Texsun Supply Corp. v. Commissioner, 17 T.C. 281 (1951)

A corporation that merges with another and expressly agrees to assume the debts and tax liabilities of the merged corporation is liable as a transferee, but the Commissioner cannot allocate gross income to a corporation under Section 45 of the Code if that corporation had no gross income to begin with.

Summary

Texsun Supply Corporation merged with Roseland Manufacturing Company and agreed to assume Roseland's debts, including taxes. The IRS assessed deficiencies against Roseland, claiming Texsun was liable as a transferee. Texsun argued the statute of limitations barred the assessment and that Section 45 of the Code was inapplicable. The Tax Court held Texsun liable as a transferee due to its contractual assumption of Roseland's liabilities. However, the court found that the Commissioner erred in allocating gross income to Roseland under Section 45 because Texsun, a cooperative, did not have gross income as it operated on a rebate system with its members.

Facts

Roseland Manufacturing Company sold Bruce boxes to Texsun Supply Corporation. Texsun was a cooperative that purchased supplies for its member associations. Texsun merged with Roseland, and in the merger agreement, Texsun expressly agreed to assume all of Roseland's debts and obligations, including all taxes. The Commissioner determined deficiencies against Roseland for income and excess profits taxes and sought to hold Texsun liable as a transferee.

Procedural History

The Commissioner assessed deficiencies against Roseland and sought to collect from Texsun as a transferee. Texsun petitioned the Tax Court, contesting the transferee liability and the applicability of Section 45. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether Texsun is liable as a transferee of Roseland, and whether the statute of limitations bars the assessment and collection of the deficiencies.
2. Whether Section 45 of the Code is applicable, given the relationship between Texsun and Roseland.
3. Whether the Commissioner erred in allocating gross income to Roseland under Section 45.

Holding

1. Yes, Texsun is liable as a transferee of Roseland because it expressly agreed to

assume Roseland’s tax liabilities in the merger agreement, and the statute of limitations was not a bar due to a waiver executed by Texsun.
2. Yes, the relationship between Texsun and Roseland satisfied the ownership or control requirements of Section 45 because Texsun owned all the shares of Roseland, had the same board of directors, and the same management.
3. Yes, the Commissioner erred in allocating gross income to Roseland because Texsun, operating as a cooperative, did not have gross income that could be allocated.

Court’s Reasoning

The court found Texsun liable as a transferee based on the merger agreement, where Texsun explicitly agreed to pay all income taxes owed by Roseland. The court distinguished the case from *Oswego Falls Corp.* and *A.D. Saenger*, noting the presence of a specific contractual obligation and a consent waiver in this case. Regarding Section 45, the court determined that Texsun owned and controlled Roseland, satisfying the statutory requirement. However, the court sided with Texsun on the allocation of income. The court emphasized that Section 45 allows the Commissioner to “distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among organizations” only if such action is “necessary in order to prevent evasion of taxes or clearly to reflect the income.” Since Texsun operated as a cooperative and returned excess revenues to its members through rebates, these rebates were excluded from Texsun’s gross income. Thus, Texsun had no gross income to allocate to Roseland. As the court noted, “The courts have consistently refused to interpret section 45 as authorizing the creation of income out of a transaction where no income was realized by any of the commonly controlled businesses.”

Practical Implications

This case clarifies that a corporation explicitly assuming the tax liabilities of another in a merger is bound by that agreement and can be held liable as a transferee. It also highlights the limitations of Section 45 of the Code. The Commissioner cannot create income where none exists to begin with. This is particularly relevant for cooperatives and other organizations that operate on a rebate or cost-sharing basis. This case reinforces that Section 45 is intended to prevent manipulation or shifting of existing income, not to conjure income where none was realized. Future cases involving Section 45 allocations must carefully examine whether gross income actually existed within the related entities before allocation can occur.

