SECTION 129 AND THE COURTS: STILL IN SEARCH OF A STANDARD

The recent decision by the United States Court of Appeals for the Ninth Circuit in the case of *Commissioner v. British Motor Car Distributors, Ltd.*,[1] has rekindled interest in section 129(a) of the Internal Revenue Code of 1939, now section 269(a) of the 1954 Code, which deals with acquisitions of loss corporations.[2] Since the Tax Court has indicated that it will follow this case,[3] the decision appears to have given new life to the section and could have a far-reaching effect on the conduct of American businessmen.

In this case, the Empire Home Equipment Co., a corporation engaged in the business of selling home appliances, sustained heavy operating losses over a three year period, and proceeded to liquidate its assets until nothing was left but the corporate shell.[4] It reported its assets on its 1951 income tax return as "Nil."[5] A partnership, the British Motor Car Co., engaged in selling foreign-made automobiles, offered to buy the outstanding stock of Empire for $21,250, provided the corporation would change its name and increase its authorized capital.[6] Empire accepted the offer and the transaction took place as outlined. The partnership then transferred all of its assets to the

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1. 278 F.2d 392 (9th Cir. 1960), reversing 31 T.C. 437 (1958).

2. Int. Rev. Code of 1939, ch. 1, § 129(a), 58 Stat. 47 (now Int. Rev. Code of 1954, § 269(a)).

> Disallowance of Deduction, Credit, or Allowance.—If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to 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 or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clause (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation.

3. Thomas E. Snyder Sons Co., 34 T.C. No. 39 (June 6, 1960).

4. Commissioner v. British Motor Car Distributors, Ltd., 278 F.2d 392, 393 (1960).

5. Id. at 393.

6. Ibid.

revitalized corporation for additional shares of stock. The corporation, now the British Motor Car Distributors, Ltd., operated profitably for the fiscal years 1952 and 1953 and attempted to deduct net operating losses of the old Empire firm, under the net operating loss carryover provisions.[7] This was disallowed by the Commissioner, but the Tax Court, on redetermination, permitted the deductions,[8] following its decisions in the *T.V.D. Co.*[9] and *Alprosa Watch Corp.*[10] cases, to the effect that section 129 applied only to *acquiring* corporations.[11] The Court of Appeals reversed, holding that section 129(a)(1) forbade exactly the type of conduct evident here.[12]

In order to appreciate the importance of this decision, it is necessary to examine the entire theory supporting the allowance of net operating loss carryovers from year to year. The annual accounting concept, inherent in the federal tax structure,[13] requires the taxpayer to measure his income within a strictly defined period. Although this arbitrary accounting period has been accepted fairly readily by the American taxpayer, its use may lead to a distorted showing of real earning ability, particularly in the case of a taxpayer with a widely fluctuating income.[14] Congress, in attempting to ameliorate these problems, has inserted provisions in the various revenue acts allowing businessmen to apply annual net operating losses to profitable prior and subsequent accounting periods.[15] These loss carryover provisions,

7. Int. Rev. Code of 1939, ch. 1, § 122, 53 Stat. 867 (now Int. Rev. Code of 1954, § 172).

8. British Motor Car Distributors, Ltd., 31 T.C. 437 (1958).

9. 27 T.C. 879 (1957).

10. 11 T.C. 240 (1948).

11. British Motor Car Distributors, Ltd., 31 T.C. 437, 440-41 (1958).

12. Commissioner v. British Motor Car Distributors, Ltd., 278 F.2d 392, 395 (9th Cir. 1960).

13. Int. Rev. Code of 1954, § 441(a); see Surrey & Warren, Cases on Federal Income Taxation 501 (1960 ed.).

14. See generally Hahn, Methods of Accounting: Their Role in the Federal Income Tax Law, 1960 Wash. U.L.Q. 1, 12-14; Harrow, Income Averaging by Loss Carry-over and Carry-back, N.Y.U. 13th Inst. on Fed. Tax 771 (1955).

