Textron Inc. & Subsidiaries v. Commissioner, 117 T. C. 115 (2001)

Losses on intercompany transactions within a consolidated corporate group are deferred until the property or stock leaves the group.

Summary

In Textron Inc. & Subsidiaries v. Commissioner, the Tax Court addressed whether Textron could deduct a capital loss on a note redemption within its consolidated group. Textron argued for a $14. 9 million loss deduction from a 1987 note redemption. The court held that under the consolidated return regulations, specifically section 1. 1502-14(d)(4), such losses must be deferred until the property or stock leaves the group. The decision emphasized the single entity treatment of consolidated groups, ensuring that internal transactions do not result in immediate tax consequences.

Facts

Textron, Inc. , the common parent of an affiliated group, filed a consolidated federal income tax return for its 1987 taxable year. AVCO Corp. (AVCO) and Paul Revere Corp. (Paul Revere) were members of the Textron group. In 1977, AVCO redeemed Paul Revere's AVCO stock, issuing a promissory note in exchange. In 1987, AVCO redeemed the note for cash, resulting in a realized loss for Paul Revere. Textron sought to deduct this loss on its 1987 tax return.

Procedural History

The case was fully stipulated and brought before the Tax Court to redetermine the Commissioner's determination of deficiencies in federal income tax for several years, including 1987. The court's decision focused solely on the deductibility of the $14. 9 million capital loss from the 1987 note redemption.

Issue(s)

1. Whether section 1. 1502-14(d)(4) of the Income Tax Regulations operates solely to override section 1. 1502-14(d)(3) and cannot otherwise defer gains or losses.
2. Whether the 1977 stock redemption was a "tax-free" exchange under section 1. 1502-14(d)(4).
3. Whether Paul Revere was considered a "nonmember" under section 1. 1502-14(d)(4)(i)(c) when it held the AVCO note.
4. Whether the AVCO stock exchanged in the 1977 redemption was "property" under section 1. 1502-14(d)(4).
5. Whether the loss was restored upon the liquidation of Paul Revere in 1987.

Holding

1. No, because section 1. 1502-14(d)(4) independently defers gains or losses on the

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redemption of an obligation, not just as an override to section 1. 1502-14(d)(3).
2. No, because the exchange qualified under section 1. 1502-14(d)(4) as the note's basis was determined by reference to the stock's basis.
3. No, because at the time of the note's redemption, Paul Revere was a member of the Textron group, and the note had never been held by a nonmember.
4. No, because the AVCO stock was considered "property" under the consolidated return regulations, despite section 317(a)'s exclusion for stock of the distributing corporation.
5. No, because the liquidation of Paul Revere was not a restoration event under section 1. 1502-14(e)(2).

Court's Reasoning

The court applied section 1. 1502-14(d)(4) to defer the loss from the note redemption, emphasizing that consolidated return regulations treat the group as a single economic entity. The court rejected Textron's arguments that the regulations should be interpreted to allow recognition of the loss, citing the purpose of the regulations to prevent tax consequences from intragroup transactions. The court also noted that the stock redemption and subsequent note redemption were covered by the regulations, and the term "property" included the AVCO stock exchanged. The court further clarified that the loss was not restored upon Paul Revere's liquidation, as it was a section 332 transaction within the group. The court's decision was supported by the regulatory framework and examples provided in the regulations.

Practical Implications

This decision reinforces the importance of understanding the consolidated return regulations when dealing with intercompany transactions. Practitioners should be aware that losses from such transactions are deferred until the property or stock leaves the group, impacting tax planning and the timing of deductions. The case highlights the need to consider the group's single entity status under these regulations, which can significantly affect the tax treatment of internal transactions. Subsequent cases involving consolidated groups should reference Textron for guidance on the deferral of intercompany losses. Businesses should carefully plan their transactions and group structure to align with these tax principles.

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