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entity, a new doctrine denying loss carryovers in continuing companies where debt is cancelled would create still further inconsistency.

The problem is that the factors discussed seldom arise separately. Change of stock ownership should not be relevant under the 1954 Code except as specified in section 382. Cancellation of indebtedness should not bar a carryover unless Congress so provides. If the two occur together, however, as will normally be the case after a Chapter X reorganization, the government will undoubtedly argue that two bad arguments make a good one, and that the opportunity to cite both factors avoids the necessity of analyzing either.

VI

ACQUISITIONS TO OBTAIN BENEFIT OF LOSSES — SECTION 269

Henry C. Harvey

Few taxpayers engage in business enterprises with the expectation of incurring losses and presumably none with that intention. To those unfortunates who do find themselves in losing ventures the net operating loss carryback and carryover provisions of the Internal Revenue Code offer some consolation, indeed, at current high tax rates, considerably more than mere glum consolation.

These provisions, however, afford relief only if the losses can be brought into conjunction with profits within the prescribed time limitations for carrybacks and carryovers. Occasionally, the necessary profits cannot be generated internally, and the unfortunate taxpayer must search elsewhere for earning assets or another profitable enterprise in order to take advantage of the partial insurance against losses afforded by the tax law.

In addition to these poor souls, predatory taxpayers also exist who are ready and willing, for an appropriate price, to purchase a dying venture and utilize its actual or potential loss deductions.

Both must reckon with a tangled web of technical and procedural statutory rules relating to the transfer and preservation of losses,[1] with the elusive concepts of the court decisions in this area,[2] and finally with

1. See Pomeroy, *Limitations Where Same Taxpayer Seeks to Carry Loss to Another Year*, at 233, *supra*, and Adelson, *Carrying Losses to a Different Taxpayer*, at 262, *supra*.

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

a portion of the law — section 269 — specifically directed at tax motivated acquisitions.[3]

BACKGROUND AND SCOPE OF SECTION 269

Section 269 of the Internal Revenue Code of 1954 had its origin almost twenty years ago in the Revenue Act of 1943 which introduced section 129 into the Internal Revenue Code of 1939. The language of the two sections is for all practical purposes identical,[4] except for the addition to section 269 of a presumption which is more fully discussed later.

Section 129 was originally enacted (and continued in the 1954 Code

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3. INT. REV. CODE OF 1954, § 269, [hereinafter cited as CODE §].

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) IN GENERAL — IF —

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

(b) POWER OF SECRETARY OR HIS DELEGATE TO ALLOW DEDUCTION, ETC., IN PART. — In any case to which subsection (a) applies the Secretary or his delegate is authorized —

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income tax for which the acquisition was made or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

(c) PRESUMPTION IN CASE OF DISPROPORTIONATE PURCHASE PRICE. — The fact that the consideration paid upon an acquisition by any person or corporation described in subsection (a) is substantially disproportionate to the aggregate —

(1) of the adjusted basis of the property of the corporation (to the extent attributable to the interest acquired specified in paragraph (1) of subsection (a)), or of the property acquired specified in paragraph (2) of subsection (a); and

(2) of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition,

shall be prima facie evidence of the principal purpose of evasion or avoidance of Federal income tax. This subsection shall apply only with respect to acquisitions after March 1, 1954.

4. Because the two sections are substantially identical, the discussion herein generally refers to § 269, although a number of the cases referred to were actually concerned with § 129.

as section 269) for the purpose, among others, of preventing the trafficking in "loss" corporations, and this has indeed been one of the most popular areas for its application. It was a statutory enactment of the general principle developed in earlier decisions that a deduction, credit, or other allowance should not be available if its effect was to distort the liability of a taxpayer when the essential nature of a transaction or situation was examined in light of the basic purpose or plan which Congress sought to effectuate by the deduction, credit, or allowance.[5]

Section 269 becomes applicable to the use of net operating losses or net operating loss deductions[6] when two conditions are present: (1) the acquisition either of control of a corporation or of corporate assets under specified circumstances, and (2) a tax avoidance motivation for the acquisition. The first condition is purely objective and examination of the facts relating to any acquisition or proposed acquisition will quickly determine whether this is met. The second, relating to motivation or purpose is, on the other hand, subjective and presents more difficult problems to the tax practitioner in ascertaining whether section 269 has application.

