Capital Gains Exception to the House's "General Utilities" Repeal: Further Indigestions from Overly Processed "Corn Products"

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CAPITAL GAINS EXCEPTION TO THE HOUSE'S GENERAL UTILITIES REPEAL: FURTHER INDIGESTIONS FROM OVERLY PROCESSED CORN PRODUCTS

by John W. Lee

I. Introduction

Under present law a purchasing corporation usually effects a cost-basis acquisition of all or a substantial part of another corporation's assets either by (a) a direct asset purchase from Target corporation in connection with its timely liquidation (to which existing section 337 applies at the corporate level and section 331 at the shareholder level), or (b) a timely purchase of "control" (at least 80 percent) of Target's stock followed by a timely election of existing section 338. In the direct asset acquisition (1) the purchasing corporation obtains a section 1012 cost basis for Target's assets and leaves behind Target's "tax attributes"; (2) Target recognizes income in a "bulk sale" of its assets only to the extent of "recapture income," which overrides the shield of existing section 337; and (3) Target's shareholders recognize capital gain on the liquidating distributions by Target. If the purchasing corporation purchased the assets on credit, Target's shareholders may report their (capital) gain on the installment method, thus treating principal payments on the purchasing corporation's "purchaser evidences of indebtedness" distributed to them in the section 331 liquidation of Target as payments (when received) for their Target stock.

Commentators and experts disagree as to whether the cost-basis rules [allowed by sections 337 and 338 of the Code] merely fuel, or are the motor that drives, the current mergernia.

With the Target stock acquisition route, (1) Target is treated pursuant to the purchasing corporation's election of existing section 338 as a new corporation, with a "clean slate" of tax attributes, which purchased (old) Target's assets on the day after purchasing corporation acquired such control. New Target corporation obtains a cost basis in such assets equal, in uncomplicated single shot 100 percent acquisition, to the sum of purchasing corporation's purchase price of such stock (including any future payments), and old Target's liabilities (including the tax on old Target's recapture income); or (2) old

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Target is deemed to have sold on the day purchasing corporation acquired control all of its assets for "fair market value in a single transaction to which section 337 applies," thereby triggering as to old Target only a tax on its recapture income; and (3) Target's shareholders recognize capital gains on the sale of their stock to purchasing corporation. If purchasing corporation's purchase price includes future payments, Target's shareholders may report their gain on the installment method. Purchasing corporation may maintain new Target corporation's continued existence (presumably filing consolidated income tax returns) or may liquidate it in a nonrecognition transaction receiving the assets at new cost-basis acquisition of (1) stock in purchasing corporation in the transaction and, of course, will have a "substituted" basis in such stock. Alternatively, purchasing corporation may transactionally elect17 carryover basis by acquiring control of Target but not electing section 338 and then maintaining or liquidating it, although in this event Target's shareholders will recognize gain or loss as to the consideration they receive, including any stock in purchasing corporation.

**H.R. 3838 continues a three decade incremental trend toward corporate level tax parity among [section 366, section 337, and section 338 transactions].**

A number of present tax law factors favor a cost-basis acquisition of Target or its assets over a carryover basis acquisition. Most significant is the cumulative effect in cost-basis acquisitions of (1) purchasing corporation obtaining the benefits of leverage plus ACRS on current fair market value of Target's depreciable assets, (2) the only Target level "toll charge" being its tax on "recapture income," which may be offset by its net operating losses, and (3) the Target shareholders receiving installment reported capital gains, thereby unlocking many dispositions.

Commentators and experts disagree as to whether the above cost-basis tax rules merely fuel, or are the motor that drives, the current "merger-mania." But clearly if the Target level toll-charge for purchasing corporation's cost basis were raised from the current tax on recapture income only to full recognition of appreciation as the House bill would in non-close corporations and with the House's proposed liberalization of section 382 regarding survival of Target's NOLs following its acquisition, in a reversal of current practice most acquisitions of Target corporations would be structured as carryover basis acquisitions with a resulting substantial increase in reve-

**II. Proposed Limitations on General Utilities**

The House's Tax Reform Act of 1985 (H.R. 3838) continues a three decade incremental trend towards corporate level tax parity among (1) corporate distributions of assets to shareholders in complete liquidation (section 336), (2) corporate (or post-distribution shareholder) sales of Target's assets pursuant to a complete liquidation (section 337), and (3) shareholder sales of the Target stock electively treated as a sale of Target's assets pursuant to a pseudo-liquidation (section 338). These reforms would also partially restore corporate level parity between (a) liquidating distributions, stock sales, or asset sales on the one hand and (b) distributions by a continuing corporation, i.e., redemptions and dividends (section 311) on the other. At the same time, H.R. 3838's partial repeal of the Target level shelter in existing sections 336-338 should also be viewed as but another step in a 20-year trend of legislatively cutting back the scope of the General Utilities doctrine.

General Utilities commonly is said to have held that a corporation is not taxed on its nonliquidating distributions of appreciated property. General Utilities commonly is said to have held that a corporation is not taxed on its nonliquidating distributions of appreciated property, but general usage extends the term to present sections 336-338's shielding of a liquidating or deemed liquidating Target from gain or loss recognition as to property it distributed in, or sold pursuant to, a liquidation or is deemed to have sold pursuant to an elective pseudo-liquidation, except for "recapture income" in all three instances. The House proposals reverse present law; generally under revised section 336-338 transactions Target would be taxed as if it had sold such property at fair market value. Some nonrecognition exceptions in such "liquidating" transactions would continue, however, largely as to long-term capital assets in the hands of closely held active business corporations, but only to the extent of their substantial long-term noncorporate ownership. Thus, if Target is an active business corporation meeting the tests of section 311(e), a proportion of Target's gain or loss on the sale or distribution of long-term capital assets will be ignored in transactions falling under proposed sections 336-338. The proportion ignored is equal to the percentage of Target's stock that is held by noncorporate shareholders who have owned at least 10 percent of Target's stock for the last five years. Of course, this narrowly drawn exemption is itself subject to the classic statutory and case-law overrides such as assignment of income, tax benefit doctrine, statutory depreciation recapture (e.g., under sections 1245 and 1250) or similar rules. The 5- and 10-shareholder and active business prerequisites are derived from section 311, which does not, however, contain a long-term capital gain restriction. This article focuses on the long-term capital gains limitation to the
limited close active business nonrecognition exception to proposed sections 336-338.

The House bill technically denies the corporate level exemption, otherwise available to Target, to the extent of qualified stock ownership (5-and-10 noncorporate shareholder rule) in an active business corporation, to (1) "any gain or loss which is an ordinary gain or loss," (2) any short-term capital gain or loss, and (3) any gain Target would recognize upon a disposition of installment obligations within section 453B.34 The House Ways and Means Committee Report illustrates ordinary gains and losses with those "derived from inventory items or items held for sale to customers."35 The probable basis for the ordinary-capital distinction was "that there is no logical basis for exempting inventory, whether or not sold in bulk, or other assets held for sale to customers in the ordinary course of business."36 Indeed, the bulk of testimony at earlier related hearings37 and of the commentary38 agree that any continued section 336-338 exemption from gain or loss recognition should be limited to largely investment or inflationary derived gains of a small or closely held (target) corporation in a liquidating setting.

The 1985 House proposals intentionally restrict the corporate-level exemption to property...[not sold or exchanged] in the ordinary course of...business.

