33 T.C. 876 (1960)

When property is transferred to a corporation by a controlling shareholder solely in exchange for stock or securities, the basis of the property in the hands of the corporation is the same as it was in the hands of the transferor, increased by any gain recognized by the transferor.

Summary

Truck Terminals, Inc. (Petitioner) was formed as a subsidiary of Fleetlines, Inc. (Fleetlines) and received motor vehicular equipment from Fleetlines in an agreement of sale. The IRS determined deficiencies in Petitioner's taxes, disallowing surtax exemptions and minimum excess profits credit, and challenged Petitioner's basis in the equipment for depreciation. The Tax Court held that securing tax exemptions was not a major purpose of the transaction and upheld the exemptions. Furthermore, it held the transfer was a non-taxable exchange under Section 112(b)(5) of the 1939 Internal Revenue Code, meaning Petitioner's basis in the equipment was the same as Fleetlines'. Even though Fleetlines reported a taxable gain on the transfer, the Court found this did not change Petitioner's basis.

Facts

Truck Terminals, Inc. was activated in 1952 as a wholly-owned subsidiary of Fleetlines, Inc. On April 1, 1952, Petitioner and Fleetlines entered into a sales agreement where Petitioner acquired 78 units of motor vehicular equipment from Fleetlines for $221,150. Payments were initially late. Fleetlines also received $5,000 for 50 shares of stock in Petitioner. In April 1953, Fleetlines' debt under the agreement was converted to advances on open account. Subsequently, additional shares of Petitioner's stock were issued to Fleetlines to cancel the open account debt. Fleetlines reported and paid taxes on the difference between the book value and the sale price. The IRS determined deficiencies in Petitioner's income and excess profits taxes based on these transactions.

Procedural History

The IRS determined deficiencies in Petitioner's income and excess profits taxes for 1952, 1953, and 1954. Petitioner contested the deficiencies, arguing it was entitled to surtax exemptions and the minimum excess profits tax credit and that its basis in the equipment was the price paid to Fleetlines under the sales agreement. The Tax Court heard the case and issued a decision.

Issue(s)

1. Whether the petitioner is entitled to a basic surtax exemption of $25,000 in each of the years and to a minimum excess profits tax credit of $25,000 for the years 1952 and 1953.

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2. Whether, for purposes of computation of depreciation and long-term capital gain, petitioner is entitled to use as its cost basis the amount paid its parent company upon the transfer of 78 pieces of motor vehicular equipment from the parent to petitioner.

Holding

1. No, because securing the exemption and credit was not a major purpose in the activation of petitioner or the transfer of equipment.

2. No, because the transfer of assets was a nontaxable exchange, so the petitioner's basis in the equipment is the same as its parent, Fleetlines.

Court's Reasoning

The Court addressed two primary issues. First, the Court considered whether obtaining tax exemptions and credits was a major purpose in activating Truck Terminals and transferring the equipment. The Court found that this determination was a question of fact, and the burden of proof was on the petitioner to show that tax avoidance was not a major purpose. The Court analyzed all the circumstances and concluded that securing these benefits was not a primary driver of the activation and transfer. The Court found the transfer was not solely for tax avoidance.

Secondly, the Court examined the proper basis for the equipment. The IRS argued that the transfer was governed by Section 112(b)(5) of the 1939 Code, which provides that no gain or loss is recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation. If this section applies, then section 113(a)(8) of the 1939 Code dictates that the basis of the property in the hands of the corporation is the same as it would be in the hands of the transferor. The Court determined that the transfer of the equipment from Fleetlines to Truck Terminals was not a bona fide sale. The Court considered that the form was a sale but the substance was a contribution of capital in exchange for stock. The Court stated, "We do not find that the agreement was such as would have been negotiated by two independent and uncontrolled parties." The Court concluded that the transfer was within Section 112(b)(5) of the 1939 Code, even though Fleetlines paid taxes on the transaction, and thus Truck Terminals took Fleetlines' basis. The Court followed *Gooding Amusement Co. v. Commissioner* in this analysis.

Practical Implications

This case highlights the importance of substance over form in tax law. Courts will look beyond the labels of transactions to determine their true nature. This is particularly important in transactions between related parties. The case clarifies

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that when a parent corporation transfers property to a wholly-owned subsidiary in exchange for stock, and the economic reality of the transaction is that the parent is contributing capital, the transaction will be treated as a non-taxable exchange. This has significant implications for depreciation deductions, as the subsidiary is locked into the parent's basis. The case underscores that even if the transferor pays tax on the transfer, the basis in the hands of the transferee is still generally determined by reference to the transferor's basis in a non-taxable transaction. Businesses should carefully document the rationale for structuring transactions and be aware that the IRS may recharacterize transactions if they appear designed primarily for tax avoidance.

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