OBJECTIVE ACQUISITION CONDITION

Control Acquisition

The first type of transaction at which section 269 is directed is the acquisition of control of a corporation by any person or persons. Control, which can be acquired directly or indirectly, is specifically defined as ownership of stock possessing at least fifty per cent of the total combined voting power of all classes of stock or at least fifty per cent of the total value of shares of all classes of stock.

This type of acquisition, commonly called a "control acquisition," presents relatively few problems. It either is present or is not as a matter of fact. There is, however, uncertainty as to the meaning of the word "indirectly" and to date no court has been called upon to interpret it. Without specific reference in section 269 to any attribution of ownership rules, which abound elsewhere in the Code, it is doubtful that an indirect acquisition of control should be found to exist by reason of attributing ownership of stock. On the other hand, it seems reasonably clear that obtaining direct ownership of forty-nine per cent of the stock of a corpo-

5. Treas. Reg. § 1.296-2(b) (1962) [hereinafter cited as Reg. §]. The decisions developing this principle include such landmark cases as Higgins v. Smith, 308 U.S. 473 (1940); Griffiths v. Helvering, 308 U.S. 355 (1939); Gregory v. Helvering, 293 U.S. 465 (1935).

6. Section 269 actually applies to any type of deduction, credit, or other allowance under the tax law, the term "allowance" having been defined as "anything in the internal revenue laws which has the effect of diminishing tax liability." Reg. § 1.269-1(a) (1962). This article, however, is confined to its effect on deductions for losses.

ration with an option to acquire the balance should be regarded as the acquisition of indirect control.[7]

The organization of a new corporation is a control acquisition to which section 269 applies.[8] This is so whether the new corporation has one or many shareholders since the acquisition can be made by any person or persons. Furthermore, a control acquisition can be made in a taxable or a non-taxable transaction. It can also occur without the addition of any stock to the existing holdings of a shareholder as, for example, the redemption of some outstanding shares leaving the remaining shareholder or shareholders in control.

Finally, a control acquisition need not be made in one step. When ten per cent of the stock of a corporation is added to a long-standing holding of forty per cent, control is acquired at that time.[9] Thus, even a relatively small stock purchase may meet the objective test of a control acquisition, making it necessary to consider section 269 in order to protect the tax future of the corporation or its shareholders.

Property Acquisition

The second type of transaction meeting the objective test of section 269 is an acquisition by one corporation of property of another corporation — a so-called "property acquisition." In a property acquisition, which can also be made directly or indirectly, it is necessary that (1) the corporate transferor of the property was not controlled, directly or indirectly, prior to the acquisition by the acquiring corporation or its stockholders, and (2) the basis of the acquired property in the hands of the acquiring corporation must be determined in whole or in part by reference to the transferor's basis.

A property acquisition, of course, most commonly exists as the result of a tax-free reorganization. Section 269 does not apply to a taxable purchase by a corporation of assets for cash even though the declared purpose may be to bring earning assets into a losing venture to utilize loss carryovers. Nor do all tax-free acquisitions of property fall within its scope. While the transfer of property by an individual to a corporation in exchange for all of its stock (tax-free under section 351 with no change in basis of the property) may be a control acquisition, it is not a property

7. In analyzing a fact situation involving losses or loss carryovers, care must always be taken to be certain that an indirect acquisition of control is not present. It seems likely that, through a combination of this concept with the fact that control may be acquired by several persons, the Commissioner may seek to extend the application of § 269 into areas hitherto considered invulnerable.

