Seminar in the Effects of Taxation on Business Policies and Practices

MULTIPLE CORPORATIONS

"Be fruitful, and multiply . . . ."
Genesis 1:28

Economics 362
March 26, 1958

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I. INTRODUCTION

Multiple incorporation may be said to exist where the same interests control more than one corporation and let these corporations maintain their separate existence rather than merging them into a single entity.

Multiple corporations may come into existence in one of three separate ways, or a combination thereof:

(1) through the acquisition of existing entities, as when one corporation buys the stock of another and maintains it as a subsidiary;

(2) through the spinning-off of existing entities, as when a new corporation is created which sells its stock in exchange for the assets of an existing firm;

(3) through the simultaneous creation, at the beginning of a business venture, of several entities instead of one.

We concern ourselves primarily in this paper with the second and third categories, since the legal and economic problems raised by acquisitions, mergers and consolidations form a separate and specialized topic in themselves. However, all will be considered when we come to problems of efficiency and policy.

The device of multiplication can take a bewildering variety of forms, stemming from any number of different motives. This being the case, it would be helpful to illustrate the possibilities with a concrete example or two:

New York Taxicab Industry. A striking illustration of the use of multiple incorporation to limit tort liability came up recently. In a blistering opinion granting a pre-trial preference to a plaintiff who had been severely injured by a taxicab, Judge Streit noted that the defendant corporation -- the Clear Service Company -- was one of 150 corporations owned by the Ackerman family, all having identical officers and using identical facilities, and each having total assets of two cabs. [New York Law Journal, March 10, 1958.] The value of the two cabs is $4600, and the bond which the owners must file in lieu of insurance guarantees payment of up to $5000 for injuries to one person, and $10,000 for injuries to more than one person. The liabilities of the corporation are limited to these amounts. The judge suggested that in such cases of complete dominion, the rules of agency might apply, and the owners become liable for corporate obligations (Berkey v. Third Ave. RR, 244 N. Y. 84, 94, 95; Mangan v. Terminal Transportation System, 157 Misc. 627, 284 N.Y.S. 183, aff'd 247 App. Div. 853). He noted that about 12,000 persons file personal injury claims each year against taxicabs, concluded that the public is inadequately protected with respect to compensation, and recommended that the required bond be quadrupled and that the medallion, now worth $17,000, be included in corporate assets for liability purposes. He suggested "that the true owners of most of the large fleets of taxicabs are using a corporate device to defraud the public."

While the primary purpose of multiple incorporation in this case appears to be the limitation of liability, a secondary motive is the minimization of the corporate income surtax on incomes above \$25,000. If the average taxicab makes \$45 per day, as Judge Streit states, the saving here comes to approximately \$800,000 per year for the Ackerman interests. (The surtax exemption for a corporation is 22% of \$25,000, or \$5500. With 150 corporations, each of them making in excess of \$25,000, the organization is entitled to 149 extra exemptions, and 149 x \$5500 is about \$800,000.)

A second intriguing example, illustrating the complications which may enter into transactions involving multiple entities, has been relegated to Chapter VI because of its length.

A common basis for multiple organization is by functional division of the operations of a business. For example, in the building construction industry, "an entity . . . is created for the purpose of superintending the construction of the homes for one or more owner corporations on either a fixed fee or a profit-sharing basis. Another entity owns construction equipment which it rents to the owner corporations for use in the construction. Another operates as a purchasing agent for the materials required on the project. Another acts as broker in selling the homes for the owner corporations. . . ." [Huberman, "Income Tax Planning for a Residential Subdivision," 8 U.S.C. Law School Tax Inst. 649, 661 (1956).]

Still another common basis is by region. For example, the separate branches of an organization may be incorporated in as many different states.

For an estimate of the size distribution of multiple corporations, see Chapter VII.

After a quick rundown of the possible motives for and against multiple incorporation, we shall make a painstaking study of tax litigation in the area, which involves primarily §§ 269, 482, and 1551 of the 1954 Code. We shall end by drawing some conclusions about the wider implications of multiple incorporation as they bear on the question of efficiency, and finish with some tentative policy recommendations.

There has been a marked tendency in recent years for "middle-class" corporations to multiply business entities in order to take advantage of the \$25,000 surtax exemption and other benefits available under the Code. However, recent decisions in the area will in all probability tend to discourage further multiplication along these lines. The practical applications of a Code section depend greatly on the decisions in the first few cases to be litigated, especially when that section involves a determination of motive and intent. Since the first few cases involving IRC § 1551 have been decided in the Commissioner's favor, it may be argued that the law is not going to be applied leniently to the taxpayers concerned, and that the evolution of interpretation of IRC 1551 will have a disturbing effect on those corporations which have recently reached the surtax bracket.

If our predictions materialize, the Commissioner and the courts will bear down heavily on smaller entities which try to utilize the multiple corporate device, while, in effect, doing nothing to discourage tax-free mergers, consolidations and the growth of large organizations. The additional credits and exemptions to be secured from the split-up of a multi-million dollar enterprise are, in general, relatively insignificant. On the other hand, the surtax exemption and accumulated earnings credit will often result in substantial tax savings for smaller corporations which divide themselves. This situation may call for legislative remedy. (Cf. infra, on policy recommendations.) [Emmanuel, "Section 15(c): New Teeth for the Reluctant Dragon?" 8 Tax L. Rev. 457, 467 (1953.]

IRC § 269, which in the past has been used by the Commissioner against multiples without conspicuous success, may become effective, prospectively and retroactively, following the "signal judicial success" which may have occurred last year. [See Landman, "Being Tax-Wise and Otherwise in Multiplying Business Entities," 30 Taxes 893, 902 (1952).]

II. ADVANTAGES AND DISADVANTAGES OF MULTIPLE CORPORATIONS

A. Tax Advantages

(1) Surtax Exemption. The practitioner's major tax consideration in suggesting multiple incorporation is the $25,000 exemption of the corporate income surtax (IRC § 11(c)), which may save 22% of $25,000 on every extra corporation formed. Wright, "Tax Planning for the Growing Corporate Business," 1954 USC Law School Tax Inst. 48; Connery, "Residential Developments: Multiple Corporations, Allocations, Administration," 14 NYU Inst. on Fed. Tax. 190 (1956); Huberman, supra, p. 651.

(2) Accumulated Earnings Credit. Shareholders are permitted to accumulate up to $60,000 of undistributed income in a corporation which need not be earmarked for business purposes (IRC § 535(c)(2)). Every extra corporation formed provides room for an additional $60,000. Cohen, Phillips, Surrey, Tarleau and Warren, "The Internal Revenue Code of 1954: Carry-overs and the Accumulated Earnings Tax," 10 Tax L. Rev. 277, 303.

(3) Spreading Expenses. (a) Officers' Salaries -- Overly large salaries to officers run the risk of being treated as dividends, thus being disallowed as business deductions. Multiple corporations make salaries appear more reasonable by spreading them out in smaller chunks. (b) "Traveling and Entertainment" Expenses -- The same considerations apply here. [Mentioned by Mr. Myles Sachs, tax attorney for J. H. Cohn & Co.; also, P-H Tax Ideas, Stutsman, "Tax Factors in Organizing a Corporation," Par. 7006.7.]

(4) Flexible Disposition of Assets. Shareholders may dispose of the assets of one corporation of a multiple set-up and secure capital gains treatment without having to liquidate the whole organization (IRC § 1014). [P-H Tax Ideas, Stutsman, ibid.]

(5) Allocation of Income in Multi-State Operations. It is possible to some extent to allocate income among branches of a business so that those incorporated in corporate income tax states earn a minimal profit, while those incorporated in states without a corporate income tax earn maximal profits. [According to Mr. Sachs.]

(6) Deferred Payment of Taxes. By spreading corporate income among several entities, the organization may escape the "pay-as-you-go" system of paying its taxes, which is required for taxable incomes over $100,000 (IRC § 6016).

(7) Safeguarding Capital Gains Candidates. "Multiple corporations may be used as a means of segregating holdings that appear to be more likely candidates for capital gains treatment from those which are in a more doubtful category, thereby strengthening the status of the former." [Huberman, supra, p. 671.]

(8) Masking of Thin Incorporation. The "thin" corporation -- one with a heavy debt to assets ratio -- is less likely to be attacked when part of a multiple organization, because its use will be less "glaring". [According to Internal Revenue Agent; see interview infra.]

(9) Avoidance of Federal Excise Taxes. The phonograph industry has used the multiple corporate device for this purpose. [According to Mr. Sachs.]

(10) Western Hemisphere Trade Corporation Deduction.

There are several provisions of the Code which, while not pertaining directly to multiple entities, encourage them. For example, additional organizational expenses may be written off over a period of not less than 60 months (IRC § 248). Again, the annualization provisions dovetail neatly with the surtax exemption. By beginning the fiscal year just after the corporations of an organization have passed $25,000 in income it is possible to compress a year's surtax exemption into the space of a few months.

