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Federal Income Tax-Operating Loss Carryover As Defined in 1954 Int. Rev. Code Section 172 Will be Allowed Unless Specifically Prohibited by Sections 269 or 382 (a); Libson Shops Doctrine Not Authority for Cases Arising Under 1954 Code. Maxwell Hardware Co. v. Commissioner (9th Cir. 1965)

James W. Hodges

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FEDERAL INCOME TAX—OPERATING LOSS CARRYOVER AS DEFINED IN 1954 INT. REV. CODE SECTION 172 WILL BE ALLOWED UNLESS SPECIFICALLY PROHIBITED BY SECTIONS 269 OR 382(a); LIBSON SHOPS DOCTRINE NOT AUTHORITY FOR CASES ARISING UNDER 1954 CODE. *Maxwell Hardware Co. v. Commissioner* (9th Cir. 1965).

Maxwell Hardware Company, a corporation which in previous years had sustained losses of over one million dollars, entered into an agreement with Arthur T. Beckett and Frederick J. Federighi, partners engaged in real estate development activities, to establish a real estate department in the hardware company. Funds for the project were furnished by the two partners through their purchase of non-voting preferred stock of the corporation equal in value to approximately two-fifths of the current value of the outstanding common stock. A voting trust agreement was made to restrict the control of the common stockholders over the corporation for a five-year period, and Federighi was named as one of the three corporation directors. The hardware business, accounted for separately from the real estate department, was discontinued and the real estate department operations continued at a profit.

The net operating losses sustained previously by the hardware business were deducted as net operating loss carryovers from the profits of the real estate department. The agreement between the investing partners and the corporation was dated October 18, 1954, and was therefore governed by the provisions of the Internal Revenue Code of 1954. The Commissioner disallowed the deduction of the net operating loss carryovers for the tax years ending January 31, 1957 to 1960 inclusive.

The Tax Court¹ found that: (1) there was a genuine business purpose for using the corporation for the real estate development enterprise; (2) the income from the real estate department was reportable as the taxable income of the corporation; (3) Beckett and Federighi did not acquire control of the corporation within the meaning of sections 382(a) or 269 of the Internal Revenue Code of 1954; (4) the primary purpose of the agreement was to avoid future taxes by offsetting prior hardware business losses against anticipated profits from the real estate department; and (5) the

¹ Arthur T. Beckett, 41 T.C. 386 (1963).

business as conducted after the agreement was not substantially the same as the business which produced the offsetting losses.

The Tax Court, applying the principles of *Libson Shops, Inc. v. Koehler*,² disallowed the deduction of the losses sustained by the hardware business. The Ninth Circuit Court of Appeals adopted the Tax Court's findings of fact but reversed the decision and held that the net operating loss carryover should be allowed. The court concluded that Congress had sanctioned operating loss carryovers under section 172 except when the taxpayer claiming the deduction falls within the express prohibitions of section 382(a) or section 269 of the Internal Revenue Code of 1954. *Maxwell Hardware Co. v. Commissioner*, 343 F.2d 713 (9th Cir. 1965).

In deciding that the loss carryovers should be allowed, the court of appeals rejected: (1) the Commissioner's assertion that section 172³ (which established the net operating loss carryover deduction) did not apply to *Maxwell* because the same taxpayer which sustained the losses did not generate the subsequent real estate income; (2) the Tax Court's holding that the case was governed by the principles of *Libson Shops*; (3) the Commissioner's contention that the deduction was disallowed by the special limitation provisions of section 382(a);⁴ and (4) the Commissioner's contention that section

² 353 U.S. 382 (1957).

³ INT. REV. CODE OF 1954, § 172. NET OPERATING LOSS DEDUCTION.

(a) *Deduction allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

⁴ INT. REV. CODE OF 1954, § 382. SPECIAL LIMITATIONS ON NET OPERATING LOSS CARRYOVERS.

(a) *Purchase of a corporation and change in its trade or business.*—

(1) *In general.*—If, at the end of a taxable year of a corporation.—

(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

(i) the beginning of such taxable year, or

(ii) the beginning of the prior taxable year,

(B) the increase in percentage points at the end of such taxable year is attributable to—

(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,
the net operating loss carryovers, if any, from prior taxable years of such cor-

269⁵ prohibited the loss carryover. The court also refused to consider the application of section 482, since the Commissioner did not rely upon it nor give notice of such issues in his Notice of Deficiency.

