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will find it advantageous to forego the election and allocate a single sur-tax exemption among the members of its group.

Example 1:

	<i>Taxable Income</i>	<i>Tax</i> (1964 rates)	
		<i>No Election</i>	<i>Election</i>
A Corporation -----	\$25,000	\$11,100	\$ 7,000
B Corporation -----	50,000	23,600	19,500
C Corporation -----	10,000	3,600	2,800
D Corporation -----	25,000	11,100	7,000
E Corporation -----	25,000	11,100	7,000
		<hr/>	<hr/>
		\$60,500	\$43,300

Example 2:

	<i>Taxable Income</i>	<i>Tax</i> (1964 rates)	
		<i>No Election</i>	<i>Election</i>
A Corporation -----	\$12,500	\$ 2,750	\$ 3,500
B Corporation -----	12,500	2,750	3,500
		<hr/>	<hr/>
		\$ 5,500	\$ 7,000

III

ALLOCATION OF INCOME, DEDUCTIONS, CREDITS, AND ALLOWANCES AMONG RELATED TAXPAYERS

Harlan Pomeroy

Section 482 of the Internal Revenue Code is one of many weapons in the arsenal of the Commissioner of Internal Revenue for defending the public fisc against raids by resourceful taxpayers. It is, in many respects, his most effective as well as his most lethal weapon.

Broad in its literal terms and scope, section 482 provides, in effect, that the Commissioner may, for certain specified purposes, shift among related entities the various items going into the equation determining taxable income. The ends or purposes for which the allocation may be made also are broadly stated. The alternative purposes are the prevention of tax evasion and the clear reflection of income.

The language of section 482 is thus deceptively simple and non-

technical. Its terms are brief. The effect of section 482, however, may have very wide range. Moreover, inasmuch as the application of the section has been held to be largely within the Commissioner's discretion, its application is not easily upset.

There are scores of cases which have been decided under section 482 and under its predecessors in the 1939 Code and earlier revenue acts. It is the purpose of this article to indicate some of the problems which may arise under section 482 and to highlight certain of the more important cases.

OUTLINE OF STATUTORY PROVISION AND ITS BACKGROUND

There are certain statutory requirements which must be met before section 482 can be applied. There must be two or more organizations, trades, or businesses. The organizations, trades, or businesses must be owned or controlled "by the same interests." The ownership or control may be direct or indirect. And there must be either an evasion of taxes or a failure clearly to reflect income. Once the conditions required for the application of section 482 are present, the Commissioner has authority under section 482 to "distribute, apportion, or allocate gross income, deductions, credits, or allowances" between or among the related organizations, trades, or businesses.

Legislative History

Section 482 originated in 1921 in conjunction with consolidated returns. At that time, the Commissioner could "consolidate the accounts" of "related trades or businesses," owned or controlled directly or indirectly by the same interests, in order to make an "accurate distribution or apportionment of gains, profits, income, deductions, or capital."¹ In 1924 this was changed so as to permit the consolidation either at the direction of the Commissioner or at the request of the taxpayer.² Then, in 1928, the Commissioner's sanctions were broadened, from consolidating the accounts to distributing, apportioning, or allocating gross income and deductions. The taxpayer could no longer *insist* upon application of the provision. At the same time, the requisite conditions for invoking the Commissioner's authority were changed to eliminate the requirement that the trades or businesses be "related." Moreover, the

1. Revenue Act of 1921, ch. 136, § 240(d), 42 Stat. 260. This provision was directed particularly at foreign subsidiaries which were "sometimes employed to 'milk' the parent corporation, or otherwise improperly manipulate the financial accounts of the parent company." It was not enacted to permit computing the tax "on the basis of the consolidated return." H.R. REP. NO. 350, 67th Cong., 1st Sess. 14 (1921).

2. Revenue Act of 1924, ch. 234, § 240(d), 43 Stat. 288.

Commissioner could act where there was evasion of taxes, and whether or not the trades or businesses were affiliated.³

In 1934, the Commissioner's authority was extended to include "organizations" in addition to trades or businesses.⁴ And finally, in 1943, the Commissioner could allocate "credits" and "allowances" in addition to gross income and deductions. The reason for this change was to broaden the Commissioner's authority under what is now section 482 to equal his authority under what is now section 269.⁵ Since 1943, the statutory provision has read substantially as it now reads.⁶

The Purpose of Section 482

Section 482 is designed to deal with the situation where two or more entities under common control are used in such a way that the various ingredients going into the equation by which taxable income is determined are manipulated or shifted so as to produce, in the aggregate, a lesser tax liability than might otherwise apply. The broad or general purpose of section 482 is to authorize the Commissioner to deal with this problem by placing a controlled taxpayer on a tax parity with an uncontrolled taxpayer.⁷ Put another way, the purpose is to ensure the correct determination of taxable income and to prevent tax avoidance by any arbitrary shifting of profits among businesses owned or controlled by the same interests.⁸

The Means Authorized to Achieve the Purpose

The statutory provision is effectuated by authorizing the Commissioner to determine, according to the standard of an uncontrolled tax-

3. Revenue Act of 1928, ch. 852, § 45, 45 Stat. 806. This change was intended, in part, to correct an erroneous interpretation of the provision, prior to its amendment, to the effect that it "permits what is in effect the filing of a consolidated return by two or more trades or businesses, even though they are not affiliated within the meaning of the section." H.R. REP. NO. 2, 70th Cong., 1st Sess. 16-17 (1927). The statute was being "broadened considerably in order to afford adequate protection to the Government." S. REP. NO. 960, 70th Cong., 1st Sess. 24-25 (1928).

4. Revenue Act of 1934, ch. 277, § 45, 48 Stat. 695. Although existing law was thought to include "organizations," the term was added "to remove any doubt as to the application of this section to all kinds of business activity." H.R. REP. NO. 704, 73rd Cong., 2d Sess. 24 (1934).

5. Revenue Act of 1943, ch. 63, § 128(b), 58 Stat. 21. It was believed that no change was made in existing law. H.R. REP. NO. 871, 78th Cong., 1st Sess. 50 (1943).

6. For changes proposed but not enacted in 1962, see H.R. REP. NO. 1447, 87th Cong., 2d Sess. 28-30 (1962); H.R. REP. NO. 2508, 87th Cong., 2d Sess. 18, 19 (1962).