Loss-carryover acquisitions require special treatment, because, while the entities created are in a sense multiple, the set-up for taxation purposes is quite different from those which make up the bulk of this paper. Corporations with losses are permitted to carry these losses back two years and then forward five years, deducting them from profits to calculate the tax base. After acquisition by a corporation with profits [sometimes the loss corporation acquires the profitable corporation; cf. Philadelphia and Reading Corp. infra], the carryover deduction may be transferred by filing a consolidated income return (IRC §§ 1501, 1504-6). Notice that filing such a return vitiates all the tax advantages of multiple incorporation listed above. In addition, consolidating corporations must pay an additional 2% in taxes, and must continue to file consolidated returns from then on unless receiving special dispensation from the Commissioner. Despite these many drawbacks, the single advantage of loss carryover allowance is sometimes sufficiently attractive to override all objections. In 1954, there were 2723 consolidated returns filed from a total of 722,805 corporate returns. [U. S. Treasury Dept. Internal Revenue Service, Statistics of Income; Corporation Income Tax Returns, 1954, Publication No. 16, p. 5. See Mertens, Code Commentary, Law of Federal Income Taxation, Par. 1551:1, p. 398; Wright, supra, p. 48.]

B. Business and Economic Advantages

(1) The insolvency or bankruptcy of one entity will not necessarily affect the other corporations. Huberman, supra, at page 671.

(2) Loans obtained by one entity do not pledge the credit and assets of the others. Ibid.

(3) "A business may be required to incorporate separately in each State in which it carries on activities. Furthermore, State laws sometimes prohibit the chartering of a corporation for more than one business purpose. A related corporation frequently will be formed for the purpose of limiting liability with respect to the development of a new and risky enterprise," Senate Report No. 781, 82nd Congress, 1st Session, pp. 67-69. Under IRC § 269 (formerly 1939 IRC § 129), the Tax Court held IRC § 269 inapplicable because of the following primary business purposes as found by the court: Berland's Inc. of South Bend et al. v. CIR, CCH Dec. 18,057, 16 T. C. 182 (1951) (acq.) (limit leasehold liabilities); Chelsea Products, Inc. v. CIR, CCH Dec. 18,240, 16 T. C. 840 (1951) (non-acq.), aff'd 197 F. 2d 620 (3rd Cir., 1952) (limit customer negligence liability, increase sales through territorial sales agencies, avoid stigma of absentee ownership and economize on freight charges); Alcorn Wholesale Co. v. CIR, CCH Dec. 18,034, 16 T. C. 182 (1951) (acq.) (increase combined borrowing capacity because of state bank loan restrictions, limit customer negligence liability, permit the handling of competitive lines of grocery merchandise and eliminate the stigma against absentee ownership). Each of the cases involved the split-up of an existing corporation. Landman, analyzing such business reasons, perceptively remarked that "perhaps Congress did not anticipate the full extent of man's ingenuity in lightening his tax burden,""Multiplying Business Corporations and Acquiring Tax Losses," 8 Tax L. Rev. 81 (1952).

(4) In addition to the constantly recurring business reason with respect to the segregation of risks which apparently was the prime motivation in the establishment of Jack Ackerman's 150 taxi-cab corporations, supra, Connery, supra, at page 190, sets forth the following non-tax advantages: (1) investment flexibility, (2) waiver of mechanics liens and (3) promoting better labor relations, i.e., the "necessity of dealing with union and non-union labor or different locals or craft unions."

C. Business and Economic Disadvantages

(1) Additional administrative expenses will be incurred in the duplication of corporate bookkeeping and records. Wright, supra, at page 48.

(2) Loss of credit rating due to the splintering of assets and income.

III. APPLICATION OF THE INTERNAL REVENUE CODE OF 1954 TO MULTIPLE CORPORATIONS

A. IRC §§ 482, 61 and the Substance v. Form Doctrine

1. Section 482

Section 482 of the Internal Revenue Code of 1954 and its predecessors (§ 45 of the 1939 Code, etc.) has had a statutory existence for some 37 years, coming into the revenue law as part of the Revenue Act of 1921. Through the course of years it has remained substantially the same, except that in 1924 the Commissioner's power to consolidate was somewhat restricted, and finally, entirely eliminated by the Revenue Act of 1928. The section applies when two or more organizations, trades, or businesses are owned or controlled by the same interests, and the Commissioner determines that an allocation or distribution is necessary in order to prevent evasion of taxes, or to clearly reflect income. IRC § 482, according to the cases, and to writers, "has generally been limited to the allocation of income and deductions among entities that are recognized as valid for tax purposes." (Anthoine, "Transactions Between Related Taxpayers," 1956 Tulane Tax Institute 269, 293 -- emphasis added.) [In this area, generally, see: Holzman, "Arms Length Transactions and § 45," 25 Taxes 389; Cooper, "Section 45," 4 Tax L. Rev.; Mortenson, "The Multiple Attack on Multiple Corporations," 35 Taxes 647; Taylor, "Problems in the Formation and Use of Multiple Organizations," 1954 Tulane Tax Institute 175; Landman, "Being Taxwise to Otherwise in Multiplying Business Entities," 30 Taxes 893.] Thus it is important to note that, unlike IRC § 269 (discussed infra), the Commissioner cannot disallow but can only allocate. Hypotheek Land Co. v. Commissioner, 200 F. 2d 390 (CA-9, 1952), and more recently, Chicago & Northwest Railway Co., 29 T. C. 104 (Feb. 27, 1958). The Commissioner has a discretionary power in applying this section, not a mandatory one, but once he does apply it there is a presumption of correctness and the burden of proof, that the section was imposed improperly and arbitrarily, is placed upon the taxpayer. National Securities Corp. v. Comm., 137 F. 2d 600 (CA-3, 1943); Seminole Flavor Co., 4 T. C. 1215 (1945). IRC § 482 does not authorize the Commissioner to create income where none existed. Thus, as an example, if one corporation lets another corporation use a building or a machine rent free, the Commissioner cannot allocate rental income to the lender (lessor). Tennessee-Arkansas Gravel Co. v. Comm., 112 F. 2d 508 (CA-6, 1940). Although the Commissioner, under the present section cannot consolidate, he can, and has, achieved the same result by his allocation of all the income to one of the entities. Advance Machinery Exchange, Inc. v. Commissioner, 196 F. 2d 1006 (CA-2, 1952).

In a recent Court of Appeals case, the court said the basic purpose of the statute was to recognize the normal tax effect of bona fide business transactions between separate organizations, even though controlled by the same interests, and also to permit and enable the commissioner "to change the bookkeeping effect of a transaction between controlled taxpayers when, by reason of the relationship, they arbitrarily or improperly shift income or deductions from one organization to another." IRC § 482 is not limited only to cases of fraud, but by the same token it won't be applied automatically just because two (or more) corporations or entities are controlled by the same interests. Simon J. Murphy Co. v. Commissioner, 231 F. 2d 639 (CA-6, 1956). See also The T.V.D. Co. v. C.I.R., 27 T. C. 879 (1957).

Although the official regulations to IRC § 482 have not, as yet, been issued, the regulations to IRC § 45 of the 1939 Code (predecessor of IRC § 482) have set up a standard by which the Internal Revenue Service can attempt to determine the applicability of the statute. "The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arms length with another uncontrolled taxpayer." Reg. 111, § 29.45-1(b). Thus, if the Commissioner feels that the transactions between two or more entities (whether it be a partnership, sole proprietorship or corporation) is not an arms length transaction for bona fide business purpose, he may apply § 482 and allocate income or deductions, etc. However, if there is a legitimate business reason for the existence of another entity, and for the transactions with it, notwithstanding that they are controlled by the same interests, an attack under this section will not stand.

Surprisingly, the number of cases in this area is not too great, considering this section's long existence. In a majority of the cases, it seems that attacks under § 482 have not been upheld. Thus we may conclude that courts are fairly liberal in construing an arms length transaction. In Polak's Frutal Works, Inc., 21 T. C. 953 (1954), where a taxpayer had removed his export operation from the corporation to avoid wartime controls of a foreign country, IRC § 482 was inapplicable. The fact that the new entity's activity could have been accomplished by one corporation wasn't sufficient to make it applicable. Seminole Flavor Co., Twin Oaks Co. v. Commissioner, 183 F. 2d 385 (CA-9). A split-up was held valid (no applicability of § 482) where a corporate business consisted of two main divisions -- a foundry and a manufacturing department, Buffalo Meter Co., 10 T. C. 83, and setting up a new entity to do an operation which had never been done before is also valid. Cedar Valley Distillery, Inc., 16 T. C. 870 (importing liquor). Expenses which are applicable to more than one of the entities have withstood IRC § 482, but where they can be attributable properly to only one of them, then this section will be sustained. Glenmore Distilleries Co. v. Commissioner, 47 B.T.A. 213. Even when tax savings are a motivating factor, as long as there is a sufficient business reason, the courts will acknowledge an arms length transaction. Berland's, Inc., 16 T. C. 182. It is apparent then, almost any legitimate

§§ 482 and 1551, the Commissioner may have in his hands a forceful weapon with which he can strike out almost all of the primary reasons for using the multiple corporate device. He may effectively be able to consolidate under § 482, as we have seen supra, and he may in addition (or in the alternative) disallow multiple exemptions and credits (discussed infra). Thus, as the law is today, the practitioner has more than merely § 482 to consider in attempting to mitigate taxes by use of the multiple corporate set-up. He must now create corporate entities that will satisfy the tests of non-evasion (or avoidance) under these code sections, as well (a thorough discussion of all aspects of these two sections follows). To what extent the Commissioner will "level his shotgun" and use the "buckshot" approach is perhaps the major inquiry, now. However, this question will have to remain unanswered for the time being.