*Libson*⁶ involved the merger of sixteen corporations, each operating a separate retail store, into another existing corporation. The stock of all seventeen of the corporations was owned by the same shareholders and in the same proportions. The pre-merger losses of three of the retail stores were carried forward and applied against the post-merger income of the unified business. The Supreme Court held that the net operating loss carryover provisions of the 1939 Code, under which the case was decided, were concerned with the fluctuating income of a single business. Therefore, the carryovers were not allowed because the income against which the offset was claimed had not been produced by substantially the same businesses which had incurred the losses.

Notwithstanding the intervening statutory change, it would seem reasonable to hold *Libson* inapplicable to the instant case⁷ in light of

poration to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

(4) *Definition of purchase.*—For purposes of this subsection, the term "purchase" means the acquisition of stock, the basis of which is determined by reference to its cost to the holder thereof, in a transaction from a person or persons other than the person or persons the ownership of whose stock would be attributed to the holder by application of paragraph (3).

(c) *Definition of stock.*—For purposes of this section, "stock" means all shares except nonvoting stock which is limited and preferred as to dividends.

⁵ INT. REV. CODE OF 1954, § 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) In general.—if—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal Income Tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then the Secretary or his delegate may disallow such deduction, credit, or other allowance. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation. As amended Feb. 26, 1964. (Statute before amendment did not contain the phrase starting—"then the Secretary . . ." The previous wording was—"then such deduction, credit, or other allowance shall not be allowed.")

⁶ 353 U.S. at 382.

⁷ Brock, *Past, Present and Future of Net Operating Loss Carryovers in Corporate Acquisitions*, 43 TAXES 586, 590 (1965).

the qualification made by the *Libson* Court: "We do not pass on situations like . . . *Alprosa Watch Corp. v. Commissioner* . . . [where] a single corporate taxpayer changed the character of its business and the taxable income of one of its enterprises was reduced by the deductions or credits of another."⁸

In *Alprosa Watch Corp. v. Commissioner*,⁹ the Tax Court allowed the successor business, the Alprosa Watch Corporation, a distribution agent of foreign-made watches, to deduct a net operating loss incurred while the business was known as the Esspi Glove Corporation. Even though all of the stock of the glove manufacturer was acquired by new owners who changed the corporate name, the place of business, and the nature of the business from that of manufacturing gloves to that of selling watches, the court stated that "In view of the established principle that a corporation and its stockholders are separate entities, it is recognized that a change in stock ownership does not produce a new corporate personality."¹⁰ Although the court held that "the petitioner and the Esspi Glove Corporation constitute for Federal tax purposes one and the same taxpayer,"¹¹ the court was not concerned with the interpretation of the word "taxpayer" as used in section 122(b)(1)(A) of the 1939 Code,¹² since *Alprosa* involved a taxable year beginning prior to December 31, 1943, the effective date of the 1939 Code.

However, in *Mill Ridge Coal Co. v. Commissioner*¹³ the court refused to allow the carryover of a loss incurred when the corporation was previously engaged in coal mining after all of the stock had been acquired by persons who used the inactive coal mining company

⁸ 353 U.S. at 390 n.9.

⁹ 11 T.C. 240 (1948) (involving INT. REV. CODE OF 1921).

¹⁰ *Id.* at 245.

¹¹ *Id.* at 246. Other cases illustrating the identification of corporate legal identities: *WAGE, Inc.*, 19 T.C. 249 (1952) (finding of a substantial business purpose in a transaction to dissolve Corporation A upon its merger with Corporation B, the latter inuring to a tax credit held by the former; held to be the same corporation); *Northway Sec. Co.*, 23 B.T.A. 532 (1931) (no change in corporate legal identity upon selling of all assets, change of corporate name, and engaging in another business); *contra*, *James Realty Co. v. United States*, 280 F.2d 394 (8th Cir. 1960) (taxpayer corporation was denied use of excess profits credit when the major stockholders [husband and wife holding all stock either themselves or in trust for their children] were found to have created it and eight other corporations to carry on land transactions for the purpose of avoiding taxes); *A. B. & Container Corp.*, 14 T.C. 842 (1950) (Commissioner cannot ignore tax consequences of a previous unsuccessful business when a further business was acquired and conducted also).

