15 T.C. 581 (1950)

A sale and leaseback of real property, when part of an integrated transaction, constitutes a like-kind exchange under Section 112(b)(1) of the Internal Revenue Code, precluding recognition of loss if the lease has a term of 30 years or more.

Summary

Century Electric Co. sold its foundry property to William Jewell College for $150,000 and simultaneously leased the property back for 95 years, with options to cancel after 25 years and every 10 years thereafter. Century claimed a loss on the sale, arguing it was a separate transaction from the leaseback. The Tax Court held that the sale and leaseback were an integrated transaction, constituting a like-kind exchange. Therefore, no loss was recognizable under Section 112(b)(1) and 112(e) of the Internal Revenue Code, but Century was entitled to depreciation on the leasehold over the 95-year term.

Facts

Century Electric owned and operated a foundry building and land with an adjusted basis of $531,710.97. The foundry was essential to Century's business. Facing pressure to improve its cash position, Century agreed to sell the foundry to William Jewell College for $150,000. As a condition of the sale, Century simultaneously leased the property back from the College for a term of 95 years, subject to cancellation options after 25 years and every 10 years thereafter. The lease required Century to pay rent, insurance, repairs, and assessments, but exempted the College from general state, city, and school taxes due to its charter. Century claimed a loss of $381,710.97 on the sale.

Procedural History

The Commissioner of Internal Revenue disallowed Century's claimed loss. Century Electric petitioned the Tax Court for review of the Commissioner's determination.

Issue(s)

1. Whether the sale and leaseback of the foundry property constitutes a like-kind exchange under Section 112(b)(1) and 112(e) of the Internal Revenue Code, precluding recognition of loss.

2. If the claimed loss is not allowed, whether Century is entitled to depreciation on the foundry building or on the lease after December 1, 1943, and in what amount for 1943.

Holding

1. No, because the sale and leaseback were interdependent steps in a single,

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integrated transaction, constituting an exchange of real property for cash and a leasehold with a term exceeding 30 years.

2. Century is not entitled to depreciation on the foundry building, but is entitled to depreciation on the leasehold, calculated over the 95-year term of the lease.

Court's Reasoning

The court reasoned that the sale and leaseback were not separate transactions but were interdependent steps in a single, integrated transaction designed to improve Century's financial position while allowing it to continue operating its foundry. The court emphasized that Century would not have sold the property without simultaneously securing a leaseback. Because the lease term was for 95 years, it qualified as a leasehold of a fee with 30 years or more to run, which Regulation 111, Section 29.112(b)(1)-1 treats as "like kind" property to real estate. The court rejected Century's argument that a fee simple and a leasehold in the same property could not be like-kind, noting that prior cases implicitly rejected such a requirement. The court also cited longstanding administrative construction of Section 112(b)(1), given force of law by reenactment of the statutory provision without material change. The court held that while Century could not depreciate the building it no longer owned, it could depreciate the basis of the leasehold, calculated as the adjusted basis of the property exchanged ($531,710.97) less the cash received ($150,000), over the 95-year term of the lease.

Practical Implications

This case clarifies that a sale and leaseback can be treated as a single, integrated transaction qualifying as a like-kind exchange under Section 1031 (formerly Section 112) of the Internal Revenue Code. It highlights the importance of examining the substance of a transaction over its form. Attorneys should advise clients that a sale and leaseback, especially when interdependent, may not result in a recognized loss for tax purposes if the lease term is 30 years or more. Later cases applying this ruling often focus on whether the transactions are truly integrated and whether the lease term meets the statutory threshold. This decision impacts tax planning for businesses seeking to free up capital without relinquishing operational control of their real estate.

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