8. James Realty Co. v. United States, 280 F.2d 394 (8th Cir. 1960).

9. Reg. § 1.269-1(c) (1962). The section, on the other hand, would not apply if ownership of 50% or more were acquired without any tax motive, and subsequently the remaining stock was purchased in order to benefit from losses.

acquisition falling under section 269. Furthermore, all corporate reorganizations do not involve section 269 property acquisitions, as two corporations under common control can be combined by the transfer of property of one to the other in a merger or sale of assets for stock without fear of section 269.[10] Certainly to one seeking to utilize losses by an acquisition, the property acquisition route presents more possibilities of avoiding section 269 than the control acquisition route and should be thoroughly explored if the utilization of losses is the primary motivation.

SUBJECTIVE PRINCIPLE PURPOSE CONDITION

Once it is determined that a control acquisition or a property acquisition meeting the objective test has occurred or is contemplated, section 269 will bar the use of losses if the principal purpose of the acquisition is the evasion or avoidance of tax by securing the benefit of losses or loss deductions which the acquiring person or corporation would not otherwise enjoy. This necessitates an inquiry into the mind of the acquirer. While subjective tests are no strangers to the tax law, they always pose difficult problems.[11]

Before discussing the factual question of whether the proscribed purpose exists, it is well to have in mind a few basic interpretations of the "principal purpose" clause. First, the purpose to be ascertained is the purpose at the time of acquisition, not at some subsequent date when the benefit of the losses is actually availed of or reflected in a tax return.[12] Second, if the purpose to evade or avoid tax exceeds in importance any other purpose, it is the principal purpose.[13]

A third basic interpretation was in considerable doubt for more than fifteen years after the enactment in 1943 of section 129 (the predecessor

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10. In a parent-subsidiary situation with losses in either company, the transfer of earning assets either by parent to subsidiary in exchange for additional stock or as a capital contribution or by subsidiary to parent in a complete liquidation should not be a § 269 property acquisition. The parent and subsidiary should be regarded as controlled directly and indirectly, respectively, by the shareholders of the parent. In Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396 (4th Cir. 1957), however, § 269 was said to be applicable to a transfer of property from parent to subsidiary although this was not essential to the decision. Also, the Regulations may be taken to indicate that a transfer of property from a parent to a losing subsidiary is a qualifying property acquisition. Reg. § 1.269-3(c) (2) (1962).

11. See, *e.g.*, CODE § 341 (relating to collapsible corporations); CODE § 531 (relating to accumulations of surplus).

12. Hawaiian Trust Co., v. United States, 291 F.2d 761 (9th Cir. 1961).

13. Reg. § 1.269-3(a) (2) (1962). The application of this rule to an acquisition involving several business or non-tax purposes is not clear. Assume an acquisition motivated in part by the desire to use loss carryovers and in part by three valid business purposes and assume that the tax purpose can be determined to represent 40% of the "overall" motivation and each of the others, 20%. Does the tax purpose "exceed in importance any other purpose"? Or will the three others be considered collectively as the business purpose and thus outweigh the tax purpose? No court to date has grappled with this question.

of section 269). During those years, a controversy raged over application of the section to the acquisition of control of a corporation which already had operating losses and which after the acquisition was merely put into a position to use these losses itself. The early decisions under section 129,[14] and even until 1960 all the decisions of the Tax Court, held that section 269 did not apply under these circumstances since the acquired corporation was not securing the benefit of any deduction, credit, or other allowance which it would not otherwise enjoy. The indirect benefit to the person acquiring control was not considered to be one to which the statute applied.

This narrow interpretation restricted the application of section 269 in control acquisitions principally to cases in which the taxpayer had no competent tax advice as most acquisitions could be arranged to fall outside its scope. It was first repudiated by several of the United States courts of appeals in reversing Tax Court decisions,[15] was finally repudiated by the Tax Court itself,[16] and currently has no support whatever. It is now clear that section 269 bars the use of losses or loss carryovers in any type of acquisition meeting its conditions in which the proscribed purpose is present, irrespective of whether the benefit of the loss is obtained by the acquired corporation or indirectly by the shareholders in a control acquisition.