¹² INT. REV. CODE OF 1939, ch. 2, § 122(b)(1)(A), 53 Stat. 1. NET OPERATING LOSS DEDUCTION. "If for any taxable year . . . the taxpayer has a net operating loss, . . ."

¹³ 264 F.2d 713 (5th Cir.), *cert. denied*, 361 U.S. 816 (1959).

to carry on the business of transporting fuel oil. The case represented an extension of the *Libson* doctrine under the 1939 Code, to the single taxpayer, an extension both followed by the courts and criticized by the writers.¹⁴

The term "taxpayer" as used in section 122 (providing for carryovers) has been the source of much controversy, especially in merger cases.¹⁵ Although not arising under the 1939 Code, *Commissioner v. Metropolitan Edison Co.* established the dominant line of reasoning by holding that "the corporate personality of the transferor is drowned in that of the transferee" when a statutory merger occurs.¹⁶ *Stanton Brewery, Inc. v. Commissioner*¹⁷ continued the same reasoning in allowing the surviving corporation in a merger, formerly the parent, to use the tax attributes of both itself and its subsidiary following the merger,¹⁸ the stockholders remaining the same, because the corporation which resulted from the merger carried on "essentially a continuing enterprise."¹⁹

Thus a corporation which merged with another business, and thereby changed or lost its original corporate identity, would not be prohibited from using its pre-merger tax attributes. However, *Libson* provides that the carryover of pre-merger losses would be allowed

¹⁴ Thomas E. Snyder Sons Co. v. Commissioner, 288 F.2d 36 (7th Cir. 1961); Commissioner v. British Motor Cars, Ltd., 278 F.2d 392 (9th Cir. 1960); Arent, *Current Developments Affecting Loss Corporations*, 35 TAXES 956, 963 (1957); Levine and Petta, *Libson Shops: A Study in Semantics*, 36 TAXES 445, 448 (1958); Levine and Petta, *Libson Shops Applied to the Single Corporate Taxpayer*, 36 TAXES 562 (1958).

¹⁵ New Colonial Ice Co. v. Commissioner, 292 U.S. 435 (1934) (held the resultant corporation from a merger cannot be *the taxpayer* with respect to the previous business entity prior to the merger; held also that, with some exceptions, a corporation and its stockholders are deemed separate entities); Virginia Metal Prods., Inc. v. Commissioner, 290 F.2d 675 (3d Cir. 1961) (no continuity of ownership or business); *contra*, National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949) (income taxed to subsidiaries when earned by them and paid to the parent); Commissioner v. Court Holding Co., 324 U.S. 331 (1945) (gain on sale by stockholders of property conveyed to them as a "liquidating dividend" held taxable to the corporation); Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943) (sale of property by an individually owned corporation held taxable to the corporation); Commissioner v. Metropolitan Edison Co., 306 U.S. 522 (1939) (resultant corporation in a statutory merger by a sale of assets and liabilities, the parent buying the assets, etc., of the subsidiary, is the same taxpayer as the former and assumes the former's tax attributes); see generally 31 U. CINC. L. REV. 462 (1962).

¹⁶ 306 U.S. 522, 529 (1939) (involving deduction of unamortized discount and expenses).

¹⁷ 176 F.2d 573 (2d Cir. 1949) (involving deduction of excess profits credit).

¹⁸ *Accord*, Newmarket Mfg. Co. v. United States, 233 F.2d 493 (1st Cir. 1956) (corporation merely changed the state of its incorporation so the resultant corporation had the same tax attributes); see Arent, *supra* note 14, at 960.

