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A Study of the application of Section 482 of the Internal Revenue Code to Certain Domestic Transactions of Related BUsiness Organizations

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A STUDY OF THE APPLICATION OF SECTION 482 OF THE INTERNAL REVENUE CODE TO CERTAIN DOMESTIC TRANSACTIONS OF RELATED BUSINESS ORGANIZATIONS

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TABLE OF CONTENTS

CHAPTER I

INTRODUCTION AND LEGISLATIVE HISTORY

Section 482 of the Internal Revenue Code is a deceptively simple provision, containing only one sentence:

> 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 Treasury Regulations (primarily dated 1968) pertaining to Section 482 are comprised of twenty pages of fine print. Although the authority stems from the statute, it is really the regulations which form the guidelines under which the Internal Revenue Service Commissioner has been able to wield this broad power given to him by Congress over forty years ago.

For about a decade the primary focus of the Commissioner has been on foreign transactions. Currently, though, Section 482 is being applied to domestic business even more than foreign.[1] From another point of view, Section 482 is becoming more and more important relative to other sections of the Code. In an article written in 1969, Section 482 was mentioned as the most frequently cited section in deficiency notices in pending cases in the Mid Atlantic Region.[2]

It is readily apparent that more and more domestic taxpayers should make themselves aware of the implications of Section 482. The purpose of this paper is to examine, by analyzing relevant court cases and Treasury Regulations, the extent to which the Internal Revenue Service Commissioner has applied Section 482 in order to prevent evasion of taxes or the shifting of income, deductions, and credits among related domestic business organizations.

Prior to the 1960's, Section 482 of the 1954 Internal Revenue Code (or its predecessor, Section 45 of the 1939 Code) was a seldom used tool of the Commissioner. The Regulations, remaining substantially unchanged since 1935, were primarily confined to definition of terms and statements of general purpose and standards.[3] What little development of the section there was occurred largely through court decisions.[4] In contrast, the decade of the 1960's was a period of activity relating to Section 482, both in the formulation of new Treasury Regulations and an expanded number of court cases. Section 482 had turned from an ordinary provision of the Code to one of the most important and all-pervasive sections.[5]

As early as 1921 Congress was aware of the arbitrary shifting of income between commonly controlled business firms.[6] Section 482 had its origin in Section 240 (d) of the Revenue Act of 1921, which gave the Commissioner the authority to "consolidate the accounts of related trades or businesses for the purpose only of making an accurate distribution of gains, profits, income, deductions, or capital between or among such related trades or businesses." The Senate Finance Committee thought this was necessary "to prevent the arbitrary shifting of profits among related businesses, particularly in the case of subsidiary corporations organized as foreign corporations."[7]

In the Revenue Act of 1928 Section 45 was set up, containing language very similar to the language of the present Section 482. The House and Senate Committee Reports with regard to Section 45 stated that the purpose of the section was to "prevent evasion by the shifting of profits, the making of fictitious sales, and other methods frequently adopted for the purpose of milking, and in order to clearly reflect their true income."[8] By the language, it appears that Congress' intent was to carry out in even stronger language the theme stressed in 1921.

An interesting discrepancy exists in the formulation of the 1928 Code. In the Committee Reports the "evasion" clause and the "clearly to reflect income" clause are joined by "and", whereas in Section 45 itself the word "or" is the conjugation used. This may be significant as an indication of Congressional intent to allow the section to be used only in purely tax-motivated situations.[9] Irregardless, the Commissioner does not consider himself restricted in his authority to utilize Section 482 in purely tax-motivated situations only.[10]

The 1968 Regulations were seven years in the making. The Revenue Act of 1962 was to have had in it an amendment to Section 482 which would have provided specific allocation rules for certain transactions between domestic corporations and their related foreign affiliates. Under pressure from many influential taxpayers the amendment was struck from the ultimate Revenue Act of 1962.[11] In its place, the Treasury Department was directed to:

> explore the possibility of developing and promulgating regulations under this authority which would provide additional guidelines and formulas for the allocation of income and deductions in cases involving foreign income.[12]

Under this directive, the Treasury Department undertook to expand the Regulations under Section 482 to define the concept of the "arm's length transaction," for the 1962 regulations established this principle but did not define it. In setting up the guidelines, the Treasury did not confine itself to allocations of foreign income and deductions as the Congress had suggested. The Regulations actually mirrored the statute in that neither made any distinction between foreign and domestic application of Section 482.[13] Thus, the stage was set for the activity directed at purely domestic transactions during the subsequent years.

FOOTNOTES - CHAPTER I

[1]Harry K. Mansfield, "Section 482 Regulations as Applicable to Domestic Taxpayers," Seventeenth Annual Tulane Tax Institute. Baton Rouge, La., 1967, 88.

[2]Thomas E. Jenks, "Treasury Regulations Under Section 482," Tax Lawyer, XXIII (Winter, 1970), p. 280.

[3]Melvin L. Hamlin, "Section 482 in the 1970's" Commissioner's Authority to Allocate - When, How, and To Whom," Twenty-fifth Tax Institute - University of Southern California Law Center, Los Angeles, Calif., 1973, p. 702.

[4]Lawrence Gerber and Warren C. Seieroe, "Section 482 - Still Growing at the Age of 50," Taxes, XLVI (December, 1968), p. 893.

[5]Hamlin, USC 25th Tax Institute, p. 703.

[6]Robert N. Lent, "New Importance for Section 482 of the Internal Revenue Code," William and Mary Law Review, VII (May, 1966), p. 345.

[7]S. Rep. No. 275, 67th Cong. 1st Sess. 20 (1920).

[8]H. Rep. No. 2, 70th Cong., 1st Sess., 16-17 (1928); S. Rep. No. 960 70th Cong., 1st Sess., 24 (1928).

[9]Robert H. Aland, "Section 482 - 1971 Version," Taxes, XLIX (December, 1971), p. 816.

[10]Treasury Regulation § 1.482 - 1(b)(1).

[11]Jenks, Tax Lawyer, XXIII, p. 280.

[12]H.R. Rep. No. 2508, 87th Cong., 2d Sess., 19(1962).

