Crowley, Milner & Company v. Commissioner of Internal Revenue, 76 T. C. 1030 (1981)

A sale-leaseback transaction is treated as a sale rather than a like-kind exchange if the property is sold for its fair market value and the leaseback has no capital value.

Summary

Crowley, Milner & Company sold a store it was constructing to Prudential Insurance Co. of America at fair market value and then leased it back for 30 years. The IRS argued this was a like-kind exchange under Section 1031 of the IRC, disallowing the company's claimed loss on the sale. The Tax Court disagreed, ruling that the transaction was a bona fide sale because the property was sold for its fair market value and the leaseback had no capital value. The court also ruled that the excess costs over the sales price were not amortizable as lease acquisition costs and that the company was not liable for a late filing penalty.

Facts

Crowley, Milner & Company, a retailer, planned to open a new store in Lakeside Mall, Detroit, as part of a development by Taubman Co. The company preferred leasing over owning real estate. It entered into a sale-leaseback arrangement with Prudential Insurance Co. of America, selling the store for $4 million and leasing it back for 30 years at a fair market rental rate. The construction costs exceeded the sales price by $336,456. 48. Crowley claimed a loss on the sale on its tax return, which the IRS disallowed, asserting it was a like-kind exchange.

Procedural History

The IRS determined a deficiency and added a late filing penalty. Crowley, Milner & Company petitioned the U. S. Tax Court, which held that the transaction was a sale, not an exchange, and allowed the loss deduction. The court also ruled that the excess costs were not amortizable and that the company was not liable for the late filing penalty.

Issue(s)

1. Whether the sale-leaseback transaction with Prudential Insurance Co. of America constituted a like-kind exchange under Section 1031 of the IRC.
2. Whether the excess of the store's cost over the sales price should be capitalized and amortized over the lease term.
3. Whether Crowley, Milner & Company was liable for a late filing penalty under Section 6651(a) of the IRC.

Holding

1. No, because the transaction was a sale for cash at fair market value, and the

leaseback had no capital value.
2. No, because the excess costs were not incurred to obtain the lease but to ensure the sale's completion.
3. No, because the company had paid more than the tax owed before the filing deadline.

Court's Reasoning

The court determined that the transaction was a sale rather than an exchange because the store was sold for its fair market value, and the leaseback had no capital value. The court relied on expert testimony that the sales price and rent were at market rates. It distinguished this case from Century Electric Co. v. Commissioner, where the lease had capital value. The court also followed Leslie Co. v. Commissioner, emphasizing that the sale-leaseback was negotiated at arm's length. The excess costs were not amortizable as they were incurred to complete the sale, not to acquire the lease. The court found that no late filing penalty was due because the company had paid more than the tax owed before the filing deadline.

Practical Implications

This decision clarifies that a sale-leaseback transaction can be treated as a sale for tax purposes if the property is sold for its fair market value and the leaseback has no capital value. It affects how businesses structure similar transactions, emphasizing the importance of negotiating at arm's length to avoid like-kind exchange treatment. The ruling also impacts the treatment of excess costs in such transactions, which are not amortizable if incurred for reasons other than lease acquisition. The decision's approach to the late filing penalty underscores the significance of timely payments in avoiding penalties. Subsequent cases, such as those involving similar sale-leaseback arrangements, have cited this case to distinguish between sales and exchanges.