The 1985 House proposals intentionally restrict the corporate-level exemption to property of a sort which Target did not sell or exchange in the ordinary course of its business. The Corn Products doctrine, under one widely followed reading, however, extends ordinary income treatment to any operating asset, whether a capital asset or a depreciable business asset, whose use is essential to or "integral" to the business. This reading would largely limit the revised section 336-338 exemption to Target's investment assets, and gain would be recognized on essential operating assets, such as plant and equipment, even though Target corporation customarily did not sell such property in the ordinary course of its business. Another, contrary reading of Corn Products holds that it does not apply to isolated sales, including a liquidation sale, of operating assets. Opponents of the proposed repeal of General Utilities are virtually unanimous that repeal should not include long-term capital assets and their argument has considerable political appeal as relief for closely held businesses.39 It is thus likely that any reform will retain at least in part an exemption drawing a capital-ordinary line. Furthermore, the conflict, noted above, between integral asset and isolated transaction alone demands that the drafters address the Corn Products issue when such line is finally drawn.

The recent proposals of the Chairman of the Senate Finance Committee do not provide relief to the General Utilities repeal at the Target level. Rather, as supported by some commentators,40 relief would be provided in certain acquisitions or liquidations where Target does not exceed $5 million in the form of a basis increase to former Target shareholders in their Target stock (thereby reducing shareholder's outside gain on the liquidation or acquisition). Such "small" business outside basis increase would approximate the gain Target recognized on its long-held capital assets.

III. Corn Products Doctrine

The term "capital asset" is defined by section 1221 as all "property" held by the taxpayer with five enumerated exceptions, the most important of which focuses on inventory and property held primarily for sale to customers in the ordinary course of business and on installment obligations generated by sales of such assets. The Supreme Court, however, engrafted a further exception onto the predecessor to section 1221 in Corn Products Refining Co. v. Commissioner.41

"The Corn Products Doctrine has exhibited an omnidirectional resilience productive of an endless stream of litigation over essentially factual issues."42 In large part because the Supreme Court's opinion did not adequately distinguish which, if any, of the following factors were decisive to its conclusion that the corn futures at issue were not capital assets, resulting in ordinary income on their sale at a gain: (1) The taxpayer, a corn refining company, recurringly purchased (and subsequently sold or exercised depending on the market) corn futures; (2) such futures, while not inventory, were a substitute since they insured a source of corn; (3) the Court agreed with the Second Circuit and Tax Court below that the purchases of the futures were an "integral part" of the taxpayer's business designed to "hedge" against price increases in corn; and (4) the taxpayer's profit from the sales of the corn futures arose from everyday operation (whether due to recurring or inventory-like aspects is unclear) and constituted a normal source of business income.43

Several unresolved Corn Products issues may pose problems under the proposed provisions.

Several unresolved Corn Products issues may pose problems under the proposed provisions. One issue which Congress should perhaps address is how Corn Products applies to proposed section 336-338 transactions where Target acquired or holds stock in subsidiaries with a mixed investment-business motive—a well-known developing area.44 Potentially much more troublesome, however, is the largely unacknowledged case-law conflict as to the role of Corn Products regarding nonrecurring sales of operating assets. One approach simply looks to whether use of the property is essential to, and an integral part of, the taxpayer's business. If so, Corn Products applies. The other focuses instead on whether such a sale constitutes (a) a regular source of the taxpayer's income, making the doctrine apply, or (b) is a sale totally or partially terminating business assets that the taxpayer does not customarily sell, thus rendering the doctrine inapplicable because the sale is not a normal source of business profits.

A. 'Integral Part' Test

In Corn Products the Supreme Court noted that the lower court decisions had found that the taxpayer's
futures transactions were “an integral part of its business designed to protect its manufacturing operations against a price increase in its principal raw material and to ensure a ready supply for future manufacturing requirements.” The Court agreed that the taxpayer’s futures activity was not separate and apart from its manufacturing operation and instead was vitally important as a form of insurance against increases in the price of raw corn. The bulk of the Corn Products progeny utilizing the term “necessary and integral” or similar language seem to employ the phrase as a synonym for “business purpose” for the acquisition and holding of the asset at issue as contrasted with an investment purpose.

The court opined that its approach did not read section 1231 out of the statute.

As the cases gradually extended this sort of necessary and integral analysis, or better words, from property held as a hedge in order to be assured of raw materials (and bought and sold regularly) to property directly used to acquire raw materials and finally to property itself used in the direct production of income, with no weight given to the frequency of disposition of such property in the business, the doctrine arguably produced increasingly wrong results. For instance, the then Court of Claims in Norton v. United States applied Corn Products to deny capital gains treatment to the liquidating sale by a logging business of a timber cutting contract, which ensured the taxpayer “a ready source of supply of a logging business raw material, timber.” The Court of Claims found that the timber cutting contract was so integrally related to the taxpayer’s ordinary business objectives of logging timber that a “business use” intention rather than an “investment” intent prevailed from acquisition until (liquidating) sale. The Norton court relied upon Corn Products notwithstanding the taxpayer’s contention that the sale represented the concluding phase of liquidating the logging business. While the court opined that its approach did not read section 1231 out of the statute for “business connected” assets, that is precisely the result that follows where the focus is on the business use of the property rather than on whether its sale constitutes a normal source of the taxpayer’s business income. Disturbingly, the district court in Becker Warburg Paribas Group Inc. v. United States extended Corn Products to allow a brokerage business an ordinary loss on the sale of one of its stock exchange seats because the asset was itself used as an integral part of the primary business. It is but a small step to next apply Corn Products to the disposition of any business connected asset, be it plant, equipment or intangibles, even goodwill.

B. Corn Products and Section 1231: ‘Integral Part’ and ‘Isolated Transaction’ Collide

Significantly, Norton and Becker Warburg Paribas did not involve section 1231 assets. In general, section 1231 provides for capital gains treatment as to net gains and ordinary loss treatment as to net losses upon the sale, exchange, or involuntary conversion of (a) depreciable property used in the taxpayer’s trade or business and held for more than six months and (b) real property so used and held, which in each instance is neither inventory nor property held primarily for sale to customers in the ordinary course of the taxpayer’s trade or business and does not fall in any other of the section 1221-type exclusions. Section 1231 is significant to the Corn Products doctrine because it has served as the arena for the conflict between the ordinary course of business and the integral and necessary part readings of the doctrine even though section 1231 no longer offers much opportunity for capital gains.

The first decisions considering the question concluded that the Corn Products doctrine was inapplicable to section 1231; the best decision reasoned that by its very nature a section 1231 asset is “integral” to the business, so that the doctrine, if applicable, would read the section out of the Code. The Court of Claims particularly had problems in effectively addressing the Corn Products-section 1231 issue since it generally relied on the integral and necessary act reading. Consequent of that tribunal held on numerous occasions that sales of section 1231 assets were not integral to the taxpayer’s mainstream business, even where they were recurring. Moreover, preservation of these precedents probably led the then Court of Claims to develop the following “elaborate rationale” where property which was used in the taxpayer’s mainstream business (e.g., leasing or manufacturing) was also sold with regularity: (1) “Primary purpose” is determined at time of sale, (2) in sale-or-rent operations, “primarily” invokes a contrast, not between selling and renting, but between selling in the ordinary course of business and selling outside of that normal course, and (3) the regular sales constituted a secondary business. Such elaborate rationale appears contrary to at least the spirit of Malat v. Riddell,58 where the Court propounded its definition of “primarily” for section 1221 as “of first importance” and “principally” in the context of apartment projects apparently developed for rental purposes or selling, whichever was more profitable, where prior decisions by-and-large had found ordinary income because the sales in such “dual purpose” areas were a “substantial” part of the mainstream business. While Malat appears to not be a dual purpose case, but rather an undecided purpose case, read against the preceding sell-or-rent cases its clear import is that where a taxpayer truly has a dual motive, e.g., primarily to use the property in rentals or manufacturing, with a lesser purpose of sale, the property is not held primarily for sale. The Court of Claims’ rationale thus is flawed. If the taxpayer regularly sells such property not held primarily for sale, such sales constitute a normal source of business income and Corn Products should apply, notwithstanding that such property literally qualifies as a “capital asset.”