[13]Mansfield, 17th Tulane Tax Institute, p. 88.

anytime taxable income is other than it would have been had the taxpayer, in the conduct of its affairs, been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.[18]

In determining the true taxable income of a controlled taxpayer, the Commissioner is not restricted to cases involving fraud, shams, or devices for avoiding taxes.[19] Authority to allocate extends to any case in which either income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.[20]

Allocations may be made of net income even though the Code section refers specifically to the allocation of gross income, deductions, and credits. This extension of the Code has been established by the courts in situations where all gross income and all deductions would have been allocated.[21] Allocating net income rather than specific items means less time spent analyzing each specific taxpayer's situation, leaving more time for the IRS for other cases. Regarding the taxpayer, it would not seem to create any additional burden in the presentation of his case since, unless no items of income or deductions are properly allocable, the taxpayer would have to present proof to the court that certain specific items are clearly not allocable.[22]

Section 482 applies only to the allocation, apportionment, or distribution of income, deductions, or credits. It may not disallow them.[23] In addition, when an allocation is made, it is limited to the amount necessary either to prevent the evasion of taxes or clearly to reflect income.[24] The Commissioner's authority does not extend to allocating assets or accumulated earnings. This means that the Commissioner would be precluded from then treating income which he allocates to a particular corporation as part of that corporation's accumulated earnings for purposes of determining whether a distribution is a dividend or for purposes of determining whether the accumulated earnings penalty tax is applicable.[25]

On the positive side, the Commissioner's authority is far reaching. For example, it has been held that the Commissioner has the authority to: require a change in accounting method; adjust the basis of property to reflect its value at the time it was acquired from a related taxpayer; reallocate income from a corporation to an individual who may be in a higher tax bracket; and reallocate income from a "loss corporation" back to an affiliate with a favorable profit picture, resulting in denial of the operating loss deduction.[26]

The Requirement of Common Control

Despite the broad scope of Section 482, certain limitations to its applicability are apparent on its face. That is, "Section 482 applies in any case of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests." The term "owned" as used in Section 482 is not defined in the Code or the Regulations, although it probably refers to legal ownership. Most of the trouble has been generated by the term "controlled."[27] The Code does not define the term "controlled," but the Treasury Regulations define the term to include:

> any kind of control, direct or indirect, whether legally enforceable, and however exerciseable or exercised. It is the reality of the control which is decisive, not its form or mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.[28]

It is interesting to note that in formulating Section 482, Congress used the phrase "owned or controlled" without any quantitative limitations. In other sections of the Code, however, Congress has specifically defined control in terms of percentage limitations. Presumably, Congress intended to have the phrase interpreted flexibly in the light of each particular case. The courts have not been eager to apply percentages to Section 482 cases, whereas, in cases dealing with other sections of the Code where percentages have been set up, those percentages are quoted almost without fail.[29]

There are two factual situations in which control is likely to be the central issue. One is in the area of indirect control, that is, control which exists not by stock ownership, but through less direct means such as control of the board of directors or through family relationships. The other is the situation in which two or more unrelated corporations jointly own a subsidiary so that no one corporation controls the subsidiary.

Nothing in Section 482 or the Regulations pertaining to it provide for either the constructive ownership or the family attribution concept in applying the test of ownership or control. The language "directly or indirectly" seems to be the basis which the courts have used for attributing to one member of a family stock held by another member.

Such attribution was not always made. In the 1944 Nelson Paper Co. case,[30] two husbands owned a majority of the stock in one corporation while their wives owned all the stock in another corporation. The Tax Court refused to treat each family as a unit, and also failed to find common control even though one husband was president of the corporation owned by the wives and was the principal individual conducting the activities of that corporation.

In the 1953 Granada Industries, Inc. case,[31] two corporations and two partnerships were owned by the members of four families. There were differences, within each family group, in the individuals who owned interests in the various entities. Nevertheless, the same group of individuals from the four families owned outright, or beneficially through trusts, more than a majority of each of the entities. The family attribution rule was employed and the Commissioner's allocation stood. In determining whether Section 45 (superceded by Section 482 of the 1954 Code) applied, the Court looked beyond ownership to actual control by the heads of the families. The same approach was followed in Friedlander Corp.[32] two years later. In two of the years involved, common control through ownership was lacking unless each family group could be treated as a unit. In the other years involved, the same group of individuals did own directly a majority interest in the corporation and partnership between which the Commissioner sought to allocate. Without distinguishing between the earlier and later years, the court upheld the allocation on the basis that the same two individuals actually managed the two entities during all the years in question.

In the majority of cases it appears that the courts consider direct or indirect control to require both the presence of legal ownership, whether direct or by family attribution, and actual control of the two entities being exercised by one individual. This is particularly well exemplified by the Granada case in which common ownership was proven, but the court looked beyond ownership to actual control by the heads of the families in determining whether Section 45 applied.

The actual control of the two or more related entities is normally by an individual who is on the board of directors or is an officer of the corporation of which he does not have direct ownership, but to which the family attributions rule applies. This need not be the case though. In Hall v. Commissioner,[33] the father had sold his entire interest in a company to a corporation owned wholly by his sons. The father was not an officer or director, nor was he active in his son's corporation. But for the three months following the sale of his company the father continued to operate the company's domestic activities and continued to handle all domestic sales as his own. In addition, he reported on his income tax return all domestic sales and expenses. The court held that all the company's income, domestic and foreign, should be allocated to the father for this period of three months after the sale of the company assets to his sons. Although the case is not purely domestic in nature, it still has potential ramifications to the purely domestic situation where the father might have been handling one of a few branches of a corporation.

In a very recent case, there was an allocation of income and expenses by the Commissioner between two corporations which were not controlled through stock ownership either directly or indirectly through family attribution rules. Rather, "the Cohens retained control of Charles Town (Inc.) until May, 1961 by reason of their election to positions as directors and officers which occurred upon organization of the corporation." In Charles Town, Inc.,[34] two brothers were the owners of a small successful steel manufacturing corporation. The brothers wished to engage in the business of operating a race track. Desiring to limit their liability to the amount invested in the venture, they set up a new corporation with limited capital. The steel corporation then loaned to the new corporation the amount which was necessary to finance the operations. In order to make the two corporations unrelated, ninety-eight of one hundred shares issued were in the name of a cousin who was experienced in managing racing events. The remaining two shares were issued to the two brothers. With the exchange of the funds, there was an agreement between the two corporations that: (1) the new corporation was to conduct the racing meet for ten percent of the net profits and (2) the majority of the officers should make all major decisions in the management of the new corporation so long as the debt to the steel corporation is still outstanding. This meant that the majority of the two brothers and the cousin would make the major decisions. This gave the brothers control of the new corporation with only two percent ownership. The court agreed with the Commissioner that all the profits should go to the new corporation, thus leaving the two brothers in the undesirable position of having only a two percent right to the horseracing profits.

