15 T.C. 581 (1950)

A sale and leaseback of real property, where the lease is for a term of 30 years or more, is considered an exchange of like-kind property under Section 112(b)(1) of the Internal Revenue Code, precluding recognition of a loss on the sale.

Summary

Century Electric Co. sold its foundry property to a college and simultaneously leased it back for 95 years. The company claimed a loss on the sale, arguing it was a distinct transaction from the leaseback. The Tax Court held that the sale and leaseback were a single, integrated transaction amounting to an exchange of like-kind property (real estate for a leasehold of 30 years or more). Consequently, the loss was not recognizable under Section 112(b)(1) of the Internal Revenue Code. The court also determined the basis for depreciation of the leasehold.

Facts

- Century Electric Co. owned foundry property with an adjusted basis of $531,710.97.
- On December 1, 1943, Century Electric conveyed the property to the Trustees of William Jewell College for $150,000 in cash.
- Simultaneously, Century Electric leased the same property back from the college for a term of 95 years, divided into eight periods with the lessee having the power to terminate the lease at the end of any one of the eight periods.
- The company continued to use the property for its foundry operations and would not have sold the property without the leaseback.

Procedural History

- Century Electric Co. claimed a deductible loss of $381,710.97 on its 1943 tax return.
- The Commissioner of Internal Revenue disallowed the loss, arguing the transaction was an exchange of like-kind property.
- Century Electric Co. petitioned the Tax Court for review.

Issue(s)

1. Whether the sale of foundry property and its immediate leaseback for 95 years constitutes a sale or an exchange of like-kind property under Section 112(b)(1) of the Internal Revenue Code.
2. If the transaction is an exchange and the loss is disallowed, whether Century Electric is entitled to depreciation on the foundry building or the lease after December 1, 1943, and in what amount.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. Yes, because the sale and leaseback were integrated parts of a single transaction, and a leasehold of 30 years or more is considered like-kind property to real estate under Treasury Regulations.
2. Yes, Century Electric is entitled to depreciation on the leasehold, not the building, over the 95-year term of the lease, with a basis equal to the adjusted basis of the property exchanged less the cash received.

Court's Reasoning

- The court reasoned that Century Electric would not have sold the property without the leaseback, making the two actions interdependent.
- It rejected the argument that the transaction was a sale with a leasehold reserved, noting that Century Electric conveyed a fee simple estate and then received a lease from the college.
- The court found no requirement in the statute or regulations that the leasehold had to be in existence before the exchange; the key factor was the reciprocal nature of the transfers.
- The court relied on Treasury Regulations defining a leasehold of 30 years or more as like-kind property to real estate and noted that this administrative construction had been consistently applied and given the force of law through the reenactment of the relevant statutory provisions.
- The court distinguished cases cited by Century Electric, such as *Pembroke v. Helvering*, noting that the facts were dissimilar and did not support the argument that the conveyance of the fee should be regarded as mere payment of rental.
- Regarding depreciation, the court cited *Weiss v. Wiener*, holding that as a lessee, Century Electric was not entitled to depreciation on the building, but was entitled to depreciation on the leasehold itself, using the adjusted basis of the exchanged property less the cash received, depreciated over the term of the lease.
- The court stated: "We think that the test of an exchange is not whether the transfers are simultaneous but whether they are reciprocal."

Practical Implications

- This case establishes that a sale and leaseback transaction involving a lease term of 30 years or more will likely be treated as a like-kind exchange for tax purposes, preventing the recognition of a loss at the time of the sale.
- Taxpayers contemplating such transactions should be aware that they will not be able to immediately deduct a loss, but they will be able to depreciate the basis of the leasehold over its term.
- This ruling encourages careful structuring of sale and leaseback agreements, particularly concerning the lease term, if the goal is to recognize an immediate loss. Shorter lease terms might allow for loss recognition, but could also trigger scrutiny from the IRS under the step-transaction doctrine.

© 2025 SCOTUSreports.com. All rights reserved.

- Later cases have cited this case to support the like-kind exchange treatment of sale-leaseback transactions, reinforcing the importance of considering the overall economic substance of the arrangement rather than its form.

© 2025 SCOTUSreports.com. All rights reserved.