The leading case applying Corn Products to section 1231 assets, Hollywood Baseball Association v. Commissioner, unfortunately relied upon an integral test—defined as “carried on to protect or to allow the function of the taxpayer’s true business.” Yet the sales there of baseball player contracts by a farm club on the demand of a major league club in fact were substantially recurring and constituted a major source of income to the taxpayer. Hence, the court could easily have rested on the ordinary course recurring tack or, even that the player contracts were held primarily for sale. Indeed, commentators have pointed to section 1231 as proof for the proposition that the integral act reading of Corn Products is overly broad.
Several decisions contrary to the “integral act” approach have found Corn Products factually inapplicable to section 1231 property used as an integral part of the business by focusing on whether the sale of such property was a regular transaction. For example, the Tax Court in Shea’s Estate v. Commissioner held that the taxpayer’s sale of a ship charter (a bilateral contract granting the taxpayer the right, and the obligation, to transport cargo by sea for a five-year period for the charterer) was not subject to the Corn Products doctrine because the sale of the charter “was not a regular transaction as a part of the business, . . . . In fact, it was highly unusual, the sale of the charter separately resulting solely from the destruction of the vessel by accident. The sale stemmed from the decision . . . to cease business.” In short, the transaction was not a normal source of business income. Save for the fact that the charter contract in Shea’s Estate was amortizable over the five-year period and, hence, a section 1231 asset, while the timber cutting contract in Norton was not depreciable and, hence, not a section 1231 asset, the two cases appear distinguishable, and hence, a section 1231 asset, the two cases appear distinguishable, and the Tax Court refused in section 1231 asset, the two cases appear distinguishable, and the Tax Court refused in

In a choice between (a) an “integral and necessary act” reading of Corn Products, focusing in effect on the degree of business necessity, and (b) a reading limiting the doctrine to dispositions of property of the type sold in the ordinary course of the taxpayer’s business, albeit not held primarily for such purpose (with perhaps a slight modification for property acquisitions made in lieu of a deductible or amortizable business expenditure), the latter approach is necessary to preserve section 1231 (or better what is left of it) and the chief proposed exemption to revised sections 336-338. And if the recurring reading is proper for section 1231 operating assets, it should be equally proper for nonsection 1231 operating assets. Although commentators have offered many other formulations and refinements of the Corn Products doctrine (often attempting to reconcile the myriad cases), the above conflicting positions are those most frequently utilized by the courts as to assets other than stock. However, which approach, if either, is correct is not decisive for purposes of this article. The possibility that cases so in conflict might apply to new sections 336-338 demands that the drafters of the statute, or more appropriately the Committee Reports, explicitly address the manner in which the Corn Products doctrine should apply to these provisions. Otherwise, the certainty or simplification goal of tax reform is lost here. Moreover, as long as the broad integral act precedents are not overruled, the common-law process creates substantial risk that Corn Products will be applied improperly in revised sections 336-338 transactions to section 1231 assets and other assets which are integrally used in business operations but not sold in everyday business operations.

C. Corn Products and Existing Section 337

Section 337 exempts gain from the corporate tax if the gain is realized on qualifying sales or exchanges of property, a term defined in section 337(b). Cases arose, however, in which courts thought it improper to exempt the gain because it would have been taxed under case law doctrines, such as the assignment of income doctrine, had section 337 not appeared to be applicable. Some decisions, notably Pridemark, Inc. v. Commissioner held that section 337 did not apply. The Pridemark court reached that result by holding an item was property under section 337 only if it would be a capital asset under section 1221. The court reasoned that (1) neither section 337 nor section 1221 was intended to allow corporate income from normal operations to escape the full corporate tax, and (2) the section 337 definition of property closely paralleled the section 1221 definition of property which was impliedly adopted by the Congress. Later decisions, however, properly refused to equate these two provisions and therefore restricted “property” for section 337 only to the extent set forth in section 337(b). Instead, wisely following a functional approach (to achieve “parity” between existing sections 336 and 337), they applied such

As a practical matter, the courts in general were very reluctant to apply Corn Products to section 1231 assets unless sales were substantially recurring.

Clearly, as a practical matter, the courts in general were very reluctant to apply Corn Products to section 1231 assets unless sales were substantially recurring, and even then the courts frequently resorted instead to “elaborate rationales” as to the taxpayer’s primary purpose. Conversely, some tribunals were considerably less reluctant to rely on Corn Products where nonsection 1231 assets were involved. However, since the decisions did not explicitly turn on the class of asset, but rather in effect on the test applied—integral use vs. isolated sale—the problem remains. As the above survey amply illustrates, if we disregard the class of asset (section 1231 asset or not) and whether gain or loss was involved, the cases are impossible to reconcile, with different treatment, according to the Corn Products test utilized, of (1) a contract used by one taxpayer to obtain timber processed in its logging businesses, a contract used by another taxpayer to obtain cargo to be shipped in its shipping business, and a contract used by still another to provide services in its mortgage servicing business, and (2) livestock used to produce offspring in a livestock breeding business, a stock exchange seat used to sell property or services to customers in a brokerage business, and surely improved real estate (plant or offices, apartments) used to manufacture or held for rental in a manufacturing or rental business.
case-law doctrines directly to section 337 where appropriate. The Ninth Circuit in Hollywood Baseball Association also declined to equate sections 1221 and 337, but did apply the Corn Products doctrine to section 337. Unfortunately, the decision was quite cryptic. On the one hand, Hollywood Baseball at different points noted that the policy underlying section 1221 (and section 1231) was not intended "to give preferential treatment to profits and losses arising from the everyday operation of the business," and similarly that the policy behind section 337 was to deny exemption to "sales in the ordinary course of business...as if the corporation were not in the process of liquidating." On the other hand, the Ninth Circuit did not turn its decision on these stated policies. Rather, similarly to the subsequently discredited Prudemar reason, it saw the development of section 337 from the House to the Senate version as "perhaps...made in order to make the language of section 337 more nearly approximate the language of sections 1221 and 1231. If so, it would seem to follow that Corn Products is applicable to section 337." Moreover, by relying on a Corn Products "integral" reasoning rather than the ordinary course of business reading, Hollywood Baseball raised the possibility that section 337 would be eviscerated as to integral operating assets. Indeed, when the Tax Court finally rejected Prudemar in favor of applying the existing section 336 case-law overrides (assignment of income in the case at bar) to existing section 337, it distinguished Hollywood Baseball on the ground that the sale of Target's mortgage servicing contracts in the case before it was not a prerequisite to the conduct of the taxpayer's business (The Tax Court appears unaware that it follows Corn Products, ..." as if the decision..."

Corn Products too often works as a one-way street...[with taxpayers reporting] sales producing gain as capital...and sales producing loss as ordinary loss.

Commentators differed as to whether the Corn Products doctrine should apply to section 337; with those in favor pointing to the similarity in policy of denying preferential treatment to ordinary course of business transactions, and those opposing its application relying on the policy of encouraging parity between existing sections 336 (to which the doctrine presumably would not apply) and 337. The absence of post-Hollywood Baseball decisions applying Corn Products to either section 1231 assets or to section 337 transactions could indicate a conscious decision by the Commissioner and the Justice Department not to utilize the integral reading in these contexts. More likely, such absence reflects their belated awareness that Corn Products too often works as a one-way street: taxpayers tend to report sales producing gain of otherwise capital assets as capital gain (and escape audit and challenge) and sales producing loss as ordinary loss. Whether the government could resist the opportunity to rely on an "integral" argument as to operating assets in new sections 336-338 is nevertheless problematic.