The courts have generally tended toward utilizing the attribution rules of Section 318 of the Code to impute control. This would be a decent guideline to start with in attempting to discern whether or not Section 482 might be applicable. In the end, of course, the existence of indirect control must be determined on a case by case basis. As in Charles Town, Inc., there need not be any legal control for Section 482 to be applicable. In Grenada Industries, Inc. it was said that record ownership of the stock is immaterial in determining whether four organizations were owned or controlled directly by the same interests, the significant thing being who dominates the organizations and thusly exercises the actual control at all times.[35] It is possible that the creditors of a corporation may be deemed in control of the corporation for purposes of Section 482. But, while the statute and the Regulations give the broadest meaning to the term "control," the courts have attempted to clarify its meaning and accordingly have more narrowly construed the requirements for control.[36]

Another area of question is whether Section 482 can be applied where two independent corporations, owned by different and unrelated stockholders, each own one-half of the stock of, and share equally the control of, another corporation with which they do business. For many years, the Lake Erie & Pittsburgh Ry. case[37] was the precedent cited for non-applicability of Section 482.

In that case, two independent railroad companies each owned fifty percent of the stock of Lake Erie Company and under an agreement, each was to have use of the tracks and other facilities of Erie. Under the agreement, the two railroad companies paid to Erie consideration equaling all of Erie's operating costs, plus an amount equal to five percent of Erie's capital stock and the amount of income tax on its taxable income. The five percent return after taxes was used as a dividend by Erie, so it was simply returned to the two railroads. In a later agreement, the two railroads decided to eliminate the five percent charge, thus leaving Erie with no net income. When the Commissioner sought to allocate part of the gross incomes of the two railroads to Erie, the court held that the two railroads were not "owned or controlled directly or indirectly by the same interests." The Commissioner acquiesced in that 1945 case, but withdrew his acquiescence in 1965, explaining that the Erie decision was contrary to the trend of recent decisions.[38]

Regardless of the change in position of the Commissioners on Erie, and the trend of recent cases, in 1970 the Tax Court arrived at a decision identical to that arrived at in 1945. On appeal, though, the decision of the tax court was reversed.[39] In B. Forman Company, Inc.,[40] two men each operated a retail department store. They were competing companies. In order to curb declining incomes, they agreed to jointly build the Midtown Shopping Center which would join the rear entrances of their stores. Each gave a million dollar interest-free loan to Midtown. The Commissioner imputed five percent interest on the loans. The Tax Court disagreed with the Commissioner's action, but on appeal the decision was reversed with the appeals court stating that:

> the conclusion is inescapable that they acted in concert in making loans without interest to a corporation, all of whose stock they owned and all of whose directors and officers were their alter egos. They were not competitors in their dealings with one another as to Midtown. Reality of control by the same interests is present no less than if they had formed a partnership.[41]

"A mutuality of interests exists, or potentially exists, in many, if not most, multiple corporate ownership cases."[42] Thus, there are many instances of jointly owned companies which might be susceptible to a section 482 allocation if it is found that the owners acted in concert. The Forman decision seems to have opened up a potentially huge area of applicability for Section 482, leaving the question of "control" still very uncertain in its application.[43]

Definition of Organization, Trade, or Business

Section 482 requires the shifting of income or deductions among two or more organizations, trades, or businesses. By use of these three terms, this section is designed to cover any conceivable situation. "The term 'organization' includes any organization of any kind, whether it be a sole proprietorship, a partnership, a trust, an estate, an association, or a corporation (as each is defined or understood in the Internal Revenue Code or regulations thereunder), irrespective of the place where organized, where operated, or where its trade or business is conducted, and regardless of whether domestic or foreign, whether exempt, whether affiliated, or whether a party to a consolidated return."[44] "The term 'trade' or 'business' includes any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on."[45]

In the vast majority of Section 482 cases there is no controversy over the question of whether two or more organizations, trades, or businesses are involved.[46] The main controversial topic is what constitutes a trade or business. A related issue extends into the area of reasonable compensation. The courts have ruled that in some cases the rendition of services by an employer is a trade or business or an employee is an organization so that the condition of two or more organizations, trades, or businesses is satisfied.

In Pauline W. Ach,[47] the assets of a profitable dress shop business conducted as a sole proprietorship by Mrs. Ach were sold to the shell of a corporation, owned by her son, which had previously generated substantial operating losses while engaged in the dairy business. The dress business was actively conducted by the mother before and after the sale of assets to the corporation. After the sale, the mother was not a stockholder, nor did she receive a salary for her services or for her positions as President, Treasurer, and Chairman of the Board of Directors. The court held that seventy percent of the earnings of the dress shop activity should be allocated to the mother as a salary for her services rendered. "Sufficient aspects of the business remained with Pauline so as not to deprive her of the status of a separate 'organization,' 'trade,' or 'business,' within the meaning of Section 482."[48]

In the recent case, Victor Borge,[49] the Tax Court reached the same result as it had in Ach on somewhat different facts. In Borge, the nature of the services rendered by Mr. Borge constituted a separate trade or business different than that which is customarily performed by an employee for an employer. Mr. Borge sold his services as an entertainer to his wholly owned corporation which had substantial operating losses from raising Cornish hens. The corporation did not pay Mr. Borge the agreed amount for his services and the Commissioner made an allocation under Section 482, based on Mr. Borge being a separate trade or business.

In the 1968 Rubin[50] case, the facts and outcome were essentially the same as Ach and Borge. The trend seems to be to include almost every type of business where a controlling shareholder renders services for his corporation in a professional, administrative, or artistic capacity.[51] Prior to these decisions, it had not been thought that an individual had to draw an arm's length salary from a controlled corporation. Based on the recent cases, a primary advantage to incorporating may be eliminated if virtually all of the income of the corporation has to be allocated to the individual in the form of salary. The problem results because with respect to his own personal services, he has no cost for such value.[52] Whereas there had existed a limitation on the maximum salary paid to a controlling stockholder-employee and still be fully deductible by the corporation, there now exists a low range of reasonableness which must be met to at least minimize the chance of a Section 482 allocation.

FOOTNOTES - Chapter II

[14] William L. Sax, "Section 482 and the 'Arm's Length' Standard of Commonly Controlled Taxpayers," University of Miami Law Review, XXIII (1968-1969), p. 829.

[15] National Securities Corporation v. Commissioner of Internal Revenue, 137 F.2d 600 (1943).

[16] Treasury Regulation § 1.482-1(b)(3).

[17] Harlen Pomeroy, "Allocation of Income, Deductions, Credits, and Allowances Among Related Taxpayers," Western Reserve Law Review, XV (1964), p. 253.

