Marprowear Profit-Sharing Trust v. Commissioner, 73 T. C. 1095 (1980)

A transfer from a corporation to a trust, when treated as a loan on tax returns, is considered "acquisition indebtedness" for purposes of calculating unrelated business taxable income under section 514 of the Internal Revenue Code.

Summary

In Marprowear Profit-Sharing Trust v. Commissioner, the Tax Court addressed whether a transfer from a corporation to a trust to fund a shopping center purchase was "acquisition indebtedness" under IRC section 514. The court found that the transfer, treated as a loan on tax documents, was indeed acquisition indebtedness, impacting the calculation of the trust's unrelated business taxable income. Additionally, the court clarified that a post-acquisition price reduction did not retroactively alter the initial acquisition indebtedness and upheld the imposition of a penalty for failure to file Form 990-T, despite the trust's reliance on an accountant's advice.

Facts

Marprowear Profit-Sharing Trust purchased a shopping center for $450,000, with part of the funding coming from Marprowear Corp. in the form of checks totaling $193,861. 77. The transaction was recorded as a loan on both the corporation's and trust's tax documents. The trust later negotiated a $58,000 reduction in the purchase price in 1975, contingent on paying off the mortgage early. The trust did not file Form 990-T for unrelated business income tax, relying on its accountant's advice that no such tax was due.

Procedural History

The Commissioner determined deficiencies in the trust's income taxes and additions for the taxable years 1973 and 1974. The trust petitioned the Tax Court to review these determinations. The court considered whether the corporate transfers constituted acquisition indebtedness, the effect of the price reduction on acquisition indebtedness, the applicable tax rates, and the trust's liability for the section 6651(a) addition to tax for failure to file.

Issue(s)

1. Whether the transfer from Marprowear Corp. to the trust was "acquisition indebtedness" under IRC section 514(c)?
2. Whether the $58,000 reduction in the purchase price negotiated in 1975 reduced the trust's "average acquisition indebtedness" for 1973 and 1974?
3. Whether the trust should be taxed at corporate rates for its unrelated business taxable income?
4. Whether the trust is liable for the section 6651(a) addition to tax for failure to file Form 990-T?

Holding

1. Yes, because the transfer was treated as a loan on tax documents and was used to acquire the shopping center, it was considered acquisition indebtedness under section 514(c).
2. No, because the reduction was negotiated after the property was acquired and did not alter the initial acquisition indebtedness.
3. No, because the trust, as an exempt organization, is taxed at trust rates under section 511(b)(1).
4. Yes, because the trust's failure to file was not due to reasonable cause, despite reliance on the accountant's advice.

Court's Reasoning

The court determined the nature of the transfer based on how it was reported on tax documents, concluding it was a loan and thus acquisition indebtedness. The court rejected the trust's argument that the 1975 price reduction should retroactively reduce the acquisition indebtedness, as the average acquisition indebtedness is calculated based on the outstanding principal during the taxable year. The trust's status as an exempt organization meant it was subject to trust rates for unrelated business income tax. On the issue of the addition to tax, the court found that the trust's reliance on its accountant's advice did not constitute reasonable cause, as the accountant's opinion, though erroneous, was not so clearly wrong as to excuse the trust's failure to file.

Practical Implications

This decision clarifies that transfers treated as loans on tax documents will be considered acquisition indebtedness for unrelated business income tax purposes, affecting how exempt organizations report and calculate such taxes. It also underscores that post-acquisition price adjustments do not retroactively change the initial acquisition indebtedness, guiding how such transactions are structured and reported. The ruling on tax rates reaffirms that exempt trusts are subject to trust rates for unrelated business income. Finally, the decision reinforces the importance of filing required tax forms, even when relying on professional advice, highlighting the need for exempt organizations to diligently comply with tax filing requirements to avoid penalties.