Ascertaining the principal purpose of any acquisition is, of course, essentially a factual question. In this area, the early decisions under section 129 also favored the taxpayer in that the courts were quite generally satisfied that the principal purpose was not the avoidance of tax if the taxpayer could advance any plausible business purpose for the acquisition.[17] Only about seven years ago did the courts begin to apply the section in the manner which seems to have been intended by Congress from the outset. Commencing with the *American Pipe & Steel Corp.* decision,[18] the courts began to weigh the relative importance of the business purpose or purposes against the tax benefits obtained or to be obtained as a result of the acquisition. It is safe to say now that the unsupported testimony of an interested taxpayer as to his business purposes for acquisition of a loss corporation will not prevail if on analysis it is in-

14. T.V. D. Co., 27 T.C. 879 (1957); Alprosa Watch Corp., 11 T.C. 240 (1948).

15. Commissioner v. British Motor Car Distribs., 278 F.2d 392 (9th Cir. 1960); Mill Ridge Coal Co. v. Patterson, 264 F.2d 713 (5th Cir. 1959), *cert. denied,* 361 U.S. 816 (1959); Coastal Oil Storage Co. v. Commissioner, 242 F.2d 396 (4th Cir. 1957).

16. Thomas E. Snyder Sons Co., 34 T.C. 400 (1960), *aff'd,* 288 F.2d 36 (7th Cir. 1961), *cert. denied,* 368 U.S. 823 (1961).

17. See, *e.g.,* Wage, Inc., 19 T.C. 249 (1952); Chelsea Products, Inc., 16 T.C. 840 (1951), *aff'd,* 197 F.2d 620 (3rd Cir. 1952); and Alprosa Watch Corp., 11 T.C. 240 (1948).

18. 25 T.C. 351 (1955), *aff'd,* 243 F.2d 125 (9th Cir.), *cert.* denied, 355 U.S. 906 (1957).

herently improbable or lacks credulity, or if the alleged business purposes are substantially outweighed by the tax benefits actually obtained.[19]

The fact that the tax benefits flowing from net operating losses are considered in the planning of an acquisition is not necessarily fatal.[20] However, a careful analysis and computation of the available operating losses and carryovers prior to an acquisition, coupled with a failure to investigate with the same thoroughness the alleged business advantages, recently weighed heavily against the taxpayer in *Urban Redevelopment Corp. v. Commissioner*.[21] It is almost certain that the Commissioner will prevail if the acquisition involved is of control of a corporation with past operating losses which is no more than a corporate shell at the time of acquisition.[22]

The tax practitioner considering a proposed acquisition, either of control or of property, which falls within section 269 and which will bring losses into conjunction with profits must arm himself with contemporaneous evidence of the business or other non-tax purposes for the acquisition. If the principal purpose is, in fact, expansion of an existing business into new products or new geographical areas, there should be market research studies, profit forecasts, and similar analyses made prior to the acquisition to demonstrate the real purpose. Otherwise the happening of unforeseen events subsequent to the acquisition may, with the benefit of hindsight, make the purpose of obtaining losses loom larger in relation to the business purposes. Alleged business advantages or purposes of the acquisition will not suffice to outweigh the realized benefits of substantial loss carryovers if the facts taking place after the acquisition fail to support them.[23]

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19. See, *e.g.*, Brown Dynalube Co. v. Commissioner, 297 F.2d 915 (4th Cir. 1962); J. G. Dudley Co. v. Commissioner, 298 F.2d 750 (4th Cir. 1962); Urban Redevelopment Corp. v. Commissioner, 294 F.2d 328 (4th Cir. 1961); Huddle, Inc., 30 P-H Tax Ct. Mem. 816 (1961).

20. Hawaiian Trust Co. v. United States, 291 F.2d 761 (9th Cir. 1961); Berland's, Inc., 16 T.C. 182 (1951).

21. 294 F.2d 328 (4th Cir. 1961).