15. The net operating loss carryover privilege was originally granted by the Revenue Act of 1918, ch. 18, § 204, 40 Stat. 1060. Subsequent acts made minor changes. Revenue Act of 1921, ch. 136, § 204, 42 Stat. 231; Revenue Act of 1924, ch. 234, § 206, 43 Stat. 260; Revenue Act of 1926, ch. 27, § 206, 44 Stat. 17; Revenue Act of 1928, ch. 852, §§ 23(i), 117(b), 45 Stat. 800, 825; Revenue Act of 1932, ch. 209, §§ 23 (i), 117, 47 Stat. 180, 207. The privilege was rescinded in 1933. National Industrial Recovery Act, ch. 90, § 218(a), 48 Stat. 209 (1933). It was regranted by the Revenue Act of 1939, ch. 247, § 211, 53 Stat. 867, as amended by Revenue Act of 1942, ch. 619, § 15(e), 56 Stat. 807; Revenue Act of 1950, ch. 994, §§ 15(g)(2), 215, 64 Stat. 919, 937-38; Revenue Act of 1951, ch. 521, § 330, 65 Stat. 505; Technical Changes Act of 1953, ch. 512, § 205, 67 Stat. 619; Internal Revenue Code of 1954, § 172, 68A Stat. 63; Technical Amendments Act of 1958, §§ 14, 1377(b), 203, 72 Stat. 1611, 1656, 1678.

while serving a useful and desirable end in the context for which they were designed, have created serious and unforeseen tax avoidance possibilities, by promoting a market for the sale of corporations with loss carryover credits, in order to decrease the acquiring entity's taxable income.[16]

Previous to the passage of section 129, courts developed several very effective methods of striking down taxpayer avoidance schemes. The tax diminishing effect of a transaction was voided if the transfer or purchase had no valid "business purpose."[17] Courts also struck down the tax benefit if they found that the transaction created a new taxable entity.[18] Although these judicial techniques were helpful, traffic in loss corporations went on unabated.[19]

In an attempt to remove tax avoidance opportunities available under the loss carryover allowances, section 129 was added to the Code in 1944.[20] However, in the stormy first decade of its existence, the Commissioner was "singularly unsuccessful" in applying its provisions.[21]

When the acquiring corporation did not have a tax credit, section 129 disallowed a benefit if the principal purpose of the transfer was avoidance of taxes.[22] Here the judicial approach of searching for a "business purpose" was employed, and if such a purpose were found,

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16. H.R. Rep. No. 871, 78th Cong., 1st Sess. 24 (1943).

17. See, e.g., Gregory v. Helvering, 293 U.S. 465 (1934); Kocin v. United States, 187 F.2d 707 (2d Cir. 1951); David's Specialty Shops, Inc. v. Johnson, 131 F.Supp. 458 (S.D.N.Y. 1955); cf. WAGE, Irc., 19 T.C. 249 (1952); Chelsea Products, Inc., 16 T.C. 840 (1951). But cf. Northup v. United States, 240 F.2d 304 (2d Cir. 1957).

18. See, e.g., Libson Shops, Inc. v. Koehler, 353 U.S. 382 (1957); Higgins v. Smith, 308 U.S. 473 (1940); Gulf Oil Corp. v. Lewellyn, 248 U.S. 71 (1918); Southern Pac. Co. v. Lowe, 247 U.S. 330 (1918); Mill Ridge Coal Co. v. Patterson, 264 F.2d 713 (5th Cir. 1959), cert. denied, 361 U.S. 816 (1959); Continental Oil Co. v. Jones, 113 F.2d 557 (10th Cir. 1940), cert. denied, 311 U.S. 687 (1940); cf. Northway Sec. Co., 23 B.T.A. 532 (1931). See generally National Investors Corp. v. Hoey, 144 F.2d 466 (2d Cir. 1944).

