

IN THE UNITED STATES COURT OF APPEALS  
FOR THE FIFTH CIRCUIT

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No. 94-40562

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EDUARDO CEPEDA and MARTHA I. CEPEDA,  
Petitioners-Appellants,

VERSUS

COMMISSIONER OF INTERNAL REVENUE,  
Respondent-Appellee.

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EDUARDO CEPEDA, M.D., P.A.,  
Petitioner-Appellant,

VERSUS

COMMISSIONER OF INTERNAL REVENUE,  
Respondent-Appellee.

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Appeal from the United States Tax Court  
(298-92-299, 92)

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(May 17, 1995)

Before HIGGINBOTHAM, SMITH, and STEWART, Circuit Judges.

JERRY E. SMITH, Circuit Judge:\*

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\* Local Rule 47.5.1 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that rule, the court has determined that this opinion should not be published.

## I.

Eduardo Cepeda, M.D., created Eduardo Cepeda M.D., P.A. ("PA" or "the corporation"), in 1980. He was its sole shareholder and president. Before 1988, PA advanced the doctor \$161,479 for personal purposes, maintaining a "due from stockholders account" reflecting these advances. No other documents memorialized these advances as loans or set forth any interest rate or repayment plan.

In late 1987, Dr. and Mrs. Cepeda filed for bankruptcy under Chapter 7. Subsequently, they listed PA as an unsecured creditor in their Statement of Financial Affairs. On January 1, 1988, PA wrote off the \$161,479 balance as a bad debt, deducting this amount on its corporate tax return. On February 29, 1988, the bankruptcy court discharged the Cepedas from all dischargeable debts.

In 1988, PA advanced another \$95,101 in payments to the doctor. Of this, \$43,461 was paid to the bankruptcy trustee for the Cepedas to repurchase PA's stock pursuant to the bankruptcy court's October 1988 authorization.

PA did not declare dividends for any of the relevant years. The Cepedas did not formally "repay" any of the funds advanced to them by the corporation, but they did deposit into the corporate account various checks made out to the order of the doctor from an unrelated investment.

## II.

In 1991, the Commissioner issued a notice of deficiency for 1988, based upon receipt of \$91,423 in unreported constructive

dividends. The doctor sought redetermination of the deficiency in the Tax Court, arguing that the \$91,423 had been a loan. The Commissioner then amended her answer to assert, in the alternative, that the funds were unreported compensation to the doctor. In response to this amended answer, PA amended its petition to claim a business expense deduction for the funds.

The Tax Court found that the \$91,423 was composed of constructive dividends rather than loans. The court refused to address the Commissioner's argument that the funds were employee compensation, stating that no evidence had been introduced in support of this issue. The doctor moved for reconsideration, arguing that under the internal revenue regulations and the Bankruptcy Code, he could not receive a constructive dividend while in bankruptcy, as the bankruptcy estate was the shareholder of PA.

The Tax Court denied this motion. In its supplemental opinion, it conceded that the bankruptcy estate))rather than the doctor himself))had been the legal owner of PA's stock at the time of the payments. The court, however, relied upon the benefits flowing to the doctor in his personal capacity to find a constructive dividend under a "beneficial ownership" theory. In the alternative, the court rested its decision upon the "substance over form" doctrine. After a detailed discussion of each of these bases for its decision, the court concluded its opinion with a footnote stating that "[e]ven if we concluded that petitioner was not a shareholder under either espoused theory, the advances were, nevertheless, an accession to petitioner's wealth and, thus, would

be income under the general principles of [26 U.S.C. §] 61."

### III.

#### A.

A distribution from a corporation to a taxpayer is not considered a dividend unless it is paid to the taxpayer in his capacity as a shareholder. 26 C.F.R. § 1.301-1(c). The commencement of a bankruptcy case under chapter 7 creates an estate that consists of all legal or equitable interests in the debtor's property. 11 U.S.C. § 541. Accordingly, at the commencement of the Cepeda's bankruptcy case on November 23, 1987, ownership of PA passed to the bankruptcy estate, and the trustee had legal title of the shares. The trustee, as representative of the estate, retained title until he sold the stock to Dr. Cepeda on October 21, 1988.

The Commissioner argues that Dr. Cepeda should be held to have received a constructive dividend, even though he was not legally a shareholder during the pendency of the bankruptcy case. To support this argument, the Commissioner cites a number of cases holding taxpayers responsible for constructive dividends where they enjoyed "beneficial ownership" of the stock.

#### B.

We need not decide whether the Tax Court erred on this issue, as we address instead the Tax Court's alternative holding that the corporate advances are taxable as income to Dr. Cepeda under the general principles of 26 U.S.C. § 61, as an accession to wealth.

As a threshold matter, we must determine whether this issue is properly before us. Dr. Cepeda argues that the Tax Court improperly relied upon § 61(a), as that ground was not asserted in the Commissioner's notice of deficiency, and cites Baird v. Commissioner, 438 F.2d 490 (3d Cir. 1970), and Evans v. Commissioner, 63 T.C.M. (CCH) 3001 (1992).

In Baird, the court vacated and remanded where the Tax Court had relied upon a broad theory of unreported income although the Commissioner's theory at trial had been much narrower. Based upon its reading of the trial transcript, the court reasoned that the taxpayer had not been on notice that a broader theory of liability was being pursued. "We say this," the court continued, "because it would be patently unfair to decide this case on a theory of which tax payer was unaware and thus did not have an opportunity to meet at the evidentiary stage." Baird, 438 F.2d 490, 493 (3d Cir. 1970).

Unlike the taxpayer in Baird, Dr. Cepeda was not prejudiced by any surprise in proof. In fact, he stipulated that the corporation had advanced the funds in question to him or on his behalf. In light of this stipulation, which practically concedes the heart of the accession-to-wealth issue, and in light of the fact that the payments were characterized at various stages of this litigation as loans, constructive dividends, and unreported employee compensation, we find that Dr. Cepeda had adequate notice of the § 61(a) accession-to-wealth argument.

Nor can there be any doubt that the advances constituted an

accession to wealth within the meaning of § 61(a). A large portion of the payments went to the bankruptcy trustee, as payment for the sale of shares of the corporation's stock back to Dr. Cepeda. The remainder went to various businesses) none of which was a creditor of Dr. Cepeda's whose accounts receivable had been discharged in bankruptcy. And, of course, Dr. Cepeda stipulated that all of these payments were made to him or on his behalf.

Accordingly, the judgment of the Tax Court is AFFIRMED on the alternative § 61(a) ground.