22. See J. G. Dudley Co. v. Commissioner, 298 F.2d 750 (4th Cir. 1962); Temple Square Mfg. Co., 36 T.C. 88 (1961); Frank Spingolo Warehouse Co., 37 T.C. 1 (1961); John S. Taft, 30 P-H Tax Ct. Mem. 1239 (1961). It also seems clear that a token continuation of the business of an acquired loss company will be regarded in the same light as the purchase of a corporate shell. F. C. Publication Liquidating Corp. v. Commissioner, 304 F.2d 779 (2d Cir. 1962); Army Times Sales Co., 35 T.C. 688 (1961); Continental Machine & Tool Corp., P-H 1962 TAX CT. REP. & MEM. DEC. (31 P-H Tax Ct. Mem.) ¶ 62,096 (May 4, 1962).

23. Brown Dynalube Co. v. Commissioner, 297 F.2d 915 (4th Cir. 1962); F. C. Publication Liquidating Corp. v. Commissioner, *supra* note 22. If the business purpose is to acquire and put new life into a losing venture, the taxpayer must be prepared to defend himself by showing reasonable prospects of reviving the business of the acquired corporation and real efforts to that end after the acquisition. In R. P. Collins & Co. v. United States, 193 F. Supp. 602 (D. Mass. 1961), *aff'd*, 303 F.2d 142 (1st Cir. 1962), he failed in this respect and lost. This case also indicates that purchase at a price which would produce a profit if the acquired company were liquidated — seemingly a showing that it was a good business deal irrespective of

PRESUMPTION OF SUBSECTION (C)

In the area of principal purpose, it was intended in 1954 that the Commissioner's arsenal of weapons be increased by the addition of subsection (c) to section 269. This provides in substance that, when the consideration paid in an acquisition described in section 269 is substantially disproportionate to the sum of (1) the adjusted basis of the property of the corporation in a control acquisition[24] or of the property acquired in a property acquisition, and (2) the tax benefits not available to the acquirer otherwise than as a result of the acquisition, this shall be prima facie evidence of the proscribed purpose. The legislative history clearly indicates that "substantially disproportionate to" means "substantially less than" and this is made clear in the Regulations.[25]

The peculiar workings of this presumption and the many problems which may arise in the interpretation of subsection (c) have been the subject of considerable discussion.[26] For example, if a taxpayer pays a high price in a control acquisition, so that the consideration approaches the adjusted basis of the corporate properties, plus the tax benefits to be obtained from loss carryovers, the presumption will not operate. On the other hand, a taxpayer who is totally uninterested in, and unwilling to pay for, loss carryovers, and who pays a price measured merely by the book value of the corporation acquired, will be presumed to be seeking the loss carryovers. It is a curious result that the presumption should thus operate against a taxpayer who has no purpose whatever of acquiring the benefits of losses.

Other facets of the presumption present a variety of puzzling questions. For example, why is the consideration measured against the adjusted basis of properties rather than their market value when market value normally sets the price paid in an acquisition? When market value exceeds basis the price paid may well equal the basis, plus tax benefits, and yet tax benefits may be acquired for a bargain price. How does one value the tax benefits of loss carryovers? Presumably, any such valuation should take into account a discount factor depending upon the time

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the losses — will not necessarily carry the day. In *Collins,* the indicated profit was about $108,000 and the possible tax benefit from losses between $120,000 and $216,000.

24. In a control acquisition, in which less than all the stock is acquired, only that portion of the basis of all the corporate properties which is attributable to the stock acquired is taken into account in determining applicability of the presumption. This can create troublesome problems if the corporation has outstanding stock of different classes with different rights.

25. S. Rep. No. 1622, 83rd Cong., 2d Sess. 228 (1954); Reg. § 1.269-5 (1962).

26. Kirkpatrick, *Section 269 of the 1954 Code — Its Present and Prospective Function in the Commissioner's Arsenal,* 15 TAX L. REV. 137, 141-45 (1960); Note, *Net Operating Loss Carryovers and Corporate Adjustments: Retaining an Advantageous Tax History under Libson Shops and Sections 269, 381, and 382,* 69 YALE L. J. 1201, 1237-38 (1960); Note, *Tax Motivated Acquisitions; I.R.C. Section 269 and the Presumption of Subsection (c),* 55 NW. U.L. REV. 755, 766-70 (1961).