[18] Treasury Regulation § 1.482-1(c).

[19] Ibid.

[20] Ibid.

[21] James O. Hewitt, "Section 482 - Reallocation of Income and Deductions Between Related Persons--Up to Date," New York University Twenty-Second Annual Institute on Federal Taxation. New York, N.Y., 1970, p. 388.

[22] Ibid., p. 390.

[23] Mansfield, 17th Tulane Tax Institute, p. 88.

[24] Ibid., p. 88.

[25] Pomeroy, Western Reserve L.R., XV, p. 262.

[26] Ibid., p. 263.

[27] Robert S. Rich, "Allocation of Deductions Among Related Taxpayers Under Section 482 of the Internal Revenue Code," Tax Counselor's Quarterly, IX (December, 1965), p. 380.

[28] Treasury Regulation § 1.482-1(a)(3).

[29] Hewitt, NYU 22nd Annual Institute, p. 385.

[30] A. G. Nelson Paper Co., Inc., T. C. Docket No. 1553 (1944).

[31] Grenada Industries, Inc. v. Commissioner of Internal Revenue, 17 TC 231 (1951).

[32] The Friedlander Corporation v. Commissioner of Internal Revenue, 25 TC 70 (1955).

[33] Hall v. Commissioner of Internal Revenue, 294 F.2d 82 (1961).

[34] Charles Town, Inc. v. Commissioner of Internal Revenue, 372 F.2d. 415 (1967).

[35] Grenada, p. 232.

[36] Rich, Tax Counselor's Quarterly, IX, p. 381.

[37] The Lake Erie and Pittsburg Railway Company v. Commissioner of Internal Revenue, 5 TC 558 (1945).

[38] Revenue Ruling 65-142.

[39] 453 F.2d 1144 reversing 54 TC 912 (1970).

[40] B. Forman Company, Inc. v. Commissioner of Internal Revenue, 54 TC 912 (1970).

[41] B. Forman Company, Inc. v. C.I.R., 453 F.2d 1144 (1971).

[42] Stephen A. Nauheim, "B. Forman & Co., Inc. - A Crucial Test of the Future of Section 482," Tax Lawyer, XXVI (Fall, 1972), p. 111.

[43] Hamlin, USC 25th Tax Institute, p. 730.

[44] Treasury Regulation § 1.482-1(a)(1).

[45] Treasury Regulation § 1.482-1(a)(2).

[46] Gerber and Seieroe, Taxes, XLIV, p. 894.

[47] Pauline W. Ach v. Commissioner of Internal Revenue, 42 TC 114 (1964).

[48] Ach, p. 124.

[49]Victor Borge and Sanna Borge, TC Docket No. 6329-65 (1967).

[50]Richard Rubin and Helena Rubin v. Commissioner of Internal Revenue, 51 TC 251 (1968).

[51]Hamlin, USC 25th Tax Institute, p. 726.

[52]*Ibid*., p. 727.

CHAPTER III

CRITERIA USED BY THE COMMISSIONER IN APPLYING SECTION 482

Where Section 482 is deemed applicable to prevent evasion of tax or clearly to reflect income, the Regulations provide that "the standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer."[53] Conversely, where commonly controlled entities can show that they have dealt "at arm's length" with one another, no allocation should be permitted.[54]

Despite the fact that the Regulations state that the arm's length standard is the sole test under Section 482, the courts have made statements such as:

> We do not agree with the Commissioner's contention that "arm's length bargaining" is the sole criterion for applying the statutory language of Section 482 in determining what the "true net income" is of each "controlled taxpayer." Many decisions have been reached under Section 482 without reference to the phrase "arm's length bargaining" and without reference to Treasury Department Regulations and Rulings which state that the talismanic combination of words--arm's length--is the "standard to be applied in every case."[55]

Those decisions which have not relied on the words "arm's length" per se have typically questioned whether the arrangement between the controlled taxpayers is "reasonable."[56]

In comparing the "arm's length" test and the "reasonable" test, they both appear to have defects. Regarding the former, as one individual put it:

> The idea of requiring related corporations to deal with each other on the same basis as unrelated companies seems to go far beyond the intentions of Congress and also seems to be completely removed from the facts of life. If a subsidiary of General Motors is having a hard time and cannot raise needed working capital except at a high rate of interest, why should the parent company charge a comparable rate of interest if the only beneficiary is the Ford Motor Company?[57]

In addition, it is difficult in most cases, due to the lack of comparable transactions or unavailability of information, to determine what would have been done in a given factual situation between unrelated parties bargaining at arm's length.[58] Regarding the "reasonable" test, it is difficult to apply such a test in the absence of standards as to what is reasonable.[59] One author suggests a partial solution to the problem by proposing that the arm's length standard should be considered the means to correct a tax avoidance situation rather than the motivating factor for an adjustment. In other words, if a transaction was based on the good faith of the taxpayer and coupled with a sound business purpose, Section 482 should not be applied.[60]

The two standards are very closely related as indicated by the Court's statement in Eli Lilly & Co. v. United States[61] that "any measure such as 'fair and reasonable' must be defined within the framework of 'fair' or 'reasonable' as among unrelated taxpayers."[62] The implication is that even if the arm's length standard is not per se the only standard which clearly reflects taxable income, it may be the only reasonable method by which to arrive at the correct amount under alternative standards for transactions between related taxpayers.[63] In general, the courts are reluctant to overturn the Treasury's Regulations where the Code itself authorizes the Commissioner to issue regulations.[64] Nevertheless, it has been done, thus contributing to the uncertainty regarding possible defenses available to taxpayers.

