Paccar, Inc. v. Commissioner, 85 T. C. 754 (1985)

A transfer of inventory does not constitute a sale for tax purposes if the transferor retains dominion and control over the transferred assets.

Summary

Paccar, Inc. transferred surplus and obsolete inventory to SAJAC, an unrelated warehouse facility, claiming it as a sale to reduce taxable income. The Tax Court held that these transfers were not sales because Paccar retained significant control over the inventory, such as deciding which items to send, when to scrap them, and when to sell them back. The court also disallowed Paccar's 10% discount to its subsidiary Paccint on truck sales, adjusting the transfer price based on the resale price method. This decision reinforces that tax benefits cannot be claimed on inventory transfers unless there is a genuine relinquishment of ownership and control.

Facts

Paccar, Inc. and its subsidiaries transferred surplus and obsolete inventory to SAJAC, an unrelated company, under agreements that allowed Paccar to repurchase the inventory at a premium within four years. Paccar claimed these transfers as sales and deducted the difference between book value and scrap value as a loss. Additionally, Paccar sold trucks and parts to its wholly owned subsidiary, Paccar International (Paccint), at a 10% discount from the domestic dealer net price, which Paccint then sold abroad.

Procedural History

The IRS issued a notice of deficiency to Paccar for the tax years 1975-1977, disallowing the claimed inventory losses and adjusting the sales prices to Paccint. Paccar petitioned the Tax Court, which upheld the IRS's determinations on both issues.

Issue(s)

1. Whether Paccar's transfer of surplus and obsolete inventory to SAJAC constituted a sale entitling Paccar to claimed deductions for inventory losses?
2. Whether the 10% purchase discount Paccar granted to Paccint on sales of trucks and parts was a discount that would have been afforded to unrelated parties dealing at arm's length, and if not, what is the proper adjustment under section 482?

Holding

1. No, because Paccar retained dominion and control over the transferred inventory, which was not a true sale under the economic substance doctrine.
2. No, because the 10% discount did not reflect an arm's-length transaction; the

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court adjusted the transfer prices of truck units using the resale price method but found no adjustment necessary for parts.

Court’s Reasoning

The court focused on the economic substance of the transactions rather than their form. For the inventory transfers to SAJAC, the court noted that Paccar retained control over what items were sent, when to scrap or sell them, and even how they could be altered, indicating that SAJAC acted more as a storage agent than a buyer. The court cited *Thor Power Tool Co. v. Commissioner* to support its decision that Paccar could not claim a loss on inventory it still controlled. For the sales to Paccint, the court used the resale price method to adjust the transfer price of truck units, finding the 10% discount excessive, but found no need to adjust the price of parts as Paccint’s margin was comparable to arm’s-length transactions.

Practical Implications

This decision clarifies that for tax purposes, a sale must involve a true transfer of ownership and control. Businesses cannot claim tax benefits for inventory they continue to manage and control. It also underscores the IRS’s authority under section 482 to adjust transfer prices to reflect arm’s-length transactions. Practitioners should ensure that any inventory transfer agreements do not retain control for the transferor and that intercompany pricing reflects market rates. Subsequent cases have cited Paccar for the principle that economic substance governs the tax treatment of transactions.

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