not a  
14 corporation during the tax years at issue. DOR responded by filing a Motion to Show Cause  
15 Why the Appeal Should Not be Dismissed and Judgment Entered Affirming the Assessment, an  
16 Opposition to the Motion to Prohibit Assessment, a Motion for Summary Judgment, and a  
17 Motion to Join James D. Pister and Virginia Pister as individuals. Oral argument on these related  
18 motions was held on January 11, 2001.

17 This decision concludes that this appeal may be resolved on the merits as a matter of law and that  
18 the corporate income tax assessment against NWMI must be abated. DOR's opposing motions  
19 are denied.

20 **Facts.**

21 On May 8, 1997 DOR issued a notice and demand for \$88,665 in additional corporate income  
22 tax, plus interest and penalties, that DOR determined were due under the corporate income tax  
23 returns that NWMI filed for 1991, 1992, 1993, 1994 and 1995. NWMI requested an informal  
24 conference to dispute the assessment. On October 13, 1999 DOR issued an informal conference  
25 decision that upheld the assessment of additional tax in the amount of \$31,949, plus interest, and  
26 upheld the negligence and failure to pay penalties. The additional taxes affirmed by the informal  
27 conference decision result from DOR disallowing substantial travel and rent deductions that  
28 NWMI claimed on its corporate income tax returns.

28 <sup>1</sup> The Motion to Prohibit Assessment is, in substance, a motion for summary judgment on the grounds that NWMI is  
29 not liable for the assessed corporate income taxes for 1991-1995 because NWMI was not a corporation at that time  
and I have treated it accordingly.

1 NWMI timely appealed the informal conference decision to the Office of Tax Appeals in  
2 November 1999, contesting the taxes and penalties assessed against its corporate income tax  
3 returns for 1991 through 1995.

4 In November 2000, after substantial pre-hearing discovery concerning the disputed corporate tax  
5 deductions, settlement negotiations on the tax and penalty issues, and a change in counsel for the  
6 taxpayer after its original attorney withdrew for health reasons, the taxpayer's new attorney filed  
7 a motion to prohibit the corporate income tax assessment on the grounds that NWMI is not a  
8 corporation and was not a corporation during the tax years at issue. This was the first time that  
9 the taxpayer raised the issue of its corporate status in contesting the 1997 assessment.

10 Public records of the State of Washington show that NWMI was issued a Certificate of  
11 Incorporation on November 10, 1988. The articles of incorporation name Dr. James Pister as the  
12 sole shareholder and director and list the purpose as providing medical radiology services to  
13 hospitals and health care providers in Alaska and Washington. The State of Washington  
14 administratively dissolved the corporation, NWMI, effective February 21, 1990. Apparently  
15 NWMI was never incorporated in Alaska.

16 After February 21, 1990 NWMI continued to represent itself as a corporation in conducting  
17 business. NWMI filed Alaska and Federal corporate income tax returns for the tax periods at  
18 issue, calendar years 1991 through 1995. NWMI entered into written contracts, as a corporation,  
19 with the Alaska Area Native Health Service to provide radiology services in Alaska and invoiced  
20 the Native Health Service as a corporation for services provided in 1991 through 1995. "NWMI,  
21 Inc." also entered into a lease agreement with Toyota Motor Credit Corporation to lease an  
22 automobile in Anchorage in 1994 and maintained a corporate checking account with an  
23 Anchorage bank.

24 In addition, Dr. James Pister told a DOR investigator in 1996 that he was employed by NWMI  
25 and that NWMI was a Washington corporation. In addition, the Notice of Appeal that NWMI  
26 filed to initiate this proceeding states that the taxpayer is a corporation formed in 1988 under the  
27 laws of the State of Washington and that Dr. Pister was an employee of the corporation during  
28 the tax years at issue. However, NWMI's representatives recently discovered that NWMI lost its  
29 corporate charter under Washington law in 1989.