IV. Corn Products and Proposed Sections 336-338

H.R. 3838, in practical effect, would codify Prudemar by continuing General Utilities only for section 337 "liquidi-__" distributions of long term capital gain property. The bill would, however, effect parity between section 337, on the one hand, and sections 336 and 338, on the other, by also eliminating General Utilities for short term capital gain and ordinary income property in transactions falling under sections 336 and 338. General Utilities thus would be left to exempt gain on long term capital assets of closely held active businesses. Such a limitation would seem certain to raise the question whether Corn Products applied to those sections in light of the fact that it was applied to section 337 although the statutory equivalence between sections 337 and 1221 was not nearly so great as it would be between proposed sections 336-338 and section 1221. Furthermore, the application of Corn Products to section 337 produced results that were not on a parity with the results under section 336 and pre-1982 section 334(b)(2). In the revised scheme under the proposed sections, parity would seem to be a stronger, more conscious aim, and Corn Products would have to be applied to sections 336-338 to achieve it. Clearly any continued exemption should not be available for property customarily sold by Target in the ordinary course of its business, although not held primarily for such sale. To this extent Corn Products or a similar doctrine is needed. But the doctrine should not be applied merely because an otherwise long-term capital or section 1231 asset is integral to Target corporation's business.

Hopefully, the drafters will focus on the conflicting readings of the doctrine in this context—integral asset vs. nonrecurring sale—and explicitly stake out a position, presumably in the legislative history. Otherwise, even after Target meets the quite technical "qualified stock ownership" and "active business" tests (itself a quagmire of conflict and threads its way through the maze of statutory and case-law recapture income rules, Target's advisors must plumb the seemingly endless, conflicting Corn Products progeny to determine whether the corporate level exemption is available. When you consider that (a) the revised sections 336-338 rules governing transactions involving widely held Target corporations, which presumably would have access to expert and diligent tax advice, would be relatively simple, and (b) closely held Targets would be less likely to have such ready access, or even realize it is needed, then the true perversity of the proposed regime begins to unfold. At least the drafters could still avoid the Corn Products trap for the unwary.

PRIOR COVERAGE

For a previous special report on the tax aspects of corporate takeovers, see "Using the Tax Code to Fend Off Corporate Takeover 'Sharks'," by Jonathan Barry Forman, Tax Notes, March 18, 1985, pp. 1162-1166.
"Target" is used in text and footnotes to refer to both (a) a corporation whose assets or stock are purchased or acquired by a purchasing corporation, and (b) a corporation distributing in a complete liquidation its assets to its shareholders for them to continue to operate in noncorporate form.

Such basis includes under Crane v. Comm'r, 331 U.S. 1 (1947), any future, e.g., installment, payments to be made by purchasing corporation and any Target liabilities assumed, or taken subject to, by purchasing corporation, see Meyerson v. Comm'r, 47 T.C. 340 (1966), but probably not in excess of the fair market value of the acquired Target's assets. See Estate of Franklin v. Comm'r, 544 F.2d 1045 (9th Cir. 1976); see generally Andrews, On Beyond Tuffs, 61 Taxes 949 (1983).

Such attributes include the laundry list contained in section 338(c), principally "earnings and profits" and "net operating losses" and carryovers of other credits, as well as various tax elections.

If Target sells the inventory of one of its businesses during the 12-month period following the adoption of its plan of complete liquidation other than to a single purchaser in a single transaction, the otherwise available shield of present section 337(a) is "lifted." Sections 338(b)(1)(A) and (2). This requirement creates a "broken lot of inventory" discontinuity with an existing section 337 sale. See Ginsburg, Taxing Corporate Acquisitions, 38 Tax L. Rev. 171, 279 (1983) ("Ginsburg, 38 Tax L. Rev."). Notwithstanding the literal language of existing sections 337(b) and 338, courts and the Service through the case-law and statutory "recapture income" doctrines and provisions tax a liquidating corporation (whether distributing its assets or selling them) on certain items. See note 33 infra.

Section 331(a). This assumes that (a) Target is not "collapsible" under section 341(b) or that section 341(e)(4) applies, see present section 337(c)(1); and (b) the stock is a "capital asset" in the shareholder's hands. This requirement too can cause discontinuity between an asset acquisition (existing section 337) and a stock acquisition (existing section 338). See Ginsburg, 38 Tax L. Rev. supra at 254-255. For excellent policy discussion of the possibility of repeal of the collapsible corporation-ratios of the General Utilities doctrine were completely repealed also, see, Ginsburg, Collapsible Corporations—Revisiting on Old Misfortune, 33 Tax L. Rev. 309, 325-328 (1976); Staff of Senate Finance Committee, Preliminary Report, The Reform & Simplification of the Income Taxation of Corporations, S. Print 98-95, 98th Cong. 1st Sess. 33-34 (1983) ("Senate Finance Staff, Preliminary Report").

Installment reporting permits a taxpayer to ratify offset basis against principal payments as received (usually in present and) in future years(s). Section 453(c). An inadequate rate of interest usually triggers the time value of money rules.


Prior to the Installment Sales Revision Act of 1980, Public Law 96-471, the receipt of the purchasing corporation's "purchaser evidences of indebtedness" constituted payment in the year of such receipt to Target shareholders to the extent of their fair market value. See Ginsburg, Taxing the Sale for Future Payment, 30 Tax L. Rev. 469, 484 (1975). This pre-1980 section 337 discontinuity with installment stock purchase of "control" of Target corporation by purchasing corporation followed by section 337 liquidation with installment stock purchase of "control" of Target corporation by purchasing corporation followed by section 337 liquidation of Target resulting in a section 338(b)(2) "cost-basis" in the assets was the policy basis of Rushing v. Comm'r, 441 F.2d 593 (5th Cir. 1971), and its progeny (permitting shareholder-level installment reporting upon sale of Target stock to third person who effects liquidation of Target and sale of its assets), effectively overruled where the third party is related by the second disposition "rules" of section 453(e). See S. Rep No. 96-1000, 98th Cong. 2d Sess. 13-14 (1980), reprinted in 98th Cong. 2d Sess. H.R. 494-500.

Under present section 338(g)(1) purchasing corporation must elect section 338 by the 15th day of the ninth month beginning after the month in which it acquired 80 percent of Target's stock ("acquisition date"). Under the "asset consistency" rules of present section 338(e), a cost-basis acquisition by purchasing corporation or any affiliate of assets from Target or any affiliate, unless sold in the ordinary course of business, during an up to three-year or more "consistency period," present section 338(h) (4)(A) and (B), triggers a deemed section 338 election. The anti-selectivity consistency rules have been criticized as a great source of complexity as well as misdirected. Ginsburg, 38 Tax L. Rev. supra at 299-300. Temporary section 338 regulations, through an elaborate web of rewards and punishment, generally turn such asset acquisition into a carryover basis acquisition, thereby not triggering a deemed election, unless purchasing corporation affirmatively elects a cost-basis in such assets. See Temp. Reg. section 1.338-4T(F)(4)(iv) Q & A No. 1; Preamble to Q & A's Relating to Domestic Matters Under Section 338, 50 Fed. Reg. 16403-04 (April 25, 1985). See generally Wellen, A Roadmap to Section 338, 28 Tax Notes 461 (July 22, 1985).

Existing section 338(a)(2).

Existing sections 338(b)(1) and (2) provide the new Target corporation's aggregate basis in old Target's "acquisition date" assets consists of (a) the "grossed up" basis of Target's stock "recently" purchased by purchasing corporation (i.e., purchased during the 12-month acquisition period, existing section 338(b)(6)(B), and (b) purchasing corporation's basis in all other Target stock, section 338(b)(6)(B), with both adjusted for Target's liabilities and "other relevant items." Such liabilities include old Target's tax liability as to "recapture income." S. Rep. No. 97-494, Vol. I, 97th Cong. 2d Sess. 193 (1982); Temp. Treas. Reg. section 1.338(b)-1T(f)(1).

