16 T.C. 1348 (1951)

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When parties exchange property in a transaction not conducted at arm’s length due to duress or unusual circumstances, the fair market value of the exchanged properties may be independently determined, rather than presumed to be equal.

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Summary

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C. G. Meaker Co. exchanged its Ivanhoe Foods, Inc. stock for a ten-year lease on warehouse premises owned by Ivanhoe. The Tax Court addressed the valuation of the lease and the stock, considering the strained relationship between the companies. The court held that because the exchange was not an arm’s length transaction due to pressure on both parties, the fair market value of the lease ($81,000) differed from the fair market value of the stock ($62,718). The court further held that the stock’s value was taxable income to Ivanhoe in the fiscal year ending September 30, 1946, when the transfer of the stock occurred.

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Facts

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C. G. Meaker Co. (Meaker) owned a significant amount of Ivanhoe Foods, Inc. (Ivanhoe) stock. For 16 years, Meaker leased warehouse space from Ivanhoe. A dispute arose between the companies, resulting in Meaker losing representation on Ivanhoe’s board and initiating a lawsuit. Ivanhoe notified Meaker it would have to vacate the warehouse. Unable to find alternative space, Meaker negotiated a new lease with Ivanhoe. Ivanhoe insisted on receiving Meaker’s stock in exchange for a 10-year lease, rather than cash. A lease was signed on September 30, 1945, with a stated term commencing that same day. Meaker sold its wholesale grocery business and assigned the lease to Empire Foods for $78,975, valuing the lease alone at $81,000.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in Meaker's income taxes for 1943-1945 and in Ivanhoe's income tax for the year ending September 30, 1946. The Commissioner initially valued the lease at $45,900 and the stock at $130,000, later arguing their values were equal (approximately $81,000 – $82,332). Meaker and Ivanhoe petitioned the Tax Court, which consolidated the cases for hearing.

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Issue(s)

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1. What were the fair market values of the Ivanhoe stock and the ten-year lease at the time of the exchange?

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2. Was the consideration received by Ivanhoe (the stock) for the lease taxable in its fiscal year ending September 30, 1945, when the lease was signed, or in the year ending September 30, 1946, when the lease took effect and the stock was transferred?

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Holding

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1. The fair market value of the lease was $81,000, and the fair market value of the stock was $62,718.

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2. The value of the stock ($62,718) was taxable income to Ivanhoe in its fiscal year ending September 30, 1946, because the lease effectively commenced on October 1, 1945, and the stock was transferred on December 3, 1945.

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Court's Reasoning

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The court recognized the general principle that in arm's length transactions, properties exchanged are presumed to have equal value. However, the court found this transaction was not at arm's length due to the family dispute, pending litigation, and the pressure on both parties. Ivanhoe pressured Meaker to relinquish its stock or face eviction, while Meaker was desperate to retain warehouse space. The court considered expert testimony, rental history, the lease's terms (including cancellation provisions), and the subsequent assignment of the lease to Empire Foods to determine the $81,000 fair market value of the lease. The court analyzed the stock's book value, dividend arrearages, and expert valuation, rejecting the application of the

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