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## Federal Taxation - Section 482, Allocation of Income and Deductions Among Taxpayers - What is Control? B. Forman & Co. v. Commissioner, 453 F.2d 1144 (2d Cir. 1972)

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*Williams* does not deviate from these principles.<sup>53</sup> The court demonstrates that the continued photocopying of articles from the plaintiff's journals could result in their ultimate demise,<sup>54</sup> an event which would retard the progress of science. In the absence of any forthcoming legislation<sup>55</sup> or voluntary agreement between copyright owners and photocopyers, it is hoped that courts confronted with the large scale photocopying of copyrighted materials will be persuaded to follow *Williams* in closely scrutinizing the financial effects of massive reproduction on the publication involved.

**Federal Taxation**—SECTION 482, ALLOCATION OF INCOME AND DEDUCTIONS AMONG TAXPAYERS—WHAT IS CONTROL? *B. Forman & Co. v. Commissioner*, 453 F.2d 1144 (2d Cir. 1972).

B. Forman & Co. and McCurdy & Co. operate retail department stores. In 1958, they caused Midtown to be formed.<sup>1</sup> Each company retained 50 percent of Midtown's common stock.<sup>2</sup> Midtown was to own and operate a shopping center from which Forman and McCurdy would lease space for their respective operations.<sup>3</sup> During the years 1965, 1966, and 1967 Midtown borrowed \$1 million from each Forman and Mc-

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304 (E.D. Pa. 1938); Note, *supra* note 4, at 544. See *Sampson & Murdock Co. v. Seaver-Radford Co.*, 140 F. 539, 541 (1st Cir. 1905) (dictum); *Thompson v. Gernsback*, 94 F. Supp. 453, 454 (S.D.N.Y. 1950).

53. As has been pointed out:

Multiple copying for limited circulation or for gratuitous or scholarly use is an infringement where there is the finding that the copies may be a substitute for, and therefore in competition with, the copyrighted material.

Note, *supra* note 37, at 183.

54. Project, *supra* note 15, at 955, 957.

55. During the infancy of radio broadcasting the court in *Jerome H. Remick & Co. v. American Auto. Accessories, Co.*, 5 F.2d 411 (6th Cir. 1925), when forced to construe a copyright statute which made no provision for the broadcasting of copyrighted musical compositions, observed:

[B]ut, until Congress shall have specifically determined the relative rights of the parties, we can but decide whether and to what extent statutes covering the subject-matter generally, but enacted without anticipation of such radical changes in the method of reproduction, are, fairly construed, applicable to the situation.

*Id.* at 411-12.

1. *B. Forman & Co. v. Commissioner*, 453 F.2d 1144, 1147 (2d Cir. 1972).

2. *Id.* at 1148.

3. *Id.*

Curdy, executing non-interest bearing notes.<sup>4</sup> The Commissioner of Internal Revenue imputed interest<sup>5</sup> on each note at the rate of five percent per annum pursuant to section 482<sup>6</sup> of the Internal Revenue Code, and assessed deficiencies against Forman and McCurdy. The Tax Court overruled the Commissioner,<sup>7</sup> holding that neither taxpayer had control of Midtown sufficient to satisfy section 482. The circuit court reversed,<sup>8</sup> holding that where two corporations act in concert in forming a third corporation, each taxpayer has sufficient control to come within the ambit of section 482.

The Commissioner's action represented a departure from the 1945 decision of *Lake Erie and Pittsburgh Ry. v. Commissioner*<sup>9</sup> which held, on similar facts, that the taxpayers did not have control within the meaning of section 482. The Commissioner originally acquiesced<sup>10</sup> in that decision but in 1965 substituted nonacquiescence.<sup>11</sup> This change of attitude was explained<sup>12</sup> by describing the *Lake Erie* decision as a narrow construction of the language of section 482 which ignored the basic purpose of the section by an interpretation wholly inconsistent with the broad language contained therein.

This comment will analyze section 482 as it relates to control. More specifically, it will attempt to determine which decision best characterizes the jointly owned subsidiary in light of the language and purpose of section 482.