If purchasing corporation acquires 80 percent, but less than 100 percent, of Target's stock by the end of the "acquisition date" and elects existing section 338, two rules deal with the presence of remaining minority Target shareholders: (1) The "gross-up" rule of existing section 338(b)(4) increases new Target's deemed purchase price as if the purchasing corporation had purchased 100 percent of Target's stock at the average per share price that it purchased the "recently purchased" Target stock. (2) As a "surrogate" toll charge for the proportionate outside Target shareholder tax that is not triggered where purchasing corporation purchases less than 100 percent of Target's stock, the deemed section 337 shield as to old Target's deemed bulk sale is proportionately lifted to the extent that purchasing corporation does not acquire through purchase or certain redemptions the remaining stock in new Target corporation held by minority old Target shareholders within a 12-month lookforward after the acquisition date. Existing sections 338(c)(1) and (h)(7). This lifting of the present deemed section 337 bulk sale shield also does not apply if new Target corporation is liquidated within such 12-month lookforward, provided that such minority shareholders do not elect section 333. Existing section 338(c)(1).

Existing section 338(a)(1) "Recapture income" overrides such deemed section 337 shield just as it would an actual section 337 sale by Target, indeed, extracting this Target level toll charge was the purpose of the deemed bulk section 337 sale in the statute. Joint Committee Staff, General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. Law 97-248, 97th Cong. 2d Sess. 133 (1982). "Recapture income" is further discussed in note 33 infra.

This assumes that section 341(a) is inapplicable and the stock is a capital asset in the hands of the selling Target shareholders. See note 5 supra.


Section 334(b)(1).

Section 361(a) This statement assumes no undistributed corporate level "boot" or nonqualifying property. Section 361(b).


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Sections 354 and 358. Receipt of nonqualifying property in addition to money in a purchase transaction is taxed at Target shareholder levels under section 356.


The statutory definitional requirements and the overriding case-law requirements of continuity of interest at the shareholder and corporate levels for the five basic acquisitive reorganizations, "A," forward triangular "A," and reverse triangular "A," and in some cases that purchasing corporation or its shareholders acquired 80 percent control of Target ("B" and reverse triangular "A"), in one step in the case of a reverse triangular "A," which qualify the shareholder level continuity of interest requirement; and (b) the requirement that purchasing corporation require "substantially all of the properties" of target "C," and both triangular "A" reorganizations constitute the principal sources of the problems in this area. See Senate Finance Staff, Preliminary Report, supra at 27-29. Due to the differences that the various formulations of these requirements play in the different reorganizations, the definitions "defy rationalization." Senate Finance Staff, Preliminary Report, supra at 27. These views may require certain differences which reorganizations may be utilized with respect to (1) consideration permitted; (2) "creeping acquisitions" (purchasing corporation acquires stock in Target either for cash or voting stock in purchasing corporation over a period of time); (3) disposition of unwanted assets by Target in anticipation of its acquisition; (4) payments by purchasing corporation or Target to dissenting shareholders in Target; (5) survival of Target's NOL's under pre-1976 rules (still in effect through 1985); (6) survival of Target as an entity and (7) the applicable rules both as to qualification and as to taxation of Target where Target's liabilities are assumed by the purchasing corporation.

Only an "A" and a forward triangular "A" permit considerable flexibility as to consideration, i.e., for this purpose the transaction must meet only the common-law "continuity of interest," for ruling purposes a 50 percent continuing equity interest in purchasing corporation by former Target shareholders (even including nonvoting preferred purchasing corporation stock). In contrast, only voting purchasing corporation stock may be utilized in a "B," "C," and reverse triangular "A" reorganization with varying amounts of "boot" permitted in those three reorganizations. See generally Dean & Egerton, Acquisitive Reorganizations: The Other Method of Buying and Selling a Corporate Business, 27 U. Fla. L. Rev. 933, 936-939 (1975); Dailey, The Votmg Stock Requirement of B and C Reorganizations, 20 Tax L. Rev. 725 (1971). How long before and after the acquisition Target shareholders must hold their stock is unclear. See Senate Finance Staff, Final Report, supra at 40.

"Creeping acquisitions," i.e., multi-stage acquisitions of Target stock by a purchasing corporation are possible in "A," forward triangular "A," and "B" reorganization, but such piecemeal acquisitions pose separate problems in "C" and intense problems in reverse triangular "A" reorganizations. See generally Levin & Bowen, Taxable and Tax-Free Two-Step Acquisitions and Minority Squatters, 33 Tax L. Rev. 825 (1978); MacLean, Creepmg Acquisitions, 21 Tax L. Rev. 345 (1966). Unwanted Target assets may be disposed of by Target prior to an acquirer merger (including through a tax-free division under section 355), see N.Y. State Bar Ass'n, Report on the


A failed second step merger may also disqualify the initial section 338(a) transaction. Reg. section 1.368-2(c)(2).

Subject to the common-law shareholder continuity of interest test, Target shareholder dissenters to Target's acquisition may be paid with cash from purchasing corporation or Target in a "A" or forward triangular "A" (although payments by Target in a forward triangular "A" may cause Target to fail the "substantially all" test of Treas. Reg. section 1.368-2(c)(1)(2)). Dissenters may be paid by Target in a "B," but never by purchasing corporation. Dissenters in a "C" theoretically may be paid cash by purchasing corporation, up to 20 percent of the total consideration, section 368(b)(2)(B), but the reality of having to count Target liabilities against the 20 percent boot rule is that rules for Treas. Reg. section 1.368-2(c)(2) Target may pay dissenters subject to the substantially all requirement in a reverse triangular "A." Under "current" NOL rules (i.e., the 1976 rules applicable to at least 1985) patently inconsistent rules apply with "B" and triangular "A" with careful planning avoiding completely the limitations, subject then of course to the consolidated return rules. See n.25, infra, for House's proposed revision of section 382.

Also, survival of Target as an entity is possible only in a "B," reverse triangular "A," and an "A" reorganization in which purchasing corporation disappears. The rules on the tax effect of assumption of Target's liabilities by purchasing corporation, as well as who can pay Target's reorganization expenses, appear hopelessly unprincipled and confused under current law. See Freling & Martin, Current Reorganization Techniques, 55 Taxes 852, 860-861 (1977); Dailey, supra at 754-58; Macon, Factors to a Tax-Free Acquisition Reorganization, Rights to Acquire Stock, Subsequent Mergers of Acquiring Corporation: Collateral Arrangements, 32 N. Y. Inst. on Fed. Tax. 549, 554-557 (1974). Surely, any reform eliminating these complexities is preferable, even if some terms are left for future developments.

"Leverage" is shorthand for debt-financing.

The current combination of ITC, depreciable basis, and acceleration of depreciation for three-year and five-year ACRS property was... designed to yield tax benefits equal to those produced by expensing capital costs or exempting capital income, since ACRS property was the new Target corporation is a new taxpayer with new " continuity business enterprise test at the time of the acquisition." Warren, Accelerated Capital Recovery, Debt, and Tax Arbitrage, 38 Tax Law. 549, 554 (1985); see Steines, Income Tax Allowances for Cost Recovery. 40 Tax L. Rev. 483, 537-539 (1985). This effect coupled with leverage may be viewed as the equivalent of combining interest deductibility with tax-exempt income, i.e., tax "arbitrage." Warren, supra, at 563.

