Tracinda Corp. v. Commissioner, 111 T. C. 315 (1998)

Simultaneous transactions are respected for tax purposes unless the form chosen is a fiction that fails to reflect the substance of the transaction.

Summary

Tracinda Corp. and Turner Broadcasting System (TBS) engaged in a complex series of transactions involving the acquisition of MGM and the sale of its subsidiary, UA, to Tracinda. The IRS sought to recharacterize the transaction as a redemption to disallow the loss on the UA sale under section 311. The Tax Court upheld the form of the transaction, finding no tax fiction or misalignment with economic reality. On the issue of applying section 267(f), the court ruled that the loss was not deferred because MGM and Tracinda were not in the same controlled group immediately after the sale, allowing MGM to deduct the loss.

Facts

TBS acquired MGM through a reverse triangular merger, and simultaneously, MGM sold all shares of its subsidiary, UA, to Tracinda. Tracinda then sold a portion of UA shares to former MGM shareholders and UA executives. MGM's tax basis in UA exceeded the sale price, resulting in a loss (UA Loss). The transactions closed on March 25, 1986, and were structured to occur simultaneously. MGM's basis in UA was higher than the consideration received, creating a loss that was claimed by TBS in its consolidated tax return.

Procedural History

The IRS disallowed the UA Loss claimed by TBS and Tracinda, asserting that the transaction should be recharacterized as a redemption under section 311, and that section 267(f) should apply to defer the loss. Both parties filed motions for partial summary judgment on these issues, which were consolidated by the Tax Court. The court granted TBS's motion and partially granted Tracinda's motion, denying the IRS's motion for summary judgment.

Issue(s)

1. Whether the transaction by which MGM sold stock of UA to Tracinda should be characterized as a sale or a constructive redemption of MGM stock under section 311.
2. If characterized as a sale, whether section 267(f) and the related temporary regulations apply to disallow the UA Loss claimed by MGM and increase Tracinda's basis in the UA stock.

Holding

1. No, because the form of the transaction was not a fiction that failed to reflect the

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substance of the transaction; thus, section 311 does not apply.
2. No, because MGM and Tracinda were not members of the same controlled group immediately after the UA sale; thus, section 267(f) does not apply to defer the UA Loss or increase Tracinda's basis in UA stock.

Court's Reasoning

The court respected the form of the transaction under the substance-over-form doctrine, finding no tax fiction or misalignment between form and substance. The court rejected the IRS's argument for sequential ordering of transactions for tax purposes, emphasizing that simultaneous transactions are recognized in tax law. The court applied the Esmark, Inc. v. Commissioner precedent, which requires the IRS to demonstrate a misalignment between form and substance to justify recharacterization. Regarding section 267(f), the court held that the temporary regulations in effect required the parties to be members of the same controlled group immediately after the transaction for the loss deferral rules to apply. Since MGM was not part of the Tracinda Group after the transaction, the loss was not deferred.

Practical Implications

This decision reinforces the principle that simultaneous transactions are valid for tax purposes unless they are a tax fiction. Tax practitioners should structure transactions with care, ensuring that the form reflects economic reality, as the court will respect the form chosen unless there is a clear misalignment with substance. The ruling clarifies the application of section 267(f) to transactions between controlled group members, particularly when the group status changes simultaneously with the transaction. This case may influence how similar transactions involving the sale of assets and changes in group status are analyzed. It also highlights the importance of understanding the timing of controlled group status in relation to transactions, as this can impact the tax treatment of gains and losses.

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