#### DOR's motion for an order to show cause

DOR has filed a show cause motion to require Dr. James Pister and his current and former  
attorneys to appear and testify under oath regarding the capacity and authority under which they  
have appeared and protested the assessment against NWMI, Inc. DOR argues that the corporate  
entity, NWMI, Inc. is the taxpayer in this proceeding and unless that corporate taxpayer is  
contesting the assessment then this appeal must be dismissed and the assessment affirmed. DOR  
contends that NWMI's representatives have effectively disclaimed that they act for NWMI, Inc.,  
the taxpayer, by raising the claim that NWMI was not and is not incorporated. DOR does not

1 argue nor is there any evidence suggesting that current counsel for NWMI is not authorized by  
2 Dr. Pister, who clearly controls NWMI, to represent the business in these proceedings.

3 In essence, DOR makes the same argument on the show cause motion that it does on the merits  
4 in support of its cross motion for summary judgment: Since NWMI filed tax returns as a  
5 corporation and was assessed as a corporation, NWMI cannot disclaim its corporate status in  
6 appealing the assessment. The issues of whether NWMI is taxable as a de-facto corporation or is  
7 estopped from now claiming that it is not a corporation for tax purposes are appropriately  
8 resolved in the context of summary judgment, not in a show cause motion concerning the real  
9 party in interest in this appeal.

10 Moreover, it seems to me that filing corporate tax returns, and being assessed additional taxes on  
11 those returns, did not bind NWMI to corporate status for tax purposes. If NWMI's  
12 representatives had discovered within three years of filing the disputed corporate income tax  
13 returns that NWMI, Inc. was not validly incorporated during the tax years at issue, they could  
14 have filed amended state and federal returns reflecting its status as an unincorporated entity. It  
15 stands to reason that if NWMI's representatives could have timely re-filed as an unincorporated  
16 business, then NWMI's representatives can raise lack of corporate status as a defense to the  
17 corporate income tax assessment in this appeal without having to prove at a show cause hearing  
18 that they are in fact representing the taxpayer.

19 For these reasons, the Motion to Show Cause is denied.

20 Is NWMI subject to Alaska corporate income tax as a de-facto corporation, or as a corporation  
21 by estoppel?

22 The main issue presented by the cross motions for summary judgment is whether NWMI is  
23 subject to the Alaska Corporation Net Income Tax in 1991-1995 although it was not validly  
24 incorporated during those years. This appears to be a question of first impression in Alaska and  
25 is important because in 1980 Alaska repealed the state individual income tax, leaving only the  
26 corporations net income tax under AS 43.20.

27 NWMI argues that DOR cannot assess a corporate income tax against NWMI because NWMI  
28 lost its corporate status long before the tax years at issue and was effectively operated by Dr.  
29 Pister as a sole proprietorship. DOR argues that regardless of whether NWMI was validly  
30 incorporated, NWMI is subject to Alaska corporation income tax as a de-facto corporation, or as  
31 a corporation by estoppel, because the undisputed evidence shows that NWMI acted as a  
32 corporation, and Dr. Pister held NWMI out as a corporation for business and tax purposes during  
33 the relevant time period.

1 DOR argues that NWMI is properly classified as a corporation under federal tax regulations that  
2 implemented the de-facto corporation doctrine and were effective during the tax years at issue.<sup>2</sup>  
3 Those IRS regulations contain standards for determining whether unincorporated entities, like  
4 limited liability companies, are treated as corporations for income tax purposes. Treasury Reg. §  
5 301.7701-2(a)(1), lists six characteristics of a corporation that distinguish it from partnerships  
6 and other entities. These characteristics are (1) associates; (2) an objective to carry on business  
7 for profit; (3) centralization of management; (4) limited liability; (5) free transferability of  
8 interest; and (6) continuity of life. The regulation provides that local law governs in determining  
9 the legal relationships relevant to determining whether an entity has these corporate  
10 characteristics.

11 DOR contends that NWMI meets all of the standards under the regulations, except for the  
12 criterion of associates, which DOR argues is inapplicable where the business in question is  
13 organized as a one man corporation. I disagree that NWMI meets the IRS standards for  
14 classification as a corporation. Without incorporation, a one-man business, like NWMI, does not  
15 have any of the corporate characteristics, except carrying on a business for profit.