Section 338 clearly precludes Target from using any of the affiliated group's NOL's to offset Target's "recapture income" arising from the deemed section 337 sale. See H. R. Rep. No. 97-756, 97th Cong. 2d Sess. 537, 539 (1982) (Comm. on Ways & Means, Treas. Reg. section 1.338-2(c)(2) supra at 269-269). Commentators initially feared that Target might not be able to use its own NOL's to offset its "recapture income" since new Target corporation is a new taxpayer with a clean slate. See Ginsburg, 38 Tax L. Rev. supra at 272; Ferguson & Smith, A Problematic Tax-Free "Recapitulation": Taxable Cash Consideration in "A" Corporations, 17 N. Y. Inst. on Fed. Tax. (Part I) 12-1, 12-53 (1984). The temporary regulations fortunately provide that Target's attributes, including NOLs, may be carried over to, and carried back from, the deemed sale return, which is deemed to occur in a separate taxable year. Temp. Reg. section 1.338-1(f)(3)(iv). Moreover, section 352(a) (as "currently" in effect) does not apply solely because of the operation of section 338 to bar a NOL carryover to old Target's final return. Temp. Reg. section 1.338-47(k)(3) Q & A No. 1. However, the temporary regulations in determining

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deemed to equal such liabilities. Proposed section 336(e)(1) in effect thus codifies Tufts v. Comm’r, 461 U.S. 300 (1983), in this context. Section 311(c) already provided a roughly similar rule as to redemptions and dividends. Then proposed sections 337 (sales of target assets pursuant to a liquidation) and 338 (sales of target stock with cash basis election by parent) are proposed (as to Target’s assets) provide for nonrecognition by Target corporation to the extent gain or loss would not be recognized under proposed section 336, if Target corporation had distributed all of its assets in liquidation. Proposed sections 337(a) and 338(c).

Proposed section 336(c)(4) incorporates the slightly modified from present law new section 311(c)(1) definition of “qualified stock,” viz., a noncorporate shareholder owning 10 percent or more of Target’s stock throughout a five-year look-back period (or Target’s existence if shorter). Proposed section 336(c)(5)’s definition of “qualified active business corporation” parallels one of the three alternative section 311 active business definitions (section 311(e)(2)): a five-year actively conducted business not acquired in a cost-basis transaction within a five-year look-back period and no “drop down” (by section 351 or contribution to capital) of substantial nonbusiness assets during such period. Additionally, unlike section 311, the limited proposed section 336 shield does not extend to (1) ordinary gain or losses, (2) a short term capital gain or loss, or (3) installation obligations generated by the sale of such assets. Proposed section 336(c)(2).

Since a major impetus for repeal of the General Utilities principle codified in present sections 336-338 is that it allows “assets to take a stepped-up basis without the imposition of a corporate-level tax,” Corporate Tax Reform Proposals, supra at 46, not surprisingly exceptions to the new general corporate level recognition rule are provided where the distributee has a carryover, rather than cost, basis, viz., (a) a section 332 liquidation of an at least 80 percent owned subsidiary by its corporate parent and (b) either an acquisitive reorganization under section 368 or divisive reorganization under section 355. See Proposed sections 336(b)(1) and (d); H.R. Rep. No. 99-426, 99th Cong. 1st Sess. 283, 285 (1985).

H.R. Rep. No. 99-426, supra at 285 (“[T]he committee does not intend to supersede other existing statutory rules and judicial doctrines (including, but not limited to, section 1245 and section 1250 recapture, the tax benefit doctrine, and the assignment of income doctrine).”) See Corporate Tax Reform Proposals, supra at 40-44, for a concise discussion of these and other paradigms of the present law general rule of nonrecognition in this area. For a laundry list of “statutory recapture” items see Ferguson & Silver, supra at 1-30 n. 76.

Proposed section 336(c)(2).

H.R Rep No. 99-426, supra at 284. The quoted passage is technically inaccurate in that property held primarily for sale, but not in the ordinary course of business, enjoys capital gains treatment. See, e.g., Thomas v. Comm’n, 254 F.2d 233, 236 (5th Cir. 1958); Howell v. Comm’r, 57 T.C. 546, 555 (1972).

Corporate Tax Reform Proposals, supra at 51.


See authorities cited in notes 37 and 38, supra. On a theoretical basis a continued corporate-level exemption for long-term capital assets merits serious consideration, basically for the same limitation of “double taxation” to operating profits. Id. But given the realities that (1) virtually no corporate level tax is currently actually levied on business operations (due to ACRS, leverage, ITC, compensation to principals in closely held
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corporations, etc.) and (2) the cost-basis liquidation provisions appear most frequently utilized to transfer a business with a single (shareholder) level capital gain tax, (plus the recapture income toll charge at the Target corporation level) the real world issue is not double taxation, but rather whether there will be a full tax at least one time. Compare Corporate Tax Reform Proposals, supra at 17-18, 49. Even if the closely held corpora-
tion is taxed on its earnings, the ridiculously low graduated bottom corporate rates in comparison with the entrepreneur's usually high bracket on any additional income coupled with the opportunity to invest the business' net profits after minimal or no taxation in capital or section 1231 assets (e.g., plant and land) even most of the corporate rate, the frequently raised argument that absent the General Utilities exemption for long-term capital and section 1231 assets, the entrepreneur who incorporated her or his farm or corner drugstore would be worse off than if he or she had operated as a sole proprietor or in a partnership. Why do you think he or she incorporated in the first place? The Senate Finance Staff said it well:

Although the General Utilities doctrine, which exempts corporate level gain from tax on liquidation or current distribution, is often thought of as a relief provision from the double tax system, in fact present law often leaves taxpayers better off on balance, than they would be if no corporate level tax were imposed. Thus, if confronted by a choice between the current system and a repeal of the corporate level tax, such taxpayers should choose current law. Senate Finance Staff Preliminary Report, supra at 88.

Sure enough, at least their tax advisers so chose (apparently for similar reasons). See Sheppard, General Utilities Repeal: Of Ostriches and Motherhood, 30 Tax Notes 691 (February 10, 1986). The tax advantages of the "inside" corporate tax shelter (of low graduated rates) are widely proclaimed in the tax literature. See generally Watkins & Jacobs, Closely Held Businesses: Tax Planning after ERTA, 13 Tax Adviser 516 (1982); Fink, Is There Still Life For Professional Corporations?, 9 Rev. of Tax'n of Indiv'ds 123, 128 (1985); Wood, Incorporation of Professionals Still Offers Benefits, 64 Taxes 38, 41 (1986). To the extent the above pattern persists after this round of tax reform, absolute repeal of General Utilities would closer approximate at least one full tax.

The Senate Finance Staff also argued that because no rationale exists for making entrepreneurs better off than they would be under a tax system without a corporate level tax, General Utilities should be repealed. Senate Finance Staff, Preliminary Report, supra at 88. Treasury's single corporate tax rate two percentage points below the top individual rate would have ended the above abuse. Given that this approach does not appear to be politically feasible, my colleague Charles Koch argues for repeal of the corporate tax in general, not on the classic ground that corporations don't actually pay the double tax (i.e., they pass it on to consumers or shareholders), but rather on the above observation that owners of close corporations at least must be better off manipulating the combination of corporate and personal income tax. The nontax advantages of incorporation are dubious at best. See generally Garlin, Partnership vs Corporation: Non-Tax Shelter Business Enterprise, 54 N.C. L. Rev. 1 (1975); Sheppard, supra at 17-18; Kessler & Yorio, Choosing the Appropriate Form for the Small Business, 1 Corp. L. Rev. 291, 297 (1978). At least for the lower levels of corporate income, a mandatory flow-through of income and loss to shareholders appears preferable to the current use of the closely held corporation as a tax shelter.