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4. *Id.*

5. *Id.* at 1149. The Commissioner relied on Treas. Reg. § 1.482-2(a) (1968), in computing interest.

6. Section 482 reads as follows:

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

INT. REV. CODE OF 1954, § 482.

7. *B. Forman & Co. v. Commissioner*, 54 T.C. 912 (1970), *aff'd in part*, 453 F.2d 1144 (2d Cir. 1972).

8. *B. Forman & Co. v. Commissioner*, 453 F.2d 1144, 1155 (2d Cir. 1972).

9. 5 T.C. 558 (1945).

10. 1945 CUM. BULL. 5.

11. 1965-1 CUM. BULL. 5.

12. Rev. Rul. 65-142, 1965-1 CUM. BULL. 233.

### *Section 482 Scope Problems*

Some writers<sup>13</sup> have insisted that section 482 is merely redundant and adds nothing to the existing statutory<sup>14</sup> and judicial remedies.<sup>15</sup> In opposition to these observations is the fact that section 482 allows the Commissioner to apply a consistent policy in the area of arbitrary shifting of income. Section 61<sup>16</sup> is particularly effective in situations where one business entity is without economic substance—a sham. Section 482 presupposes two valid business entities.<sup>17</sup> Section 269<sup>18</sup> requires the acquisition of a business with the primary purpose as tax avoidance. Section 482 will apply without the necessity of an acquisition and without regard to tax motive.<sup>19</sup> These examples indicate the helpful nature of section 482 in dealing with tax avoidance situations.

There is an additional problem—what are the consequences when application of section 482 directly contradicts the specific language of another section?<sup>20</sup> Case law<sup>21</sup> and legal writers<sup>22</sup> seem to agree that

13. J. CHOMMIE, *FEDERAL INCOME TAXATION* 496 (1968); Hewitt, *Section 482—Allocation of Income Deductions Among Related Taxpayers*, N.Y.U. 20TH INST. ON FED. TAX. 463 (1962).

14. INT. REV. CODE OF 1954, §§ 61, 267, 269, 382, 1551.

15. The courts have developed common law concepts in dealing with situations where active tax avoidance is present. These concepts include: (1) sham, (2) step transactions, (3) business purpose doctrine, (4) net economic effect doctrine, and (5) assignment of income. Hewitt, *supra* note 13, at 490. See also *J. R. Land Co. v. Commissioner*, 361 F.2d 607 (4th Cir. 1966); *Phillip Bros. Chems., Inc.*, 52 T.C. 240 (1969), *aff'd*, 435 F.2d 53 (2d Cir. 1970). But see *United States v. Ross*, 251 F. Supp. 175 (S.D. N.Y.), *aff'd*, 368 F.2d 455 (2d Cir. 1966); *Siegel*, 45 T.C. 566 (1966), *acquiesced in* 1966-1 CUM. BULL. 7; *Chelsea Prods., Inc.*, 16 T.C. 840 (1951), *aff'd*, 197 F.2d 620 (3d Cir. 1952).

16. INT. REV. CODE OF 1954, § 61.

17. *Advance Mach. Exch., Inc. v. Commissioner*, 196 F.2d 1006 (2d Cir.) (dictum), *cert. denied*, 344 U.S. 835 (1952). *Contra*, *Alpha Tank & Sheet Metal Mfg. Co. v. United States*, 116 F. Supp. 721 (Ct. Cl. 1953) (dictum).

18. INT. REV. CODE OF 1954, § 269.

19. Treas. Reg. § 1.482-1(c) which states in part:

In determining the true taxable income of a controlled taxpayer, the district director is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits or allowances. The authority to determine taxable income extends to *any case* in which either by *inadvertance* or design, the taxable income . . . is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer. (Emphasis supplied).