16 Clearly, NWMI fails to meet the limited liability standard for the tax years at issue because it  
17 was not validly incorporated. As DOR recognizes in its contemporaneous motion to join Dr.  
18 Pister and his wife as individuals in this appeal, if NWMI was not validly incorporated Dr. Pister  
19 is personally liable for the business debts of NWMI under state law. DOR can't have it both  
20 ways. If Dr. Pister is liable for NWMI's debts, and he is, then NWMI lacks the limited liability  
21 requirement for classifying NWMI as a corporation for income tax purposes.

22 A company possesses the corporate characteristic of centralized management "if a person (or  
23 group of persons that does not include all of the members) has continuing exclusive authority to  
24 make management decisions reasonably necessary to the conduct of the business for which the  
25 organization was formed." Tres. Reg § 301.7701-2 (c)(1). In applying this regulation, the IRS  
26 treats a company as lacking centralized management if the members retain management control  
27 in themselves instead of appointing managers. See, BNA Multistate Tax Portfolio: State  
28 Taxation of Limited Liability Companies and Partnerships, 1995 ed. at 1560:0004. In the instant  
29 case, the undisputed evidence shows that Dr. Pister was the sole member and officer of NWMI  
30 and managed the business himself. Because NWMI had no management separate from its  
31 membership (i.e. sole member), it failed to meet the centralized management criterion for  
32 classification as a corporation under the IRS rules.

33 Likewise, because Dr. Pister was the sole member, manager, and person who performed the  
34 medical radiology services that constituted the business of NWMI, it is difficult to see how  
35 NWMI qualifies under the remaining corporate characteristics of continuity of life and free  
36 transferability of interests. If Dr. Pister died no member or manager would survive to continue  
37 the business or to make a transfer of his interest in any capital or profits of the business. Instead,

---

28 <sup>2</sup> Effective January 1, 1997, the IRS adopted new rules that simplified the tax classification of unincorporated  
29 businesses by substituting a "check-the-box" classification election which allows business entities to elect to be  
30 taxed as either a corporation or as a partnership on a pass-through basis.

1 without incorporation, NWMI would die as a business entity if its sole member and manager  
2 died.

3 For these reasons, I conclude that NWMI had more noncorporate characteristics than corporate  
4 characteristics and more clearly resembled a sole proprietorship during the tax years at issue.  
5 Concluding that NWMI lacked the characteristics necessary for classification as a corporation for  
6 income tax purposes under the applicable IRS regulations is dispositive with respect to the issue  
7 of whether NWMI can be held liable for corporate income tax for 1991 through 1995 as a de-  
8 facto corporation. The answer is no.<sup>3</sup>

9 DOR argues that even if NWMI is not classified as a de-facto corporation under the IRS  
10 classification rules, NWMI is taxable under AS 43.20 as a corporation under the estoppel  
11 doctrine. But none of the cases that DOR cites in support of its corporation-by-estoppel argument  
12 involve an attempt to impose corporate income taxes on a business entity that was  
13 unincorporated during the tax years at issue.

14 The case that comes closest to the facts of this case is *Group Administration Premium Services,*  
15 *Inc., et. al v. Commissioner*, 72 TCM 834 (1996). In the GAPS case the company had conducted  
16 business since 1986 based on the belief that it was validly incorporated. After being advised in  
17 February 1989 by an attorney that the incorporation was not valid, GAPS re-filed articles of  
18 incorporation on March 1, 1989 to become validly incorporated on that date. In a dispute with  
19 the IRS over treatment of its earnings for the first two months of 1989, before GAPS was validly  
20 incorporated, the Tax Court ruled that GAPS should be treated as a corporation for the entire tax  
21 year. I do not find the GAPS case to be persuasive authority for holding an unincorporated  
22 business that was not validly incorporated at any time during the relevant tax period liable for  
23 corporate income taxes.