Quite often when taxpayers have found themselves without the benefit of the arm's length defense, an alternative defense frequently offered by the taxpayer and frequently accepted by the courts is that a transaction had a reasonable and legitimate business purpose.[65] The success of the business purpose defense has been limited to a special case and, accordingly, should not be thought of as a panacea. Its success has been limited to cases in which the Commissioner has either tried to declare the entity a sham, or to allocate the whole income of one taxpayer to another. In these cases, the one hundred percent allocation of net income called for was thought to be improper where there had been a valid business purpose for the existence of the separate entity.[66] It appears that Section 482 had been misapplied in these cases which dealt with whether or not the entity was bona fide. In fact, Section 482 applies only to the extent that transactions occurring between the entities are not at arm's length.[67]

The last statement made has become a generality due to the decision in Wisconsin Big Boy Corp. (WBB).[68] WBB had obtained a restaurant franchise covering a multistate area and entered into licensing agreements with the restaurant's subsidiaries, obligating it to perform substantial advisory, administrative, accounting, and personnel services for the subsidiaries. The two principal shareholders in WBB served as officers and directors of all the subsidiary corporations and performed the chief management functions for them all. They also arranged the financing, locating, and leasing of restaurant sites. The Tax Court held that there was a single, integrated restaurant conducted and controlled by WBB which generated all the income. This differs from prior cases in that the Tax Court did not declare the subsidiaries shams. The essence of the case is that the taxpayer was saddled with the burden of proof and the conclusion that "reconstruction of intercompany transactions in a highly integrated enterprise conducted through multiple corporations in order to comply with the arm's length standard is probably neither realistic or feasible."[69] The significance of this court opinion is that it raises serious doubts about the availability of the arm's length, or any standard, as a defense to a Section 482 allocation where a highly integrated and overlapping corporate structure is involved.[70]

FOOTNOTES - Chapter III

[53]Treasury Regulation § 1.482-1(b).

[54]Simon J. Murphy Company v. Commissioner of Internal Revenue, 231 F.2d 639 (1956).

[55]Frank v. International Canadian Corporation, 308 F.2d 520 (1962).

[56]Willard C. Warren, "Many Escape Hatches Exist to Avoid Reallocation of Income, etc., Under Section 482," Taxation for Accountants, VII (October, 1971), p. 218.

[57]Karl H. Spaeth, "Section 482--Past and Future," Taxes, XLVII (January, 1969), p. 49.

[58]Robert H. Aland, "Section 482-1971 Version," Taxes, XLIX (December, 1971), p. 819.

[59]Stanley S. Surrey, "Treasury's Need to Curb Tax Avaoidance in Foreign Business Through Use of 482," Journal of Taxation, XXVIII (February, 1968), p. 76.

[60]Henry W. Dekosmian, "Section 482--Allocation of Income and Deductions Among Controlled Taxpayers," Fourteenth Annual Tulane Tax Institute. Baton Rouge, La., 1965, p. 427.

[61]Eli Lilly & Company v. The United States, 372 F.2d 990 (1967).

[62]Ibid., p. 1000.

[63]Howard A. Krom, "Comment: The Application of Section 482 to the Transfer or Use of Intangible Property," Tax Counselor's Quarterly, XIV (December, 1970), p. 544.

[64]Ibid., p. 545.

[65]Hewitt, NYU 22nd Annual Institute, p. 395.

[66]Jeffrey A. Kern, "Recent Extensions of Section 482 of the Internal Revenue Code," Memphis State University Law Review, III (1972-73), p. 120.

[67]Hewitt, <u>NYU 22nd Annual Institute</u>, p. 397.

[68]Marc's Big Boy-Prospect, Inc. v. Commissioner of Internal Revenue, 52 TC 1073 (1969).

[69]John W. Lee, "CA-7's Wisconsin Big Boy Case has Dire Implications in 482 Area," <u>Journal of Taxation</u>, XXXVI (June, 1972), p. 350.

[70]Kern, <u>Memphis State Univ. L.R.</u>, p. 121.

CHAPTER IV

APPLICATION OF SECTION 482 TO SPECIFIC TRANSACTIONS

Loans and Advances

Where one member of a controlled group makes a loan or advance to another member, without interest or at a non-arm's length interest rate, the district director (of the IRS) is authorized to make appropriate allocations to reflect an arm's length interest rate for the use of such loan or advance.[71] This authority extends to all bona fide indebtedness including credit extended in the case of sales of property or the rendering of services in the ordinary course of business.[72]

The arm's length interest rate is the rate which would have been charged in independent transactions between unrelated parties under similar circumstances. However, if the creditor is not in the business of making similar loans, the arm's length rate is deemed to be (i) the actual rate charged, if at least 4% and not more than 6% simple interest, or (ii) 5% if no interest was charged, or the rate charged was less than 4% or more than 6%.[73] This range of rates has been termed a "safe-haven" rule for controlled taxpayers, in that the taxpayer can rely on it being the rate utilized by the Commissioner if an allocation is made. The taxpayer, however, has the right to demonstrate that the appropriate arm's length rate is more or less than the safe-haven rate if it benefits him to do so. For example, if the arm's length rate was established as 8% and the actual rate charged was 7%, the latter rate rather than the safe-haven rate 5% rate would be the rate used if the taxpayer so desired. The same is true in the reverse situation; if the arm's length rate is 3% and 3½% was the actual charge, the actual rate controls if the taxpayer so desires.[74]

The Regulations provide that loans and advances which are in fact contributions of capital are not subject to the provisions of Section 482.[75] Before one jumps to the conclusion that exemption from Section 482 can be had by claiming a loan or advance is a contribution to capital, one must consider the effect such a claim would have upon repayment of such loans at some future date as dividends.[76]

The safe haven interest range is definitely to the taxpayer's advantage. First, it allows for a maximum interest charge of 6% for the taxpayer not regularly engaged in the business of making loans of the same general type as the loan in question. Considering today's money market, it is quite advantageous for the related taxpayers who attempted to engage in a no interest loan situation. Second, the taxpayer has the right to attempt to prove a lower than 4-6% rate is applicable. Third, the formula provides a reasonable element of certainty in planning transactions.[77]

Cases associated with loans are discussed in Chapter V of this paper. In that these cases are concerned more with the Commissioner's right to allocate, rather than with the mechanics just discussed, it is more appropriate to consider them later.

Performance of Services for Another

Allocations to reflect an arm's length charge may be made whenever services are rendered by one member of a controlled group for the benefit of, or on behalf of, another member of the group at no charge, or at less than an arm's length charge. According to the Regulations, "Services" include virtually any activity requiring the use of personnel.[78] There is a significant exception for services which are rendered in connection with the transfer or use of property, and which are "ancillary and subsidiary" to the transfer or commencement of effective use of the property.[79] These services are treated under Regulations 1.482-2(c)(d) or (e), pertaining to use of tangible property, transfer or use of intangible property, or sale of tangible property. This brings up the point that the distinction between types of transactions covered under Section 482, such as services and leasing or licensing or sale of property is more often one of form than substance. For this reason, care should be taken in giving the form to intercompany transactions to correspond with the provisions of the regulations one would like to have apply.[80] The latitude one has in doing so is limited, but yet broad enough to warrant consideration.