20. See, e.g., INT. REV. CODE OF 1954, § 351 (non-recognition of gain or loss in certain situations).

where a strict application of the Code would result in a distortion of income, section 482 should be applied to correct that distortion. This analysis would seem to conform to legislative purpose of the section—accurate reflection of the income of each taxpayer.<sup>23</sup> One writer<sup>24</sup> has advocated that section 482 should be limited in this regard to cases involving active tax avoidance and transactions completely devoid of economic reality. It is clear that the Commissioner is not willing to limit section 482 in this manner, and it doubtful that the courts will so interpret the statute in light of the recent cases broadening the scope of section 482.

### *Section 482 Requirements*

Section 482 requires that three<sup>25</sup> elements coexist before a reallocation can be made: (1) two or more organizations, (2) owned or controlled by the same interest, and (3) a finding that reallocation is necessary in order to prevent evasion of taxes or to reflect clearly the income of the taxpayers. It was the intent of Congress<sup>26</sup> to give "organizations" the broadest possible meaning. The courts have generally given effect to that intent in a variety of different situations.<sup>27</sup> It is safe to conclude that when two entities arbitrarily shift income among themselves, they will come under the scrutiny of section 482 regardless of the business form utilized.<sup>28</sup>

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21. *Rooney v. United States*, 305 F.2d 681 (9th Cir. 1962); *National Sec. Corp. v. Commissioner*, 137 F.2d 600, 603 (3d Cir.), *cert. denied*, 320 U.S. 794 (1943).

22. Cooper, *Section 45*, 4 TAX L. REV. 131, 156 (1949); Plumb & Kapp, *Reallocation of Income and Deductions Under Section 482*, 41 TAXES 808, 827 (1963).

23. S. REP. No. 627, 78th Cong., 1st Sess. 58-61 (1943). See also Treas. Reg. § 1.482-1(d)(5) which reads as follows: "Section 482 may, when necessary to prevent the avoidance of taxes or to clearly reflect income, be applied in circumstances described in sections of the Code (such as section 351) providing for non-recognition of gain or loss."

24. Aland, *Section 482: 1971 Version*, 49 TAXES 815, 841 (1971).

25. See Plumb & Kapp, *supra* note 22, at 810.

26. H.R. REP. No. 704, 73d Cong., 2d Sess. 24 (1933); S. REP. No. 558, 73d Cong., 2d Sess. 29 (1933).

27. The section has been applied in situations involving two corporations, *Commissioner v. Chelsea Prods., Inc.*, 197 F.2d 620 (3d Cir. 1952); a partnership and a corporation, *Grenada Indus., Inc.*, 17 T.C. 231 (1951), *acquiesced in* 1952-2 CUM. BULL. 2, *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953); a corporation and sole proprietorship, *Hall v. Commissioner*, 294 F.2d 82 (5th Cir. 1961); a corporation and an exempt foundation, *Stevens Bros. & Miller Hutchinson Co.*, 24 T.C. 953 (1955), *acquiesced in* 1956-1 CUM. BULL. 5.

28. Treas. Reg. § 1.482-1(a)(1) which defines organization to "include any organization of any kind, whether it be a sole partnership, a partnership, a trust, an estate, an

The nature and definition of control will be discussed extensively in a later section, but it should be emphasized that the presence of control alone is not sufficient for the application of section 482. It is only when this control is present along with some distortion of income that section 482 is activated.

The transaction between the two controlled entities must result either in an evasion of taxes or in a distortion of income.<sup>29</sup> Originally, it was thought that some intentional tax avoidance was necessary, but later cases<sup>30</sup> indicated that completely inadvertent action could bring the transaction under the scope of section 482. In *Ballentine Motor Company*,<sup>31</sup> the court suggests that the Commissioner would have greater latitude when dealing with a situation where there is a complete lack of business purpose.

Procedurally the Commissioner has the advantage. His determination will "be set aside only if it is shown to be arbitrary and capricious, and the taxpayer has the burden of proving it so."<sup>32</sup> Because of this ad-

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association, or a corporation . . . , irrespective of the place where organized, where operated, or where its trade or business is conducted. . . ."

29. Treas. Reg. § 1.482-1(c) which states in part:

In determining the true taxable income of a controlled taxpayer, the district director is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances. The authority to determine true taxable income extends to any case in which by inadvertance or design the taxable income . . . is other than it would have been [if the transactions were of arm's length].