7. Treas. Reg. § 1.482-1(b)(1) (1962) [hereinafter cited as Reg. §].

8. S. REP. NO. 275, 67th Cong., 1st Sess. 20 (1921); *Advance Mach. Exch., Inc. v. Commissioner*, 196 F.2d 1006, 1009 (2d Cir.), *cert. denied*, 344 U.S. 835 (1952). Section 482 also permits correction of taxable income for purposes of the accumulated earnings tax, *Seminole Flavor Co.*, 4 T.C. 1215 (1945), *acq.*, 1945 CUM. BULL. 6, and the personal holding company tax, *Hugh Smith, Inc.*, 8 T.C. 660 (1947), *acq. on this issue*, 1947-2 CUM. BULL. 4, *aff'd per curiam*, 173 F.2d 224 (6th Cir.), *cert. denied*, 337 U.S. 918 (1949).

payer, the "true taxable income" of a controlled taxpayer.⁹ Thus, the important criterion becomes a determination of the taxpayer's true taxable income. According to the Treasury Regulations, true taxable income is determined by applying the standard of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.¹⁰

Application of Section is Discretionary With Commissioner

As previously indicated, since 1928, the application of section 482 has been entirely subject to the Commissioner's discretion.¹¹ The taxpayer, therefore, has no right to insist that the section be applied. Generally, the Commissioner need not apply the provision if the result would be a tax benefit to the taxpayer. In a recent case, however, the court held that the Commissioner was estopped from refusing to make a reallocation under section 482 where the reallocation had been initiated by a revenue agent and the taxpayer had incurred substantial expense in preparing the necessary accounting data to permit the reallocation.¹²

Taxpayer's Intent and Motives are Immaterial

The Commissioner is free to apply section 482 irrespective of the taxpayer's good faith and despite a showing of an honest attempt to allocate properly.¹³ In fact, this section is applicable if 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.¹⁴

Relationship of Section 482 With Other Sections and With General Principles

The following table lists some of the sections of the Code which deal with adjustments to income where related taxpayers are involved. It should be noted that section 6038, in requiring annual information returns as to certain controlled foreign corporations, is designed to ferret out information which will be helpful to the Commissioner in applying section 482 and other similar provisions.

Section 482 is a *gloss* upon the substantive provisions of the Internal Revenue Code and may be applied, as shall be seen, even though its

9. Reg. §§ 1.482-1(b)(1), (a)(6) (1962).

10. Reg. § 1.482-1(b)(1) (1962).

11. See p. 251 *supra*; Reg. § 1.482-1(b)(3) (1962).

12. *Interstate Fire Ins. Co. v. United States*, 215 F. Supp. 586 (E.D. Tenn. 1963), *appeal pending on other grounds* (6th Cir.).

13. *But see* *Simon J. Murphy Co. v. Commissioner*, 231 F.2d 639 (6th Cir. 1956).

14. Reg. § 1.482-1(c) (1962).

<i>Section</i>	<i>Acts Covered</i>	<i>Items Covered</i>	<i>Sanction</i>	<i>Degree Of Control</i>	<i>Attribution</i>	<i>Intent</i>
61	placing income in sham entity	net income	tax to another	unspecified	unspecified	lack of business purpose or reality
267	incurring of losses and expenses between related parties	losses from sale of property, business, or investment expenses and interest	disallow	related parties	specified	immaterial
269	acquisition of control of corporation or acquisition of property	gross income, deductions, credits, and allowances	(1) disallow in whole or in part (2) distribute, apportion, or allocate	50%	unspecified	tax avoidance principal purpose
482	operation of organizations, trades or business	gross income, deductions, credits, and allowances	distribute, apportion, or allocate	by same interests	unspecified	immaterial
1551	corporate transfer of property to new or inactive corporation	surtax exemption and accumulated earnings credit	deny, with power to distribute, apportion, or allocate	80%	specified	major purpose to obtain tax benefit
6038	control of foreign corporation	information	penalties	50%	specified	immaterial

application would conflict with other provisions of the Code.¹⁵ Moreover, section 482 should be considered in the light of certain well-known general principles, sometimes referred to as the common law of taxation, such as the doctrines relating to sham entities, sham transactions, net economic effect, no economic effect, assignment of income, and the like. And section 482 must be re-evaluated in the light of the provisions enacted in connection with multiple corporations in the Revenue Act of 1964.¹⁶

ANALYSIS OF CONDITIONS NECESSARY TO THE APPLICATION OF SECTION 482

Two or More Organizations, Trades, or Businesses

The terms "organization" and "trade or business" are defined in the Regulations.¹⁷ They include corporations, proprietorships, partnerships, trusts, estates, and associations. In fact, the scope of these terms and the character of the organizations which they embrace is so broad that it is entirely immaterial whether the particular entity is exempt from tax or is a foreign entity. The terms also embrace holding companies although they are not engaged in business.¹⁸ The section may be applied although the entities are technically not affiliated, and it is immaterial whether the individual entities file separate or consolidated returns.¹⁹

Owned or Controlled by the Same Interests

Ownership or control by the same interests is an essential requirement before section 482 can be invoked. The phrase, particularly when coupled with the modifying qualification that the ownership or control may be indirect as well as direct, is of broad sweep. The question arises as to whether ownership will be attributed between related parties. The specific and detailed attribution rules of the Code are not expressly made applicable to situations arising under section 482. Moreover, the Regulations are silent as to attribution of ownership. There is thus no explicit statutory authority for attributing ownership *except* for the phrase "owned or controlled directly or indirectly by the same interests" which appears in section 482 itself. This phrase, of course, is an invitation to the Commissioner to apply sweeping rules of attribution.

15. See notes 70, 87-89 *infra* and accompanying text.

16. See Colquhoun, *Multiple Corporations*, 15 W. RES. L. REV. 242 (1964).

17. Reg. §§ 1.482-1(a)(1), (2) (1962). The Regulations first included associations within the definition of organizations in 1962. Compare Reg. 118, § 39.45-1(a)(1).

18. *Asiatic Petroleum Co. v. Commissioner*, 79 F.2d 234 (2d Cir.), *cert. denied*, 296 U.S. 645 (1935); *Interior Sec. Corp.*, 38 T.C. 330 (1962), *acq.*, 1962-2 CUM. BULL. 4.

19. Thus, INT. REV. CODE OF 1954, § 482 [hereinafter cited as CODE §] may be applied even where consolidated returns have been filed. Reg. § 1.482-1(b)(2) (1962); *Autocar Co. v. Commissioner*, 84 F.2d 772 (3d Cir. 1936).