Not all services having any relationship to the operation of affiliates are subject to allocation. It is necessary to determine that the services rendered were undertaken (i) for the joint benefit of the members of the controlled group or (ii) for the exclusive benefit of another member of the group.[81] There are two exceptions to this allocation rule:

(i) Allocations will not be made if the probable benefits to the other members were so indirect or remote that unrelated parties would not have charged for such services.[82]

(ii) Allocations will generally not be made if the services are merely a duplicate of services which the related party has independently performed or is performing for itself.[83]

Unlike other Section 482 adjustments, the party rendering services to other members of the group is not required to earn a profit from such services, unless the services are an "integral part of the business activity" of either the member rendering or receiving the services.[84] Services are an "integral part of the business activity" of a member of the group in four circumstances:

(i) Where the renderer or the recipient of the services is engaged in the trade or business of rendering similar services to unrelated parties.

(ii) Where the renderer renders services to one or more related parties "as one of its principal activities."

(iii) Where the renderer is peculiarly capable "of rendering the services and such services are" a principal element in the operations of the recipient.

(iv) Where the recipient has received the benefit of a "substantial amount of services from one or more related parties during the taxable year."[85]

Subdivision (iii) has produced the most domestic activity. Local Finance Corp.[86] is typical of numerous cases in which a finance company utilizes its influential relationship with customers to induce the borrowers to take out credit life insurance with an affiliated life insurance company. The court allocated part of the premium revenue back to the finance company because it performed significant services related to the insuring activity. Not every casual attempt to generate additional business for members of a related group would fall under Section 482. The cases indicate that a significant amount of business must be obtained by the insurance company through the finance company, although the insurance selling activity may represent only a small part of the finance company's total activities.[87]

A second area of domestic activity is represented well by the Borge case in which the taxpayer was rendering entertainment services to a corporation which he controlled. The services were then resold by the corporation at many times the salary paid to the taxpayer. The court approved substantial allocations of income from the corporation to the taxpayer to reflect the arm's length value of the taxpayer's services.

Use of Tangible Property (Leases)

In the case of intercompany transfer of the use of tangible property, the Commissioner is authorized by the Regulations to test the consideration under the arm's length standard and to make appropriate allocations if he finds that the consideration fails to comply with that standard. This authority extends to both written and oral agreements between related parties.[88] The arm's length rental charge is the amount which would have been charged for the use of similar property in independent transactions between unrelated parties under similar circumstances. However, if neither the owner nor the user was engaged in the trade or business of renting property of the same general type, an appropriate rental will be determined by use of a formula set forth in the Regulation, unless the taxpayer establishes a more appropriate charge.[89]

The formula amount is the sum of the following four amounts:[90]

(a) An amount equal to the straight-line depreciation of the property, that is, the original cost or other basis, adjusted for items chargeable to capital account and reduced by estimated salvage value, divided by the useful life of the property in the hands of the owner.

(b) An amount of profit equal to 3% of the depreciable basis, as determined above.

(c) The amount of all expenses connected with the property borne by the owner, such as taxes, maintenance and repair, cost of utilities and management expenses. Interest expense is not included.

(d) The amount of all expenses connected with the use of the property by the lessee, which are borne by the owner.

No profit markup is required on a sublease, presumably on the assumption that the sublessor has no capital investment in the lease. Such an assumption may, of course, be contrary to fact.

The first case to arise interpreting the new Section 482 Regulations, Bluefeld Caterer, Inc.,[91] involved a sublease from a related sublessor. The rentals paid by the taxpayer to the sublessor which were deducted by the taxpayer were greatly in excess of the rentals due from the sublessor to its lessor. The sublessor had net operating losses, no investment in the lease, and no assumed expenses. The Tax Court limited the sublessee's deduction to the rental payable by the sublessor to the original lessor.

A classic situation for application of this section of the Regulations is Boyer v. Commissioner[92] in which a partnership owned an office building which was leased to a wholly owned corporation. The partners were in a position to control the taxable income of both entities by determining when rent was payable and by permitting the corporation to use its rental income for improvements usually payable by the owner, thereby reducing partnership income while the corporation offset its rental income against losses on another venture and amortized improvement costs.

Transfer or Use of Intangible Property

Where intangible property is "transferred, sold, assigned, loaned, or otherwise made available" by one member of a controlled group to another member, the Commissioner is authorized to make appropriate allocations to reflect an arm's length consideration for the property or its use.[93] The definition of "intangible property" is extremely comprehensive.[94] In addition to the standard intangible items, it includes such things as "methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, technical data and other similar items." Many such items have been freely exchanged among affiliates in the past, without much thought to compensation. Such activity is now subject to a Section 482 allocation.[95]

For all the potential intangibles named or described in the Regulations, goodwill is not among them. This is strange in that almost all pre-1968 Regulations cases dealing with intangibles have been concerned with goodwill.[96] In Hamburger's York Road, Inc.,[97] the stockholders of a downtown men's clothing store formed a separate corporation to operate a suburban store with approximately the same name.

The court justified a reallocation of 100% of the income of the new corporation back to the original corporation on the basis that the suburban store's sales were due to the goodwill, trade names, experienced buying and selling organization, customer lists, and advertising format furnished by the downtown store. In the Pauline Ach case, a pre-1968 Regulations case which was discussed earlier in this paper, the court justified an allocation to Pauline solely on the basis of the services she rendered. Any goodwill she had built up over the twenty-nine successful years she operated the business before transferring it to the controlled corporate taxpayer was not considered by the court.[98] Needless to say, the 1968 Regulations have caused the courts to look more closely at the value of intangibles which are exchanged between related taxpayers.

The arm's length consideration may take several forms, such as (i) royalties based on sales, profits, or output, (ii) a lump sum payment, or (iii) reciprocal licensing rights.[99] Regardless of the form, the amount of the arm's length consideration is the amount that would have been paid by an unrelated party for the same intangible property under the same circumstances.[100] In the absence of a sufficiently similar transaction involving unrelated parties, consideration is required to be given to eleven factors listed in the Regulations which might influence the amount of consideration.[101]

Often one member of a controlled group will undertake development of intangible property for the benefit of the group. In this situation, the developer and other members of the group have a choice. Members of the group may enter into a "bona fide cost sharing arrangement," defined as an agreement in writing providing for the sharing of costs and risks of developing intangible property in return for a specified interest in the property. In such circumstances, no allocations will be made with respect to the acquisitions of an interest in the property by members of the group, except to reflect their arm's length share of the costs of development.[102] In the absence of such an agreement, the developer of intangible property is not subject to an allocation with respect to the costs of development, but when an interest in the property is transferred or made available to another member of the group, an allocation will be made.[103]

Sales of Tangible Property

Most of the Section 482 cases which have come before the courts involved the question of intercompany pricing.[104] The leading cases, for the most part, deal with United States corporations and their foreign affiliates because of the potential tax savings due to lower tax rates faced on affiliate income when income can be transferred to these affiliates. Yet, this section of the Regulations does apply to purely domestic situations also.