30. *Eli Lilly & Co. v. United States*, 372 F.2d 990 (Ct. Cl. 1967); *Tennessee Life Ins. Co. v. Phinney*, 280 F.2d (5th Cir.), *aff'd*, 364 U.S. 914 (1960); *Simon J. Murphy Co.*, 22 T.C. 1341 (1955), *rev'd*, 231 F.2d 639 (6th Cir. 1956); *Asiatic Petroleum Co. v. Commissioner*, 79 F.2d 234 (2d Cir.), *cert. denied*, 296 U.S. 645 (1935).

31. 39 T.C. 348, *aff'd*, 321 F.2d 796 (4th Cir. 1962). *See also* Aland, *supra* note 24, at 820-27 where the author analyzes three cases dealing with intercompany pricing and concludes, "it seems fair to state that the *Woodward Governor*, *PPG Industries* and *Lufkin Foundry* cases have imposed severe restraints on the Commissioner's power to substitute his judgment under the guise of Section 482 allocation for that of taxpayers in the inter-company pricing area where tax avoidance is not present." *Id.* at 827.

32. *Plumb & Kapp*, *supra* note 22, at 830. *See, e.g.*, *Hall v. Commissioner*, 294 F.2d 82 (5th Cir. 1961); *G.U.R. Co. v. Commissioner*, 117 F.2d 187, 189 (7th Cir. 1941); *Connerly Coal & Inv. Co. v. Commissioner*, 84 F.2d 1018 (7th Cir. 1931); *Seminole Flavor Co.*, 4 T.C. 1215, 1228 (1945); *National Sec. Corp.*, 46 B.T.A. 562, 564 (1942), *aff'd*, 137 F.2d 600, 602 (3d Cir.), *cert denied*, 320 U.S. 794 (1943); *Briggs-Killian Co.*, 40 B.T.A. 895 (1939); *Welworth Realty Co.*, 40 B.T.A. 97 (1939). *See also* *Young & Rubican, Inc. v. United States*, 410 F.2d 1233, 1244 (Ct. Cl. 1969); *Spicer Theatre, Inc.*, 44 T.C. 198, 206 (1964), *aff'd*, 346 F.2d 704 (6th Cir. 1965); *Hamburgers York Rd., Inc.*, 41 T.C. 821, 835 (1964).

vantage, the courts have required the Commissioner to give advance notice, usually in the deficiency notice, that he will rely on section 482.<sup>33</sup>

### *What 482 Does Not Do*

Generally speaking, it is said that section 482 does not allow the Commissioner to do three things: (1) disregard separate business entities if they are being used for a bona fide business purpose,<sup>34</sup> (2) disallow deductions,<sup>35</sup> and (3) create income.<sup>36</sup>

When a business entity may lack a business purpose, an analysis is generally made under section 61. Section 482 assumes the validity of the corporate entities. The second proposition—that section 482 does not disallow deductions—can be somewhat misleading. In the usual section 482 case, the Commissioner will be attempting to allocate to or from a loss corporation. This corporation will not be able to take advantage of the deduction and in this sense the Commissioner has denied a deduction. The third area has spawned a tremendous amount of controversy. The *Tennessee-Arkansas Gravel Co.*<sup>37</sup> case involved the lease of certain equipment to a corporation owned and controlled by the same interests as the taxpayer. The Commissioner attempted to impute rental income to taxpayer without a correlative adjustment to the other corporation. The court held<sup>38</sup> this to be a creation of income not within the power granted by section 482.

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33. See, e.g., *Maxwell Hardware Co. v. Commissioner*, 343 F.2d 713 (9th Cir. 1965); *United States v. First Sec. Bank*, 334 F.2d 120 (9th Cir. 1964); *Commissioner v. Chelsea Prods., Inc.*, 197 F.2d 260 (3d Cir. 1952); *Ross v. Commissioner*, 129 F.2d 310 (5th Cir. 1942).

