33 T.C. 411 (1959)

When determining whether a sale is of partnership interests or partnership assets, the substance of the transaction, rather than its form, controls for tax purposes; and losses on sales to related corporations are not deductible if the seller owns more than 50% of the stock.

Summary

The case concerns Herbert A. Nieman and other petitioners' tax liabilities. The key issue was whether a transaction between a partnership, Nieman Fur Farms Co., and a corporation, Herbert A. Nieman & Co., constituted a sale of partnership assets or a sale of the partners' partnership interests. The Tax Court sided with the IRS, holding that it was a sale of partnership interests. Consequently, the court determined that the partners realized capital losses, which could not be used to create a net operating loss carryback. Furthermore, the court addressed whether Herbert A. Nieman could deduct a loss incurred in 1947, given his ownership stake in the purchasing corporation. The court ruled that he could not deduct the loss because, under Section 24(b) of the Internal Revenue Code of 1939, losses from sales between individuals and corporations where the individual owns over 50% of the stock are non-deductible.

Facts

Nieman Fur Farms Co., a partnership, operated a fox fur farm. On November 29, 1947, the partnership sold its assets to Herbert A. Nieman & Co., a corporation. The consideration included 1,270 shares of the corporation's stock and the assumption of partnership liabilities. Herbert A. Nieman, and his relatives, owned the majority of the corporation's stock. The partnership reported a substantial loss on the sale. Herbert A. Nieman claimed a net operating loss carryback to 1945 and sought to deduct a loss from the 1947 sale. The IRS disallowed the carryback and the deduction, arguing that the sale was of partnership interests, and the loss was not deductible per tax regulations on sales to related entities.

Procedural History

The IRS determined tax deficiencies for Herbert A. Nieman, Arnold F. Nieman, and Roland J. Nieman for the years 1944, 1945, and 1947. The taxpayers filed petitions in the United States Tax Court challenging the IRS's determinations, contesting the denial of a net operating loss carryback from 1947 to 1945 and the disallowance of a loss deduction for Herbert A. Nieman in 1947. The Tax Court consolidated the cases, and after a trial based on stipulated facts, rendered its decision.

Issue(s)

1. Whether the sale by the partners to Herbert A. Nieman & Co. constituted a sale of the partnership's assets or a sale of the partners' interests in the

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partnership.
2. Whether the petitioners are entitled to a net operating loss carryback from 1947 to 1945.
3. Whether a loss incurred by petitioner Herbert A. Nieman in 1947 is deductible in that year.

Holding

1. Yes, because the transaction's substance indicated the partners sold their interests.
2. No, because the loss was a capital loss from the sale of partnership interests, and capital losses cannot be used to create a net operating loss carryback.
3. No, because Herbert A. Nieman owned, directly or indirectly, more than 50% of the corporation's stock, making the loss non-deductible under the tax code.

Court's Reasoning

The court's reasoning hinged on the principle that

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