The general rule is that where one member of a group of related taxpayers sells or transfers tangible property to another member of the group, the district director may make appropriate allocations to reflect an arm's length price. An arm's length price is the price that an unrelated party would have paid for the property under similar circumstances. Normally this involves a profit to the seller.[105] The term "tangible property" includes capital assets, even though the Regulations deal only with inventory.

Three methods of determining an arm's length price are described in the Regulations. The Treasury Department established a preferential order which must be followed by the taxpayer. If the standards for a more preferred method are met, that method must be used. In preferential order, the methods are: (1) the "comparable uncontrolled price method," (2) the "resale price method," and (3) the "cost plus" method.[106] Other methods of pricing may be utilized if the taxpayer can establish that such a method is more appropriate in the circumstances or if none of the three preferred methods can reasonably be applied under the facts of a particular case.[107]

<u>Comparable Uncontrolled Price Method</u>. An "uncontrolled sale" is one in which the seller and buyer are not members of the same controlled group. An uncontrolled sale is "comparable" to a controlled sale if the physical property and

circumstances of the uncontrolled sale are not nearly identical to the controlled sale that any differences have no effect on price or can be reflected by reasonable adjustments to the price.[108] Difficulty of application of such principles stems from the fact that determination of whether differences in the product or in the terms of sale have a definite and measurable effect on the price involves a qualitative judgment.[109]

<u>Resale Price Method</u>. Under this method, the arm's length price is determined by subtracting from the "applicable resale price" an appropriate discount determined by multiplying the resale price by an appropriate markup percentage. The "applicable resale price" is the price at which it is anticipated that the property will be resold in an uncontrolled sale. The "appropriate markup percentage" is the gross profit margin which the controlled reseller earns in uncontrolled transactions involving resales of similar property.[110] This method is designed for pricing sales to a related distributor performing primarily resale functions.

<u>Cost Plus Method</u>. Under this method, the arm's length transfer price in a controlled sale is determined by adding to the cost of producing the property an appropriate markup on cost. The markup is determined essentially in the same way as the markup in the resale price method. Both this method

and the resale price method rely on finding comparable uncontrolled markups. Industry average profit margins may be unreliable. The use of third party data, which is available to the government but not the taxpayer, is unfair if the taxpayer has no means of determining comparability.[111] Because of the problem of comparability, there are no "safe-haven" rules for sales of tangible property. This disadvantage has been offset by a Treasury Department proclamation that adjustments will be made only where there is a significant deviation from arm's length dealings or where there has been significant shifting of income.[112]

In Balantine Mft. Co.,[113] the Commissioner allocated to the original transferor corporation's income from the sale of inventory by the related transferee corporation, since the corporations entered into the inventory transfer for the primary purpose of offsetting income from the sale of the inventory by a net operating loss carryover of the transferee.

In Brentwood Homes, Inc.,[114] where three corporations were organized to erect and sell homes under the control and operation of one man who knew that a corporation was taxed 22% on its first $25,000 taxable income and 48% above that figure, and neither the second or the third corporation produced any income that could not have been produced by the first corporation, the only justification for creation of the second and third corporations was to hold taxable income below the $25,000 figure. The entire income of the second and third corporations was allocated to the first.

FOOTNOTES - Chapter IV

[71]Treasury Regulation § 1.482-2(a)(1).

[72]Treasury Regulation § 1.482-2(a)(3).

[73]Treasury Regulation § 1.482-2(a)(2).

[74]Jenks, Tax Lawyer, XXIII, p. 293.

[75]Treasury Regulation § 1.482-2(a)(3).

[76]Warren, Taxation for Accountants, VII, p. 221.

[77]Mansfield, 17th Tulane Tax Institute, p. 106.

[78]Treasury Regulation § 1.482-2(b)(1).

[79]Treasury Regulation § 1.482-2(b)(8).

[80]Harvey S. Levenson, Allocations (Sec. 482) - Specific Transactions, #230: Tax Management Portfolios (Washington, D.C.: Tax Management, Inc., 1970), p. A-8.

[81]Treasury Regulation § 1.482-2(b)(2)(i).

[82]Ibid.

[83]Treasury Regulation § 1.482-2(b)(2)(ii).

[84]Treasury Regulation § 1.482-2(b)(3).

[85]Treasury Regulation § 1.482-2(b)(7).

[86]Local Finance Corporation v. Commissioner of Internal Revenue, 407 F.2d 629.

[87]Levenson, Tax Management, #230, p. A-15.

[88]Treasury Regulation § 1.482-2(c)(1).

[89]Treasury Regulation § 1.482-2(c)(2)(i).

[90] Treasury Regulation § 1.482-2(c)(2)(ii).

[91] Bluefeld Caterer, Inc. v. Commissioner of Internal Revenue, 28 TCM 315.

[92] Robert A. Boyer v. Commissioner of Internal Revenue, 58 TC 316(1972).

[93] Treasury Regulation § 1.482-2(d)(1).

[94] Treasury Regulation § 1.482-2(d)(3).

[95] Jenks, Tax Lawyer, XXIII, p. 302.

[96] Krom, Tax Counselor's Quarterly, XIV, p. 530.

[97] Hamburgers York Road, Inc. v. Commissioner of Internal Revenue, 41 TC 821 (1964).

[98] Ach, p. 116.

[99] Treasury Regulation § 1.482-2(d)(2).

[100] Treasury Regulation § 1.482-2(d)(2)(ii).

[101] Treasury Regulation § 1.482-2(d)(2)(iii).

[102] Treasury Regulation § 1.482-2(d)(4).

[103] Treasury Regulation § 1.482-2(d)(1)(ii)(a).

[104] Zultan M. Mihaly, "Intercompany Pricing, Offset Adjustments and Constructive Dividends Resulting From Section 482 Adjustments." Twenty-Fifth Tax Institute--University of Southern California Law Center. Los Angeles, 1973, p. 736.

[105] Treasury Regulation § 1.482-2(e)(1)(i).

[106] Treasury Regulation § 1.482-2(e)(1)(ii).

[107] Treasury Regulation § 1.482-2(e)(1)(iii).

[108] Treasury Regulation § 1.482-2(e)(2)(ii).

[109] Jenks, Tax Lawyer, XXIII, p. 307.