34. *W. Braun Co. v. Commissioner*, 396 F.2d 264 (2d Cir. 1968).

35. *Hypotheek Land Co. v. Commissioner*, 200 F.2d 390, 396 (9th Cir. 1952); *General Indus. Corp.*, 35 B.T.A. 615, 617 (1937). See also *Hawaiian Trust Co. v. Commissioner*, 291 F.2d 761, 770 (9th Cir. 1961); *A.G. Nelson Paper Co.*, 3 CCH TAX CT. MEM. 914, 916 (1944).

36. *Tennessee-Arkansas Gravel Co. v. Commissioner*, 112 F.2d 508 (6th Cir. 1940). *Smith-Bridgman & Co.*, 16 T.C. 287 (1951), *acquiesced in* 1951-1 CUM. BULL. 3, *explained*, Rev. Rul. 67-79, 1967-1 CUM. BULL. 117. See also *E.C. Laster*, 43 B.T.A. 159, 175-77 (1940), *acquiesced in* 1941-1 CUM. BULL. 7, *aff'd (rev'd) on other grounds*, 128 F.2d 4 (5th Cir. 1942); *Eustice, Tax Problems Arising from Transactions Between Affiliated or Controlled Corporations*, 23 TAX L. REV. 451, 489-92 (1968); *Seieroe & Gerber, Section 482—Still Growing at the Age of 50*, 46 TAXES 893, 902-04 (1968); Note, *Interest-Free Loans and Section 482—Creation of Income?*, 9 WM. & MARY L. REV. 509 (1968).

37. 112 F.2d 508 (6th Cir. 1940).

38. *Id.* at 510.

*Smith-Bridgnian & Co.*<sup>39</sup> was the first case to deal with interest-free loans. Here the subsidiary loaned the parent corporation money without charging interest. Again the Commissioner attempted to impute interest income to the taxpayer. The court rejected the Commissioner's attempt, holding<sup>40</sup> that the Commissioner could not create income. In Revenue Ruling 67-79<sup>41</sup> the Commissioner attempted to explain the case by suggesting that the reason for the decision was his failure to make a correlative adjustment. In *Huber Homes, Inc. v. Commissioner*,<sup>42</sup> the court held that the Commissioner's failure to make the adjustment was a factor to be considered, but not necessarily dispositive of the case. The court in *Forman* acknowledged these cases but stated that:

To the extent that the above cases cited by the taxpayers may be read as holding that no interest can be allocated under 482 under the facts of this case, they are not in accord with economic reality, or with the declared purpose of section 482.<sup>43</sup>

In 1968, the Commissioner promulgated new regulations<sup>44</sup> under section 482 which permit the imputation of interest. The *Forman* court held that these regulations "are entirely consistent with the scope and purpose of § 482"<sup>45</sup> and therefore must be followed. Thus, the Commissioner has seemingly gained added strength in this area, at least in transactions involving interest-free loans.

### *Legislative History*

The legislative history of section 482 will be dealt with only insofar

39. 16 T.C. 287 (1951).

40. *Id.* at 294.

41. 1967-1 CUM. BULL. 117.

42. 55 T.C. 598 (1971).

43. 453 F.2d at 1156.

44. Treas. Reg. §§ 1.482-1(d), 1.482-2, T.D. 6952, 1968-1 CUM. BULL. 218. In 1962 the House passed a Bill that would have set up definitions of arm's length standard, the Senate deleted this provision because:

the objectives of section 6 of the Bill as passed by the House can be accomplished by amendment of the regulations under the present section 482.

Section 482 already contains broad authority to the Secretary of the Treasury or his delegate to allocate income and deductions.

H.R. REP. No. 2508, 87th Cong., 2d Sess. 18-19 (1962). This would add strong support for the *Forman* court's decision on this point.