If the H.R. 3383 shift of $150 billion in tax burden from individuals to corporations is effective, it will largely be to the public corporations. They will pay an inside tax. The close corporation can continue to use the inside low rate corporate shelter. Yet the continued General Utilities exemption will be available only to the likely abuse candidates, the close corporation. "Principle" and politics here aren't even strange bedfellows; they sleep in different towns.

4See Wolfman, supra at 87; Cf. Johnson, supra. But see Beck, supra at 862.

"Corn Products has been extensively cited and applied, but only a few of these subsequent cases involve repetitive, everyday transactions like that evoked the Corn Products doctrine. " 2 Bittker, Federal Taxation of Income, Estates and Gifts, para. 51.10 3 (1981); accord, Campbell Taggart, Inc. v. United States, 744 F.2d 442, 450 (5th Cir. 1984). Other commentators note the inventory-like aspects of the original decision. Note, The Impact of Corn Products: Twenty-Three Years Later, 12 Suffolk U. L. Rev. 669, 674, 677 (1979).
"See W.W. Windle Co v. Comm'r, 65 T.C. 694, 712-713 (1976), appeal dismissed, 550 F.2d 43 (1st Cir.), cert. denied, 431 U.S. 966 (1977). See generally Comment, The Unpleasant Taste of Corn Products, 53 So. Cal. L. Rev. 311 (1979); LeMaster, Corporate Securities Losses: Is Corn Products Now Irrelevant?, 3 J. Corp. Tax. 141 (1976). If, as this article advocates below, Corn Products' application to sections 336-338 is limited to assets as to which Target engages in repetitive, everyday transactions, this issue of the proper standard for testing motivation for stock acquisitions largely becomes moot since the reported cases have not involved repetitive acquisitions and dispositions of stock in order to obtain a source of supply, etc.
"503 U.S.S. at 50.
"Campbell Taggart, Inc. v. United States, supra at 456 and 457 n. 41 analyzing authorities cited thereat (rejecting thesis that "necessary and integral act" is a separate element in the Corn Products doctrine).
"551 F.2d 821, 826 (Cl. Ct. 1977).
"The taxpayer in Norton may have been relying on the traditional "liquidation of investment" avenue to capital gains, viz., in liquidating or selling an investment, typically land, the taxpayer may take reasonable steps to improve the property in order to make it readily salable, or even make multiple sales from a block acquired in a single transaction without assuming the mantle of dealer. See, e.g., Aylng v. Comm'r, 32 T.C. 704, 709 (1959); accord, Chandler v. United States, 226 F.2d 403 (7th Cir. 1955). Some decisions would apply this doctrine to section 1231 assets as well. See Fishing Tools, Inc v. Uary, 232 F. Supp. 400, 402 (E.D. La. 1964). Property viewed, any such avenue is very narrow. See Biedenbahr Realty Co. v. United States, 526 F.2d 409, 421-422 (5th Cir.), cert. denied, 429 U.S. 819 (1976); Cf. Ehman v. Comm'r, 120 F.2d 607, 610 (9th Cir.), cert. denied, 314 U.S. 668 (1941).

Some commentators would apply special rules to liquidating sales of section 1231 assets pursuant to a complete liquidation under section 337. See Rabinovitz & Shashy, Properties of Property: Indigestion From Corn Products, 27 U. Fla. L. Rev. 964, 973, 981, 983, 984 (1976). Compare, Howe, Transfers of Technology: The Appropriateness of Capital Gain Treatment, 64 Taxes 3, 9 (1986). Some cases also would bestow capital gains upon a bulk sale of inventory or property otherwise held primarily for sale to customers in the ordinary course of business. See Int'l Shoe Mach. Corp. v. United States, 491 F.2d 157, 160 (1st Cir.) (dictum), cert. denied, 419 U.S. 834 (1974). A perhaps analogous theory is the "end-of-the-cycle" rule purportedly explaining (section 1231) capital gains treatment afforded "the rehabilitation of an obsolete factory, old rental cars, or lost or damaged rental tools." Hollywood Baseball Ass'n v. Comm'r, 423 F.2d 494, 502 (9th Cir. 1970) (dictum), see Int'l Shoe Mach. Corp. v. United States, supra at 160 (dictum). The discussion in text assumes that the proper focus is not whether the property is sold in bulk in a liquidation, but rather whether the property is customarily sold by the taxpayer in the ordinary course of its business.
"351 F.2d at 827 n.18.
"The fire pot," "hot pot," and five-year lookback recapture of section 1231, and sections 1245-1250 depreciation recapture are discussed in 2 Bittker, Federal Taxation of Income, Estates and Gifts, para. 54.1 (1981). These rules eliminate most capital gain from section 1231 transactions. Cf. Rabinovitz & Shashy, supra at 470. H.R. 3383 would eliminate preferential income tax treatment of capital assets and section 1231 assets for corporate

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taxpayers by eliminating the current alternate maximum 28 percent rate, see H.R. 3838, supra at section 302, while retaining those categories of income or loss. In effect this just increases the stakes in revised section 339-338 transactions for Target continuing ordinary corporate-level long-term capital income: recognition at ordinary rates v exemption.

337 Of y consideration of this argument is superficial.

51 When the Tax Court earlier had applied the Corn Products doctrine to a termination of business sale of timber cutting contracts, on the grounds that they had been acquired in the ordinary course of the taxpayer's business. J.R. Simplot Co. v. Comm'r, 26 T.C. M. 488, 492 (1967).


307 F.2d 897, 90 (5th Cir. 1962). ("By no stretch of the imagination can the routine day-to-day sale of corn futures be equated with an isolated sale of an agency contract.") See also Oliva v. Comm'r, 77 T.C. 524, 545 (1981), appeal dismissed, (1st Cir. 1982) (sale of inventions by business of machining metal parts was not an accepted and predictable part of such business, but instead was isolated, nonrecurring and, hence, entitled to capital gains). The Fifth Circuit historically has staked out the position that a "single payment for the transfer of capital income is not a sale in the ordinary course of business. See note 35 supra.

338 So Campbell Taggart, Inc. v. United States, supra at 451-52; Arkansas Best Corp. v. Comm'r, 83 T.C. 640, 656 (1984). See generally Javaras, Corporate Capital Gains and Losses—The Corn Products Doctrine, 52 Taxes 770, 772 (1974). The ramifications on the substitute for deductible business expense line of cases of the origin-of-the-claim doctrine, see Lee & Murphy, Capital Expenditures: A Result in Search of a Rationale, 15 U. Richmond L. Rev. 473, 484-99, 523-24 (1981), and the cutback on business purpose overrides as to capital expenditures (e.g., the overturning of Five Star Mfg. Co. v. Comm'r, 355 F.2d 724 (5th Cir. 1966), by section 314 of H.R. 3838, see H.R. Rep. No. 99-4265, supra at 244-49) are yet to be fully manifested.

339 Some commentators would interpret "integral" as meaning the sales, rather than the use of the asset, need be integral to the taxpayer's mainstream business for the Corn Products doctrine to apply. See Case Note, 24 Vand. L Rev. supra at 188-189; Heyde, supra at 11. This would usually be the case if sales were recurring (except, perhaps, under the former Court of Claims approach, see note 55, supra and accompanying text), but such an approach could easily turn into a substitute for ordinary deduction (see note 70 supra).

340 See, e.g., Javaras, supra; Rabinovitz & Shashy, supra. Although beyond the scope of this article, more of the reported decisions involving otherwise capital or section 1231 assets not held primarily for sale probably could be reconciled under a model focusing on the source of the income or loss, rather than on the importance of the taxpayer's motives. Gain arising from market appreciation would be capital unless the taxpayer regularly engaged in the transactions, in which case the ordinary source of business income principle would override. Conversely, losses arising from business use would be ordinary. Of course, precisely this capital gain/ordinary loss result bothered the Tax Court so in W.W. Windle Co. v. Comm'r, supra, and probably disturbed other tribunals as well. See Wright v. Comm'r, 756 F.2d 1039 (4th Cir. 1985).