The courts at first were reluctant to apply attribution rules. In fact, as late as 1950, a court of appeals refused to find that control existed merely because one of the taxable entities at issue was owned by the husband and the other by the wife.²⁰ The trend, however, is clearly in favor of applying extensive, *practical* rules of attribution to determine whether, in substance, the particular entities are owned or controlled by the same interests. It, therefore, has been held that major stock ownership by a family or family group does establish control, but that minor stock ownership by itself does not.²¹

It would seem that there could well be control even where the taxpayers are entirely unrelated, or only remotely related,²² or where there is no common ownership.²³ The decisive consideration here is the "reality of control;" it is quite unimportant that the control is not legally enforceable.²⁴ In fact, the requisite control is presumed if income or deductions are arbitrarily shifted.²⁵

Typical situations where ownership or control by the same interests has been found are parent and subsidiary corporations, brother-sister corporations, partnerships or individuals, corporations, trusts and beneficiaries, and the like. One surprising exception is exemplified in a case involving a subsidiary owned equally by two publicly-held corporations, a case of evident practical control. The tax court held that the subsidiary was not controlled by the same interests, the "interests" being viewed as the individual public shareholders of the two parent corporations.²⁶ Even more surprising is the fact that the Commissioner acquiesced in this decision. Pointing to the contrary, however, is a more recent Revenue Ruling indicating that where there is equal corporate ownership of a subsidiary, the question of allocation between the subsidiary and two parent corporations is a question of fact.²⁷

In determining whether or not a partnership and a corporation are related, *common* ownership of more than 50% probably is enough, and the mere fact that no single partner owns a majority of the stock of the related corporation is immaterial if those partners who are shareholders own, in the aggregate, more than 50% of the stock.²⁸

20. *Denning & Co. v. Commissioner*, 180 F.2d 288 (10th Cir. 1950).

21. *Friedlander Corp.*, 25 T.C. 70 (1955), *acq.*, 1956-1 CUM. BULL. 3. *Contra*, *Cedar Valley Distillery, Inc.*, 16 T.C. 870 (1951), *acq.*, 1951-2 CUM. BULL. 2.

22. *Shaw Constr. Co.*, 35 T.C. 1102, 1119, n.13 (1961), *aff'd*, 323 F.2d 316 (9th Cir. 1963); G.C.M. 2856, 1928-1 CUM. BULL.

23. See *Hall v. Commissioner*, 294 F.2d 82 (5th Cir. 1961).

24. Reg. § 1.482-1(a) (3) (1962); *Jesse E. Hall, Sr.*, 32 T.C. 390 (1959), *acq.*, 1959-2 CUM. BULL. 4, *aff'd*, 294 F.2d 82 (5th Cir. 1961).

25. Reg. § 1.482-1(a) (3) (1962); *Hall v. Commissioner*, 294 F.2d 82 (5th Cir. 1961).

26. *Lake Erie & Pittsburgh Ry.*, 5 T.C. 558 (1945), *acq.*, 1945 CUM. BULL. 5.

27. Rev. Rul. 54-596, 1954-2 CUM. BULL. 51.

28. *Forcum-James Co.*, 7 T.C. 1195 (1946), *acq.*, 1948-1 CUM. BULL. 2, *vacated pursuant to compromise*, 176 F.2d 311 (6th Cir. 1949).

*Allocation Is Needed To Prevent Evasion or To
Reflect Income Clearly*

The statutory objectives of section 482 are stated in the alternative. They correspond to the motive, intent, or purpose provisions of sections such as sections 269 and 1551 of the Internal Revenue Code. For purposes of applying section 482, the evasion of taxes includes tax avoidance.²⁹ Thus, it is probably true that the absence of a tax motive may not be important in determining whether or not section 482 is applicable.³⁰

It has been suggested that the presence of a business purpose also is immaterial.³¹ However, it is evident from some of the more recent cases that the courts have stressed the absence of a business purpose for a particular transaction or situation as a reason, among others, for invoking section 482.³² Conversely, the showing of a strong business purpose has been given as a reason for denying the application of section 482.³³ In this respect, section 482 may be applied even though the particular arrangement which allocates profits between the parties is legally binding.³⁴

In the factual determination of whether income has been clearly reflected or taxes have not been evaded, many nebulous and sometimes elusive factors often must be weighed. The presence of a persuasive business motive for the particular allocation employed by the taxpayer thus may well turn out to be the makeweight to the Internal Revenue Service or to a court in upholding the taxpayer's allocation. After all, the ultimate test is whether the situation measures up to arm's length dealing between the related parties. And a showing of business purpose or sound business rationalization is often a major factual element in the determination of an arm's length relationship. Thus, as a practical matter, it would seem that the presence of a business purpose often may be of considerable, if not controlling, importance in determining whether section 482 is applicable and, if applicable, how it is to be applied.

The presence of common control between related taxpayers is not enough to invoke the sanctions of section 482. That is, the mere fact

29. *Asiatic Petroleum Co. v. Commissioner*, 79 F.2d 234 (2d Cir.), *cert. denied*, 296 U.S. 645 (1935). See also Reg. § 1.269-1(b) (1962).

30. *Central Cuba Sugar Co. v. Commissioner*, 198 F.2d 214 (2d Cir. 1962), *cert. denied*, 344 U.S. 874 (1952).

31. *Dillard-Waltermire, Inc. v. Campbell*, 255 F.2d 433 (5th Cir. 1958).

32. *Alpha Tank & Sheet Metal Mfg. Co. v. United States*, 116 F. Supp. 721 (Ct. Cl. 1953).

33. *Mel Dar Corp. v. Commissioner*, 309 F.2d 525 (9th Cir. 1962), *cert. denied*, 372 U.S. 941 (1963); *Virginia Metal Prods., Inc.*, 33 T.C. 788, *nonacq.*, 1960-2 CUM. BULL. 8, *aff'd, rev'd and remanded on other issues*, 290 F.2d 675 (3d Cir.), *cert. denied*, 368 U.S. 889 (1961); *The Esrenco Truck Co.*, 22 CCH Tax. Ct. Mem. 287 (1963).

34. Reg. § 1.482-1(a) (6) (1962).

that two entities are controlled by the same interests does not permit the invocation of section 482 inasmuch as there must first be a showing that there has been evasion or avoidance of taxes or a failure to reflect income clearly.³⁵

ANALYSIS OF COMMISSIONER'S AUTHORITY UNDER SECTION 482

Distribute, Apportion, or Allocate

The Commissioner's grant of authority is in terms of distributing, apportioning, or allocating. Similar language is used in sections 269 and 1551 of the Code. The latter sections, however, unlike section 482, also extend the authority to *disallow* deductions or exemptions. Thus, the Commissioner's authority is limited to *spreading* or *shifting* the various items going into a determination of net income as distinguished from imposing the sanction of denial.³⁶

Gross Income, Deductions, Credits, or Allowances

The items over which the Commissioner is granted this special authority under section 482 are "gross income, deductions, credits, or allowances," the same as under section 269. Section 1551, however, limits the items upon which the Commissioner may act to the surtax exemption and accumulated earnings credit.