¹⁹ 176 F.2d at 577.

only so long as they were applied to post-merger income generated by the same assets.²⁰

It has been theorized that the problems raised by the presence of the word "taxpayer" in the 1939 Code no longer exist due to the omission of the word in section 172 of the 1954 Code.²¹ Thus, "the point of contention from which arose the *Libson Shops* case" has now been eliminated.²² The idea that even the acquiring corporation in a merger is entitled to the deduction (assuming it not be to the loss corporation) is urged,²³ based on section 381 of the 1954 Code,²⁴ which sanctions carryovers in certain corporate acquisitions. Support is added to this position by the Senate Report containing an example wherein an acquiring corporation assumed the net operating loss of the merging corporation without the requirement that the loss carry-over be limited to the assets which produced it.²⁵

The Tax Court in *Maxwell* stated that, due to the type of statutory merger involved, section 381 of the 1954 Code²⁶ would probably allow the carryover in *Libson Shops*, were the same facts to occur again.²⁷ This opinion had been expressed previously by a number of writers.²⁸

²⁰ Berger, *Purchase of Loss Companies; Code Section 382(a)*, 32 TAXES 876, 883 (1954); Cohen, Phillips, Surrey, Tarleau, and Warren, *The Internal Revenue Code of 1954: Carryovers and the Accumulated Earnings Tax*, 10 TAX L. REV. 277, 292 (1955); see *Alprosa Watch Corporation*, 11 T.C. 240, 245 (dictum).

²¹ Statute cited note 3 *supra*.

²² Sinrich, *Libson Shops—An Argument Against Its Application Under the 1954 Code*, 13 TAX L. REV. 167, 176 (1958).

²³ *Id.* at 178.

²⁴ INT. REV. CODE OF 1954, § 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) *General rule.*—In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2); or

(2) in a transfer to which section 361 (relating to non-recognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

²⁵ S. REP. NO. 1622, 83d Cong., 2d Sess. 275 (1954); Sinrich, *supra* note 22, at 178.

²⁶ Statute cited note 24 *supra*.

²⁷ 41 T.C. at 417.

²⁸ Arent, *supra* note 14, at 963; Blake, *Carryovers and Limitations on Carryovers of Net Operating Losses in Corporate Acquisitions*, N.Y.U. 21ST. INST. ON FED. TAX 1247, 1265 n.65 (1963); Brock, *supra* note 7, at 589; Levine and Petta, *supra* note 14, at 452; Reese, *Reorganization Transfers and Survival of Tax Attributes*, 16 TAX L.

Section 382(a) of the 1954 Code²⁹ provides certain limitations on a corporation's ability to utilize operating loss carryovers. One of these limitations, failure to carry on substantially the same business, has been one of the main points of contention in carryover cases for years.³⁰ The limitation, before its incorporation in the 1954 Code, was the deciding point in *Libson Shops*.³¹ Carryovers have been denied in many cases because of the absence of "substantially the same business."³² The decisions of the courts and the interpretations by the Commissioner have often been criticized,³³ interpreted,³⁴ and second-guessed³⁵ as to how the "substantially the same business" concept

Rev. 207, 209 (1961); Sinrich, *supra* note 22, at 172; *contra*, Julius Garfinckel & Co. v. Commissioner, 335 F.2d 744, 749 (2d Cir. 1964), *cert. denied*, 379 U.S. 962 (1965) ("The lesson that the Commissioner draws from these cases is more to the point, namely, that *Libson Shops* is not rendered inapplicable by the fact that the surviving corporation which seeks the deduction is the same corporation that incurred the losses.").

²⁹ Statute cited note 4 *supra*.

³⁰ Cohen, Phillips, Surrey, Tarleau, and Warren, *supra* note 20, at 292.

³¹ 353 U.S. at 390 ("We conclude that petitioner is not entitled to a carry-over since the income against which the offset is claimed was not produced by substantially the same businesses which incurred the losses.").

