Huber Homes, Inc. v. Commissioner, 55 T. C. 598, 1971 U. S. Tax Ct. LEXIS 205 (1971)

The IRS cannot use Section 482 to create income for a controlled taxpayer where no income was realized by the controlled group.

Summary

Huber Homes transferred 52 unsold houses to its subsidiary, Huber Investment, at cost for rental purposes. The IRS attempted to allocate income to Huber Homes based on the difference between the houses' cost and fair market value, arguing that an arm's-length sale would have generated this income. The Tax Court held that Section 482 does not authorize the IRS to create income where none existed within the controlled group. The decision limits the IRS's ability to adjust income between related parties when no income is realized by the group.

Facts

Huber Homes, Inc. , a home construction and sales company, transferred 52 unsold houses to its wholly owned subsidiary, Huber Investment Corp. , at cost in 1965. Huber Investment converted these houses into rental properties. At the time of transfer, the fair market value of the houses exceeded their cost. The IRS determined that Huber Homes realized a profit equal to this difference and sought to allocate this amount to Huber Homes under Section 482 of the Internal Revenue Code.

Procedural History

The IRS issued a notice of deficiency to Huber Homes, asserting that income should be allocated to it under Section 482. Huber Homes petitioned the U. S. Tax Court for a redetermination of the deficiency. The Tax Court ruled in favor of Huber Homes, holding that the IRS's determination was not authorized by Section 482.

Issue(s)

1. Whether the IRS can allocate income to a controlled taxpayer under Section 482 when no income was realized by the controlled group.

Holding

1. No, because Section 482 does not authorize the IRS to create income where none existed within the controlled group; it only allows for the allocation of income actually realized.

Court's Reasoning

The court's decision was based on the interpretation of Section 482, which

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authorizes the IRS to "distribute, apportion, or allocate gross income" among controlled taxpayers to prevent tax evasion or to clearly reflect income. The court emphasized that this section does not allow the IRS to create income where none was realized by the controlled group. The court cited *Tennessee-Arkansas Gravel Co. v. Commissioner* as precedent, where the IRS's attempt to attribute income to a taxpayer for the use of equipment by a related party was rejected because no income was realized. The court distinguished cases where Section 482 was upheld, noting that those involved the reallocation of income derived from dealings with third parties, not the creation of income. The court also noted that the IRS's proposed adjustment to Huber Investment's basis in the houses did not constitute an allocation of realized income to Huber Homes.

Practical Implications

This decision limits the IRS's authority under Section 482 to situations where income is actually realized by the controlled group. Taxpayers can rely on this ruling to challenge IRS allocations that attempt to create income from transactions between related parties where no income is realized. The decision may influence how similar cases are analyzed, particularly those involving the transfer of assets between related entities for non-sales purposes. It also underscores the importance of the realization principle in tax law, potentially affecting how businesses structure transactions within controlled groups. Later cases, such as *E. C. Laster* and *Smith-Bridgman & Co.* , have followed this precedent, reinforcing its impact on tax practice.

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