Thus, section 482 is broader in scope, in terms of the items to which it applies, than section 1551 and is as broad as section 269. In fact, the words "credits" and "allowances" were added to section 482 in 1943, the year when section 269 was first enacted, to assure that section 482 would be as broad as section 269.³⁷ Actually, the scope of the items which may be distributed, allocated, or apportioned under section 482 is extremely broad because the authority extends to "any item or element affecting taxable income."³⁸ Indeed, the meaning of "allowances" is particularly broad for it has been defined, in another but similar context, as "anything" which diminishes tax liability.³⁹

From the Property and Business

The particular item being shifted or spread by the Commissioner must be, according to the Regulations, "from the property and business."⁴⁰

35. *Grenada Indus., Inc.*, 17 T.C. 231, 254 (1951), *acq.*, 1952-2 CUM. BULL. 2, *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953).

36. See notes 52 & 53 *infra* and accompanying text.

37. See note 5 *supra* and accompanying text.

38. Reg. §§ 1.482-1(a)(6), (b)(1) (1962).

39. See Reg. § 1.269-1(a) (1962).

40. Reg. § 1.482-1(b)(1) (1962).

This language is not further clarified, except for a provision in the Regulations that extends the Commissioner's authority to items affecting taxable income arising from a "particular contract, transaction, arrangement, or other act."⁴¹

Between Organizations, Trades, or Businesses

The entities subject to the Commissioner's authority are limited to related organizations, trades, or businesses. The Commissioner, therefore, has no authority under section 482 to spread or shift the items outside the related group or to remove items into the related group from outside the group.

To Reflect True Taxable Income

The statute is silent, in its express terms, as to the standard to be applied by the Commissioner when he acts under section 482. By implication, however, his authority is limited to such shifting or spreading as will correctly reflect the taxable income of the related entities or prevent tax avoidance. Presumably he can apply either of these two standards. One standard is simply to make sure that his distribution, allocation, or apportionment will prevent tax evasion or avoidance. The other is to ensure that income is correctly reflected. Theoretically, at least, the standards are not necessarily the same. Perhaps the possible difference in standards is more theoretical than real. In any event, the Regulations articulate a single standard: the determination, "according to the standard of an uncontrolled taxpayer," of the "true taxable income" of a controlled taxpayer.⁴²

APPLICATIONS OF SECTION 482

What the Commissioner Cannot Do

Allocation of Net Income

There are substantial authorities to the effect that the Commissioner cannot ignore a legal entity under section 482. From these authorities the conclusion has been drawn that the Commissioner has no authority to allocate *net* income.⁴³ However, there are substantial recent authorities

41. Reg. § 1.482-1(a)(6) (1962).

42. Reg. § 1.482-1(b) (1962).

43. Commissioner v. Chelsea Prods., Inc., 197 F.2d 620 (3d Cir. 1952); T.V.D. Co., 27 T.C. 879, 884-85 (1957), *acq. as to result only*, 1963-1 CUM. BULL. 4; Cedar Valley Distillery, Inc., 16 T.C. 870 (1951), *acq.*, 1951-2 CUM. BULL. 2. For a case recognizing that while the Commissioner cannot disregard a valid tax entity, he nevertheless may allocate all of such entity's income to another entity, see *Advance Mach. Exch., Inc. v. Commissioner*, 196 F.2d 1006 (2d Cir.), *cert. denied*, 344 U.S. 835 (1952).

to the contrary.⁴⁴ And the Commissioner has been sustained in allocating *all* of the taxpayer's *gross* income.⁴⁵

The Commissioner is given the authority under section 482 to allocate, distribute, or apportion gross income, deductions, credits and allowances. Therefore, there is no persuasive reason why he should not apply his authority to *all* gross income, to *all* deductions, to *all* credits, and to *all* allowances, provided he first has determined that it is necessary to do so either to prevent evasion of taxes or to reflect income clearly. Of course, the Commissioner can not do this in every case, for it would have to appear that such a sweeping allocation is necessary under the particular facts. Moreover, the problem may often be somewhat academic inasmuch as the Commissioner generally invokes section 482 with section 61 of the Code. Section 61 has been held to give the Commissioner authority to ignore an entity and to allocate the entity's *entire* net income to the entity to which it is properly taxable. Of course, there must be a showing that the entity which the Commissioner ignores is a *sham* entity.⁴⁶

Where the taxpayer's entire net income is reallocated by the Commissioner, it may make a difference to the taxpayer in some cases whether the Commissioner acts under section 61 or under section 482. Under section 482, the taxpayer probably cannot insist that other tax benefits, such as certain credits, be reallocated with the taxpayer's net income. If the Commissioner invokes section 61, however, he probably must be consistent and reallocate the other tax benefits as well.⁴⁷

If section 482 alone does not authorize the allocation of *net* income to another taxable entity, certainly the Commissioner may have that authority when section 482 is invoked with section 61. The Commissioner, however, may find it more difficult to show that an entity is a sham than to show that an allocation is needed to reflect income clearly. It thus may be important in certain cases to know whether section 482 permits the allocation of all net income. The authorities presently are split, but the legislative history suggests, albeit not strongly, that section 482 does not reach net income.⁴⁸

In connection with the recognition of entities which are not clearly sham, it has been held that the Commissioner must recognize a corpora-

44. Ballentine Motor Co., 39 T.C. 348 (1962), *aff'd*, 321 F.2d 796 (4th Cir. 1963); Alpha Tank & Sheet Metal Mfg. Co. v. United States, 116 F. Supp. 721 (Ct. Cl. 1953).

45. Advance Mach. Exch., Inc. v. Commissioner, 196 F.2d 1006 (2d Cir.), *cert. denied*, 344 U.S. 835 (1952).

46. Shaw Constr. Co., 35 T.C. 1102 (1961), *aff'd*, 323 F.2d 316 (9th Cir. 1963).

47. See Advance Mach. Exch., Inc. v. Commissioner, 196 F.2d 1006 (2d Cir.), *cert. denied*, 344 U.S. 835 (1952), where Commissioner was upheld in reallocating all net income under § 482 but not the excess profits tax credit.

48. See note 3 *supra*.

tion⁴⁹ or a proprietorship⁵⁰ which is itself engaged in active business; he cannot treat such an entity as sham for purposes of section 482.

Creation of Gross Income

It also has been held, or at least the cases state, that the Commissioner cannot "create" gross income under section 482.⁵¹ The somewhat surprising thing about this statement by the courts is that the Commissioner, while he may not have authority to *create* gross income, generally is free to allocate sufficient gross income from one entity to another so that the effect is to *create* additional taxable income. For example, where equipment is used by one corporation and owned by a second related corporation and no rent is paid for the use of the equipment, the Commissioner has been held to have no authority to allocate fictitious or constructive rent from the second corporation to the first one.⁵² However, it would seem that if the Commissioner were to allocate a sufficient amount of gross income to the first corporation to reflect the amount of rent which the second company would have had to pay to obtain the use of such equipment, or which the first corporation would have been entitled to receive from a third party for the use of the equipment, such a determination by the Commissioner probably would be sustained.