³² *Foremost Dairies, Inc. v. Commissioner*, 341 F.2d 580 (5th Cir. 1965); *Patten Fine Papers, Inc. v. Commissioner*, 249 F.2d 776 (7th Cir. 1957); *E. & J. Gallo Winery v. Commissioner*, 227 F.2d 699 (9th Cir. 1955) (opinion does not disclose whether or not a continuing enterprise was involved); *contra*, *Goodwyn Crockery v. Commissioner*, 315 F.2d 110 (6th Cir. 1963); *J. G. Dudley Co. v. Commissioner*, 298 F.2d 750 (4th Cir. 1962); *Hawaiian Trust Co. v. United States*, 291 F.2d 761 (9th Cir. 1961); *Virginia Metal Prods., Inc. v. Commissioner*, 290 F.2d 675 (3d Cir. 1961); *H. F. Ramsey, Inc.*, 43 T.C. 367 (1965); *Baton Rouge Supply Co.*, 36 T.C. 1 (1961); *Kolker Bros., Inc.*, 35 T.C. 299 (1960); see Blake, *supra* note 28, at 1272; Feder, *The Application of Section 269 to Corporations Having Net Operating Loss Carry-Overs and Potential Losses*, N.Y.U. 21st INST. ON FED. TAX 1277, 1290 (1963) (cites examples of taxpayers who were able to convince the court that the addition of a new line of business was worthwhile or essential).

³³ Levine and Petta, *supra* note 14, at 564 (discloses errors in *Mill Ridge Coal Co. v. Commissioner*, 264 F.2d 713 (5th Cir.), *cert. denied*, 361 U.S. 816 (1959)); Speiller, *Acquisitions by Loss Corporations of Profitable Businesses*, 40 TAXES 22, 35 (1962) (criticizes Commissioner for keeping silent on application of *Libson* rule to single corporation going into a new line of business); 21 U. CINC. L. REV. 462, 463-65 (criticizes Commissioner for applying *Libson* to single corporations, contrary to the court's intentions as stated in the *Libson Shops* case).

³⁴ S. REP. NO. 1622, 83d Cong., 2d Sess. 285 (1954) (describing amount of change necessary to disqualify a carryover); Berger, *supra* note 20, at 879, Eldridge, *When Can a Successor Corporation Use a Predecessor's Loss?*, 8 J. TAXATION 46 (1958) (purchase of corporate "shells" will not be sanctioned); Friedman, *Tax Court Says Adding a New Line Isn't Change of Business; Allows Carryover*, 16 J. TAXATION 90, 91 n.4 (1962) (reiterating that the *Libson* Court said that the decision was not concerning single corporations); Levine and Petta, *supra* note 14, at 453 (*Libson* does not apply to single corporations); Levine and Petta, *supra* note 14, at 564 ("... where there is continuity of business, the successor corporation is the same taxpayer as its predecessor, and where continuity is absent, they are different taxpayers."); Sinrich, *supra* note 22, at 176 (carryover allowed by a corporation adding a new line of business—quoting H.R. REP. 2543, 83d Cong., 2d Sess. (1954) to the same effect).

³⁵ Arent, *The Impact of the Coastal Oil Decision Upon Loss Corporations*, 8 J.

should be applied. The Tax Court applied the *Libson* doctrine to Maxwell Hardware Co. with the qualification that *Maxwell* was an "unusual factual situation."³⁶ Although the court of appeals in *Maxwell* held *Libson* inapplicable to cases arising under the 1954 Code,³⁷ the Treasury has recently stated that "*Libson* will . . . be applied in any loss carryover case under the 1954 Code where there has been both a 50 per cent or more shift in the benefits of a loss carryover . . . and a change in business as defined in Section 382(a) and the regulations thereunder."³⁸

Section 382(a) further provides that the net operating loss carryover will not be allowed when the ownership of the corporation changes substantially. In essence, the section provides that if specified persons³⁹ own a percentage of the total fair market value of the outstanding stock of the corporation which is at least 50 percentage points more than they owned at the beginning of the tax year or at the beginning of the prior tax year, the deduction will not be allowed. The court of appeals concluded that the requisite change of ownership was not present in *Maxwell* since the Tax Court found that the stock acquired by the partners was "nonvoting stock which is limited and preferred as to dividends. . . ."⁴⁰ Therefore, by virtue of the definition of stock contained in section 382(c),⁴¹ the stock in

TAXATION 14, 16 (1958); Arent, *supra* note 14, at 961 (theorizing that the Commissioner may use *Libson* "as justification for reading into the current law an overriding doctrine that operating losses are usable only against the profits of the same business, . . ."); Levine and Petta, *supra* note 14, at 451 (as applied to a newly acquired business or division); Levine and Petta, *supra* note 14, at 564 (anticipation of use of *Mill Ridge* to prevent utilization of carryovers in a different division of the same corporation); Speiller, *IRS Will Not Apply Libson Shops or Section 269 to Single Corporate Taxpayers*, 18 J. TAXATION 290, 291 (1963) (cannot apply *Libson* unless there is "so drastic a change in the ownership of the corporation" as to warrant its application).

