Glen Raven Mills, Inc. v. Commissioner, 59 T. C. 1 (1972)

A corporation can use pre-acquisition net operating loss carry-forwards if it continues to engage in substantially the same business after the acquisition.

Summary

Glen Raven Mills acquired Asheville Hosiery, a financially distressed company with prior net operating losses. Post-acquisition, Asheville's full-fashioned knitting machines were converted to produce flat fabric for Glen Raven's profitable knit-de-knit operations, while continuing to manufacture seamless hosiery until the end of 1965. The IRS challenged the use of Asheville's pre-acquisition losses under Sections 382 and 269, arguing a change in business and tax avoidance motives. The Tax Court held that Asheville continued in substantially the same business and Glen Raven's acquisition was driven by business necessity, not tax avoidance, allowing the use of the carry-forwards.

Facts

In early 1964, Glen Raven sought to increase its supply of knitted fabric for its profitable knit-de-knit yarn operations. Asheville Hosiery, facing financial difficulties and recent closure of its full-fashioned hosiery line, was acquired by Glen Raven on May 12, 1964. Post-acquisition, Asheville's 26 full-fashioned machines were converted to produce flat fabric for Glen Raven's knit-de-knit process, while continuing to manufacture seamless hosiery on its 91 seamless machines until the end of 1965. Asheville then ceased hosiery production to make room for new double-knit machinery. Glen Raven was aware of Asheville's prior net operating losses at the time of acquisition.

Procedural History

The IRS disallowed Asheville's net operating loss carry-forwards for 1964 and 1965, citing Sections 382 and 269 of the Internal Revenue Code. Glen Raven petitioned the Tax Court, which held in favor of Glen Raven, allowing the use of the carry-forwards.

Issue(s)

1. Whether Asheville Hosiery continued to carry on a trade or business substantially the same as before its acquisition by Glen Raven under Section 382(a)(1)?
2. Whether Glen Raven's principal purpose in acquiring Asheville was tax avoidance under Section 269(a)(1)?

Holding

1. Yes, because Asheville continued to engage in the business of knitting yarn into fabric using the same machinery and many of the same employees, despite changes in product and customers.

2. No, because Glen Raven's principal purpose was business necessity, not tax avoidance, as evidenced by its need for additional fabric supply and the acquisition of Asheville's knitting capacity.

Court's Reasoning

The court applied the factors listed in Section 1. 382(a)-1(h)(5) of the regulations to determine if Asheville continued in substantially the same business. It found that Asheville used the same employees and equipment, with changes only in product and customers. The court emphasized that Section 382 allows for some flexibility, requiring only that the business remain "substantially the same. " The court distinguished this case from others where the business fundamentally changed, citing *Goodwyn Crockery Co.* as precedent. For Section 269, the court found that Glen Raven's acquisition was motivated by a need for fabric, not tax avoidance, despite knowledge of Asheville's losses. The court also noted that the price paid for Asheville's stock was less than the combined value of its assets and tax benefits, but this was overcome by Glen Raven's business justification.

Practical Implications

This decision clarifies that a corporation can use pre-acquisition net operating loss carry-forwards if it continues in substantially the same business, even if it makes significant changes to become profitable. Attorneys should focus on the continuity of business operations rather than exact product lines when advising clients on acquisitions. The ruling also emphasizes the need for clear business justification to counter allegations of tax avoidance under Section 269. Subsequent cases have applied this ruling to allow loss carry-forwards in similar situations, while distinguishing cases where the business fundamentally changed. Businesses considering acquisitions should carefully document their business reasons for the acquisition to support the use of any loss carry-forwards.