341 Simplification denotes to practitioners attainment of a reasonably certain conclusion by diligent and expert research without expenditure of excessive research time. Committee on Tax Policy, New York State Bar Ass'n, Tax Section, A Report on Complexity and the Income Tax, 27 Tax L. Rev. 325, 327 (1972).


344 See Bernstein, supra at 1107-09.

345 See id. at 1112.


347 See Note 54, supra.


348 Confusingly, the Tax Court earlier had applied the Corn Products doctrine to a termination of business sale of timber cutting contracts, on the grounds that they had been acquired in the ordinary course of the taxpayer's business. J.R. Simplot Co. v. Comm'r, 26 T.C. M. 488, 492 (1967).


307 F.2d 897, 90 (5th Cir. 1962). ("By no stretch of the imagination can the routine day-to-day sale of corn futures be equated with an isolated sale of an agency contract.") See also Oliva v. Comm'r, 77 T.C. 524, 545 (1981), appeal dismissed, (1st
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Stewart Trust v. Comm'r, 63 T.C. 682 (1975); Rev. Rul. 77-190, 1977-1 C.B. 88.

The "parity" issue prior to TEFRA arose most frequently in the contrast between Target corporation level treatment in Target stock and Target asset sales. See generally Bonovitz, Problems in Achieving Parity in Tax Treatment Under Sections 337 and 334(b)(2), 34 N.Y.U. Inst. on Fed. Tax 57, 60-75 (1976) Target asset sales pursuant to a complete liquidation under section 331 triggered section 337 if its timing requirements were met. Prior to section 338 (enacted in 1982), the acquiring or "purchasing corporation" could obtain a "cost-basis" in Target's assets following a timely qualified purchase of "control" of Target's stock only by "timely" liquidating Target under section 332, thereby triggering the cost-basis adjustments of now repealed section 334(b)(2). The liquidation of Target triggered application of section 336 at the Target level and, thus, the issue of parity between stock and asset sales. The goal of parity here has come ever closer with the enactment and successive amendments of existing section 338, although total parity has not yet been reached; see Ginburg, 36 Tax L. Rev. supra at 255-256, 289, 295-297 (1983); Ferguson & Stiver, supra, at 12-35-12-39, 12-48-12-56. Neither, unfortunately, would H.R. 3838 reach perfect parity, see, e.g., proposed section 337(b)(3)(A).

423 F.2d at 498.

Id. at 500.

Stewart Trust v. Comm'r, supra at 692 n.4.

See, e.g., W.W. Windle Co. v. Comm'r, supra at 710-711 (whether proper test in mixed business-investment context is (a) "predominant" business motivation or investment motivation or (b) business motivation with no substantial investment motivation "has seemingly so troubled the Court of Claims"); accord, Miller v. Comm'r, 70 T.C. 448, 455 n.7 (1978). The actual conflict between the judges then on the Court of Claims appears to have centered more on the "permanency" doctrine. In Dearborn Co. v. United States, 444 F.2d 1145, 1148 (Cl. Ct. 1971), the Court of Claims found Corn Products inapplicable to a sale at a loss of corporate stock where the taxpayer-parent corporation manifested a substantial investment intent (to continue permanently the subsidiary's business, to receive dividends, to earn management fees from services provided to the subsidiary, and to share in capital appreciation), even though the parent had business reasons (source of supply and production facilities) which were more important: 444 F.2d 1148 and 1166. Agway, Inc. v. United States, 524 F.2d 1194, 1261 (Cl. Ct. 1975), in a three-judge panel (agreeing on this point) opinion, confirmed that Corn Products applied to a purchase of corporate stock to obtain a source of supply only where there is no substantial investment intent. But in Union Pac. R.R. v. United States, 524 F.2d 1343 (Cl. Ct. 1975), decided the same day as Agway, the majority of the en banc Court of Claims read the traditional source of supply stock acquisition cases (without citing Dearborn) for the rule that corporate stock which is held for business purposes, that is, one intimately related to the taxpayer's normal source of business income, is not a capital asset. Stock not so related, and held for investment purposes, is a capital asset. 524 F.2d at 1358.

On the facts before it, the Union Pac. majority found that the taxpayer had acquired the stock of subsidiary railroad companies (previously owned by it but sold in a distress workout) for an operating business purpose (to obtain connecting railroads and run as a unified business) and not to make an investment 524 F.2d at 1359.

The author of the Agway opinion (Judge Nicholls) dissented on this point, reasoning that the subsidiaries were intended to be a permanent addition to the taxpayer's assets 524 F.2d 1368. Indeed, he would virtually restrict Corn Products as to corporate stock to a "temporary expedience" where the stock is acquired "as an expedient to tide the buyer over a period of shortage and high prices of some material vitally needed in its business [and with] an intention to dispose of the acquisition when the shortage ended, which was carried out with reasonable promptness." Waterman, Largen & Co. v. United States, 419 F.2d 845, 859 (Cl. Ct. 1969) (Nicholls, J., dissenting). And, conversely under this view, a permanent addition of a subsidiary to a corporation's capital would not enjoy Corn Products' ordinary loss status. Union Pac. R.R. v. United States, supra at 1387, 1388 (Nicholls, J., dissenting); Waterman, Largen & Co. v. United States, supra at 855 (Davis, J., dissenting) ("I note, in addition, that I am not yet convinced that the standard of investment or business purpose is appropriate for this type of case in which a permanent acquisition of stock is made.").

At the other extreme, the Fifth Circuit in Schlumberger Tech. Corp. v. United States, 443 F.2d 1115, 1121 (5th Cir. 1971), rejected a "temporary business expedient" requirement. Instead it viewed such "rule" as merely a factual element that, under appropriate circumstances, justifies a taxpayer's acquisition of what would otherwise be a capital asset, and, in turn, requires the acquiring taxpayer, if he desires to avoid capital asset treatment of the acquisition, to dispose of the asset once the temporary condition being remedied has terminated and the nature of the asset has changed from business purpose to investment purpose. Id.

The Fifth Circuit in Campbell Taggart, supra at 457, similarly viewed the "necessary and integral act" test, which it believed many courts apparently considered synonymous with business purpose, as merely the previously rejected as controlling "degree of business needed," phrased slightly differently and hence only a factor in determining intent. See Rabinovitz & Shasy, supra at 981 (but would not apply to doctrine to a bulk sale of Target's assets); Note, Applicability of the Corn Products Doctrine to Dispositions of Section 1231 Property Pursuant to a Section 337 Liquidation, 51 B.U.L. Rev. 120, 131 (1971).


See Note 54 supra. The government's litigating stance in Norton indicates this is not the case. Even if it were, taxpayers might still raise these arguments where to their advantage as witnessed by Becker Warburg Paribas.

See W.W. Windle Co. v. Comm'r, supra at 713.

For instance, even after Windle, had clearly articulated the "Heads-I-win, Tails-you-lose" features of the Corn Products doctrine and at the same time that the Justice Department clearly hoped to limit the doctrine to inventory-like situations and eschew motive analysis, see Brief for Appellee at 44-48, 52, W. Windle Co. v. Comm'r, 550 F.2d 49 (1st Cir.), dismissing appeal, cert. denied, 431 U.S. 966 (1977), the Service nevertheless short-sightedly attempted in Bell Fibre Prod's Corp. v. Comm'r, 36 CCH T.C. M. 182, 190 (1977), appeal dismissed F.2d (7th Cir. 1977), to repudiate Windle, apparently because the taxpayer at bar had realized a gain, rather than a loss.

See note 78 supra for prior law.

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