16 T.C. 54 (1951)

A loss incurred in a bona fide sale-leaseback transaction, conducted at arm's length with a purchaser over whom the seller has no control, is deductible for income tax purposes, even if the seller's cash position is improved due to tax benefits.

Summary

May Department Stores Co. sold land and buildings used in its business and leased them back. The Commissioner argued the sale was a sham to create a tax loss. The Tax Court held that the sale was a bona fide, arm's-length transaction with an independent purchaser and that the loss was deductible under Section 23(f) of the tax code. The court emphasized the lack of control May had over the buyer and the genuine business purpose behind the sale and leaseback.

Facts

May Department Stores Co. (petitioner) sold land and buildings it used in its trade or business to an unrelated third party, Meisel. The sale was negotiated through independent real estate brokers. As part of the agreement, May leased back the property. The lease included a provision where Meisel would invest up to $50,000 in improvements. May had the option to lease the premises for 24 years at an annual rental of $6,000 plus expenses but had no repurchase option. May sought to expand its physical facilities and considered the tax consequences of the sale.

Procedural History

The Commissioner of Internal Revenue disallowed May's deduction for the loss claimed on the sale. May appealed to the Tax Court, challenging the Commissioner's determination.

Issue(s)

Whether May Department Stores Co. is entitled to deduct a loss from income under Section 23(f) of the Internal Revenue Code, stemming from the sale of land and buildings used in its trade or business, when it simultaneously leased back the property from the purchaser.

Holding

Yes, because the sale was a bona fide, arm's-length transaction with an independent purchaser, and May materially changed its position as a result of the transaction. The loss is deductible.

Court's Reasoning

The court found that the sale to Meisel was a legitimate business transaction. There

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was no evidence of any relationship or agreement beyond that of buyer and seller. The transaction was at arm's length, and the fee in the property was absolutely transferred to Meisel. The court distinguished this case from those involving transactions between taxpayers and entities they control, where the taxpayer's economic position remains unchanged. Here, May relinquished ownership and gained only a leasehold interest. The court acknowledged May considered the tax consequences, but cited *United States v. Cumberland Public Service Co.*, 338 U.S. 451, and *Commissioner v. Hale*, 67 Fed. (2d) 561, noting that taxpayers can consider tax consequences. The court also noted May had a business purpose in expanding its physical facilities. The court stated, "Any loss which it suffered in the sale of the land and buildings, therefore, is deductible from its income."

Practical Implications

This case establishes that a sale-leaseback transaction can be recognized for tax purposes if it is a bona fide, arm's-length deal. The key factor is whether the seller relinquishes control of the property and materially changes its position. Taxpayers contemplating sale-leasebacks should ensure the transaction is with an independent party and has a legitimate business purpose beyond mere tax avoidance. Later cases have distinguished *May Department Stores* by focusing on whether the lease term is essentially equivalent to a fee interest or if there are repurchase options, indicating a lack of genuine transfer of ownership.

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