19. The following advertisement appeared in the New York Times business section: "Excess Profits Tax Savings Opportunity For Sale: Stock of Corporation having 1943 tax loss deduction of $120,000. Sole assets are $80,000 in cash and equivalent." N.Y. Times, Oct. 31, 1943, § 5, p. 11, col. 8. See generally, Rudick, Acquisitions to Avoid Income or Excess Profits Tax: Section 129 of the Internal Revenue Code, 58 Harv. L. Rev. 197 (1944).

20. Added by ch. 63, 58 Stat. 47 (1944).

21. Magill & Kosmian, The Internal Revenue Code of 1954: Income, Deductions, Gains & Losses, 68 Harv. L. Rev. 201, 218 (1954).

22. See, e.g., Alpha Tank & Sheet Metal Mfg. Co. v. United States, 126 Ct. Cl. 878, 116 F.Supp. 721 (1953). See Holzman, Who Wants a Tax Loss?, Monthly Digest of Tax Articles 23 (Jan. 1953).

the credit was granted.[23] Judges seemed reluctant to rule that the principal purpose of a business transaction was tax avoidance.[24]

However, if the *shares* of a corporation having a tax credit had been *acquired* prior to the acquiring of another business by that corporation, the courts did not recognize that this was also a type of acquisition forbidden by the spirit of the statute.[25] Since the corporation already had the allowance, they reasoned, the section did not apply. These cases might well have resulted in a ruling favorable to the government, had the courts been willing to go beyond the corporate entity and face the reality that even if the corporation had not acquired a credit, the new stockholders *had,* but this, they were reluctant to do.[26]

This reluctance may be explained in part by the distinctions drawn in the older cases between the form of the transaction and its substance. One of the very early cases held that "if the device is carried out by means of legal forms, it is subject to no legal censure."[27] As late as 1935, so eminent a jurist as Judge Learned Hand said "a man's motive to avoid taxation will not establish his liability if the transaction does not do so without it."[28] Thus courts were hesitant to look behind the form of the device into the substance of the scheme itself, and apparently, the corporate form was not scrutinized if there was a scintilla of business purpose.

Before the *British Motor Car* decision, the most influential opinion discussing section 129 was handed down by the Tax Court in the

23. See, e.g., WAGE, Inc., 19 T.C. 249 (1952). For a similar approach prior to § 129 see W.P. Hobby, 2 T.C. 980 (1943).

24. See American Pipe & Steel Corp. v. Commissioner, 243 F.2d 125 (9th Cir. 1957). Here the court found a business purpose on what appears to be extremely tenuous evidence.

25. See Alprosa Watch Corp., 11 T.C. 240 (1948).

26. Id. at 245. For example, if S, the stockholder, controlled the A corporation, a very profitable business, and purchased all the shares of a loss corporation B, and merged A into B, the courts would allow B to offset the income from its new operations (A's) against its old net operating losses on the theory that B was a separate taxable person from S. A willingness to look at the transaction on the shareholder level, however, would immediately show that S was the sole beneficiary of the purchase (the old owners—those who had originally suffered the loss —having sold their interests to him) and the real acquiring party gaining a benefit he was not already entiled to. Since there does not seem to be any reason why the parties involved in the Alprosa Watch transaction, infra, could not have incorporated a new firm rather than buy a loss corporation, application of this analysis to the Alprosa case would have resulted in a finding for the government. But see American Coast Line v. Commissioner, 159 F.2d 665 (2d Cir. 1948) (an early case recognizing this concept).