2. Section 61 and Substance v. Form Doctrine

The Commissioner is cognizant that, generally, § 482, alone, is a weak attack and he has often coupled it with other sections of the code -- IRC §§ 269 and 1551, discussed infra. On occasion he has tried to use IRC § 61 (Gross Income Defined) to invalidate this type of set-up. In Higgins v. Smith, 308 U. S. 473, the court adopted the "substance versus form" doctrine and applied it to the Internal Revenue law, i.e., to corporate entities. Thus the court looked through the form of the entity to the substance of it and said that a corporate entity may be disregarded if its existence is sham, e.g., not a good business purpose or reason. The broad scope of this doctrine was limited somewhat in Moline Properties, Inc. v. Commissioner, 319 U. S. 436 (1943), where the court said, "But so long as that purpose is the equivalent of business activity or is followed by the carrying on of the business by the corporation, the corporation remains a separate taxable entity." Thus, if the corporation is engaged in some activity other than avoiding taxation, the Commissioner may not disregard the corporate entity. See National Investors Corp. v. Hoey, 144 F. 2d 466 (CA-2). The doctrine of "substance versus form" still has efficacy, though. A recent Tax Court decision, in finding the existence of separate entities, talked in terms of it. R. G. Le Tourneau, Inc., 29 T. C. 82 (Jan. 10, 1958).

This dual attack by the Commissioner has been successful in Kocin v. U. S., supra, and in the Advance Machinery case, supra, the Tax Court decided it upon both grounds, but the Court of Appeals, in affirming, decided only upon the grounds of § 482. We may conclude, that although the Commissioner has been able to use this approach with a modicum of success, it is still a difficult proposition to strike down the existence as a separate entity.

B. IRC § 269

Code § 269, following old 1939 Code § 129 which was added by Revenue Act of 1943, 58 Stat. 47, deals with acquisitions of control by "any person" of a corporation or the acquisition by a corporation of property of another corporation not controlled by such corporation immediately prior to the acquisition having a derivative basis in the hands of the acquiring corporation. It provides for the disallowance of corporate deductions, credits, or other allowances where "the principal purpose for which such acquisition is made is evasion or avoidance of Federal income tax by securing the benefit of" corporate allowances. IRC § 269(c), added by the 1954 Code and so far untested, provides that where the consideration paid by the acquiring person or corporation is "substantially disproportionate" to the aggregate of (1) the adjusted basis of the property of the corporation whose stock or property is acquired and (2) the tax benefits of such corporation not otherwise available but for said acquisition, such fact "shall be prima facie evidence" of said principal purpose.

The problem with respect to the effect of IRC § 269 on the formation of multiple entities may be phrased in the form of several questions: (1) Does IRC § 269 cover any areas not already covered by IRC § 1551, infra? (2) Assuming that IRC § 1551 applies exclusively to multiple entities, what is the function of IRC § 269 in the light of IRC §§ 381 and 382 which restricts the use of loss carryforwards and the absence of the excess profits tax? (3) If IRC § 269 is not a mere appendange, should not its use be restricted to the high value-low basis fact situation as decided in American Pipe and Steel Corp. v. CIR, CCH Dec. 21,352, 25 T. C. 351 (1956), aff'd 243 F. 2d 125 (9th Cir., 1957), cert. den'd 78 S. Ct. 333, infra?

The answers to these questions will be discussed in this and the following sections.

According to the legislative history of 1939 Code § 129, the essential purpose of the provision was to "terminate the traffic in corporations which had net operating losses, the benefits of which were sought by persons acquiring their control." H. R. Rep. No. 871, 78th Cong., 1st Sess. 23, 49 (1943), 1944 C. B. 901, 919-920, 938-9.

The Commissioner has consistently met with failure in the attempted application of IRC § 269 to the split-ups of existing corporations, i.e., Berland's Inc. of South Bend v. CIR, supra; Chelsea Products, Inc. v. CIR, supra; Alcorn Wholesale Co. v. CIR, supra; and Dilworth v. Henslee, 98 F. Supp. 957 (M.D. Tenn. 1951). In the Berland's case, supra, decided January 25, 1951, the "parent" which formerly operated a chain of retail shoe stores incorporated 22 of the existing branch stores to avoid liability on new leases executed in a rising rental market and the court held the IRC § 269 was inapplicable, the 22 petitioners being therefore entitled to the specific excess profits exemption of old § 710(b)(1). The parent Delaware corporation, not a party, had transferred to each new corporation in exchange for all its capital stock, the assets of one of the retail shoe businesses owned in the state. Since the primary issue was the "principal purpose" of the transaction, the

Tax Court did not consider taxpayers' argument that they were not "acquiring" corporations within the meaning of the section. The Court at page 188 remarked that the "consideration of the tax aspects of the plan was no more than should be expected of any business bent on survival under the tax rates then current. Such consideration is only the part of ordinary business prudence." Clearly, said statement signified a most lenient attitude toward the establishment of multiple entities with respect to the effect of IRC § 269.

The Commissioner unsuccessfully in the Chelsea case, supra, decided April 19, 1951, attempted to add the net income to the parent taxpayer of three sales companies which the parent had incorporated to sell taxpayer's products (fans and blowers) and had assigned separate sales territories. However, five Tax Court judges dissented in a strong opinion written by Opper, J., i.e., at page 854, "Nor does it seem to me possible to say so cavalierly that section has no application when the alleged business purposes are as flimsy as they were here; when the question is concededly one of fact, . . . and when as the hearer of the evidence, I would have found that no substantial purpose was, nor could have been expected to have been, served by the sales companies, see MacPherson v. Buick Motor Sales Co., 217 N. Y. 382, except the tax avoidance objective which has apparently been attained." In footnote 1, p. 853, he argues that "an analysis of the findings shows that the only services purportedly rendered by the sales companies during each of the tax years were to bill customers, to receive payment from them, and to enter sales agreements with sales agents. All of these functions had previously been performed by petitioner. When performed during the tax years nominally on behalf of the sales companies, they were actually rendered by officers and employees of petitioner for whose compensation full deduction has been allowed by respondent's determination. Hence, it appears that the sales companies rendered no service of any value to petitioner . . . ." Opper, J.'s dissent points to a reasonable approach suggested in a recent law review note, to-wit:

> If the taxpayer is to be permitted to minimize his taxes while at the same time he is prohibited from "evading" them, the only rational test should be whether or not the corporation has engaged in "substantial genuine business activities". It would then seem that the taxpayer's purpose on establishing the corporation is not relevant in determining whether the corporate entity will be respected. (Note, "Taxation of Gifts to Closely Held Corporations," 57 Colum. L. Rev. 240, 245.)

Similarly, Prof. Anthoine writes that:

> The approach of the courts, in general, has been to ascertain whether the alleged taxpayer actually engaged in business activities. If an independent business activity was conducted in the taxable year in question the entity will be recognized for tax purposes. (Anthoine, "Transactions Between Related Taxpayers," 1956 Tulane Tax Inst. 269, 294.)

The split-up in the Alcorn case, decided January 17, 1951, involved the immediate dissolution of the parent; to-wit, the assets of the parent were transferred to, and its liabilities assumed by, the taxpayers on the basis of the assets and liabilities applicable to each of the five grocery stores and the stock in the taxpayers (five groceries) were issued to the parent's shareholders in the proportion that the shareholders owned stock in King and shortly thereafter the parent was dissolved. IRC § 269 was held inapplicable, supra, on the finding of a valid business purpose. Therefore, the Tax Court refused to consider the taxpayers' contentions that IRC § 269 "was not intended to apply to 'split-up' reorganizations." Cf. IRC § 355. The court emphasized that the reorganization was not an unmixed blessing because the "profits of one store could no longer be offset by losses of another store."

The reorganizations in the last three cases occurred in the year 1944 when the excess profits tax was enforced.

In the Dilworth case, decided July 26, 1951, wherein petitioner recovered excess profits tax from the government, the court argued that the parent-taxpayer-petitioner didn't acquire a new corporation or new assets through the formation of the subsidiary, i.e., § 269 inapplicable. A Tennessee corporation organized a Mississippi subsidiary and transferred to the subsidiary all the assets used by the parent in its Mississippi business. Dilworth would restrict the application of IRC § 269 to those situations where "new assets" were "acquired" by a corporation or individual.