[110] Treasury Regulation § 1.482-2(e)(3).

[111]Jenks, <u>Tax Lawyer</u>, XXIII, p. 310.

[112]<u>Ibid</u>., p. 311.

[113]Balantine Mfr. Co., Inc. v. Commissioner of Internal Revenue, 39 TC 348 (1962).

[114]Brentwood Homes, Inc. v. United States, 240 F.Supp 378 (1952).

CHAPTER V

THE CREATION OF INCOME DOCTRINE

The most controversial of all the general provisions of the Section 482 Regulations is subsection (d)(4), which provides that adjustments may be made between related entities even though "the ultimate income anticipated from a series of transactions may not be realized or is realized in a later period. . . . The Provisions apply even if the gross income contemplated from a series of transactions is never, in fact, realized by the other members."[113] The question here is whether the Commissioner can use Section 482 to create a current item of income with respect to an intercorporate transaction where the parties do not expressly so provide.[114]

The Regulations, which represent the stand of the Commissioner, were written in opposition to what the courts had been deciding in related cases. In Tennessee-Arkansas Gravel Co.,[115] one commonly controlled taxpayer was renting equipment to another commonly controlled taxpayer. By agreement, the rent was not paid for a period of time. The Commissioner increased the lessor's income by the amount of cancelled rental payments. The court held that Section 45 does not authorize the Commissioner to set up income where none existed. Eleven years later the courts reinforced their stand and added some clarity to the confusing issue of creation of income. In Smith-Bridgman Co.,[116] a subsidiary made interest free loans to its parent. The Commissioner allocated an amount equal to four percent of the loans to the income of the subsidiary. In both of these cases, no reduction of gross income of the other related party was made, even though those parties had gross income from some source. In the latter case, the court says that Section 482 is not applicable unless the transaction produces gross income. It also seems to indicate that the result would have been different if the Commissioner had reduced the taxable income of the subsidiary by the amount allocated to the parent.[117] The Commissioner expressed his agreement with the decisions of these two cases on the basis that no correlative adjustments were made.[119]

In 1971 the court echoed the stand it took back in 1951 when it stated that Section 482 is not applicable unless the transaction produces gross income. In Huber Homes, Inc.,[119] the taxpayer, who was engaged in the construction and sale of houses, transferred some unsold houses at cost to a wholly owned subsidiary to be converted to rental property. Because of his earlier stand on correlative adjustments, the Commissioner attempted to allocate to the taxpayer from the sudsidiary an amount equal to the difference between the fair market value of the houses transferred and their cost to the taxpayer. The court held that the subsidiary did not resell the houses and thereby receive a profit which could be attributable to the taxpayer. This clarified the earlier cases by indicating that the dominant factor in an allocation of this sort is the required presence of realized income. The fact that a correlative adjustment was made is only a supporting factor.[120]

The Commissioner found his correlative adjustment stand supported by the Second Circuit Court of Appeals in the <u>Forman</u> case when the court stated:

> To the extent the above cases (the court refers to Tennessee-Arkansas Gravel, Smith-Bridgman, and Huber Homes) cited by taxpayers may be read as holding that no interest can be allocated under Section 482 under the facts of this case, they are not in accord with economic reality, or the declared purpose of Section 482. . . . interest income may be added to taxpayers' incomes, as long as a correlative adjustment is made to Midtown, for then the true taxable income of all involved will be properly reflected.

In two subsequent cases, <u>Kerry Investment Co</u>.[121] and <u>Kahler Corp</u>.,[122] interest free loans were made between commonly controlled corporations. In both cases, the Tax Court refused to sustain the Commissioner's allocation of interest income to the taxpayers where either the Tax Court found that the taxpayer had met his burden of proof by showing that the loans were used by the recipient for non-income producing purposes (Kerry), or where the Commissioner did not assert that the proceeds of the loan were traceable to income generated by the recipient (Kahler).[123]

The creation of income issue seems to have come to a head. On the one hand is the position taken by the Commissioner and supported by the Second Circuit Court of Appeals in the <u>Forman</u> case. On the other hand is the consistent opposition by the Tax Court. The conflict will ultimately have to be resolved by either legislation or by the Supreme Court. The highly factual nature of a Section 482 case would suggest that legislation is the preferred route.[124]

FOOTNOTES - Chapter V

[113]Treasury Regulation § 1.482-1(d)(4).

[114]Aland, Taxes, XLIX, p. 829.

[115]Tennessee-Arkansas Gravel Co. v. Commissioner of Internal Revenue, 112 F.2d 508.

[116]Smith-Bridgeman Co. v. Commissioner of Internal Revenue, 16 TC 287 (1951).

[117]Mac Asbill, Jr., "The Application of Section 482 to Domestic Taxpayers - Current Status and Trends." Nineteenth Tax Institute - University of Southern California Law Center. Los Angeles, 1967, p. 694.

[118]Mansfield, 17th Tulane Tax Institute, p. 103.

[119]Huber Homes Inc. v. Commissioner of Internal Revenue, 55 TC 598 (1971).

[120]James W. Lewis, "Tax Court in Huber Homes holds that the IRS may not use 482 to create income." Journal of Taxation, XXXiV (April, 1971), p. 209.

[121]Kerry Investment Co. v. Commissioners of Internal Revenue, 58 TC 49 (1972).

[122]Kahler Corp. v. Commissioner of Internal Revenue, 58 TC 50 (1972).

[123]Nauheim, Tax Lawyer, XXVI, p. 113.

[124]Ibid., p. 122.

CHAPTER VI

CONCLUSIONS

There can be little doubt that Section 482 applies to purely domestic transactions. Many of the cases which have helped to clarify the scope of application and definition of terms have been purely domestic in nature. The cases cited in Chapters IV and V of this paper with regard to each type of transaction specifically designated in the 1968 Regulations also indicate that Section 482 is an important section of the code for domestic taxpayers who enter into transactions with commonly controlled tax entities to become acquainted with.

The scope of application of Section 482 has been broadened through the more liberal interpretation by the courts of both what is required for two tax entities to be "commonly controlled" and what constitutes an "organization, trade, or business." Such a liberal interpretation by the courts of these two phrases leaves the extent of the section's applicability quite uncertain.

There have been complaints about the 1968 Regulations that they are too general to be applied to the myriad of potential factual situations that they are to cover. The argument may be valid when dealing with certain of the transactions, such as intercompany pricing. Whether more regulations would help clarify the application of the statute is debatable. But the uncertainty both in the applicability and the application of Section 482 is a burden on taxpayers which should be minimized if practical and possible.

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