³⁶ 41 T.C. at 418.

³⁷ 343 F.2d at 716.

³⁸ 34 U.S.L. WEEK 2207 (IRS; TIR 773, Oct. 13, 1965).

³⁹ INT. REV. CODE OF 1954, § 382(a) provides:

(2) *Description of Person or Persons.*— The person or persons referred to in paragraph (1) shall be the 10 persons (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year) who own the greatest percentage of the fair market value of such stock at the end of such taxable year; except that, if any other person owns the same percentage of such stock at such time as is owned by one of the 10 persons, such person shall also be included. If any of the persons are so related that such stock owned by one is attributed to the other under the rules specified in paragraph (3), such persons shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less) who own the greatest percentage of the fair market value of such outstanding stock.

⁴⁰ 41 T.C. at 417.

⁴¹ Statute cited note 4 *supra*.

question did not meet the change of ownership requirements established in section 382(a).⁴²

This measure of continuity with respect to ownership, or control, has been applied frequently and quite strictly.⁴³ It would seem that the provision will continue to be applied without modification, since, as one author questions "If Congress wanted anything done about this problem, why did it set a 50 per cent figure in Section 382?"⁴⁴

Having determined that only one of the requirements of section 382(a) (failure to carry on substantially the same business) was met, the court of appeals in *Maxwell* considered the applicability of section 269.⁴⁵

Just as Section 382(a) requires more than proof of a substantial change in the trade or business conducted to disqualify the deduction, so does Section 269 require more than proof of a purpose to evade or avoid taxes. The additional requirement is the acquisition directly or indirectly of control of a corporation, specifically, the ownership of stock possessing at least fifty per cent of the voting power or at least fifty per cent of the total value of shares of all classes.⁴⁶

The court goes on to say "The Tax Court correctly said: 'We think it clear that the provisions of Section 269 are not applicable here because of the absence of the type of acquisition provided for . . . [in that section].'"⁴⁷

⁴² H.R. REP. NO. 1079, 78th Cong., 2d Sess. (1944), reprinted in 1944 CUM. BULL. 1059, 1069; TREAS. REG. 118 #39.129-1(d) (1953); Berger, *supra* note 20, at 882; Eldridge, *supra* note 34, at 48; Speiller, *supra* note 35, at 290 (paraphrasing Rev. Rul. 63-40, I.R.B. 1963-12); Comment, *Net Operating Loss Carryovers and Corporate Adjustments: Retaining an Advantageous Tax History Under Libson Shops and Section 269, 381, and 382*, 69 YALE L.J. 1201, 1262 (for purposes of determining control, "nonvoting preferred" is not included).

⁴³ E.g., Commissioner v. Alabama Asphaltic Limestone Co., 315 U.S. 179 (1942) (deduction allowed); Huyler's v. Commissioner, 327 F.2d 767 (7th Cir. 1964) (not allowed); Norden-Ketay Corp. v. Commissioner, 319 F.2d 902 (2d Cir.), *cert. denied*, 375 U.S. 953 (1963) (not allowed); Commissioner v. Hutchens Metal Prods., Inc., 281 F.2d 174 (8th Cir. 1960) (not allowed); Jackson Oldsmobile, Inc. v. United States, 237 F. Supp. 779 (D.C. Ga. 1964) (allowed); Westinghouse Air Brake Co. v. United States, 342 F.2d 68 (Ct. Cl. 1965) (not allowed); Wisconsin Cent. R.R. v. United States, 296 F.2d 750 (Ct. Cl. 1961) (not allowed); *contra*, Julius Garfinckel & Co. v. Commissioner, 335 F.2d 744, 749 (2d Cir. 1964), *cert. denied*, 379 U.S. 962 (1965) ("We can make only the unilluminating statement that in a transaction in which a 58% owner of a loss corporation causes it to acquire a wholly owned profit corporation, with a consequent increase in its ownership of the survivor to 95% the discontinuity between the before and the after seems sufficient to cause the case to be attracted by *Libson Shops*.").