45. 453 F.2d at 1156.

as it illustrates the Congressional policy considerations in the enactment of that section.<sup>46</sup>

During World War I excess profits taxes were first levied, and as a result corporations began inter-company transactions that resulted in tax losses to government. To combat this situation the Treasury, without benefit of statutory authority, issued regulations that provided for consolidated returns.<sup>47</sup>

In 1918 Congress passed a provision<sup>48</sup> that allowed the Commissioner to consolidate returns of affiliated taxpayers. The provision's effect was described in the Senate Report as one that would "prevent *evasion* which cannot be successfully blocked in any other way."<sup>49</sup> It would seem that at this point the clear intention of Congress was to prevent the deliberate avoidance of taxes through arbitrary transactions between affiliated taxpayers.

In the 1928 Act,<sup>50</sup> the section was changed from a consolidation section to one that allowed the Commissioner to "distribute, apportion, or allocate gross income or deductions."<sup>51</sup> The purpose of this change was to broaden the section in order to provide adequate protection for the government from arbitrary action by the taxpayer that could erode the tax base.<sup>52</sup>

The 1934 Act<sup>53</sup> added the word "organizations" to the statute. The House Report<sup>54</sup> stated that although it was not thought to change the present law, it would remove any ambiguity that might tend to limit the scope of the section. Again it is apparent that Congress was concerned that a narrow reading of the statute would lead to an erosion of the tax base.

In 1944 Congress amended<sup>55</sup> the section to include "gross income, deductions, credits, or allowances." Again the announced intention

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46. The following articles rigorously develop section 482: Cooper, *Section 45*, 45 TAX L. REV. 331 (1949); Eustice, *Tax Problems Arising from Transactions Between Affiliated or Related Corporations*, 23 TAX L. REV. 451, 481-523 (1968); Plumb & Kapp, *Reallocation of Income and Deductions Under Section 482*, 41 TAXES 809 (1963); Seieroe & Gerber, *Section 482—Still Growing at the Age of 50*, 46 TAXES 893 (1968); Sherman, *A Case History of Section 45*, 29 TAXES 13 (1951).

47. Spaeth, *Section 482—Past and Future*, 47 TAXES 45 (1969).

48. Revenue Act of 1918, ch. 18, § 240(a), 40 Stat. 1081.

49. S. REP. NO. 617, 65th Cong., 3d Sess. 8 (1918) (Emphasis supplied).

50. Revenue Act of 1928, ch. 852, § 45, 45 Stat. 806.

51. *Id.*

52. H.R. REP. NO. 2, 70th Cong., 1st Sess. 16 (1928).

53. Revenue Act of 1934, ch. 277, § 45, 48 Stat. 695.

54. H.R. REP. NO. 704, 73d Cong., 2d Sess. 24 (1934).

55. Revenue Act of 1943, ch. 63, § 128(b), 58 Stat. 47.

was to make sure that other section changes would not have the tendency of narrowing the scope of section 45 by implication.<sup>56</sup> The next manifestation of Congressional intent came in 1948 when the House Ways and Means Committee discussed the possibility of limiting the section to deliberate distortions.<sup>57</sup> That provision was never reported out of committee. This refusal to limit the section gives rise to the negative implication that Congress intended the Commissioner to have broad authority in maintaining the tax base. Further, it would seem to imply a ratification of Regulation 86 of 1934 which specifically applied the section to cases of inadvertence.<sup>58</sup>

The 1954 Act enacted section 482 in essentially the same form as section 45 of the 1939 Act and no significant change was contemplated until 1962. The House Bill that year included amendments to section 482 that would have defined arms-length transactions. The Senate<sup>59</sup> deleted that section from the Bill by stating that it was their belief that the present section gave the Commissioner sufficiently broad powers to promulgate regulations in this area. This invitation was accepted by the Commissioner and resulted in the 1968 regulations.<sup>60</sup> Underlying this action is the implicit Congressional understanding of section 482, that the scope of the Commissioner's power is very broad.