Apparently, it is the subsequent division of a corporation rather than the initial multiplication of a business that the Commissioner will be more apt to attack. According to Stutsman, supra, P-H Tax Ideas, upon the initial organization of the business as many different corporations as may be desired can be used as long as they are kept within the bounds of reason. See Webster, "A Tax Check List on Incorporation," 30 Taxes 587 (1957). Also, it may be argued that if IRC § 269 was specifically designed to restrict traffic in loss corporations, supra, and since said section refers only to the "acquiring" of control and not to the formation and acquisition of new corporations, the provision does not apply explicitly to multiple corporations. It is interesting to note that Code § 341(b) refers to those corporations which are "formed or availed of". And the Tax Court has consistently interpreted IRC § 269 to apply to the "acquiring corporations", not to the "acquired corporations", i.e., Alprosa Watch Corp., CCH Dec. 16,559, 11 T. C. 240 (1948); Commodore's Point Terminal Corp., CCH Dec. 16,602, 11 T. C. 411 (1948); A. B. and Container Corp., CCH Dec. 17,641, 14 T. C. 842 (1950); and The T.V.D. Co., CCH Dec. 22,271, 27 T. C. 879 (1957). Thus, the argument, according to this premise, would run that if IRC § 269 is restricted to the "acquiring" party, the formation of multiple entities falls outside the purview of the provision for the surtax exemption of the new corporation is an inherent attribute, available to it alone and not "acquired" by the "acquiring" taxpayer. As with the acquisition of "income-producing property" by an "acquiring taxpayer", assuming that the parent corporation is the so-called "acquiring corporation", no deduction, credit or allowance which the latter "would not otherwise enjoy" is present. However, in the three Tax Court split-up cases, supra, the court sidestepped this problem by holding that tax avoidance simply wasn't the "principle purpose" of the plan. Until the recent Coastal Storage decision, supra, the general opinion of some writers was that "although there has been no clear cut decision on the applicability of that statute to split-ups, all guide posts point to a safe passage if any substantial business reason for the division can be demonstrated," Emmanuel, "Section 15(c): New Teeth for the Reluctant Dragon?" 8 Tax L. Rev. 457, 461 (1953). See Mortenson, "The Multiple Attack on Multiple Corporations," 35 Taxes 647 (1957); Cuddihy, "Tax and Other Legal Considerations in a Corporation's Acquisition of an Existing Corporation," 1957 Tulane Tax Inst. 524. On the other hand, according to Rice ("Internal Revenue Code, Section 269: Does the Left Hand Know What the Right Is Doing," 103 U. Pa. L. Rev. 579 (1955)), the provision is still broad enough to include corporate divisions within its scope where they are undertaken with the "principal purpose" of avoiding federal income tax.

1. The Coastal Oil Storage Case

Coastal Oil Storage Co. v. CIR, CCH Dec. 21,262, 25 T. C. 1304, was decided March 29, 1956 in an opinion written by Atkins, J., without any dissents. Petitioner, newly organized subsidiary of Coastal Terminals warehoused and stored petroleum products in bulk. According to petitioner, the organization of the subsidiary and the transfer of storage tanks from the parent to the subsidiary were motivated by the need of separating operations under renegotiable government contracts from commercial contracts in view of a threatened claim by the government for $150,000 of excessive profits with respect to its renegotiable business. Also, separation would enable the government to profit from lower storage rates thus securing more government contracts to petitioner. Although the Commissioner disallowed the $25,000 surtax exemption and the $25,000 minimum excess profits credit under 1939 Code § 431 arguing that although 1939 Code § 15(c), infra, was inapplicable to any period before March 31, 1951, the disallowance of said exemption and credit for the earlier period as well as the entire year could be justified under 1939 Code § 129. The Tax Court disallowed petitioner's exemption and credit but only under the provision of 1939 Code § 15(c) which was effective only after March 31, 1951. The Tax Court in holding section 129 inapplicable declared at p. 1312 that "this petitioner did not acquire control of another corporation. . . . We have held that the word 'otherwise' can only be interpreted to mean that a deduction, credit, or allowance, if it is to be disallowed under section 129, must stem from the acquisition. . . . We hold that the acquisition of the tanks did not secure to the petitioner the benefit of any exemption or credit which it would not otherwise enjoy under section 15(b) and 431, respectively, and that therefore section 129 has no application to the instant case . . . ." In effect the Tax Court not only firmly reiterated its belief that § 129 applied only to the acquiring party but that a surtax exemption is an inherent attribute of the newly created subsidiary which is not derived from the presence of an acquisition, if any. A literal interpretation of § 129 (IRC § 269) clearly supports this view; if adopted it would virtually exclude split-ups from the coverage of § 129.

But the Fourth Circuit disagreed. On appeal, although the appellate court affirmed the Tax Court with respect to the application of § 15(c), it reversed in so far as § 129 had been held inapplicable to the two months in question prior to March 31, 1951. Coastal Oil Storage Co. v. CIR, 242 F. 2d 396, 398-9, decided March 11, 1957. The late C. J. Parker in a somewhat strained construction asserted that § 129 was clearly applicable, to wit:

> . . . [T]he parent corporation acquired complete control of taxpayer through stock ownership and the parent corporation was certainly a person within the meaning of subsection (1) of the statute. As a result of the transfer of its property in exchange for the stock, it was able to obtain through the splitting up of its corporate business the benefit of an exemption and credit which it would not otherwise have enjoyed. While the exemption is claimed by taxpayer, the sole benefit thereof would accrue to the parent corporation, the sole owner of its stock. Cf. Higgins v. Smith, 308 U. S. 473, 476, 60 S. Ct. 355, 84 L. Ed. 406. . . . Subsection (2) is applicable also, since taxpayer, as a result of the transfer from the parent corporation, received property having a basis for tax purposes which would be determined by reference to its basis in the hands of the parent corporation, and the transfer resulted in the securing of a surtax exemption and minimum profits credit, to which neither the taxpayer nor the parent corporation could have been entitled otherwise; for the taxpayer could not have enjoyed the benefit of the surtax exemption and excess profits tax credit but for the acquisition of the property producing the income from or against which the exemption and credit are claimed . . . .

With respect to the alleged business purpose, Parker suggests that any difficulty could have been taken care of by the keeping of "separate accounts". Whereas the government brief reasoned that § 129 was applicable because the parent's shareholders were the "persons" indirectly acquiring and securing the benefit of the new exemption, Parker went further asserting that "the sole benefit thereof would accrue to the parent corporation, the sole owner of the stock." However, a "corporation" is not "any person" (Reg. 1.1551-1). It is interesting to note that 1939 Code § 129 referred to "any person" as well as "any corporation" but 1939 Code § 15(c) merely mentioned "any corporation". Never before was the surtax exemption of an "acquired corporation" disallowed by virtue of § 129. Only two weeks prior to the Fourth Circuit's decision, the Tax Court reaffirmed its interpretation of § 129 in concise and clear language, i.e., "It is manifest from the unambiguous terms of section 129 that it applies only to an acquiring corporation and does not apply to an acquired corporation." The T.V.D. Co. v. CIR, CCH Dec. 22,271, 27 T. C. 879, decided February 28, 1957. It is probable that the Circuit Court was unaware of T.V.D.; if the unanimous Tax Court decision had been before the Circuit Court at that time the result, at least with respect to the application of § 129, might have been different. However, even though a Tax Court decision be reversed on appeal, the former decision may yet apply outside that Circuit Court's jurisdiction assuming the Tax Court, which specializes in tax disputes, refuses to follow the reversal. If cases from other circuits favor the taxpayer, which is a reasonable probability, the Supreme Court will be petitioned to grant certiorari to settle the conflict.

2. Purchase of Loss Corporations and Carry-forwards

The "acquired-acquiring" dichotomy had its genesis in a series of cases in which § 129 was ineffective in preventing the use of tax benefits in tax-motivated acquisitions involving the acquisition of a corporate shell having a large loss carry-over or other tax attribute and the use of the loss corporation as the survivor in a merger because of the difficulty in finding that the "principal purpose" of the transaction was the avoidance of taxes. Alprosa Watch Corp., CCH Dec. 16,559, 11 T. C. 240 (1948); A. B. & Container Corp., CCH Dec. 17,641, 14 T. C. 842 (1950); Commodore's Point Terminal Corp., CCH Dec. 16,602, 11 T. C. 411 (1948) (acq.); Wage, Inc., CCH Dec. 19,301, 19 T. C. 249 (1952); and The T.V.D., supra. It would appear that this weakness has been effectively remedied with the enactment in the 1954 Code of those provisions restricting the use of loss carry-overs when an interest in a loss corporation is acquired, Code §§ 381-2. Since the problem of loss carry-forwards is primarily connected with the diminution rather than the multiplication of entities, its treatment here is limited. See Senrich, "Libson Shops -- An Argument Against Its Application Under the 1954 Code," 13 Tax L. Rev. 167 (1958); Phillips, Cohen, Surrey, Tarleau and Warren, "The Internal Revenue Code of 1954: Carry-overs and the Accumulated Earnings Tax," 10 Tax L. Rev. 277; Ekkman, "Purchase of Loss Corporations, Sections 269 and 382; Carry-overs: Section 381," 15 N.Y.U. Inst. on Fed. Tax. 741 (1957).

3. The Purchase of Depreciation

Code § 129, however, has been effectively applied against transactions involving the acquisition of the stock of a corporation with high-basis--low-value assets, usually real estate corporations, followed by a deficiency sale of such assets and an effort to utilize such losses. American Pipe & Steel Corporation, CCH Dec. 21,352, 25 T. C. 351 (1955), aff'd 243 F. 2d 125 (9th Cir., 1957); Elko Realty Co., 29 T. C. No. 106 (1958). Taxpayers unsuccessfully attempted to file a consolidated return by the profitable parent with the acquired subsidiary in order to utilize the losses. Such transactions lead to the diminution rather than the multiplication of entities. It would seem that the procedural device inserted in § 269, so far untested but subject to criticism, was primarily aimed at such "high basis-low value asset" situations, i.e., a presumption in the case of a disproportionate purchase price. See, e.g., H. R. Rep. No. 1337, 83d Cong., 2d Sess. 32 (1954), in which it was stated as to § 269(c) of the 1954 Code, "It is believed that the addition of this new provision will strengthen existing law in an area that has presented a serious problem of tax avoidance." Mertens, Code Commentary, Law of Federal Income Taxation, Sec. 269(c):2. For a criticism of this presumption, see Ness, "The Role of Statutory Presumptions in Determining Tax Liability, 12 Tax L. Rev. 321, 393 (1957).