27. United States v. Isham, 84 U.S. (17 Wall.) 496 (1873).

28. Chisholm v. Commissioner, 79 F.2d 14, 15 (2d Cir. 1935).

case of the *Alprosa Watch Corp.*[29] A partnership, Paul V. Eisner & Co., purchased a quantity of Swiss-made watches in 1943 through its overseas agent, and later learned that the purchase was in violation of an exclusive marketing contract between the foreign manufacturer and a rival domestic distributor.[30] Due to the turbulent state of wartime communications, the shipment could not be cancelled and the watches were delivered in New York. Rather than become involved in litigation over the matter, Eisner and its competitor agreed to market the watches through some existing organization, not then in the watch business, and share the profits. An advisor of the Eisner Co. suggested that the partners' wives buy the stock of a dormant glove retailing business and market the watches through it. The suggested transaction was consummated and the name of the glove company was changed to the Alprosa Watch Corp.[31] The watches were sold, and tax credits of the old company were applied to offset profits of the new corporation.

In upholding taxpayer's claim to the credits, the court found that the Alprosa Watch Corp. and its predecessor glove company were the same jural person for tax purposes.[32] Although section 129 did not apply because the credits were claimed for a taxable year beginning before the effective date of the statute, the court said in an oft-quoted passage, "That section [129] would seem to prohibit the use of a deduction, credit, or allowance *only by the acquiring person or corporation* and not their use by the corporation whose control was acquired."[33]

Typical of the litigation in the years following *Alprosa* were the *A.B. & Container Corp.*,[34] *WAGE, Inc.*,[35] and *T.V.D. Co.*[36] cases. None resulted in rulings for the government. In the *T.V.D. Co.* case,[37] the Tax Court noted that "the petitioner here . . . is an acquired corporation, and . . . section 129 has no application in this case."[38] The rationale here seems to be that a taxpayer is entitled to his credits, and a corporation is a separate taxpayer.

In *Alprosa,* the glove company was viewed as the acquiring corporation, even though *it had been acquired* by the wives of the partners

29. 11 T.C. 240 (1948).
30. Id. at 241.
31. Id. at 242.
32. Id. at 246.
33. Id. at 245. (Emphasis added.)
34. 14 T.C. 842 (1950).
35. 19 T.C. 249 (1952).
36. 27 T.C. 879 (1957).
37. Ibid.
38. Id. at 886.

who owned the watches. In the *British Motor Car Co.*[39] case, the appliance company was the acquiring corporation in this sense, since it too had been acquired by the partners in the auto company and then, in turn, had acquired the assets of the automobile agency.[40] The real difference between the holding in the two cases is one of statutory interpretation.

One of the first government victories under the new reading of the section was *Coastal Oil Storage Co. v. Commissioner*,[41] decided in 1957. Coastal Terminals Inc. operated a terminal facility for oil storage at North Charleston, S.C., and leased some of its property there to the Quartermaster General. In 1951, Coastal Oil Storage Co. was organized as a wholly-owned subsidiary of Coastal Terminals, holding all of the storage tanks used by the government.[42] The Tax Court allowed the $25,000 surtax exemptions and minimum excess profits credits claimed by the new corporation on a finding that section 129 was inapplicable.[43] The Court of Appeals for the Fourth Circuit held that the taxpayer secured the "*benefit* of an exemption and credit which it would not otherwise have enjoyed,"[44] and reversed that portion of the Tax Court's decision dealing with section 129.

Although the case was a split-up rather than an acquisition, the legal principle it established has been applied to various situations where a tax *benefit* accrued to a shareholder. The courts have followed this line of reasoning in *Mill Ridge Coal Co. v. Patterson*,[45] *Thomas E. Snyder Sons Co.*,[46] and, of course, in the *British Motor Car* case,[47] all dealing with acquisitions of loss corporations.

Decisions like *Alprosa* read the words in section 129, "which such person or corporation would not otherwise enjoy," as modifying "deduction."[48] Accordingly, if no deduction was acquired, the credit was granted. But the Court of Appeals in *Coastal Oil* took a different stand and read these words as modifying "*benefit* of a deduction" and disallowed the credit since the *use* of the allowance was acquired.[49]

39. British Motor Car Distributors, Ltd., 31 T.C. 437 (1958).

40. Id. at 438.

41. 242 F.2d 396 (4th Cir. 1957), affirming in part and reversing in part 25 T.C. 1304 (1956).

42. Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396, 397 (4th Cir. 1957).

43. Coastal Oil Storage Co., 25 T.C. 1304, 1312 (1956).

44. Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396, 398 (4th Cir. 1957). (Emphasis added.)

45. 264 F.2d 713 (5th Cir. 1959).

46. 34 T.C. No. 39 (June 6, 1960).

47. Commissioner v. British Motor Car Distributors, Ltd., 278 F.2d 392 (9th Cir. 1960).

48. T.V.D. Co., 27 T.C. 879, 886 (1957).

49. Commissioner v. British Motor Car Distributors, Ltd., 278 F.2d 392, 394-95 (9th Cir. 1960).

The result has been that the courts will now go beyond the corporate facade and search the affairs of the shareholders.

This interpretation means that section 129(a) may now be used to prevent the acquisition of corporations which are attractive because of certain tax characteristics (even though those corporations would use the credits in their own tax returns) provided the acquisitions would result in diminished liability for the acquiring shareholders.[50]

The older cases took the position that business dealings take place on either of two levels. That is, corporations deal with each other and shareholders deal with other shareholders. Although the first type of transaction was examined, the courts felt that the latter was beyond the scope of section 129 when the taxpayer was a corporation. With few exceptions,[51] courts refused to recognize that a benefit accruing to a corporation eventually is a benefit to the shareholders, and that if a corporation claims a deduction, even one it already has, a newly-acquiring stockholder is getting an allowance *he* did not have.

With the precedent of *Coastal Oil,* the windfall benefits supported by the *Alprosa* interpretation can be disallowed. Courts will no longer recognize a distinction between the corporate and stockholder levels in loss carryover acquisition cases; the corporate fiction will be ignored in a search for the ultimate beneficiary.

This interpretation moves the matter along to the real issue, the application of the "principal purpose" test.[52] That is, can the trier of fact find a valid business purpose behind the transaction? This, of course, is in line with the established judicial method of invalidating taxpayer avoidance attempts.[53] The *British Motor Car* case[54] did not upset this doctrine. The new line of judicial reasoning, apparent in these modern cases, merely means that now a business purpose on the corporate level may need additional support, by a showing of business purpose on the shareholder level also, if the credit is to be granted.[55] Many problems still remain unsolved. For example, if there is a sufficient corporate business purpose, must the shareholder also show a business purpose, or will this fact be enough to bar a penetration of

50. See, e.g., Commissioner v. British Motor Car Distributors, Ltd., 278 F.2d 392 (9th Cir. 1960); Mill Ridge Coal Co. v. Patterson, 264 F.2d 713 (5th Cir. 1959); Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396 (4th Cir. 1957); James Realty Co. v. United States, 176 F.Supp. 306 (D. Minn. 1959); Thomas E. Snyder Sons Co., 34 T.C. No. 39 (June 6, 1960).

51. American Coast Line v. Commissioner, 159 F.2d 665 (2d Cir. 1948).

52. See Surrey & Warren, op. cit. supra note 13, at 1595.

53. See cases cited at footnote 17 supra.

54. Commissioner v. British Motor Car Distributors, Ltd., 278 F.2d 392 (9th Cir. 1960).

55. Compare Thomas E. Snyder Sons Co., 34 T.C. No. 39 (June 6, 1960), with Virginia Metal Products, Inc., 33 T.C. No. 88 (Jan. 29. 1960).

the corporate entity? Must *both* the corporation and the shareholder satisfy the court that a legitimate business purpose motivated their actions, or will a business purpose on the shareholder level justify the credit even if there is no valid corporate purpose?[56]