As can readily be seen by the foregoing discussion, Congress has consistently approached section 482 with the idea that it was a powerful tool enabling the Commissioner to prevent inter-company transactions that fail to reflect accurately the income of the respective companies; and Congress has consistently rebuked efforts to narrow its provisions. Congress did not intend that a corporation could escape the provisions of section 482 by organizing a joint venture in such a manner that income could be arbitrarily shifted from one entity to another. The Supreme Court in *United States v. Donruss Co.*,<sup>61</sup> recognized this Congressional intent, holding that a fair reading of the statute could effectively eliminate the evil of arbitrary shifting of income that reduces tax revenues. The *Forman* court also believed that a fair reading of the statute could effectuate the underlying Congressional intent.<sup>62</sup>

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56. H.R. REP. NO. 871, 78th Cong., 1st Sess. (1943).

57. J. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAWS 1475 (1954).

58. See Spaeth, *supra* note 47, at 49.

59. See note 45 *supra* & accompanying text.

60. *Id.*

61. 393 U.S. 297 (1969).

62. 453 F.2d at 1156.

*Nature of Control*

One of the requirements<sup>63</sup> of section 482 is that the two business entities be "owned or controlled. . . by the same interests."<sup>64</sup> Clearly, "owned or controlled" is limited by the "same interests." However, in applying this provision the courts sometimes stray from a rigorous construction and talk of the separate elements as if they are one. In *Forman*, the court addressed the question of control when the real issue was determining what the "same interests" were. As soon as the court found that McGurdy and Forman were the same interest, it necessarily follows that the two entities were owned and controlled by them.

The first point of analysis turns on the phrase "owned or controlled." Seemingly, the obvious intent of Congress in using the disjunctive "or" was to allow allocation whenever either of the two elements were present. Early cases ignored that interpretation and required both elements to co-exist.<sup>65</sup> It was soon realized that the evil sought to be cured could flourish in a situation where control without ownership existed.<sup>66</sup>

The General Counsel<sup>67</sup> has described "control" as "not necessarily limited to strict legal control, but to a 'genuine and real control actually exercised . . . .' Obviously the control intended is, however, not that of the stock or shares of the entities owning the business . . . but control of the trades or businesses themselves." Thus, as early as 1928 it was recognized that it was the substance of the control and not the form that would satisfy the statute. But as late as 1951 the courts<sup>68</sup> were still refusing to imply inferred or apparent control when not coupled with ownership. As the underlying purpose of section 482 became recognized by the courts<sup>69</sup>—to put controlled taxpayers on parity with uncontrolled taxpayers—the courts began making the necessary infer-

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63. See notes 26-32 *supra* & accompanying text.

64. INT. REV. CODE of 1954, § 482.

65. See Hewitt, *supra* note 13, at 471.

66. *Id.*

67. VII-1 CUM. BULL. 138 (1928).

68. John L. Denning & Co., 180 F.2d 288 (10th Cir. 1950); Nelson Paper Co., 3 CCH TAX CT. MEM. 914 (1944).

69. See *Tennessee Life Ins. Co. v. Phinney*, 280 F.2d 38 (5th Cir.), *aff'd*, 364 U.S. 914 (1960); *Simon J. Murphy Co. v. Commissioner*, 231 F.2d 639 (6th Cir. 1956); *V & M Homes, Inc.*, 28 T.C. 1121 (1957), *aff'd*, 263 F.2d 837 (6th Cir. 1959). See also *Treas. Reg. § 1.482-1(b)(1)* where it states in part:

The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer.

ences and recognizing apparent control. In *Grenada Industries*<sup>70</sup> the businesses were divided among several trusts and individuals. The court held that even though the ownership was divided among several interests, "the actual control at all times material . . . was really exercised by J.A. Goodman, L.L. Goodman, Kobin and Barskin."<sup>71</sup> In *Hall v. Commissioner*,<sup>72</sup> Hall, Sr. owned a sole proprietorship and Hall, Jr. owned substantially all the stock of a corporation. The court held that Hall, Sr. was in actual control of the corporation so that an allocation could be made to his sole proprietorship. Although there was a vigorous dissent,<sup>73</sup> one commentator<sup>74</sup> suggests that the Congressional purpose was to stop arbitrary transactions that reduced taxes, and that purpose was best satisfied by the attribution made in *Hall*.