The Circuit Court in American Pipe & Steel Corp. characterized the transaction in question at page 128:

> The reasons advanced by petitioner that its acquisition of a practically defunct corporation was the potential value of the lots does not overshadow the conclusion that the acquisition was for a huge potential tax benefit. The fact that within two months of acquisition Palos Verdes was a mere corporate shell is highly significant as militating against petitioner's contention of his nontax motivation.

The tax basis of the lots in question were in excess of $430,000 while the market value was only $25,000. Petitioner for a mere cost of $11,248.96 would have secured a $400,393.91 carryover of net operating losses following the liquidation sale of the lots on the rejected consolidated return.

Elko, supra, on similar facts, cited American Pipe & Steel Corp., supra, and explained that "if a corporation with a net income of $10,000 and a Federal tax liability of $3,000 acquires another corporation with the principal purpose of wiping out or significantly reducing its own $3,000 tax, section 129 would be applicable."

If the 1954 Code § 269(c) had been applied to these two fact situations, the fact of the unquestionably disproportionate purchase price would constitute "prima facie evidence of the principal purpose of evasion or avoidance of Federal income tax."

With respect to the use of a consolidated return under such circumstances the Tax Court in Elko declared that "In J. D. & A. B. Spreckels Co., 41 B.T.A. 370 (1940), we laid down the rule that where the ownership of a subsidiary's stock by a parent corporation served no business purpose, as distinguished from a tax-reducing purpose, the subsidiary is not an affiliate within the intent of Section 141", and held that the same rule applied to the case at bar "regardless of distinctions of fact, where the petitioner is unable to show a business purpose, as distinguished from a tax-reducing purpose, was served by the acquisition in question." The possible impact of this rule on multiple corporations is not clear.

However, referring to the questions presented, and discussed supra, Code § 129 should be restricted to the type of factual situation arising in American Pipe and Steel Corp. and Elko Realty.

C. IRC § 1551

The vague statutory language of Code § 129 in effect defeated any Congressional intent with respect to restricting the use of multiple entities. The Tax Court's interpretations gave rise to the "acquired or acquiring corporation dichotomy" as well as a general controversy as to whether or not split-ups were covered by the section at all. Congressional reaction was the addition of 1939 Code § 15(c), enacted as § 121(f) of the Revenue Act of 1951, current 1954 Code § 1551.

Section 1551 is directed at the multiplication of a corporation of its $25,000 surtax exemptions and its $60,000 accumulated earnings credit through the transfer of "all or part of its property (other than money)" to newly-created or inactive corporations whereby the transferor corporation and/or its stockholders gain control of the transferee corporation. The exemption and credit may be disallowed in whole or in part to such transferee corporation "unless such transferee corporation shall establish by the clear preponderance of the evidence that the securing of such exemption or credit was not a major purpose of such transfer."

The provision by directly treating the problem of the surtax exemption in effect diminishes "the importance of the application of section 129 to split-ups and substitutes the more immediate problem of determining to what extent the new law superintends the orderly division of corporate entities." Emmanuel, "Section 15(c): New Teeth for the Reluctant Dragon?" 8 Tax L. Rev. 457, 461 (1953). It appears to be almost mandatory in terms and automatic in operation.

Thus, in situations where the parent corporation forms a new subsidiary through the contribution of assets other than cash, the Commissioner has an effective weapon. Anthoine, "Transactions Between Related Taxpayers," 1956 Tulane Tax Inst. 269, 294.

According to its legislative policy, the section should not discourage the legitimate expansion of an existing business as against a mere split-up of an existing business. See Committee Reports, 564 CCH 4996.20. Since it only refers to "any corporation", it should not prevent an individual or group of controlling shareholders from creating new corporations using any cash or property they own to engage in a similar or different business. Mortenson, "The Multiple Attack on Multiple Corporations," 35 Taxes 647 (1957). Nor should it prevent a corporation from using its funds to form the capital of a new subsidiary and acquiring its stock in exchange. In other words, the parent corporation could transfer cash to the new subsidiary to develop additional land or to be used to purchase capital equipment from the parent. (Reg. 1.1551-1(d).) The section does not apply to transfers emanating from the new corporation. Perhaps the shift from the vague statutory language of Code § 129 to the detailed specificity of § 15(c) may create additional interpretation problems and "loopholes"!

The provision was held inapplicable in T.V.D. Co. v. CIR, 27 T. C. 879 (1957), which was, however, a net-operating carry-over loss situation, not a split-up. The Tax Court explained at page 886:

> Section 15(c) prevents a transferee corporation, if it is controlled by the transferor corporation or its stockholders, from taking advantage of the $25,000 exemption from the surtax granted by section 15(b) or the $25,000 minimum excess profits credit granted under 431, unless such transferee corporation can show by a clear preponderance of the evidence that the securing of such exemption or credit was not a major purpose of the transfer. We fail to see how this section bears on this case. The issue involved here has nothing to do with the surtax on corporations, and, further, the petitioner is a transferor corporation and not a transferee corporation. (Emphasis added.)

In its initial application, Coastal Oil Storage Co. v. CIR, supra, the Tax Court and the Circuit Court were in complete accord. According to the Tax Court (see facts, supra), the petitioner had acquired "property" in the form of seven oil storage tanks from the parent in exchange for all its stock as part of the consideration for the transfer of said tanks and the transferee was organized for the express purpose of acquiring such property. Disallowance, it continued, would be automatic unless the transferee-petitioner met the heavy burden of persuasion proving that securing the exemption was not the "major purpose" of the transaction. But petitioner failed to carry the burden; "[a]lthough he (an officer) testified that the tax consequences of the transaction were discussed he did not state whether, or to what extent, the tax benefit to be derived influenced the decision to set up the new corporation and transfer the tanks to it." Both courts felt that separate accounting records could have been used rather than separate incorporation.

The separation of the commercial from the negotiation contracts failed to satisfy the "clear preponderance of the evidence" burden under § 15(c) which refers to a "major purpose", according to the Tax Court and the Circuit Court. But the Circuit Court in applying § 129 (1954 Code § 269) failed to distinguish between the wording of § 15(c) ("major purpose" and a "clear preponderance of the evidence") and § 129 ("principal purpose" and no explicit burden clause). This raises two problems. First, a "business reason" which may have satisfied a "principal purpose" may not satisfy a "major purpose". (Reg. 1.1551-1(e).) However, the Circuit Court, without any discussion, implied that the "business reason" in Coastal Oil Storage also did not satisfy the "principal purpose" of § 129 even though the Tax Court had been prone to accept "business reasons" in this area and the Tax Court had held § 129 inapplicable. Secondly, the use of procedural devices in the area of tax evasion raises additional questions. According to one writer:

> While the various procedural provisions creating presumptions, rules of prima facie evidence, and rules as to the degree of proof vary in terminology, they have one striking attribute in common. All of these devices are employed in situations in which one of the essential facts upon which tax liability is based is the purpose or state of mind of the taxpayer; the device relates to the proof of the existence of that state of mind. It is also generally true that these sections, involving a subjective element as a necessary ingredient of tax liability, have been added to the Code to cope with particular problems of tax avoidance. (Ness, "The Role of Statutory Presumptions in Determining Tax Liability," 12 Tax L. Rev. 321, 325 (1957).) [See Code §§ 269(c), 357, 532 and 1551.]

Apparently, then, the "clear preponderance" procedural device, necessary to rebut the government's presumption, is to weight the scales to the government's advantage thus counterbalancing the taxpayer's advantage illustrated by the Commissioner's poor litigation record under § 129. Accordingly, the normal functioning of such devices, part of the law of trial procedure and evidence, is to affect the outcome of litigation under § 269(c), supra, and § 1551. However, if the taxpayer has the burden of proof in the first instance, what is the effect of shifting the burden of proof from the government to the taxpayer through such devices? Ness, supra, at page 412, characterizes those procedural devices creating mere presumptions or rules of prima facie evidence as ineffective but feels that the "clear preponderance" device is a legally effective means of strengthening the government's position by increasing the degree of persuasiveness of the evidence required to avoid the disallowance. A more reasoned view argues that in effect there is little substantial difference between a "clear preponderance", a "fair preponderance" or a mere "preponderance" of the evidence. Emmanuel, "Section 15(c): New Teeth for the

Reluctant Dragon?" 8 Tax L. Rev. 457, 468 (1953). In other words, the use of a "clear preponderance" does not really place upon a taxpayer any larger burden than the burden of proof usually required to overcome the Commissioner's prima facie case based on his fact findings. Thus, a better rule would reject such devices since whatever constitutes a preponderance of the evidence will vary depending upon the opponent's evidence and presumptions.