Disallowance of Deduction

The cases hold, and rightly so, that the Commissioner has no authority simply to *disallow* a deduction.⁵³ The plain language of section 482 is in terms of distributing, allocating, or apportioning. This language does not give the Commissioner authority merely to disallow a deduction and stop at that point. While this may be the net effect of the Commissioner's allocation, distribution, or apportionment where the other entity cannot obtain a tax benefit from the deduction, nonetheless, the Commissioner's authority very properly has been limited to the actual dividing of deductions among various entities.

49. See *Shaw Constr. Co.*, 35 T.C. 1102 (1961), *aff'd*, 323 F.2d 316 (9th Cir. 1963). See also *Advance Mach. Exch., Inc. v. Commissioner*, 196 F.2d 1006 (2d Cir.), *cert. denied*, 344 U.S. 835 (1952). It has been held that the Commissioner must recognize a transaction which is real rather than sham. *Koppers Co.*, 2 T.C. 152 (1943), *acq.*, 1943 CUM. BULL. 14.

50. *Miles-Conley Co.*, 10 T.C. 754 (1948), *acq.*, 1948-2 CUM. BULL. 3, *aff'd on other grounds*, 173 F.2d 958 (4th Cir. 1949).

51. *Tennessee-Arkansas Gravel Co. v. Commissioner*, 112 F.2d 508 (6th Cir. 1940); *Smith-Bridgman & Co.*, 16 T.C. 287 (1951), *acq.*, 1951-1 CUM. BULL. 3.

52. *Tennessee-Arkansas Gravel Co. v. Commissioner*, *supra* note 51.

53. *Hawaiian Trust Co. v. United States*, 291 F.2d 761 (9th Cir. 1961); *Hypothek Land Co. v. Commissioner*, 200 F.2d 390 (9th Cir. 1952).

*Allocation of Gross Income Limited To Amount Necessary
To Achieve Statutory Purpose*

Section 482 is by no means a blank check to the Commissioner once its terms and conditions have been met. A definite if somewhat elusive standard has been established in applying section 482. That standard limits an allocation to the amount necessary either to prevent the evasion of taxes or clearly to reflect income.⁵⁴ While the Commissioner's authority under section 482 is to a large extent discretionary, nonetheless, this standard properly should and practically does restrain the Commissioner to doing only what is necessary to achieve the statutory purpose.

Allocation of Assets, Surplus, or Accumulated Earnings

While the Commissioner's authority extends to gross income, deductions, credits, and allowances, it has been said that the Commissioner has no authority to allocate, distribute, or apportion assets, surplus, or accumulated earnings.⁵⁵ This result, and the Commissioner's acquiescence therein, seem a little surprising in view of the fact that the Regulations provide that the Commissioner's authority extends to "any item or element affecting taxable income."⁵⁶

This limitation upon the Commissioner's authority could be most important to taxpayers inasmuch as the Commissioner seemingly would be precluded then from treating income which he allocates to a particular corporation as part of that corporation's accumulated earnings either for purposes of determining whether a distribution is a dividend or for purposes of determining whether the accumulated earnings penalty tax is applicable.⁵⁷ Thus, in a typical situation, the Commissioner has been precluded, after first allocating the income of a liquidating corporation for years prior to the liquidation to a related corporation, from then taxing as a dividend to the related corporation's shareholders the amount of the distributions to them in liquidation of the first corporation.⁵⁸

54. *Grenada Indus., Inc.*, 17 T.C. 231 (1951), *acq.*, 1952-2 CUM. BULL. 2, *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953).

55. *Walter L. Morgan*, 33 T.C. 30 (1959), *acq.*, 1960-1 CUM. BULL. 5, *rev'd and remanded on another issue*, 288 F.2d 676 (3d Cir. 1961), *cert. denied*, 368 U.S. 836 (1961).

56. Reg. § 1.482-1(a)(6) (1962).

57. *Seminole Flavor Co.*, 4 T.C. 1215 (1945), *acq.*, 1945 CUM. BULL. 6.

58. *Walter L. Morgan*, 33 T.C. 30 (1959), *acq.*, 1960-1 CUM. BULL. 5, *rev'd and remanded on other grounds*, 288 F.2d 676 (3d Cir.), *cert. denied*, 368 U.S. 836 (1961). See *Seminole Flavor Co.*, *supra* note 47. *Contra*, *Forcum-James Co.*, 7 T.C. 1195 (1946), *acq.*, 1948-1 CUM. BULL. 2, *vacated pursuant to compromise*, 176 F.2d 311 (6th Cir. 1949), where amounts paid to partnership but allocated to related corporation were treated as dividends to partners.

Allocation Where Multiple Entities Used To Reduce Taxes

Certainly, the Commissioner is not free to apply section 482 merely because multiple entities are used and merely because the effect of the use of such entities is to reduce income taxes.⁵⁹ As a corollary, the section is not applicable merely because income would have been earned by a single entity if a new entity into which a separate business had been placed had not been created.⁶⁰

What The Commissioner Can Do

On the positive side, the extent or scope of the Commissioner's authority in specific situations seems to be almost without limit. For example, it has been held that the Commissioner has the following authority: to require a change in accounting method⁶¹ or at least to employ the taxpayer's accounting method so as to reflect income clearly;⁶² to adjust the basis of property to reflect its value at the time it was acquired from a related taxpayer;⁶³ to reallocate income or deductions to prevent the unwarranted use of a net operating loss carryover or carry-back;⁶⁴ to reallocate gain on a sale placed in a foreign corporation;⁶⁵ to allocate income or deductions where the transfer of a business occurred prior to its anticipated profitable operation;⁶⁶ and to correct seasonal or chronological imbalances between income and expense.⁶⁷

The Commissioner's authority, however, is limited to income, gain, or loss which has been earned or accrued at the time of a transfer between

59. *Polak's Frutal Works, Inc.*, 21 T.C. 953 (1954), *acq.*, 1955-1 CUM. BULL. 6.

60. *Ibid.*

61. *See Tennessee Life Ins. Co. v. Phinney*, 280 F.2d 38 (5th Cir.), *cert. denied*, 364 U.S. 914 (1960).

62. *Dillard-Waltermire, Inc. v. Campbell*, 255 F.2d 433 (5th Cir. 1958); *Jud Plumbing & Heating, Inc. v. Commissioner*, 153 F.2d 681 (5th Cir. 1946).

