19 T.C. 1017 (1953)

When a corporation acquires assets from other corporations during a period in which a consolidated tax return is filed, the acquiring corporation must use the same basis for those assets as the transferor corporations, as mandated by consolidated return regulations.

Summary

Kanawha Gas & Utilities Co. acquired gas-producing properties in 1929 from eight corporations and several individuals/partnerships. A consolidated tax return was filed for 1929 including these entities. When Kanawha sold some of these properties in 1943, a dispute arose over the basis for calculating profit. The Tax Court held that because a consolidated return was filed in 1929, Kanawha was required to use the original basis of the properties in the hands of the eight transferor corporations, adhering to the consolidated return regulations under the Revenue Act of 1928.

Facts

Anderson Development Company contracted to purchase the stock of six corporations and gas leaseholds from individuals/partnerships in 1929. These entities owned gas-producing properties in West Virginia. North American Water Works & Electric Corporation then agreed to purchase these stocks and leaseholds from Anderson. North American assigned its agreement to Kanawha Gas & Utilities Co. Kanawha acquired the stocks of eight corporations owning 132 gas wells and properties, as well as 62 gas wells and properties from individuals/partnerships. Atlantic Public Utilities, Inc. filed a consolidated tax return for 1929, including Kanawha and the acquired corporations. In 1941-1943, Kanawha sold some of these gas properties, leading to the basis dispute.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Kanawha’s 1943 income tax. Kanawha contested this determination, claiming an overassessment. The case was brought before the United States Tax Court to resolve the dispute over the basis of the gas properties sold in 1943.

Issue(s)

Whether Kanawha Gas & Utilities Co., having filed a consolidated return in 1929, must use the basis of gas-producing properties in the hands of the eight corporations from which it acquired them, or whether it can use a different basis reflecting a unitary plan to acquire all 194 gas operating properties.

Holding

No, because section 141 of the Revenue Act of 1928 and related regulations require

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that when a consolidated return is filed, the acquiring corporation must use the transferor's basis for assets acquired during the consolidated return period.

Court's Reasoning

The court emphasized the specific delegation of power to administrative officers under section 141 of the Revenue Act of 1928 to promulgate regulations regarding consolidated returns. The court noted that Congress delegated the authority to the Commissioner to prescribe regulations legislative in character. Treasury Regulations 75 specified that the basis of property transferred within an affiliated group during a consolidated return period remains unaffected by the transfer. The court distinguished cases cited by Kanawha, such as *Muskegon Motor Specialties Co.*, where a consolidated return was deliberately not filed. The court stated: "In view of such specific delegation of power to administrative officers to promulgate regulations, and which has been continued in successive revenue acts, a clear showing must be made of authority to cut across such regulations and to reach a result other than that spelled out by the regulations." The court also rejected Kanawha's argument that the consents filed by the acquired corporations were invalid, finding that the corporations continued to exist and own properties until December 19, 1929.

Practical Implications

This case reinforces the importance of adhering to consolidated return regulations when determining the basis of assets acquired during a consolidated return period. It clarifies that the "step transaction" doctrine, which allows courts to collapse a series of transactions into a single transaction for tax purposes, cannot override specific regulations authorized by statute. The case underscores that filing a consolidated return carries specific obligations and consequences regarding asset basis. It cautions taxpayers that general tax principles cannot trump specific rules governing consolidated returns and that careful planning is necessary when considering filing consolidated returns to fully understand the long-term tax implications on asset basis and future dispositions.

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