or times when the carryovers can be utilized, the rates of tax otherwise applicable to income offset by the carryovers, and the real possibility that profits may not be available against which to offset them. Having valued the tax benefits, when is the consideration paid substantially less than their value, plus the adjusted basis of the property? Presumably, some small differential would not give rise to the presumption, but the problem of determining substantiality is frequently far from simple.[27]

Since certain types of control acquisitions do not involve payment of any consideration, the presumption will not operate in all cases otherwise subject to section 269. A simple example is the acquisition of control by a minority shareholder as a result of the redemption by the corporation of the shares of one or more other shareholders.[28]

Speculation on these questions may well be largely an exercise in intellectual curiosity, since the presumption in section 269(c) seems to add little, if anything, to the presumption of correctness which always accompanies a determination by the Commissioner.[29] Both, of course, are rebuttable by appropriate evidence. The Regulations state that section 269(c) is designed to give further weight to this normal presumption,[30] but it is questionable whether it will in fact do much more than to encourage examining agents to propose the application of section 269 to otherwise doubtful cases. In the one decision to date which has given any real consideration to the subsection (c) presumption, the court held that it had been rebutted by the same type of evidence which would seem necessary to rebut the normal presumption in favor of the Commissioner.[31]

REGULATIONS UNDER SECTION 269

Although section 269 was enacted in 1954, the Regulations under it were only recently adopted.[32] Generally speaking, they reflect developments of case law, most of which have been discussed above. The Regulations contain illustrations and examples of acquisitions for the purpose of obtaining the benefit of loss carryovers of the type which one would expect. They also point out that control or property acquisitions designed

27. See, *e.g.*, cases under CODE § 341 (relating to collapsible corporations) or CODE § 368(a)(1)(C) (relating to reorganization transfers of substantially all the assets of a corporation).

28. Other examples might be a partial liquidation involving a distribution which is not pro rata to all shareholders, a divisive reorganization, or a recapitalization converting voting shares into non-voting preferred.

29. Furthermore, because of its strange and probably unintended results the repeal of subsection (c) has been proposed. *Report of Committee on Corporate Stockholder Relationships, Tax Section, American Bar Ass'n* (1962).

30. Reg. § 1.269-5 (1962).

31. Baton Rouge Supply Co. Inc., 36 T.C. 1 (1961), *acq.*, 1961-2 CUM. BULL. 4.

32. T.D. 6595, 1962 INT. REV. BULL. NO. 19, at 10.

to produce future benefits by creating or utilizing tax reducing losses are within the operation of the section.[33] Finally, the Regulations make it clear that the Internal Revenue Service intends to apply section 269 in appropriate cases independently of other provisions of the Code, such as section 382, which also prohibit loss carryovers in whole or in part under specified circumstances.[34] If the acquisition is accomplished in a manner that avoids the application of section 382, or that requires a partial disallowance under section 382, section 269 may nevertheless require the disallowance of all or the remaining portion of the loss carryovers.

CONSEQUENCES OF SECTION 269 APPLICATION

Once section 269 is found applicable to an acquisition, the benefits of the losses which motivated the acquisitions will be disallowed. In the first place, this clearly means that operating loss carryovers from taxable years prior to the acquisition year, and net operating losses incurred in the acquisition year prior to the acquisition, will not be deductible.

Until two cases decided in 1962, it was far from clear whether section 269 also applied to disallow post-acquisition operating losses.[35] The first of these decisions, *Collins & Co. v. United States*,[36] involved the acquisition in March, 1954, by the Collins company of control (about sixty-seven per cent) of a company (Priscilla) with prior losses. On May 21, 1954, it acquired the balance of the stock in Priscilla and at about the same time decided to liquidate Priscilla. On July 29, 1954, the assets of Priscilla were sold at a substantial loss, and it commenced engaging in a different business which it operated at a profit until finally liquidated in 1957. From March to July, Priscilla had continued to incur operating losses.