24 DOR also relies on *U.S. v. Theodore Accounting Service et.al.*, 347 F. Supp. 1070 (D SC 1972).  
25 That case involved enforcement of an n IRS summons issued to an accounting service for tax  
26 records of some of its customers. The accounting business had represented itself as a corporation  
27 but in fact had not been validly incorporated and resisted enforcement of the summons on the  
28 grounds that it was not a corporation and the records sought were therefore personal business  
29 records. The court held that the accounting business was estopped to deny its corporate status.  
Given that very different fact situation, *Theodore Accounting* is not persuasive authority for  
imposing corporate income tax liability by estoppel on an unincorporated business.

Other cases cited by DOR in support of its estoppel argument involve businesses that were  
validly incorporated during the tax year at issue but argued that they should be treated for tax  
purposes as sole proprietorships or partnerships despite incorporation. For example, in *United*  
*States.v. Scornavacco's Restaurant*, 528 F. 19 (7<sup>th</sup> Cir. 1975), a family-owned restaurant  
business was validly incorporated in January 1969 but didn't file corporate income tax returns  
until 1970 and instead reported the 1969 restaurant income on the individual income tax return of

---

<sup>3</sup> There is no need to consider the effect of AS 10.06.218, which expressly abolishes the doctrine of de-facto corporations in Alaska (but clearly, this statute does not help DOR's argument.)

1 the family patriarch. The court rejected the taxpayer's argument that the business was in fact run  
2 as a sole proprietorship until 1970 and should be so treated for tax purposes. Instead, the court  
3 found that the fact of valid incorporation in 1969 was dispositive and that the taxpayer couldn't  
4 escape the legal consequences of incorporating in January 1969. *Scornavacco* does not support  
5 DOR's argument in this case that NWMI should be treated as a corporation for tax purposes in  
6 1991-1995 when it was not validly incorporated but filed corporate income tax returns and called  
7 itself a corporation.

8 Concluding that NWMI is not liable for Alaska corporate income taxes under these  
9 circumstances is troubling because it seems to reward Dr. Pister for conduct that, at best, was  
10 negligent with respect to business and tax matters. On the other hand, there is nothing in this  
11 record to indicate that Dr. Pister intentionally mislead state or federal taxing authorities  
12 concerning NWMI's corporate status. Significantly, the fact that NWMI was not validly  
13 incorporated after February 21, 1990 was a matter of public record.

14 More importantly, Dr. Pister did not gain any advantage with respect to Alaska tax liability by  
15 representing NWMI as a corporation after February 1990 and filing state corporate income tax  
16 returns.<sup>4</sup> For Alaska tax purposes, Dr. Pister would have been better off if he had recognized  
17 NWMI's legal status as an unincorporated entity because Alaska has not imposed a personal  
18 income tax since 1980. Concluding that NWMI is not liable to the State of Alaska for income  
19 taxes on the hundreds of thousands of dollars that Dr. Pister earned by practicing medicine in  
20 Alaska during 1991-1995 because NWMI was not a corporation results from Alaska's tax  
21 structure. NWMI is only one of many profitable small businesses doing business in Alaska that  
22 do not pay state income taxes because the business is unincorporated or elects pass-through tax  
23 status.

24 For the reasons above, I conclude that NWMI is entitled to judgment as a matter of law that it is  
25 not liable for corporate income taxes under AS 43.20 for 1991 through 1995. DOR's motion for  
26 summary judgment on tax liability is denied on the merits and its motion to join Dr. Pister  
27 individually is denied as moot.

28 It is so ordered.

29 Dated: March 2, 2001

\_\_\_\_\_  
Administrative Law Judge

30 \_\_\_\_\_  
31 <sup>4</sup> Whether Dr. Pister gained any advantages under federal tax law by filing as a corporation, or alternatively, whether  
32 Dr. Pister is potentially liable for additional federal income taxes because NWMI was not a corporation, is not a  
33 matter of record in this appeal and is a matter for the IRS, not OTA.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29