63. *National Sec. Corp. v. Commissioner*, 137 F.2d 600 (3d Cir.), *cert. denied*, 320 U.S. 794 (1943); *G.U.R. Co. v. Commissioner*, 117 F.2d 187 (7th Cir. 1941).

64. *Ballentine Motor Co. v. Commissioner*, 321 F.2d 796 (4th Cir. 1963); *Aiken Drive-In Theatre Corp. v. United States*, 281 F.2d 7 (4th Cir. 1960); *Central Cuba Sugar Co. v. Commissioner*, 198 F.2d 214 (2d Cir.), *cert. denied*, 344 U.S. 874 (1952). Compare *Hawaiian Trust Co. v. United States*, 291 F.2d 761 (9th Cir. 1961). But where a net operating loss is otherwise available, the Commissioner cannot deny its benefits under CODE § 482. *Virginia Metal Prods., Inc.*, 33 T.C. 788 (1960), *nonacq.*, 1960-2 CUM. BULL. 8, *aff'd, rev'd and remanded on other issues*, 290 F.2d 675 (3d Cir.), *cert. denied*, 368 U.S. 889 (1961); *T.V.D. Co.*, 27 T.C. 879 (1957), *acq. as to result only*, 1963-1 CUM. BULL. 4.

65. *Asiatic Petroleum Co. v. Commissioner*, 79 F.2d 234 (2d Cir.), *cert. denied*, 296 U.S. 645 (1935); *Jesse E. Hall, Sr.*, 32 T.C. 390 (1959), *acq.*, 1959-2 CUM. BULL. 4, *aff'd*, 294 F.2d 82 (5th Cir. 1961); see T.I.R. 491, 7 CCH 1963 STAND. FED. TAX REP. J 6517 (July 17, 1963).

66. *Tennessee Life Ins. Co. v. Phinney*, 280 F.2d 38 (5th Cir.), *cert. denied*, 364 U.S. 914 (1960); *Central Cuba Sugar Co. v. Commissioner*, 198 F.2d 214 (2d Cir.), *cert. denied*, 344 U.S. 874 (1952). *Contra*, *Simon J. Murphy Co. v. Commissioner*, 231 F.2d 639 (6th Cir. 1956).

67. *Aiken Drive-In Theatre Corp. v. United States*, 281 F.2d 7 (4th Cir. 1960).

related entities. Under section 482, he cannot allocate income, gain, or loss earned or accrued *after* a transfer to a related entity by the taxpayer making the transfer,⁶⁸ at least where the transfer is not a sham.⁶⁹

Generally speaking, the Commissioner has authority to allocate real estate tax deductions, and he can do so in a manner in which unrelated parties might be prohibited from doing under the Internal Revenue Code.⁷⁰ He has been held to have authority to disallow a construction loss on a contract between related parties and to treat the loss as a capital contribution to the related entity.⁷¹ However, where the parties were related but the construction contract was shown to have been entered into at arm's length, a contrary result has been reached and the loss has been allowed.⁷² The Commissioner also has been held to have the authority under section 482 to allocate a single surtax exemption among several corporations.⁷³ This authority is also explicitly available to the Commissioner under section 1551.

The Commissioner, furthermore, has authority to allocate income to an entity which never received it,⁷⁴ just as he can allocate income away from an entity which did receive it.

METHODS OR STANDARDS OF ALLOCATION

Methods or standards of allocation which have been applied by the Commissioner and approved by the courts are about as varied as the factual situations from which they have arisen. Unfortunately, the Commissioner has not undertaken to promulgate guidelines as to the allocation standards which may generally be applied in common or typical situations.⁷⁵ However, in a limited area relating to domestic corporations and their Puerto Rican manufacturing affiliates, the Commissioner recently set out in detail some of the problems likely to arise and the methods which he will use to reach a determination of the domestic

68. T.V.D. Co., 27 T.C. 879 (1957), *acq. as to result only*, 1963-1 CUM. BULL. 4.

69. Ballentine Motor Co. v. Commissioner, 321 F.2d 796 (4th Cir. 1963).

70. Tennessee Life Ins. Co. v. Phinney, 280 F.2d 38 (5th Cir.), *cert. denied*, 364 U.S. 914 (1960); Rev. Rul. 62-45, 1962-1 CUM. BULL. 27. *Contra*, Simon J. Murphy Co. v. Commissioner, 231 F.2d 639 (6th Cir. 1956).

71. V & M Homes, Inc., 28 T.C. 1121 (1957), *aff'd per curiam*, 263 F.2d 837 (6th Cir. 1959).

72. Long Corp. v. United States, 298 F.2d 450 (Ct. Cl. 1962).

73. Kessmar Constr. Co., 39 T.C. 778 (1963), *appeal pending* (9th Cir.). See also Colquhoun, *Multiple Corporations*, 15 W. RES. L. REV. 242 (1964).

74. Hugh Smith, Inc., 8 T.C. 660 (1947), *acq. on this issue*, 1947-2 CUM. BULL. 4, *aff'd per curiam*, 173 F.2d 224 (6th Cir.), *cert. denied*, 337 U.S. 918 (1949).

75. In the limited area involving sales of tangible property within a related group which included a foreign entity, specific statutory standards were proposed. See H.R. REP. NO. 1447, 87th Cong., 2d Sess. 28-30 (1962) (not enacted); H.R. REP. No. 2508, 87th Cong., 2d Sess. 18-19 (1962).

taxpayer's "true taxable income."⁷⁶ While the Commissioner's ruling is expressly limited to situations involving domestic corporations and Puerto Rican affiliates, nonetheless, it is believed that some of the standards and principles set forth may be helpful in other situations. An analysis of this ruling, however, will not be attempted here.

Among the various standards which have been applied by the Commissioner and recognized by the courts are: allocation of gross income in proportion to the number of properties owned or operated by the entity,⁷⁷ allocation of income on the basis of customary sales commissions or mark-ups,⁷⁸ a reasonable return on capital,⁷⁹ use or benefit derived, full market price on sale, and the earning of income through work actually performed.⁸⁰

Where the Commissioner has attempted to allocate expenses in proportion to the gross income of the particular entity, he has been successful on at least one occasion,⁸¹ but has been repudiated in another situation.⁸² It would seem that unless the taxpayer can show that the deductions being allocated were not incurred in proportion to gross receipts or that a substantial number of deductions have no relation to one of the entities, it is likely that the Commissioner's allocation will be upheld simply on the taxpayer's failure to show an abuse of discretion.

DEFENSES TO THE APPLICATION OF SECTION 482

Arm's Length Dealing

The principal defense to section 482 is that the taxpayer's taxable income is the same as if the members of the related group had dealt with each other at arm's length.⁸³ This is another way of saying that the proposed adjustment of the Commissioner is not necessary to reflect income clearly or to prevent tax evasion or avoidance. Thus, under this defense, one of the necessary statutory conditions to the ap-

76. See Rev. Proc. 63-10, 1963-1 CUM. BULL. 490.

77. *Peacock v. Commissioner*, 256 F.2d 160 (5th Cir. 1958).