In a consolidated return for its fiscal year ended August 31, 1954, the Collins company offset against its income the operating losses of Priscilla incurred after May 21, 1954, and the loss from the disposition of its properties in July. In a consolidated return for the following fiscal year, income of Priscilla (then operating a different business profitably) was offset by the carryover of (1) its operating losses prior to March, 1954, (2) its operating losses for the period from March, 1954, to May 21, 1954, and (3) the unused portion of the losses claimed in the prior year's

33. Reg. §§ 1.269-3(b)(3), 1.269-3(c)(1) (1962).

34. Reg. § 1.269-6 (1962).

35. The court did apply the section to post-acquisition losses in Elko Realty Co., 29 T.C. 1012 (1958), *aff'd per curiam*, 260 F.2d 949 (3d Cir. 1958), but that case has been seriously criticized as being an unwarranted extension of § 269. Kirkpatrick, *Section 269 of the 1954 Code — Its Present and Prospective Function in the Commissioner's Arsenal*, 15 TAX L. REV. 136, 151-55 (1960).

36. 193 F. Supp. 602 (D. Mass. 1961), *aff'd*, 303 F.2d 142 (1st Cir. 1962). See note 23 *supra*.

consolidated return. The court of appeals affirmed the decision of the district court, with one dissent, holding that the Collins company could not use in its consolidated returns any of the Priscilla net operating losses, losses on property dispositions, or loss carryovers. The finding of the district court was that the principal purpose of the acquisition was to obtain tax benefits from the past and prospective losses of Priscilla. On appeal, the taxpayer argued that, whatever its "overall" purpose might have been, it certainly could not have proposed to acquire Priscilla's net operating losses incurred after May, 1954, as no one could have a primary purpose of losing a dollar to save fifty-two cents in taxes. Despite the logic of this argument, the court of appeals rejected it, stating:

> We find this argument unpersuasive because, on the facts of this case, it unrealistically attempts to segregate into isolated segments a course of conduct which is essentially unitary both in conception and in impact. Assuming, as taxpayer would have us do, that the court could conclude that the 'overall' purpose of the acquisition was to avoid taxes, viz., to obtain the capital losses resulting from the sale of the plant and equipment, then we believe that it must have been within the fair contemplation of the taxpayer that certain operating losses would necessarily be incurred before this ultimate purpose could be effectuated and, to that extent, the operating losses would be included as a necessary incident of the 'overall purpose.' In effect once it is conceded that Priscilla was acquired with a view towards obtaining the tax advantages stemming from a corporate dismemberment, then we believe that all the losses which immediately precede this ultimate act are constituent elements of a course of conduct proscribed by Section 129. They are tarred by the same brush.[37]

The second case, *Zanesville Inv. Co. & Affiliates*,[38] concerned the activities of Mr. Jones, the owner of all the stock of Zanesville which, in turn, owned most of the stock of Enterprises, a profitable newspaper publishing company. Jones also owned substantially all the stock of Muskingum, a coal mining company, which had been operating at a loss for a number of years with expectations of further losses.

On September 1, 1955, Jones transferred the Muskingum stock to Zanesville which filed a consolidated return with its two subsidiaries for 1955, offsetting Muskingum's operating losses from September 1st to December 31st against the profits of Enterprises. By July, 1956, Jones decided to abandon the coal mining business, and sold the mining properties of Muskingum at a substantial loss after it had also incurred further operating losses in the period from January 1st to July, 1956. Both these operating losses and the loss on its sale of properties were offset in a consolidated return for 1956 against the profits of Enterprises.

The Tax Court found that the principal purpose of the acquisition of control of Muskingum by Zanesville was to offset its losses against the

37. 303 F.2d 142, 146 (1st Cir. 1962).
38. 38 T.C. No. 44 (June 25, 1962).

income of Enterprises and thus secure a benefit not otherwise available. It rejected the argument that section 269 did not apply to a consolidation in this manner of two commonly controlled corporations. It further held that, although the purpose of the acquisition was to offset post-acquisition operating losses of Muskingum against the profits of Enterprises, and although at the time of the acquisition there was no decision to liquidate Muskingum, section 269 applied to all tax loss benefits which flowed from the acquisition and therefore required disallowance of the property disposal losses as well.