> In the final analysis, therefore, since Section 15(c) creates no new presumption, the taxpayer's burden is neither greater nor less than it has always been in a civil suit -- the burden of going forward with the evidence and proving the Commissioner's determination clearly wrong by the greater weight of the evidence. (Emmanuel, supra, at page 469.)

Because of the specificity of § 15(c) (1954 Code § 1551) and the lenient attitude previously taken by the Tax Court with respect to "business reasons" for split-ups, it was believed that the scope of the provision could be predicted and circumscribed by the tax practitioner, to-wit:

> Suppose the transaction between corporation A and B involved a lease by corporation A to corporation B of all of the assets used in the enterprise which it was abandoning. Would such a lease fall within the definition of a transfer for the purposes of section 15(c)? Probably not, because the use of the word "transfer," without more, has become equivalent, throughout the law with the terms "alienate" and "convey". (Emmanuel, "Section 15(c): New Teeth for the Reluctant Dragon?" 8 Tax L. Rev. 457, 465 (1953).)

The first reaction of the Commissioner to attempt to escape the effect of § 1551 was Revenue Ruling 57-202, IRB 1957-20, 12, which warned that any "lease arrangement" between a parent corporation and its wholly owned subsidiary formed for the purpose of acting as a sales agent on a commission basis would constitute a "transfer of property" under § 1551. It explained that the "lease of the facilities effected a passage to the subsidiary of the use, possession, and control over the economic benefits to be derived from such facilities".

Although the Regulations (1.1551-1) do not refer in terms to a lease and lessee but to a transfer and transferee, the term "transfer" depending on the purpose of the Act or provision may be broadly construed, i.e., § 1(30) of the Bankruptcy Act (11 U.S.C. § 1(30)):

> (30) "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property, or with an interest therein or with the possession thereof . . . or otherwise; . . . .

Recently, the Tax Court affirmed the Commissioner and foreclosed future recourse to "leases", thereby expanding the scope of § 1551. Theatre Concessions, Inc., 29 T. C. No. 83, decided January 31, 1958, without dissent. The parent corporation which operated a chain of theatres incorporated the petitioner in 1951 transferring to the new subsidiary $2,000 in exchange for its stock. The parent then leased the concessions in four houses to the subsidiary, the parent reporting and paying tax on the rental income from the theatres, the new subsidiary reporting and paying tax on the concession profits. The Commissioner successfully disallowed the petitioner's surtax exemption under 1939 Code § 15(c).

Petitioner argued that securing the surtax exemption was not the "major purpose" of the transaction but the Tax Court decided that the presence of _other_ valid business reasons were inconsequential. With respect to the "lease" defense, the Court held no limitations were contemplated as to the phrase "transfers . . . all or part of its property", i.e., a leasehold is property within the purview of the section and the execution of the agreement was such a transfer to the petitioner even though the latter was also required to pay rent. Apparently the Commissioner argued under both §§ 15(c) and 129 but the Tax Court ruled it unnecessary to consider the respondent's contention with respect to the application of § 129 surtax exemption in view of its conclusion under § 15(c). The Tax Court ruled that the parent "effected by the lease agreement a transfer of a leasehold interest in certain theatres and equipment to petitioner which was 'another corporation . . . created for the purpose of acquiring such property . . . .'"

Not only is _Theatre Concessions_ important because of its broad interpretation of the term "transfer", but it involves an application of the section to an intercorporate transaction subsequent to the acquisition of control through the exchange of cash for 100% stock control. Thus, the parent was in control of the new subsidiary _before_ as well as _after_ the transaction in question, i.e., the parent had formed the new subsidiary through a contribution of _cash_ not property, the _first_ transaction. A cursory reading of § 1551 would seem to indicate that the "control" in question derives from the original exchange. However, although the Tax Court offers no explanation, it would appear that the court viewed the exchange and the execution immediately thereafter as in effect a single transaction for the purposes of the application of IRC § 1551. Perhaps the court reasoned that the new subsidiary used the $2,000 to purchase the lease in question from the parent. Then, if IRC § 1551 can be effectively applied against the initial organization of a new subsidiary, _Coastal Oil Storage_, _supra_, as well as to intercorporate transactions which occur soon thereafter between the parent and the new subsidiary thereby disallowing the latter's surtax exemption, the Commissioner now has a weapon almost automatic in operation under the "major purpose" test.

Not only is _Theatre Concessions_ within the "spirit" of _Coastal Oil_ but it appears to go even further and serves as a warning to all that the Tax Court will examine with closer scrutiny tax-motivated multiplications and intercorporate transactions. It is interesting to note that the petitioners in such cases have been "middle-class" corporations. It may well be argued that no transaction is conceivable in which taxes are reduced, no matter how incidentially, whereby such reduction would not constitute a "major purpose"!

The tax practitioner treads on treacherous ground in this area; Revenue Ruling 54-172 declares that no ruling or determination letter will be issued relating to a question of fact as to "whether a transfer or acquisition is within section 15(c) or section 129 of the Internal Revenue Code."

Apparently statements of the effect of IRC § 1551 made when the 1954 Code had been recently adopted will have to be reconsidered, i.e.:

> . . . [O]ld section 15(c) was of questionable effectiveness in preventing the obtaining of more than one surtax . . ., and there is no reason to believe that section 1551 will be of greater effectiveness. (Cohen, Phillips, Surrey, Tarleau and Warren, "The Internal Revenue Code of 1954: Carry-overs and the Accumulated Earnings Tax," 10 Tax L. Rev. 277, 303.)

Various proposals for the avoidance of IRC § 1551 have been set forth, to wit:

> . . . not applicable if separate corporations are used at the outset of the enterprise in such manner that there is no transfer by a corporation to another corporation controlled by the transferor or its shareholders . . . . It is also to be noted that the formation of new corporations at the outset avoids problems of the Code provisions dealing with the acquisition of credits or loss carryovers . . . . (Connery, "Residential Developments: Multiple Corporations, Allocations, Administration," 14 N.Y.U. Inst. on Fed. Tax. 189, 193 (1956).)

Also, since "control for the purposes of IRC § 1551 is fixed at 80%, outside interests should be invited to purchase more than 20% of the stock of the new corporation. Wright, "Tax Planning for the Growing Corporate Business," 1954 U.S.C. Law School Tax Inst. 48, 49; Landman, "Multiplying Business Corporations and Acquiring Tax Losses," 8 Tax L. Rev. 81, 82 (1952).

With respect to the future construction and application of IRC § 1551, several unanswered problems may be raised, problems which have so far merely passed across the tax lawyer's desk and caused a raised eyebrow (interview with Mr. Myles Sachs, supra):

(1) Although IRC § 1551 does provide that the "constructive ownership under section 544(a)(2) shall be determined only with respect to the individual's spouse and minor children", to what extent may the Commissioner also apply the "constructive ownership" provisions of IRC §§ 267 and 318 to determine control through the existence of related shareholders for the purpose of invoking IRC § 1551 as well as IRC §§ 269 and 482? In other words, in planning multiple entities, what is the permissible scope of "identity of interest" and to what extent will the participation of outside investors ensure protection?

(2) In view of the fact that the Rulings Division of the Corporate Reorganization and Dividends Branch has refused to rule out the

application of IRC § 1551 to an otherwise qualified spin-off, will a divisive type of reorganization which qualifies under IRC § 368(a)(1)(D) and meets the tests of IRC § 355 (active business and non-tax avoidance purpose) nevertheless be subject to the restrictions of IRC § 1551 disallowing the surtax exemption? In other words, to what extent will an IRC § 355 "active business" overcome the IRC § 1551 "major purpose" presumption?

(3) If the multiple corporations qualify under IRC § 1503 to file a consolidated return and since the Commissioner may not apply IRC § 531 against an individual corporation when a consolidated return is filed, must the Commissioner then examine all the related corporations in applying IRC § 531 to an individual entity when a consolidated return is not filed by the multiple corporations? And, if the Commissioner does in fact examine all the multiple related corporations, may he determine in a cumulative sense that such corporations in toto are accumulating too much money? Also, since only one surtax exemption or accumulated earnings credit is available in the case of members of an affiliated group which files a consolidated return, should not the provisions of IRC § 1551 have application only in those instances where separate rather than consolidated returns are filed? Thus, should not IRC § 1551 be inserted elsewhere in the Code?

D. IRC § 355

Generally, there are three methods for creation of the multiple corporate set-up. The first, naturally, is creation at the beginning of the enterprise. The second method is the acquisition or purchase of a corporation. The third of these methods, the "spin-off" is used to create new entities from the old. Under § 355 of the Internal Revenue Code of 1954, the distribution of stock in a spin-off transaction is given tax-free treatment. Without becoming detailed about the operation and uses of this section (which is beyond the scope of this paper) IRC § 355 provides that where a corporation distributes stock of a corporation which it controls immediately before distribution to its shareholders, and the device is not used as a means of distributing earnings or profits and the distribution is of all the stock held by it prior to distribution -- or an amount equal to "control" under § 368(c) (80% of stock of all classes) -- "then no gain or loss shall be recognized to (and no amount shall be includible in income of) such shareholder or security holder on the receipt of such stock or securities." There is a general requirement of "active conduct of a trade or business" for both the distributing corporation and the controlled corporation(s). The five year test is used here. The tax-free spin-off may be simply illustrated: A corporation transfers to B corporation assets in exchange for all of B corporation's stock. A corporation then distributes B corporation's stock to A corporation's shareholders. The shareholders recognize no gain or loss.