⁴⁴ Speiller, *supra* note 35, at 292 n.7.

⁴⁵ Statute cited note 5 *supra*.

⁴⁶ 343 F.2d at 720.

⁴⁷ *Id.* at 721.

The position has been taken⁴⁸ that section 382(a) of the 1954 Code, providing limitations on the ability of a corporation to use net operating loss carryovers, was intended to replace that part of section 129 of the 1939 Code (predecessor of section 269 of the 1954 Code) which dealt with limitations. However, since section 269 of the 1954 Code also contains limitations on the availability of carryovers, the better interpretation would seem to be that sections 382(a) and 269 are not to be construed together, but each is to be applied on its own merits.⁴⁹ Thus, section 382(a) alone may disallow a carryover without the requirement of an intent to avoid taxes, and section 269 may also disallow a carryover with a limitation different from that of section 382(a) concerning "control" and with the additional requirement, not contained in 382(a), that an intent to avoid taxes be present. Therefore, a carryover may be disallowed by either section and the inapplicability of one section does not preclude the application of the other.⁵⁰

Although the regulations under section 269 provide that the section "may be applied to disallow a net operating loss carryover even though such carryover is not disallowed (in whole or in part) under section 382 and the regulations thereunder,"⁵¹ seldom does the taxpayer lose when he contests the application of section 269 by the Commissioner, due to the difficulty of proving that the principal purpose for which the acquisition was made was evasion or avoidance of taxes.⁵² One author points out that a taxpayer's successful passing of the *substantially the same business* test of section 382(a) "seems to confer a substantial degree of immunity from Section 269. Thus far, with but a single exception, in all cases where both the . . . [tax evasion] issue and the continuity of business issue have either been expressly or implicitly decided, the decision on both issues has been the same."⁵³ One distinction between the "control" tests of the two sections is that section 269 states that "control" may be gained by stock acquisitions equal to "at least 50 percent of the total value of

⁴⁸ Eldridge, *supra* note 34, at 47; Rice, *Internal Revenue Code, Section 269: Does the Left Hand Know What the Right Is Doing?*, 103 U. PA. L. REV. 579, 592 (1955).

⁴⁹ Arent, *supra* note 14, at 968; Berger, *supra* note 20, at 883, 896; Rice, *supra* note 48, at 591.

⁵⁰ Authorities cited note 49 *supra*.

⁵¹ TREAS. REG. § 1.269-6 (1962).

⁵² Arent, *supra* note 35, at 14; Eldridge, *supra* note 34, at 47; Rice, *supra* note 48, at 592.

⁵³ Brock, *supra* note 7, at 594 ("The statement covers jury verdicts for the taxpayer under instructions to consider both issues.") (one exception is dictum in *H. F. Ramsey, Inc.*, 43 T.C. 367 (1965)).

shares of all classes of stock of the corporation,"⁵⁴ a requirement not met in *Maxwell*.⁵⁵ It may be that the reluctance of the *Maxwell* court to construe the voting trust agreement as an acquisition of control by the partners⁵⁶ is an indication that future litigation may be expected concerning the problem of indirect control under section 269.

The court of appeals in *Maxwell* concluded that Congress intended to substitute "statutory rules for judge-made law," and, "unless the special circumstances interpreted within the letter and spirit of Sections 382(a) and 269 obtain," operating loss carryover "trafficking" will be permitted.⁵⁷ The problems involved in drafting the 1954 Code have been recognized by one author, who points out the difficulties existing in laying down an "objective defense against the subjective hazard of 'undue' tax avoidance," suggesting that a "very effective job has been accomplished."⁵⁸ He states that "There should be little uncertainty in applying the conditions, except as to whether the corporation 'has not continued to carry on' the same trade or business."⁵⁹

Maxwell would seem to leave the Commissioner with but one available alternative under the 1954 Code with regard to tax evasion cases where the limitations of sections 382(a) or 269 are not met.⁶⁰ This alternative is section 482.⁶¹ The *Maxwell* court states that "no reliance may be placed on Section 482 to justify a decision because

⁵⁴ Statute cited note 5 *supra*.