The lesson to be learned from these two decisions is that, when a tax motivated acquisition occurs, not only will the losses which motivated the acquisition be disallowed, but other post-acquisition operating or property disposal losses, which perhaps formed no part of the motivation, will probably also be disallowed.

Subsection (b) of section 269 gives the Commissioner the power to allow a portion of the losses or to distribute or apportion income and losses among the corporations and properties to the extent that he determines will not result in the avoidance of tax. It does not appear in any reported case that the Commissioner has ever exercised this power.

In *Thomas E. Snyder Sons Co. v. Commissioner*[39] the court was asked to find that the Commissioner had abused his discretion in failing to allow loss carryovers in part, but it refused to do so. The taxpayer argued that he had owned a substantial portion of stock of the loss company from the time of its incorporation and that, although he had subsequently acquired the balance of the stock (and hence control) in a tax motivated transaction, nevertheless a portion of the loss carryovers attributable to his original stock ownership should be allowed. Despite the fact that his original stock had unquestionably been acquired without any evil tax motive and the fact that, as a shareholder from the beginning, he had suffered the economic loss attributable to this holding, the court denied any relief. From this it appears that a partial allowance of tax benefits in a section 269 acquisition must be obtained, if at all, from the Commissioner not the courts.

TREND OF SECTION 269

The Commissioner in the past seven years has had greatly increased success in obtaining court decisions supporting his disallowance of losses and other benefits under section 269. About twenty court decisions in that period have supported the Commissioner and only three decisions have been favorable to the taxpayer.

The growing tendency of the courts to analyze closely the circumstances of an acquisition and the business purposes advanced by the tax-

39. 288 F.2d 36 (7th Cir. 1961).

payer, to weigh these in the balance against the tax benefits of the losses, and to bear heavily on a taxpayer seeking to upset the Commissioner is dramatically illustrated by the very recent Tax Court decision in *J. T. Slocomb Co.*[40]

The taxpayer in *Slocomb* presented considerable evidence of business purpose for the acquisition in the form of diversification into a related business, acquisition of a loss company which nevertheless had a good reputation and name in the industry, and assets acquired in the loss company with a value considerably in excess of the purchase price. These factors together added up to a respectable showing that the taxpayer had made a good business deal irrespective of any loss carryovers. The Tax Court, however, took careful note of the amount of loss carryovers (over $300,000) and found that the taxpayer had not introduced sufficient evidence to overcome the presumptive correctness of the Commissioner's determination that the principal purpose was to avoid tax by using the carryovers.

Further evidence of the Tax Court's increasing support of the Commissioner was its willingness in *Temple Square Mfg. Co.*[41] to apply the "step transaction" doctrine to the area of section 269. In this case, the loss company acquired a profitable business before the acquisition of control, but the Tax Court held the two steps to be all part of one plan and consequently disallowed carryovers under section 269.

Despite the recent successes of the Commissioner, room still remains for planning with a view to avoiding the application of section 269. *Zanesville Inv. Co.*[42] is a prime example of a situation where section 269 might have been avoided. The loss and profit companies in that case were under common control, and there was no attempt to use loss carryovers from periods prior to their combination. If Jones had been well advised he might have liquidated Enterprises, the profitable corporation, into its parent, Zanesville, in a tax-free liquidation. This being an acquisition of property from an already controlled corporation, section 269 would not apply. Following this, Jones might have merged Muskingum, the loss company, into Zanesville which now owned the profitable newspaper publishing business, Zanesville thus acquiring again properties from a corporation controlled by its stockholders. Subsequent operating and property disposal losses of Muskingum could have been applied against profits of the publishing business without fear of section 269.[43]

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40. 38 T.C. No. 75 (Aug. 29, 1962).

41. 36 T.C. 88 (1961).

42. 38 T.C. No. 44 (June 25, 1962). See discussion of this case at 300, *supra*.

43. Whether this course of action would also preserve the loss deductions from disallowance under the *Libson Shops* rule is as yet unresolved. See Pomeroy, *Limitations Where Same Taxpayer Seeks to Carry Loss to Another Year*, at 258, *supra*.