As one court has stated, "What kind of 'business purpose' must be shown as necessary . . . is not made clear. . . ."[57] The reason and necessity for the *Alprosa* transaction was apparent; the reasons for the *British Motor Car* transfers cannot clearly be determined if one destroys the tax benefits. The *Alprosa* acquisition probably would have been made absent the tax advantages, for the tax benefits were really only icing on the cake, making *this particular* corporation that much more desirable. It seems unlikely, however, that British Motor Car Distributors would have made any move had not the tax benefits been present.[58]

The test then can probably be expressed by a simple rephrasing of the standard tort question: what would the reasonably prudent taxpayer have done under the circumstances? The trier of fact must make the decision relying on an objective standard of conduct.[59] The difficulty with this type of test is immediately apparent. What seems to be good business practice to one person may appear to be reckless speculation to another. Business judgments invariably differ and some companies prosper where others fail. What later turns out to be the better choice leads to a profit; a poor decision becomes a loss. But, unlike a mistake by the "unreasonable, imprudent" man, business mistakes usually do not result in civil liability or a legal censure equivalent to a branding of "negligent." Yet this rule could conceivably subject a taxpayer to the ordeal of protracted litigation with the Internal Revenue Service and its concomitants—possible loss of reputation, decreased business activity, and large expenditures for legal defense. Even good faith does not save such a corporate taxpayer, for there was no showing, or even allegation of fraud in the *British Motor Car* case; the petitioner simply made no attempt to show that tax evasion was not a purpose of the acquisition.[60]

Realizing that section 129 was inadequate as originally enforced by the courts,[61] Congress, in enacting section 382, specifically barred

56. These questions arise only when the corporations are controlled by an identifiable interest. See the section dealing with constructive ownership. Int. Rev. Code of 1954, § 318.

57. W.P. Hobby, 2 T.C. 980, 985 (1943).

58. British Motor Car Distributors, Ltd., 31 T.C. 437, 441 (1958).

59. Alcorn Wholesale Co., 16 T.C. 75, 89 (1951).

60. "[P]etitioner has made no attempt to prove . . . that the stock acquisition was not done for the purpose of tax evasion." British Motor Car Distributors, Ltd., 31 T.C. 437, 441 (1958).

61. S. Rep. No. 1622, 83d Cong., 2d Sess. 53 (1954).

the allowance of net operating loss carryovers, if there was a purchase of a corporation *and* a change in its business activity, providing certain other technical requirements were present.[62] Therefore, in these areas at least, the question of business purpose has become a dead issue. Yet, because section 382 sets out very specific standards, many transactions will not fall within its prohibition.[63]

Only one significant case discussing section 129 has been passed on by the Supreme Court. *Libson Shops Inc. v. Koehler*[64] involved the amalgamation by merger of sixteen retail stores and a management concern, all separately incorporated and all having the same stockholders, into what had been the management corporation.[65] Three of the retail outlets had net operating losses. In denying the management firm the right to deduct these losses under the carryover provisions, the court also denied the applicability of section 129, finding no purpose of tax evasion.[66] The deduction was denied on the ground that there was no "continuity of business enterprise."[67] Six years earlier, the Tax Court had decided a case with analogous facts in favor of the taxpayer on a finding of "business purpose."[68] Seemingly, the *Libson Shops* case would now preclude any such finding, since a "business purpose" is implicit in a specific ruling that there was no evasion or avoidance purpose in the reorganization.

If "business purpose" will not support the taxpayer's position, just what type of continuity of enterprise is required? In a footnote to the

62. Int. Rev. Code of 1954, § 382(a). Some writers feel that most if not all of the old § 129 situations can now be cast so as to be covered by § 382(b) and the allowance granted or denied under the terms of this section without recourse to § 269. Cohn, Acquiring the Loss Corporation: Fact or Fancy, N.Y.U. 13th Inst. on Fed. Tax 757, 768 (1955). Because § 382 does not mention § 269, it seems to be entirely independent of it. Thus if a taxpayer avoids the technical pitfalls of § 382, he must still clear the hurdle of § 269. An argument has been made that if §§ 381 or 382 will allow the transaction, the Congressional intent was that § 269 should not limit its benefits. Rice, Internal Revenue Code, Section 269: Does the Left Hand Know What the Right Is Doing?, 103 U. Pa. L. Rev. 579, 590-95 (1955). Because of the technical questions presented by § 382, this note will not attempt to discuss that section in detail.

