Trinova Corp. v. Commissioner, 108 T. C. 68 (1997)

The transfer of assets within a consolidated group followed by a stock transfer out of the group does not trigger investment tax credit recapture if it adheres to the regulations, despite a prearranged plan to remove the assets from the group.

Summary

Trinova Corp. transferred its glass division, including section 38 assets, to a subsidiary within its consolidated group and then exchanged the subsidiary's stock for shares in Trinova held by another shareholder, Pilkington Holdings. The IRS argued that this should trigger investment tax credit (ITC) recapture under section 47(a)(1), relying on Rev. Rul. 82-20. However, the Tax Court held that no recapture was required, as the regulations under section 1. 1502-3(f)(2) and Example (5) of the regulations explicitly stated that such transactions do not trigger recapture, even if part of a prearranged plan. This decision underscores the importance of adhering to the literal interpretation of tax regulations over revenue rulings in determining tax liabilities in consolidated group transactions.

Facts

Trinova Corp. operated a glass division and transferred its assets, which included section 38 property with previously claimed ITCs, to a newly formed subsidiary, LOF Glass, Inc. , on March 6, 1986. One day later, Trinova agreed to exchange all of LOF Glass, Inc. 's shares for shares in Trinova held by Pilkington Holdings. The exchange occurred on April 28, 1986, resulting in LOF Glass, Inc. being removed from Trinova's consolidated group. The IRS assessed a deficiency for failure to recapture ITCs based on Rev. Rul. 82-20, which suggested recapture was required when property was transferred outside the group under a prearranged plan.

Procedural History

Trinova filed a petition with the U. S. Tax Court challenging the IRS's determination of a deficiency for not recapturing ITCs on its 1986 consolidated tax return. The case was submitted fully stipulated under Rule 122. The Tax Court ruled in favor of Trinova, holding that the regulations under section 1. 1502-3(f)(2) and Example (5) controlled and no recapture was required.

Issue(s)

1. Whether the transfer of section 38 property within a consolidated group followed by a stock transfer out of the group triggers investment tax credit recapture under section 47(a)(1) when there was a prearranged plan to remove the property from the group?

Holding

1. No, because the transactions did not trigger ITC recapture under the regulations. The court held that section 1. 1502-3(f)(2) and Example (5) of the regulations explicitly stated that such transactions do not trigger recapture, even if part of a prearranged plan.

Court's Reasoning

The court's decision was based on a literal interpretation of the consolidated return regulations under section 1. 1502-3(f)(2) and Example (5), which stated that no recapture occurs when assets are transferred within a consolidated group followed by a stock transfer out of the group. The court rejected the IRS's reliance on Rev. Rul. 82-20, stating that it was an unwarranted attempt to limit the scope of the regulations. The court emphasized that if the IRS was dissatisfied with the regulation, it should amend it rather than seek judicial modification. The court also rejected the application of the step transaction doctrine, as there was no evidence of unnecessary steps or a lack of business purpose in the transactions. The dissent argued that the substance of the transactions, viewed as an integrated whole, should trigger recapture, but the majority adhered to the regulations' clear language.

Practical Implications

This decision clarifies that tax regulations take precedence over revenue rulings in determining tax liabilities in consolidated group transactions. Taxpayers can rely on the literal language of regulations, even if it leads to seemingly unintended tax benefits. The IRS should consider amending regulations if they lead to unintended results rather than relying on revenue rulings or judicial interpretation. This case also highlights the importance of understanding the nuances of consolidated group transactions and the potential tax implications of asset and stock transfers. Subsequent cases may reference this decision when analyzing similar transactions, and it may influence how tax professionals structure corporate reorganizations to minimize tax liabilities.