Probably the main reason for the use of the spin-off is to give stockholders stock in two companies for the purpose of manipulation. However, it is also used to create new entities by simply transferring a portion of a business to a newly created corporation in exchange for its stock (following all the requirements laid down in IRC § 355). The Commissioner may be able to put this provision of the Code to even another purpose, for a new point of difficulty for the business advisor may have had its nascency in a recent revenue ruling, Rev. Rul. 58-54, C. B. 1958-8, 12 (Feb. 24, 1958). Although this ruling is in the area of § 355 it may give the Service a brand new avenue of approach to striking down multiple corporations. There, a corporation operating a soft drink business (both bottling and distributing) transferred assets applicable only to the distributing portion of the business at three locations to three new corporations in exchange for all their capital stock. The old corporation then distributed this stock to its shareholders. This distribution did not qualify as a tax-free distribution under IRC § 355 as the bottling was done at the main plant and the activities in the three locations made up only one single operation. According to the ruling, "the selling or distributing activities of the one business did not constitute a separate business or businesses despite some geographical differences in warehouse locations. They all formed part of one integrated business wherein the product was manufactured in one place, although distributed through several warehouse points." If a distribution will not be allowed under § 355 of the Internal Revenue Code because it is not a separate business, the Commissioner may not allow the other advantages accruing to the new corporations (multiple corporate set-up) for the very same reason, i.e., it is one enterprise. This is a situation that practitioners might do well to consider in the future, when the spin-off is used to create a new entity-multiple corporation.

E. Title Holding Company Problem

The Commissioner's contention that a corporation which merely holds bare legal title to real property (a purely passive function) should not be recognized as a taxable entity has been generally affirmed by the courts, e.g., Whitfield Estate v. CIR, 192 F. 2d 294 (5th Cir., 1951); William F. Buckley, 22 T. C. 1312 (1954). Thus, it may be argued that the parent corporation in Theatre Concessions, Inc., supra, if, after it leased the concessions to the new subsidiary merely held the legal title to the property of its theatre subsidiaries and performed no active business activities should no longer be recognized for tax purposes. See Anthoine, "Transactions Between Related Taxpayers," 1956 Tulane Tax Inst. 269, 302. Professor Anthoine suggests that a "corporation used only to acquire title to real property and to be the party to the purchase money mortgage in order to avoid personal liability of the interested individuals will not be recognized as a taxpayer."

F. Personal Holding Company Problem

At page 70 of the A.L.I. pamphlet, "Organizational Problems of Small Businesses" by Leonard Sarner (Revision by Howard C. Metts, 1956), it says, "If a large part of the income of the enterprise is to be derived from sources other than the operation of a commercial business, the parties may find their use of the corporate medium circumscribed by the personal holding company tax" (imposed by § 541 of the 1954 Internal Revenue Code). The tax imposed is a penalty tax at an extremely high rate -- 75% of the undistributed personal holding company income not in excess of $2,000, plus 85% of the amount in excess of $2,000.

The danger of being considered a personal holding company can be a very real problem in the area of the multiple corporation, for personal holding company income consists of such things as: dividends, interest, royalties, annuities, gains from commodities and securities transactions, amounts from personal service contracts, rents, and the like (§ 543(a)). Often times, in the area of multiples, one corporation (generally the parent) will be receiving income primarily of such a nature that it could be deemed personal holding company income. However, two requirements must be met before a corporation can be considered a personal holding company, and avoidance or side stepping one, or both of these, removes the danger of a penalty tax, which is imposed in addition to the corporate tax of § 11. First, there is a stock ownership requirement (§ 542(a)(2)). If at any time during the last half of the taxable year more than 50% (in terms of value) of the outstanding stock of the corporation is owned directly or indirectly by not more than five individuals, this requirement is satisfied. The second requirement (§ 542(a)(1)) is that at least 80% of the corporation's gross income consists of personal holding company income.

As onerous and as strict a penalty as is imposed by the various sections of the Code relating to this problem of the personal holding company, it is almost as difficult to be considered such an entity, within the requirements just mentioned -- at least in the area of the "middle-class" corporation just having reached the surtax bracket. Generally, then, with just a little bit of care on the part of the practitioner, the real threat of the personal holding company can be eliminated from this area of the multiple corporation.

G. Conclusions

Although the Code sections applicable to multiple corporations have been characterized as a "semantic wonderland" and the Congressional intent found "obscure", the challenged tax devices which have been condemned generally involve bookkeeping or conveyancing legerdemain devoid of business content. Mortenson, "The Multiple Attack on Multiple Corporations," 35 Taxes 647 (1957). However, the "pinch" in the area has primarily affected "middle-class corporations" and the tax planner's powers of prediction are rather limited.

The element of confusion in the area is made apparent by the Commissioner's growing tendency to use the "buck-shot approach", supra, in running down his quarry. Under such circumstances, a taxpayer, if somewhat doubtful of his legal position, will be willing to consent to the application of IRC § 482 if the Commissioner promises not to use IRC § 1551. Interview with Mr. Myles Sachs, supra.

It would seem apparent that there is considerable need for technical tax revision in the area of multiple corporations. If a particular group ("middle-class corporations") is now being harassed by existing sections, a change in the law should not be suspect because it eases the burden on such a group or spreads it among other groups. Accordingly, the applicable sections, particularly IRC §§ 482 and 1551, should be coordinated, the harsh "major purpose" test modified and a more reasonable test which recognizes the exigencies of the market-place adopted.

IV. INTERVIEWS

A. Certified Public Accountant's View of the Use of the Multiple Corporation

Mr. Milton Guttenplan, a Certified Public Accountant who has practiced extensively in the New York City area, is convinced not only of the general feasibility of the use of the multiple corporate device but believes, as well, in its general desirability. He said that "one of the basic principles by which we operate under the tax law is that we can mitigate income tax. The use of multiple corporations is the easiest and most legitimate way of saving taxes." Of course, Mr. Guttenplan cautioned that there must be a good business reason, but when deciding upon organization of any type of new business, the multiple corporate device is almost automatically considered; there being no problem of additional cost (generally) in administration nor any problem of efficiency in operation.

Among the reasons that Mr. Guttenplan gives as important practical considerations decisive in a practitioner's choice of the multiple set-up, exclusive of the other major reasons (both tax and business) discussed elsewhere in this paper, are: Spreading of travelling and entertainment expenses among the various corporations (lessening the likelihood of inquiry into these items), eliminating the possibility of having owner's and officer's salaries called excessive thereby resulting in dividend treatment which would mean a loss of the deduction to the corporation, and the possibility of getting rid of a piece of property which is in a separate corporation by liquidating and taking advantage of § 337 -- no loss or gain recognized. The latter point is especially valuable where you have a piece of appreciated property. You can take advantage of this provision without liquidating the entire business and also get only one capital gain instead of two.

The threat imposed by the various sections of the Internal Revenue Code are constantly kept in mind as a danger in the multiple corporation situation. Practitioners are aware of the possibility of attack, and defeat, of one of the primary reasons for use of this device (tax considerations) and they, consequently, take great pains to avoid any application of these sections of the Code upon their corporate creations. According to Mr. Guttenplan, they seek to avoid § 482 of the Internal Revenue Code by making sure that there is an actual and legitimate business transaction. Another example of practitioner's care, § 1551 is avoided by not transferring assets to the new entity upon its creation. They will, instead, transfer money -- a token amount to be sure -- and the new corporation does its buying on credit, i.e., permitting the new corporation to build itself up.

Mr. Guttenplan concluded, practitioners are aware of the provisions of the Internal Revenue Code and of the possibility of attack by the Internal Revenue Service, but, to the best of his knowledge, there is very little government activity in this area. In fact, in all his years of practice, he has never seen a corporation attacked upon these grounds.

B. Internal Revenue Agent's View of the Use of the Multiple Corporation

In a recent interview with one of the senior auditors of the Brooklyn office of the Internal Revenue Service, he indicated that the use of the multiple corporate device is quite common. There are many reasons for its popularity, especially the advantage of allocation (manipulation of travelling and entertainment expenses, salaries, capital gains, transfers and the like) and the avoidance of the 22% surtax. In addition to these major reasons, multiple corporations are useful: to reduce the difficulty of the valuation of a gift of a corporation (important in the gift and estate tax areas), to permit easy access to ready cash by liquidation of one small corporation, and finally, to protect the use of "thin corporations." "Thin corporation" investments are better in an area of multiple corporations, than in an area of single corporations, because it will not seem so glaring.

The government has four methods of attack against the use of multiple corporate entities, according to the Agent. They are: Disallowance, reallocation, disregard of the corporate entity, and attribution of taxes (income taxable to one who earned it). The general, and normal, method of inquiry by the Commissioner (in this area) is, is it a legitimate entity for tax purposes under the "business purpose" test -- is there a business purpose for the existence of the corporation as an entity? Secondly, he will inquire, was the corporate creation (or acquisition) merely for evasions? He will ask, for instance, what was the reason <u>now</u> for the sudden formation of new corporations, especially if the operation has previously been conducted without this type of business organization? A tax practitioner, accountant, or lawyer must be able to negate any presumption that may arise as a result of these inquiries. As the Auditor said, "If there can be demonstrated good business purposes and arms length transactions <u>and</u> sufficient capitalization (to disprove sham) the chances of being attacked are slight.

