Loewen v. Commissioner, 76 T. C. 90 (1981)

Transferring substantially all business assets, including use of retained real property, to a corporation can avoid investment credit recapture if it constitutes a mere change in form of conducting the business.

Summary

In Loewen v. Commissioner, the Tax Court ruled that the transfer of a farming business's assets to a newly formed corporation, while retaining the real property and leasing it back to the corporation, did not trigger recapture of previously claimed investment tax credits. The court found that the transfer was a mere change in the form of conducting the business because all assets necessary to operate the business were transferred or made available through a lease. The decision emphasized that the purpose of the recapture rules was not frustrated, as there was no threat of multiple tax credits or tax avoidance. This case clarifies the conditions under which a business can reorganize without losing tax benefits associated with investment credits.

Facts

George and Selma Loewen operated an unincorporated farming and cattle-feeding business before 1976, receiving investment credits on equipment purchased for the business. In January 1976, they formed a corporation and transferred to it all movable assets of the business, including grain inventories, cattle, and machinery. They did not transfer the real property used in the business, which included 160 acres of farmland and various fixtures, but instead leased it to the corporation on a year-to-year basis. The corporation continued to operate the same farming business as before the transfer. The Commissioner argued that the transfer of the section 38 property to the corporation triggered recapture of the investment credits.

Procedural History

The Commissioner determined a deficiency in the Loewens' 1976 federal income tax due to the alleged recapture of investment credits upon transfer of assets to the corporation. The Loewens petitioned the United States Tax Court to contest this deficiency. The Tax Court, after stipulation of facts by both parties, ruled in favor of the Loewens, holding that the transfer did not trigger recapture of the investment credits.

Issue(s)

1. Whether the transfer of the Loewens' farming business assets to a corporation, while retaining the real property and leasing it back to the corporation, constituted a mere change in the form of conducting the business under section 47(b) of the Internal Revenue Code of 1954.

Holding

1. Yes, because the transfer included substantially all the assets necessary to operate the farming business, and the use of the real property was made available to the corporation through a lease, satisfying the requirements of section 47(b) and the regulations.

Court's Reasoning

The court applied section 47(b) of the Internal Revenue Code, which exempts from recapture the transfer of section 38 property that constitutes a mere change in the form of conducting the business. The court focused on the regulation's requirement that substantially all assets necessary to operate the business must be transferred. The Loewens transferred all movable assets and leased the real property to the corporation, which the court deemed equivalent to transferring all necessary assets, citing prior cases like R. & J. Furniture Co. and James Armour, Inc. The court also considered the legislative intent behind the recapture rules, noting that the purpose was not frustrated since there was no threat of multiple tax credits or tax avoidance. The court acknowledged the special circumstances in Kansas regarding corporate ownership of farmland, which influenced the Loewens' decision not to transfer the real property title. The court concluded that the transfer was a mere change in the form of conducting the business, thus no recapture was required.

Practical Implications

This decision provides guidance for businesses considering reorganization into a corporate form while retaining certain assets. It clarifies that retaining real property and leasing it back to the corporation can be considered as transferring all necessary assets if the lease arrangement effectively allows the corporation to continue the business operations. Practitioners should consider this ruling when advising clients on reorganizations to avoid unintended tax consequences like investment credit recapture. The case also highlights the importance of understanding state-specific regulations, such as those on corporate ownership of farmland, in planning business structures. Subsequent cases have referenced Loewen when analyzing whether a transfer of assets constitutes a mere change in the form of conducting a business, particularly in the context of tax credit recapture rules.

