*2 T.C. 152 (1943)*

Section 45 of the Revenue Act of 1934 does not authorize the Commissioner to reallocate income between a parent company and its subsidiary when the parent's purchase and subsequent redemption of the subsidiary's bonds were legitimate transactions conducted at arm's length.

**Summary**

Koppers Co. (petitioner), the sole stockholder of Koppers Products Co. (taxpayer), purchased the taxpayer's bonds on the open market and later had them redeemed. The Commissioner argued this was a scheme to shift profit from the subsidiary to the parent, disallowed certain deductions taken by the subsidiary, and assessed a deficiency against the petitioner as the transferee of the subsidiary's assets. The Tax Court held that the purchase of the bonds by the parent was a legitimate transaction and not a fictitious sale under Section 45, as the amount received on redemption was no more than any other bondholder would have received.

**Facts**

Koppers Products Co. issued bonds to the public. Due to a business downturn, it negotiated an extension agreement with bondholders that deferred some interest payments. Later, business improved, but the extension agreement restricted dividend payments to its sole stockholder, Koppers Co. Koppers Co. then decided to liquidate Koppers Products Co. To facilitate this, Koppers Co. borrowed funds and purchased the subsidiary's outstanding bonds in the open market at below par value. As a step in liquidation, Koppers Products Co. then called the bonds for redemption at 102 plus accrued interest, paying Koppers Co., now the bondholder, according to the bond indenture. Koppers Co. reported the excess received over its cost as income.

**Procedural History**

The Commissioner determined a deficiency against Koppers Products Co. based on the bond transactions, arguing it was an attempt to shift profits. Koppers Co., as the transferee of Koppers Products Co.'s assets, was assessed the deficiency. Koppers Co. petitioned the Tax Court, contesting the deficiency.

**Issue(s)**

1. Whether the Commissioner was authorized under Section 45 of the Revenue Act of 1934 to allocate income from Koppers Co. to its subsidiary, Koppers Products Co., based on Koppers Co.'s purchase and redemption of the subsidiary's bonds.

**Holding**

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1. No, because the parent company's purchase and redemption of the subsidiary's bonds was a legitimate transaction conducted at arm's length and did not constitute a "shifting of profits" or a "fictitious sale" to evade taxes.

**Court's Reasoning**

The Tax Court analyzed whether Koppers Co. had evaded tax by causing a transaction that was effectively the subsidiary's to be carried out in the parent's name. The court distinguished this case from others where sales were made at artificial prices solely for tax purposes. Here, the court found that the purchase of the bonds by the parent was a real transaction. The court emphasized that the taxpayer paid no more to redeem the bonds from Koppers Co. than it would have paid to any other bondholder under the terms of the bond indenture. The court noted, "It was the same transaction, insofar as the consideration paid by the taxpayer for the redemption, as it would have been had it been carried out by the taxpayer with the public owners of the bonds prior to their acquisition by petitioner." The court also pointed out Koppers Co. had a right to arrange its affairs to minimize its tax burden, stating, "It was free to and did use its funds for its own purposes. It was under no obligation to so arrange its affairs and those of its subsidiary as to result in a maximum tax burden. On the other hand, it had a clear right by such a real transaction to reduce that burden."

**Practical Implications**

This case clarifies the scope of Section 45, emphasizing that it cannot be used to reallocate income when transactions between related entities are conducted at arm's length and reflect economic reality. Taxpayers have the right to structure transactions to minimize their tax liability, provided the transactions are genuine. The decision indicates that the Commissioner's authority under Section 45 is not unlimited and requires a showing of a "shifting of profits" through "fictitious sales" or similar manipulative devices. Later cases have cited Koppers for the principle that legitimate business transactions between related parties will not be disturbed simply because they result in a lower tax liability.

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