⁵⁵ 343 F.2d at 720.

⁵⁶ *Ibid.*

⁵⁷ *Id.* at 718, 723; *but see*, U.S.L. WEEK, *supra* note 38.

⁵⁸ Berger, *supra* note 20, at 880-81; *contra*, Cuddihy, *Tax and Other Legal Considerations in a Corporation's Acquisition of an Existing Corporation*, TULANE 6TH TAX INST. 524, 545, 552 (1957).

⁵⁹ Berger, *supra* note 20, at 881.

⁶⁰ *Contra*, Brock, *supra* note 7, at 595 states: "Strictly speaking, the problems raised by loss carryovers could be solved completely by making their transfer either impossible or unnecessary—two quite different approaches.

"The transfer of carryovers could be made impossible by requiring their cancellation in the event of any substantial change in the direct or indirect ownership of the corporation sustaining the losses. . . .

"The transfer of carryovers could be rendered unnecessary by allowing loss corporations to claim a negative tax essentially equivalent to a subsidy."

⁶¹ INT. REV. CODE OF 1954, § 482. ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

the Commissioner did not rely upon it and gave no notice of such issues in his Notice of Deficiency to Maxwell Hardware Co."⁶² But in the court's analysis of the case: "It is arguable that the combination of factors in this case . . . are sufficient to justify a conclusion that the subdivision business of Maxwell Hardware was controlled by . . . [the real estate partners] if the Commissioner in his discretion, had properly so determined. . . ."⁶³

Section 482, the successor to section 45 of the 1939 Code, has two prerequisites for its application by the Commissioner: "(1) common ownership of control of the taxpayers involved; and (2) either resulting evasion of tax *or* a failure clearly to reflect the income of the respective taxpayers."⁶⁴ The provision has been described as an "amorphous merging" of statutory enactment with the taxpayer's right to organize his business as he wishes.⁶⁵ Writers have found the section difficult to define⁶⁶ and indefinite in application⁶⁷ but concede that its indefiniteness may be one of its strongest points⁶⁸ and foresee an expanded use of the section, with results becoming more favorable for the Commissioner,⁶⁹ the only one authorized to invoke the section.

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⁶² 342 F.2d at 721.

⁶³ *Id.* at 722.

⁶⁴ Plumb and Kapp, *Reallocation of Income and Deductions Under Section 482*, 41 TAXES 809, 810 (1963); see Ekman, *Warning Signals Under Sections 45 and 129*, N.Y.U. 12TH INST. ON FED. TAX 693, 695-96 (1954).

⁶⁵ Anderson, *Reexamination of Commissioner's Powers to Reallocate Income and Expenses Among Related Entities Under Section 482*, U. SO. CAL. 10TH TAX INST. 343, 348 (1958).

⁶⁶ Paley, *Multiple Corporations Face Ever-Increasing Attack; Realty Development Vulnerable*, 18 J. TAXATION 130, 136-37 (1963).

⁶⁷ Paley, *Forming Multiple Corporations*, 39 TAXES 375, 383-84 (1961); Anderson, *supra* note 65, at 372-73; Groh, *Multiple Entities*, 40 TAXES 486, 487-88 (1962); *contra*, Wood, *Examples of How IRS Uses Section 482 to Reallocate Income and Expenses*, 16 J. TAXATION 261 (1962) (rejects shotgun approach by § 482 and shows twelve examples of how the section has been used); Mortenson, *The Multiple Attack on Multiple Corporations*, 35 TAXES 647, 653 (1957) ("Apparently its sanctions can only be invoked in situations where there are dealings *between related taxpayers*, and then only where such dealings are not at 'arm's length'").

⁶⁸ Anderson, *supra* note 65, at 372-73.

⁶⁹ *Id.* at 373; Plumb and Kapp, *supra* note 64, at 834; see also Bacon, *Taxing Foreign Income of United States Taxpayers*, 43 TAXES 362 (1965) (author notes that § 482 reallocations have become common in the foreign income area); Paley, *supra* note 67, at 382 (§ 482 has had frequent application in numerous areas).