78. *Jesse E. Hall, Sr.*, 32 T.C. 390 (1959), *acq.*, 1959-2 CUM. BULL. 4, *aff'd*, 294 F.2d 82 (5th Cir. 1961).

79. See *Cedar Valley Distillery, Inc.*, 16 T.C. 870 (1951), *acq.*, 1951-2 CUM. BULL. 2.

80. *Forcum-James Co.*, 7 T.C. 1195, 1214 (1946), *acq.*, 1948-1 CUM. BULL. 2, *vacated pursuant to compromise*, 176 F.2d 311 (6th Cir. 1949).

81. *Leedy-Glover Realty & Ins. Co.*, 13 T.C. 95, 107 (1949), *acq.*, 1950-1 CUM. BULL. 3, *aff'd per curiam*, 184 F.2d 833 (5th Cir. 1950).

82. *Campbell County State Bank, Inc. v. Commissioner*, 311 F.2d 374 (8th Cir. 1963).

83. *Mel Dar Corp. v. Commissioner*, 309 F.2d 525 (9th Cir. 1962), *cert. denied*, 372 U.S. 941 (1963); *Virginia Metal Prods., Inc.*, 33 T.C. 788 (1960), *nonacq.*, 1960-2 CUM. BULL. 8, *aff'd, rev'd and remanded on other issues*, 290 F.2d 675 (3d Cir.), *cert. denied*, 368 U.S. 889 (1961); *Buffalo Meter Co.*, 10 T.C. 83 (1948), *acq.*, 1948-1 CUM. BULL. 1; *Seminole Flavor Co.*, 4 T.C. 1215 (1945), *acq.*, 1945 CUM. BULL. 6.

plication of section 482 has not been met, and section 482 therefore cannot be invoked.

An important question arises as to the amount of proof which may be required to show that a particular transaction is at arm's length.⁸⁴ Of course, a transaction between related parties normally is not, by definition, at arm's length, so that the real question is whether the transaction is one in which unrelated parties might enter. Therefore, when a question arises as to the amount of the contract price between related parties, the amount for which merchandise should be sold, or the amount which should be charged for services, it would be most helpful if the taxpayer has available some evidence, preferably documentary, showing what a third and unrelated party might have charged under similar circumstances.⁸⁵ It would seem that contemporaneous evidence to support the validity of the particular amount charged by or to the taxpayer would be preferable to evidence located after the fact, that is, after a challenge had been made by the Commissioner.

The fact that the taxpayer is able to show that it attempted to treat the related taxpayer as though it were dealing at arm's length should be helpful not only in showing the absence of one of the conditions to the application of section 482, but also in placing the taxpayer in the stronger equitable position of having done what was reasonably necessary under the circumstances to protect itself.

Illegality

The fact that the allocation of income proposed by the Commissioner may have the effect of charging the taxpayer with a sales price larger than the taxpayer could legally have collected for the particular products which it sold has been held to be a valid reason for overturning the Commissioner's attempted allocation.⁸⁶ This decision would seem to be in accordance with common sense and sound business practice.

However, the fact that the purported allocation of either an item of income or deduction is contrary to some substantive provision of the Internal Revenue Code is generally immaterial. Although a deduction is allowable by another section, there is no reason for disallowing the deduction to the taxpayer and allocating it to another entity.⁸⁷ Likewise, the fact that a deduction is not allowed to the related entity by another section of the Code does not preclude the Commissioner from

84. See *V & M Homes, Inc.*, 28 T.C. 1121 (1957), *aff'd per curiam*, 263 F.2d 837 (6th Cir. 1959).

85. See, *e.g.*, *Long Corp. v. United States*, 298 F.2d 450 (Ct. Cl. 1962).

86. *L. E. Shunk Latex Prods., Inc.*, 18 T.C. 940 (1952).

87. *National Sec. Corp. v. Commissioner*, 137 F.2d 600 (3d Cir.), *cert. denied*, 320 U.S. 794 (1943).

allocating the deduction to the related entity, which would not be able to deduct it but for the application of section 482.⁸⁸ So, too, gain not recognized under another section of the Internal Revenue Code, such as section 351 or section 361, may, nonetheless, in effect be recognized because of the application of section 482.⁸⁹

At least one court has held that the Commissioner cannot apply section 482 where the failure to reflect income clearly is not due to the control of the related entities but to the application of the substantive provisions of the Code.⁹⁰ However, it would seem that this position is open to serious question. There are substantial authorities, as indicated above, reaching the opposite result, holding that section 482 controls when it conflicts with other provisions of the Code. This recognition that section 482 is a gloss upon the other provisions of the Code should preclude the taxpayer from successfully contending that the failure to reflect income clearly is not due to the control but to the application of other provisions of the Code.

Related Entity Obtains No Tax Benefits

The mere fact that the related entity gets no tax benefit from the Commissioner's allocation would seem to have no bearing upon the application of section 482.⁹¹ No case has been found where a hybrid version of the tax benefit rule has been raised by the taxpayer to defeat the application of section 482.

Such an argument might be that where a deduction which the Commissioner seeks to allocate away from the taxpayer would not result in a tax benefit to the receiving entity, the Commissioner cannot apply section 482. This argument, if made where the related entity is a non-taxable entity, would go too far. One of the purposes of section 482 is to prevent the shifting of otherwise taxable income to a non-taxable entity such as a foreign corporation or a tax exempt foundation, where it will not bear its share of the tax burden. If the related entity were taxable but had no taxable income in the year in which the allocation was made, the argument would have more force. It would seem, however, that the important point in applying section 482 is that a deduction may not be allowed to a taxpayer which is not entitled to the deduction. Moreover, the fact that no tax benefit can be obtained from the deduction by the related entity should be immaterial.

88. See note 70 *supra*.

89. *Rooney v. United States*, 305 F.2d 681 (9th Cir. 1962); *Central Cuba Sugar Co. v. Commissioner*, 198 F.2d 214 (2d Cir.), *cert. denied*, 344 U.S. 874 (1952).

90. *Simon J. Murphy Co. v. Commissioner*, 231 F.2d 639 (6th Cir. 1956).

91. *National Sec. Corp. v. Commissioner*, 137 F.2d 600 n.3 (3d Cir.), *cert. denied*, 320 U.S. 794 (1943).