The trend is apparent; courts are becoming more willing to find "control" when *de facto* control exists. The above cases illustrate the courts' willingness to find control by the "same interests" when family relationships are involved. Some writers<sup>75</sup> have suggested that the statute was purposely vague to allow flexibility in the administration of the section. As one early case<sup>76</sup> pointed out, had Congress meant to say "controlled by the same persons" it could have done so. The clear implication is that persons and interests are not the same thing.

It seems that a fair interpretation of "same interests," in light of the above discussion, would include the situation where two corporations combine in a joint venture for their mutual benefit. There seems to be no greater force in the argument that family member, as in the *Hall* case, or that trusts for various individuals, as in *Grenada*, are the "same interests" than in the argument concerning the two corporations in the *Forman* case. It is clear that the *Lake Erie* decision was an anomaly in the law. It allowed two corporations to escape the purpose<sup>77</sup> of Con-

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70. 17 T.C. 231 (1951), *aff'd*, 202 F.2d 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953).

71. *Id.* at 254.

72. 294 F.2d 82 (5th Cir. 1961).

73. *Id.* at 87.

74. See Hewitt, *supra* note 13, at 475.

75. See Plumb & Kapp, *supra* note 22, at 811 where the author suggests that "[t]he words 'directly or indirectly' imply at least that beneficial ownership, through trust, partnership or holding company will be regarded as the same as ownership of legal title." Eustice, *supra* note 36, at 451 noted that Congressional intent must have been to provide flexibility in the section, otherwise Congress would have inserted specific percentage requirements as they did in §§ 269 and 1551.

76. *Rishell v. Phonograph Co.*, 2 B.T.A. 229, 232 (1925).

77. See notes 47-62 *supra* & accompanying text.

gress and erode the tax base with arbitrary transactions when a fair reading of the statute would prohibit this conduct. The court in *Forman* recognized the realities of the relationship and found that two corporations, acting in concert in a joint transaction, were the "same interests," and therefore within the scope of the section 482.<sup>78</sup>

One writer has suggested that the finding of arbitrary transactions would necessarily mean that sufficient common control exists.<sup>79</sup> Other writers suggest that this type of reasoning will render the control requirement meaningless.<sup>80</sup> It is not necessary to go this far. Joint participation in the venture clearly rendered *Forman* and *McGurdy* the "same interests"; accordingly it follows that they have control of the two or more businesses.

It has been seen that the basic underlying policy of section 482 is maintenance of a parity between controlled and uncontrolled taxpayers, so that the tax base will not be eroded. Stated differently, section 482 was designed to eliminate the artificial and arbitrary shifting of income and deductions so as to reduce tax liability. Given the above policy bases, it would seem unreasonable to allow two corporations to frustrate the Congressional purpose simply by incorporating a jointly owned subsidiary. One question remains—how many entities must own a corporation before it would be exempt from section 482? It seems that so long as owners are acting in concert for their mutual benefit, and at the same time arbitrarily shifting accounts, they should be considered the "same interests" for the application of section 482. There is no reason to allow some interests to "hide" income while making the less adventurous pay the full bill.

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78. 453 F.2d at 1155.

79. See *Cooper*, *supra* note 22, at 139. See also Treas. Reg. § 1.482-1(a)(3) which states that a presumption of control will arise whenever there has been arbitrary shifting.

80. Seieroe & Gerber, *supra* note 36, at 898 where the authors describe the interaction of the presumptions:

As the Regulations provide, control will be presumed if income or deductions have been arbitrarily shifted. Seemingly, if income or deductions have been 'shifted,' the shifting has been arbitrary. Whether there has been a shifting would seem to hinge on the trier's view of where the income or deductions properly belonged in the first instance. Therefore, if an allocation is indicated, it would follow that there had been a shifting which was arbitrary which gives rise to the presumption of the requisite control, thereby making the allocation permissible.

With this trend, requisite control would be found without difficulty in cases involving jointly owned subsidiaries such as considered in *Lake Erie & Pittsburgh Railway Co.*