Berenson v. Commissioner, 59 T. C. 412 (1972)

A transaction with a tax-exempt entity may not be treated as a sale of a capital asset if it lacks substance and is primarily a means to share tax benefits.

Summary

The Berensons and others sold their stock in two sportswear companies to a tax-exempt religious organization for $6 million, payable over 13 years. The sellers continued to manage the business, and the price was grossly disproportionate to the fair market value. The Tax Court held that this was not a bona fide sale of a capital asset but rather an arrangement to share tax benefits, distinguishing it from Commissioner v. Brown. The decision underscores the importance of substance over form in tax transactions, denying capital gains treatment to the sellers.

Facts

Louis Berenson and others owned Kitro Casuals, Inc. and Marilyn Togs, Inc. , which produced and sold women's sportswear. In 1965, they negotiated the sale of their stock to Temple Beth Ami, a tax-exempt religious organization, for $6 million, payable over 13 years with interest. The sellers continued to manage the business as salaried employees of a new partnership formed with the temple and Robert Bernstein. The price was significantly higher than what a nonexempt buyer would have paid, and the sellers retained control over the business's success.

Procedural History

The petitioners reported the transaction as a long-term capital gain. The Commissioner of Internal Revenue determined deficiencies, treating the gain as ordinary income. The case was heard by the U. S. Tax Court, which consolidated several related cases for trial and opinion.

Issue(s)

1. Whether the transaction between the petitioners and Temple Beth Ami constituted the sale or exchange of a capital asset within the meaning of section 1222(3) of the Internal Revenue Code.

Holding

1. No, because the transaction lacked substance and was primarily an arrangement to share tax benefits rather than a bona fide sale of a capital asset.

Court's Reasoning

The court analyzed the transaction's substance over its form, applying the principle that tax consequences depend on the economic realities of a transaction. The court

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noted that the price was grossly disproportionate to the fair market value, suggesting the transaction's primary purpose was to utilize the temple's tax-exempt status. The sellers' continued management and control over the business's success further indicated that they had not truly sold their interest. The court distinguished this case from Commissioner v. Brown, where the price was more closely aligned with the asset's value. The court cited Gregory v. Helvering, emphasizing that transactions must have substance to achieve intended tax results. The dissenting opinions argued that the transaction should be treated as a sale, with some suggesting that only the excessive portion of the price should be taxed as ordinary income.

Practical Implications

This decision emphasizes the importance of substance over form in tax transactions, particularly those involving tax-exempt entities. It warns taxpayers that structuring transactions to exploit tax exemptions without a genuine transfer of ownership may be disregarded for tax purposes. Legal practitioners must carefully evaluate the economic realities of such transactions, ensuring they are not merely arrangements to share tax benefits. The ruling influenced subsequent cases and legislation, notably the enactment of section 514 of the Internal Revenue Code, which addressed debt-financed property held by tax-exempt organizations. This case remains relevant for analyzing transactions with tax-exempt entities and understanding the limits of capital gains treatment.

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