Commissioner's Action Is Arbitrary

A most important defense to the application of section 482, but one which is not often successful, is that the District Director's allocation is arbitrary. It has been held in numerous cases that the Commissioner's discretion in the application of section 482 is very broad and that a taxpayer seeking to defeat the Commissioner's determination must show that the determination was arbitrary or unreasonable.⁹² Such a determination, of course, is difficult to attack and is subject to limited review. On occasion, however, the Commissioner's determination has been successfully upset in court on the ground that it was arbitrary or unreasonable.⁹³

Other Defenses

Another defense which can be raised is that, in fact, there has been no shifting of income and no tax advantage to the taxpayer.⁹⁴ Of course, if it can be shown that the Commissioner's adjustment is not necessary to prevent evasion of taxes or to reflect income clearly, this should defeat the Commissioner's action.⁹⁵

Yet another defense is that the income actually has been earned by the recipient from whom the Commissioner seeks to allocate it.⁹⁶ Of course, the Commissioner is free also to allocate income to another related entity which earned it.⁹⁷ The fact that the businesses are separate and readily divisible may be helpful in justifying the taxpayer's particular allocation.⁹⁸ When a new business is started in a separate entity, there may be a sound basis for contending that no justification exists for allocating income or deductions to or from the entity conducting the separate business.⁹⁹

92. *Ballentine Motor Co. v. Commissioner*, 321 F.2d 796 (4th Cir. 1963); *Grenada Indus., Inc.*, 17 T.C. 231 (1951), *acq.*, 1952-2 CUM. BULL. 2, *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953).

93. See, e.g., *Campbell County State Bank, Inc. v. Commissioner*, 311 F.2d 374 (8th Cir. 1963).

94. *Interior Sec. Corp.*, 38 T.C. 330 (1962), *acq.*, 1962-2 CUM. BULL. 4; *Buffalo Meter Co.*, 10 T.C. 83 (1948), *acq.*, 1948-1 CUM. BULL. 1.

95. *Seminole Flavor Co.*, 4 T.C. 1215 (1945), *acq.*, 1945 CUM. BULL. 6; *Briggs-Killian Co.*, 40 B.T.A. 895 (1939), *acq.*, 1940-1 CUM. BULL. 1.

96. *Mohe Epstein, Inc.*, 29 T.C. 1005 (1958), *acq.*, 1958-2 CUM. BULL. 6; *T.V.D. Co.*, 27 T.C. 879 (1957), *acq. as to result only*, 1963-1 CUM. BULL. 4; *Stevens Bros.*, 24 T.C. 953 (1955), *acq.*, 1956-2 CUM. BULL. 8; *Grenada Indus., Inc.*, 17 T.C. 231, 256 (1951), *acq.*, 1952-2 CUM. BULL. 2, *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953); *Briggs-Killian Co.*, *supra* note 95.

97. *Birmingham Ice & Cold Storage Co. v. Davis*, 112 F.2d 453 (5th Cir. 1940).

98. *Raymond Pearson Motor Co. v. Commissioner*, 246 F.2d 509 (5th Cir. 1957); *Mohe Epstein, Inc.*, 29 T.C. 1005 (1958), *acq.*, 1958-2 CUM. BULL. 6; *Grenada Indus., Inc.*, 17 T.C. 231, 255 (1951), *acq.*, 1952-2 CUM. BULL. 2, *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953); *Buffalo Meter Co.*, 10 T.C. 83 (1948), *acq.*, 1948-1 CUM. BULL. 1.

99. *Cedar Valley Distillery, Inc.*, 16 T.C. 870 (1951), *acq.*, 1951-2 CUM. BULL. 2.

Of course, a sale for full value or a customary mark-up would normally be a valid defense.¹⁰⁰ Likewise, a showing of reasonable compensation for services,¹⁰¹ reasonable rent,¹⁰² or reasonable profit,¹⁰³ may defeat the application of section 482.

PROCEDURAL QUESTIONS

Procedural questions are bound to arise in view of the fact that different tax entities are involved where section 482 is applied. Thus, a taxpayer was not allowed to deduct an item which a related taxpayer had been held entitled to deduct under section 482 in a separate judicial proceeding in a different court.¹⁰⁴ Conceivably, different courts might reach inconsistent results inasmuch as there seems to be no legal requirement (such as the doctrine of *res judicata* or collateral estoppel) that the second court recognize and follow the first court's determination under section 482.¹⁰⁵ Fortunately, no case has been discovered where inconsistent results under section 482 have been reached by different tribunals.

Increasing attention is being given to foreign related entities. Some of this increased attention by the Commissioner is generated by his interest in the possible application of section 482. After all, one of the purposes of section 482 is to prevent the shifting of income to foreign entities where it escapes domestic taxation.¹⁰⁶ Likewise, another purpose is to prevent the shifting of deductions to a domestic taxpayer where an added unwarranted tax benefit might be obtained. The Commissioner has recently warned taxpayers that adjustments may be made under section 482 which will entitle the related foreign taxpayer to a refund of

100. *Friedlander Corp.*, 25 T.C. 70 (1955), *acq.*, 1956-1 CUM. BULL. 3; *Buffalo Meter Co.*, 10 T.C. 83 (1948), *acq.*, 1948-1 CUM. BULL. 1.

101. *Polak's Frutal Works, Inc.*, 21 T.C. 953 (1954), *acq.*, 1955-1 CUM. BULL. 6; *Cedar Valley Distillery, Inc.*, 16 T.C. 870 (1951), *acq.*, 1951-2 CUM. BULL. 2.

102. *Buffalo Meter Co.*, 10 T.C. 83 (1948), *acq.*, 1948-1 CUM. BULL. 1; *Welworth Realty Co.*, 40 B.T.A. 97 (1939), *acq.*, 1939-2 CUM. BULL. 39.

103. *Grenada Indus., Inc.*, 17 T.C. 231, 260 (1951), *acq.*, 1952-2 CUM. BULL. 2, *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953); *Buffalo Meter Co.*, *supra* note 102.

104. *Perpetual Bldg. & Loan Ass'n*, 34 T.C. 694 (1960), *aff'd on other grounds sub nom. Cooper Estate v. Commissioner*, 291 F.2d 831 (4th Cir.), *cert. denied*, 368 U.S. 919 (1961).

105. See, e.g., *American Range Lines, Inc. v. Commissioner*, 200 F.2d 844 (2d Cir. 1952), *modifying on other grounds* 17 T.C. 764 (1951); *Elsie Keil Mathisen*, 22 T.C. 995 (1954). Compare *D. Bruce Forrester*, 4 T.C. 907 (1945), *acq.*, 1945 CUM. BULL. 3. The mitigation provisions of CODE §§ 1311-15 do not completely cover the situations likely to arise, for the statutory provisions are limited both as to the items covered (§ 1312) and as to the degree and type of relationship between the related entities (§ 1313(c)).

106. See note 1 *supra*.