63. The Senate, recognizing this, said:

> If a limitation in this section [382] applies to a net operating loss carryover, section 269, relating to acquisitions made to evade or avoid income tax, shall not also be applied to such net operating loss carryover. However, the fact that a limitation under this section does not apply shall have no effect upon whether section 269 applies. S. Rep. No. 1622, 83d Cong., 2d Sess. 284 (1954).

64. 353 U.S. 382 (1957).

65. Libson Shops, Inc. v. Koehler, 353 U.S. 382, 383 (1957).

66. Id. at 389.

67. Id. at 386. Accord, Patten Fine Papers, Inc. v. Commissioner, 249 F.2d 776 (7th Cir. 1957).

68. Berland's Inc. of South Bend, 16 T.C. 182 (1951).

Libson Shops decision, the court indicated its refusal to decide "situations like those presented in . . . *Alprosa Watch Corp. v. Commissioner* . . . *A.B. & Container Corp. v. Commissioner* . . . *WAGE, Inc. v. Commissioner* . . . [since] in these cases a single corporate taxpayer changed the character of its business. . . ."[69] In *Libson Shops*, however, the only change was in the ownership of the stock. Although it had once been owned by individuals, it was now owned by a single corporation with an enlarged capital structure, all of which was owned by these same individuals.[70] In essence, this was the same kind of change made in the *Alprosa* and *A.B. & Container Co.*[71] cases, so that the issue was at least decided by implication, unless when a single corporation is involved, a "business purpose" is sufficient to justify the allowance.

But then the question is why should single and multiple corporations be governed by different rules? Possibly the court felt justified in treating them differently because of the specific excess profits tax exemption originally granted to each corporation.[72] But the splitting of a large corporation into several smaller subsidiary corporations had been deemed cause to deny the basic exemption.[73]

Another possibility is that if the losing business activity is carried on for any length of time, the Supreme Court will allow the tax credit.[74] But if this is what the *Libson Shops* case meant, it is a strange holding indeed, bad for business and government both. In effect, such a ruling would force a taxpayer to continue in a losing operation, simultaneously depleting both his own resources and governmental revenue.

The *Libson Shops* case has failed to establish any useful rule for deciding cases involving loss corporations.[75] This might be explained in part by the complexity of the transactions involved and the basic difficulty in getting to the real heart of the situation. Nevertheless, complex or not, some standard must eventually be established against

69. Libson Shops, Inc. v. Koehler, 353 U.S. 382, 390 (1957).

70. Id. at 383.

71. 14 T.C. 842 (1950).

72. Int. Rev. Code of 1939, ch. 1, § 710(b)(1), 54 Stat. 975 (1940).

73. Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396 (4th Cir. 1957); see Cohen, Exemptions and Credits of Multiple Corporations: Sections 15(c) and 129, U. So. Cal. 1953 Tax Inst. 1, 10. But cf. National Carbide Corp. v. Commissioner, 336 U.S. 422 (1949).

74. A.B. & Container Corp., 14 T.C. 842 (1950).

75. The Internal Revenue Service announced that it would not rely on the Libson Shops decision in any cases involving a merger or any transaction described in § 381(a) of the Int. Rev. Code of 1954. Rev. Rul. 58-603, 1958-2 Cum. Bull. 147. See generally Levine & Petta, Libson Shops Applied to the Single Corporate Taxpayer, 36 Taxes 562 (1958); Levine & Petta, Libson Shops: A Study in Semantics, 36 Taxes 445 (1958).

which businessmen may test their alternative moves with some degree of certainty as to the outcome.

