Resorts International, Inc. v. Commissioner, 60 T. C. 778 (1973)

Net operating loss carryovers must be limited when related corporate transactions are treated as a single reorganization, and gains from business sales depend on whether they constitute a sale of a going concern or a licensing agreement.

Summary

Resorts International, Inc. merged with Victor Paint Co. and later liquidated its subsidiaries, attempting to claim full net operating loss carryovers. The Tax Court ruled these transactions as a single reorganization under IRC § 368(a)(1)(C), limiting the carryovers under § 382(b). Additionally, the court determined that the sale of paint stores was a sale of a going business, taxable as capital gain, while the transfer of Biff-Burger restaurants was a licensing agreement, taxable as ordinary income. The decision emphasizes the importance of treating related corporate transactions as a whole and distinguishing between sales of businesses and licensing agreements.

Facts

Resorts International, Inc. merged with Victor Paint Co. , acquiring stock in its 47 subsidiary corporations. These subsidiaries were subsequently liquidated, and Resorts International claimed net operating loss carryovers from them. Resorts also acquired Biff-Burger corporations and sold their restaurants under franchise agreements. Resorts reported gains from selling Victor Paint stores as capital gains and gains from Biff-Burger restaurants as capital gains.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Resorts International's tax returns for the years 1962-1965. Resorts International petitioned the U. S. Tax Court for relief. The Tax Court considered the merger and subsequent liquidations as a single reorganization, limited the net operating loss carryovers, and ruled on the characterization of gains from the sales of paint stores and restaurants.

Issue(s)

1. Whether the merger with Victor Paint Co. and subsequent liquidation of its subsidiaries should be treated as separate transactions for purposes of net operating loss carryovers.
2. Whether the acquisition and liquidation of Biff-Burger corporations should be treated as a reorganization.
3. Whether the gain from selling Victor Paint stores should be characterized as capital gain.
4. Whether the gain from transferring Biff-Burger restaurants should be characterized as capital gain.

Holding

1. No, because the merger and liquidations were part of a continuing series of transactions and should be considered together as a reorganization under IRC § 368(a)(1)(C), limiting the net operating loss carryovers under § 382(b).
2. No, because the acquisition and liquidation of Biff-Burger corporations were part of a reorganization, limiting the net operating loss carryovers under § 382(b).
3. Yes, because the sale of the Victor Paint stores constituted the sale of a going business, making the gain taxable as a long-term capital gain.
4. No, because the transfer of Biff-Burger restaurants was a licensing agreement, making the gain taxable as ordinary income.

Court's Reasoning

The court determined that the merger with Victor Paint Co. and the subsequent liquidation of its subsidiaries should be considered a single reorganization under IRC § 368(a)(1)(C). This was based on the continuity of the transactions and the intent to dissolve the subsidiaries from the outset, which was evident from the timing and the overall plan. The court applied the "continuity of interest" test under § 382(b), reducing the net operating loss carryovers due to the less than 20% ownership by Victor Paint's shareholders in Resorts International. For the Biff-Burger corporations, the court similarly found that the acquisition and liquidation were part of a reorganization, thus applying the same limitation on net operating loss carryovers. Regarding the sales, the court distinguished between the sale of Victor Paint stores as a going business, qualifying for capital gain treatment, and the Biff-Burger restaurant transfers as licensing agreements, resulting in ordinary income. The court relied on the nature of the agreements and the control retained by Resorts International over the Biff-Burger operations.

Practical Implications

This decision highlights the importance of considering related corporate transactions as a whole for tax purposes, particularly when assessing net operating loss carryovers. Tax practitioners must carefully evaluate whether a series of transactions constitutes a reorganization under IRC § 368, which could limit the carryover of losses. Additionally, the case underscores the need to distinguish between the sale of a going business, which may result in capital gains, and licensing agreements, which generate ordinary income. This distinction is crucial for proper tax planning and reporting. The ruling has influenced subsequent cases involving corporate reorganizations and the tax treatment of business sales, emphasizing the need for clear documentation and understanding of the nature of business transfers.

