29 T.C. 754 (1958)

A corporation formed and utilized primarily to secure a tax benefit, such as a surtax exemption, and lacking a genuine business purpose beyond tax avoidance, may be disregarded for tax purposes under Section 15(c) of the 1939 Internal Revenue Code.

Summary

Theatre Concessions, Inc. was created by Tallahassee Enterprises, Inc., which owned and operated four theaters and their concession businesses. Tallahassee Enterprises transferred the concession business to Theatre Concessions via a lease agreement. The Tax Court determined that a major purpose of this transfer was to secure a surtax exemption, disallowed the exemption, and held that the lease constituted a transfer of property under Section 15(c) of the 1939 I.R.C. The court also addressed and rejected the Commissioner's attempt to retroactively apply a new argument regarding excess profits tax computation.

Facts

Tallahassee Enterprises, Inc. (TEI) operated four theaters and their concession businesses since at least 1936.

Theatre Concessions, Inc. (TCI) was incorporated on January 4, 1951, with authorized capital stock of $2,000, all subscribed to by TEI.

On February 7, 1951, TEI and TCI executed a lease agreement where TCI acquired the right to operate the concession businesses in TEI's theaters.

TCI agreed to pay TEI a percentage of gross revenue as rent and to purchase supplies and equipment from TEI at TEI's cost.

Officers and directors of both companies were substantially overlapping.

TCI began operating the concession business in TEI's theaters using the same space and equipment with no significant changes in business operations.

TEI's directors minutes indicated a purpose to separate the concession business from the theater business, citing reasons such as facilitating sale, concealing profits from managers, discouraging salary demands, and limiting liability from food sales.

The Tax Court found that a major purpose of forming TCI and the lease agreement was to achieve tax savings.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in TCI's income and excess profits tax for 1951, disallowing the surtax exemption and minimum excess profits credit under Sections 15(c) and 129 of the 1939 I.R.C.

TCI petitioned the Tax Court contesting this deficiency.

The Tax Court upheld the Commissioner's disallowance of the surtax exemption but found in favor of TCI regarding the excess profits tax computation method.

Issue(s)

1. Whether the formation of Theatre Concessions, Inc. and the lease agreement with Tallahassee Enterprises, Inc. constituted a transfer of property under Section 15(c) of the 1939 Internal Revenue Code, such that the surtax exemption could be disallowed.
2. Whether a major purpose of the transfer was to secure the surtax exemption.
3. Whether the petitioner was prevented from computing its excess profits tax under Section 430(e)(1)(A) due to provisions of Sections 430(e)(2)(B)(i) and 445(g)(2)(A).

Holding

1. Yes, because the lease agreement constituted a transfer of property within the meaning of Section 15(c).
2. Yes, because the petitioner failed to prove by a clear preponderance of evidence that securing the surtax exemption was not a major purpose of the transfer.
3. No, because the transaction did not fall under Section 445(g)(2)(A), and the Commissioner's late-raised argument under Section 430(e)(2)(B)(ii) was not properly raised.

Court's Reasoning

The court reasoned that Section 15(c) of the 1939 I.R.C. disallows surtax exemptions if a corporation transfers property to a newly created or inactive corporation controlled by the transferor, and a major purpose of the transfer is to secure the exemption.

The court found that the lease agreement was indeed a "transfer of property," rejecting the petitioner's narrow interpretation that "transfer" only meant exchange for stock. The court stated, "The statute uses the words 'transfers * * * all or part of its property' without limitations of any kind. It seems obvious to us that the congressional intent was to include any transfer of any property. It requires no citation of authority to establish the proposition that a leasehold interest in real and personal property constitutes 'property.'"

The court determined that the petitioner failed to prove that tax avoidance was not a major purpose. The stated business purposes were deemed secondary to the tax benefit.

Regarding excess profits tax, the court rejected the Commissioner’s argument that purchasing supplies at cost from the parent meant the petitioner’s basis was determined by reference to the transferor’s basis under Section 445(g)(2)(A). The court held that “the fact that the price paid for merchandise is to be calculated with reference to the vendor’s cost does not warrant a conclusion that its basis ‘is determined by reference to the basis of such properties to the transferor.'”

The court also refused to consider the Commissioner’s argument under Section 430(e)(2)(B)(ii) raised for the first time in his brief, deeming it procedurally unfair as it deprived the petitioner of the opportunity to present evidence against it.

Practical Implications

Theatre Concessions underscores the importance of demonstrating a genuine business purpose beyond tax avoidance when forming subsidiary corporations or engaging in intercompany transactions. It clarifies that “transfer of property” under tax law is broadly construed and includes leasehold interests, not just outright sales or exchanges for stock.

This case is a reminder that tax benefits cannot be the primary driver for corporate structuring. Transactions lacking economic substance beyond tax advantages are vulnerable to being disregarded by the IRS.

Later cases have cited *Theatre Concessions* to support the principle that tax avoidance motives can invalidate tax benefits if they are a major purpose behind a transaction, especially in the context of related corporations and the creation of new entities.