It is difficult to formulate any really workable test which fully eliminates the objections.[76] Any subjective test would undoubtedly lead to inequitable enforcement against some taxpayers; continuation of the objective test in the absence of any hard and fast standards of conduct would leave the businessman always on the edge of uncertainty and place the final decision in each case on judicial determination of the particular, peculiar facts of each case.

Even the presumption written into the 1954 Code, although specifically designed to solve these problems, has not been able to satisfy the writers. This section, 269(c), provides that any purchase price disproportionate to the sum of the adjusted basis of the property and the tax benefits not reflected therein is prima facie evidence of a principal purpose of tax avoidance.[77] This places the burden of proof squarely on the claimant.[78] In effect, it warns all prospective buyers of a loss corporation that they had better be able to produce evidence satisfactorily supporting a claim of business purpose, or lose all tax benefits at the very outset. Still, the standard is not clearly defined, but the presumption requires that any attempted showing of a business purpose must at least outweigh any tax benefits incidental to that purpose.

More certainty would be desirable.[79] The interest of the Internal Revenue Service is really twofold. As Congress has explained it, it is "to insure that the small minority who have indulged in these schemes take nothing by their artifice, and to protect the overwhelming majority of taxpayers who have refused to participate in such transactions."[80] Thus, the real aim is to eliminate only unjustified tax credits.[81]

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76. Many solutions have been proposed. For example, one authority suggests that loss carryovers be limited to 50% of the consideration paid for the company. Surrey, Income Tax Problems of Corporations and Shareholders: American Law Institute Tax Project—American Bar Association Committee Study on Legislative Revision, 14 Tax L. Rev. 1, 34 (1958). Presently proposed regulations would establish very narrow limits in which mergers or sales of companies would be allowed. Metz, Tax-Loss Merger Becoming Harder, N.Y. Times, Feb. 5, 1961, § 3, p. 1, col. 1.

77. Int. Rev. Code of 1954, § 269(c).

78. Ibid.

79. Surrey & Warren, Cases on Federal Income Taxation 37 (1960 ed.).

80. H.R. Rep. No. 1079, 78th Cong., 2d Sess. 55 (1944).

81. "The key to the solution of problems involving avoidance should be the policy rather than the mere letter of the law. The policy of the law clearly countenances certain types of avoidance . . . . " Rudick, Acquisitions to Avoid Income or Excess Profits Tax: Section 129 of the Internal Revenue Code, 58 Harv. L. Rev. 197, 223 (1944). See I.T. 3757, 1945 Cum. Bull. 200 (Companies

The *British Motor Car* case removed one of the major obstacles to the formulation of a really workable test,[82] and it may now be possible to use section 269 in order to protect the federal revenue and the innocent taxpayer simultaneously. It might be desirable to amend the statute so that the presumption would be applied only to the real beneficiary of the deduction, after examination has shown that he would be getting an allowance to which he was not already entitled, if the credit were granted. Constructive ownership rules could be made applicable, as in present sections,[83] so that joint beneficiaries would also be subject to the test. Although this does not entirely eliminate the possibility of business purpose problems, since business purpose would still be a prerequisite to recognition of the credits, it does assure that they will be presented only when absolutely justified; that is, only when there has been a *previous* showing that tax avoidance *may have been* one of the major reasons for the transaction.[84]

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quailifying as Western Hemisphere trade corporations under § 109 will not be subject to § 129 even if the principal purpose of their formation was to gain the deductions granted in § 15(b)).

82. See pp. 79-80 supra.

83. See, e.g., Int. Rev. Code of 1954, § 382(a)(3).

84. For a discussion of the loss carryover provisions and their effects on governmental revenue and business, see Sears, Minimizing Taxes 102-04 (1922); Simons, Federal Tax Reform 56, 139-40 (1950); Twentieth Century Fund, Facing the Tax Problem 282-83, 302-03, 393-94, 399 (1937).