Mars, Incorporated, and Uncle Ben’s, Inc. , Petitioners v. Commissioner of Internal Revenue, Respondent, 88 T. C. 428 (1987)

The transformation of a foreign partnership into a foreign corporation is not considered a tax avoidance plan under Section 367 if motivated by legitimate business purposes.

Summary

Mars, Inc. , and its subsidiary Uncle Ben’s, Inc. , transformed their French partnership (MIC) into a French corporation (MICSA) to limit liability and improve business efficiency. The Commissioner argued this transformation was a tax avoidance plan under Section 367, requiring recapture of previously deducted losses. The Tax Court disagreed, holding that the transformation was not motivated by tax avoidance and that the tax benefit rule did not apply, as there was no fundamentally inconsistent event. This ruling reaffirmed the principle from Hershey Foods Corp. v. Commissioner, emphasizing that a transaction’s business purpose can override presumptions of tax avoidance.

Facts

Mars, Inc. , and Uncle Ben’s, Inc. , were the sole partners of a French partnership, Mars Inc. et Compagnie (MIC), formed in 1974. In 1984, MIC was transformed into a French corporation, Mars Incorporated et Compagnie, S. A. (MICSA), and subsequently merged with Mars, S. A. (MSA), a French subsidiary of Mars Ltd. The transformation and merger were motivated by business reasons, including limiting the partners’ liability, improving administrative and economic efficiency, enhancing financial reporting, and avoiding French disclosure requirements.

Procedural History

Mars and Uncle Ben’s requested a ruling from the IRS under Section 367 regarding the transformation and merger. The IRS issued an adverse ruling, requiring the petitioners to recapture prior losses as an “added amount” to prevent tax avoidance. The petitioners protested this ruling and sought a declaratory judgment from the Tax Court. The Tax Court reviewed the IRS’s determination and found it unreasonable.

Issue(s)

1. Whether the transformation of MIC into MICSA was in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax within the meaning of Section 367.
2. Whether the transformation constitutes a fundamentally inconsistent event under the tax benefit rule.

Holding

1. No, because the transformation was motivated by legitimate business purposes, not tax avoidance, consistent with the holding in Hershey Foods Corp. v. Commissioner.
2. No, because the transformation does not constitute a fundamentally inconsistent event as defined in United States v. Bliss Dairy, Inc.

Court's Reasoning

The Tax Court applied the principle from Hershey Foods Corp. v. Commissioner, which held that the transformation of a foreign partnership into a corporation does not constitute tax avoidance if supported by legitimate business purposes. The court found that Mars and Uncle Ben's had compelling business reasons for the transformation, including limiting liability, improving efficiency, and avoiding disclosure requirements. The court rejected the IRS's argument that the transformation required recapture of previously deducted losses under the tax benefit rule, as defined in United States v. Bliss Dairy, Inc. , because there was no recovery of previously deducted losses. The court also dismissed the IRS's reliance on subsequent legislative amendments to Section 367, stating that the views of a later Congress on prior law have little significance.

Practical Implications

This decision clarifies that the transformation of a foreign partnership into a foreign corporation can be treated as a non-taxable event under Section 367 if motivated by legitimate business purposes. Legal practitioners should focus on documenting and substantiating business reasons for such transactions to avoid IRS challenges. The ruling also limits the application of the tax benefit rule in similar cases, emphasizing that only fundamentally inconsistent events trigger its application. Businesses considering restructuring foreign operations should consider this precedent when planning transactions to mitigate tax risks. Subsequent cases have followed this ruling, reinforcing its impact on tax planning involving foreign entities.