In actual practice many multiple corporation devices, which might be attacked as methods of evasion or avoidance of taxes, are left untouched, simply because they are not being discovered by the Service. There are various reasons for making the detection and ferreting out of such devices relatively impossible. Corporation names are often completely dissimilar and often times they are located at different premises, thus permitting them to file their returns in different districts. Then, too, these separate entities operate on different fiscal years and, therefore, their overall operations are rarely considered together by the investigating agent. This means, as a general practice, that an agent may not be able (and, indeed, often is not able) to examine all the multiple entities together, because there is no nexus between them -- for the aforementioned reasons. Another factor that is significant and worth bearing in mind, according to the Agent, is that "some Internal Revenue Agents are not capable men and may not, therefore, be able to recognize multiple corporations as devices of evasion and avoidance."

"If the multiple corporate set-up is going to be attacked, it will be attacked in the first year of its use." This is readily explained by the fact that the first year's investigation is probably the most extensive and thorough one, catching these attempts at evasion at their inception. There is an assumption in the Service, as well, that if there was no attack in the first year then there is no reason for attack at all. Generally, but not as a hard and fast rule, one agent will not reopen another's work -- in our situation that of the auditor who made the first investigation.

Perhaps the most common method and use of multiple corporations is the existence of separate entities for manufacturing, distributing and for sales. An agent can attack these as a single business, but seldom will do so, unless all the activities are conducted on the same premises and he has some reason for believing that the operation actually is only one enterprise. This, too, is not a strict rule applied with invariable vigor, because "the same set of facts with one or two variations can (and often does) change the government's attitude."

In twenty-five years of varied experience, examining mostly large corporations, this senior auditor of the Brooklyn office of the Internal Revenue Service can recall applying § 482 (and its predecessors) not more than six times. As for §§ 269 (and its predecessors) and 1551 (and its predecessor), he has never had any occasion where their use was deemed necessary or essential.

V. PROBLEMS OF EFFICIENCY AND POLICY

We propose to consider three questions:

(1) What are the effects of multiple incorporation on the overall operation of the economy?

(2) What specific effects do the tax laws have -- via their influence on multiplication -- on economic efficiency?

(3) What possible improvements in tax policy recommend themselves in view of the answers to the preceding questions?

There does not appear to be any readily available statistics on the incidence of multiple incorporations in the economy. A glance at the proliferation of subsidiary and associated companies in Moody's Industrials or Standard and Poor's Corporations shows their popularity, at least among larger firms. However, even if totals had been compiled for the numbers of affiliated organizations, together with asset and income size distributions, which has not been done, to our knowledge, it is likely that the true extent of multiplication in the economy will have been underestimated. For example, a stockholder group controlling several corporations engaged in diverse sorts of business constitutes a multiple entity, but such an organization would not readily be tabulated unless the stockholder group set up a holding company to handle its interests.

The paucity of statistics on the effects of multiple incorporation forces us to rely on individual cases, opinion and conjecture. Almost all the cases we have come across involve relatively small entities. Furthermore, the multiplications seem to be essentially of an accounting and legal character, and rarely have much effect on the technological organization of the enterprise. That is, while there is a great deal of manipulation of title transfers, equities, incorporation charters, tax liabilities and so forth, underneath all the paperwork the productive structure seems to remain, by and large, relatively undistorted. Incorporating as several entities rather than one has a negligible effect on efficiency, according to Mr. Guttenplan. Aside from the employment of a few more lawyers and accountants than would otherwise be necessary, the multiple set-up will operate almost exactly as the single one might.

The possible damage to the credit-rating of corporations which splinter their assets is customarily overcome by presenting a consolidated balance sheet and income statement to the public. (This practice also serves to conceal internal operations from competitors and government agents. Note that filing consolidated statements has nothing to do with filing consolidated income-tax returns.)

So far there seems to be little cause for concern. A potentially more serious source of diseconomies lies in the "unnatural union" by acquisition of corporations to take advantage of the loss-carry-over provisions of the Code. A most intriguing example of this is provided by the recent operations of the Philadelphia and Reading Corporation. [Our attention was drawn to this corporation by Professor J. C. Bonbright of the Business School.]

The Philadelphia and Reading Corporation was engaged principally in the anthracite coal business, and had made losses in the years 1954 and 1955. An aggressive new management (the Graham-Newman interests) took advantage of the extensive cash resources and assets of the corporation to transform it into a holding company. It acquired the Union Underwear Company ("Fruit of the Loom") in 1955 for $15,000,000: $4,600,000 down with the balance to be paid over five years. In 1956 it acquired the Acme Boot Company (cowboy boots) for $3,200,000: $1,500,000 down with the balance to be paid over five years.

In 1956, the corporation converted its deficit into a pre-tax income of $9,598,358. The provision for Federal and State income taxes was a mere $950,000, less than 10% of earnings. Without the loss carryover from previous deficits, the tax would have been at least $3,700,000. [Philadelphia and Reading Corporation, Annual Report, 1956.] The income figure represents the consolidated income of parent and subsidiaries. Although breakdowns were not given in the Annual Report, ". . . it can be deduced with reasonable certainty that the earnings of the two newly acquired companies contributed about half of the total earnings of $8,600,000." [B. Cavalier for Springam, Heine & Co., "Philadelphia and Reading Corporation," April 8, 1957. According to Professor Bonbright, the company has recently been branching out again -- this time into the spectacles business.]

Thus, the loss carryover provisions of the Internal Revenue Code create an affinity between large loss and large gain corporations that sometimes leads to rather weird combinations.

There are many other examples of the same theme:

> Chesapeake Industries, Inc., with nine diversified subsidiaries, has a large tax umbrella which W. C. MacMillan, Jr., president, displayed for a group of security analysts yesterday.
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> Mr. MacMillan said the company's tax carryovers of losses in the past years add up to nearly $8 million, good through 1955, and added, "We're going to use the entire $8 million." He stated Chesapeake purchased Vandewater Paper yesterday . . . and asserted "we're still looking for other sellers to bring under the umbrella." [Wall Street Journal, May 19, 1953, quoted in Tarleau, Federal Tax Policy for Economic Growth and Stability, p. 615. For further examples and extended discussion of the general problem of acquisitions, see Federal Trade Commission, Report on Corporate Mergers and Acquisitions, May, 1955; J. K. Butters, J. Lintner, W. L. Cary, Effects of Taxation on Corporate Mergers, 1951.]

It is difficult to judge how much inefficiency, if any, is introduced by such acquisitions. If decentralization is maintained, and the old management kept in its position, operations before and after acquisition may be all but undisturbed, the effect being simply to reduce the revenues of the government.

On the other hand, the effect of such acquisitions may sometimes be to breathe artificial life into a business which could not maintain itself without such support and which, from the point of view of overall efficiency, might best have been left to expire peacefully. This possibility is aggravated by the Code provisions §§ 381-382 requiring continued operation after acquisition of a loss corporation in order for a firm to be eligible for the loss-carryover benefit. (This provision does not apply where the loss corporation acquires the profitable one, as in the Philadelphia and Reading case, rather than the other way around.) If, however, the losses were due to incompetent management rather than to sickness of the industry, acquisition of the firm and replacement of the old management may restore the vigor of an inherently sound enterprise, and incidentally save the costs of liquidating the firm. Conversely, acquisition of a profitable corporation by a firm with losses may enable the incompetent management of the latter to hang on for a few more years before being tossed out by the stockholders or going bankrupt. These are all possible situations; we have no data to estimate their relative importance.

Although tax considerations obviously play a role in corporate acquisitions, it is easy to exaggerate their importance. They are rarely involved in sales of corporations with less than $1,000,000 in assets, and figure as a major reason for sales in about one-quarter of transactions involving firms with more than $1,000,000 in assets. [J. Lintner, Federal Tax Policy for Economic Growth and Stability (henceforward abbreviated FTP), p. 701; Butters, Lintner and Cary, op. cit., p. 16.]

On the whole, taxes appear to influence the form in which a transaction clothes itself, rather than whether or not the transaction itself will take place. ". . . [B]y and large, the tax structure appears to have had only a relatively limited and specialized impact both on the basic incentives which motivate the private economy and on the structure of this economy." [J. K. Butters, "Taxation Incentives and Financial Capacity," American Economic Review, May, 1955, p. 505, quoted in Taylor, FTP, p. 652.]

That such "limited and specialized impact" does in fact operate to some extent to encourage multiple incorporation has been made abundantly clear by the cases discussed throughout this paper. But it is hard to make a case for the claim that such effects have decreased efficiency to any noticeable degree. Rather, taxes are just one of many different influences operating, and even where their effect can be isolated, it will in general take a form which has no direct influence on efficiency.

We may, in view of this conclusion, not expect any world-shaking consequences from revisions in tax policy relating to multiple corporations. But even so the provisions of the Code as it stands are very far from perfect.

We use the following three criteria as the basis of our criticism:

(1) equity -- it is hard to formulate this criterion with precision, but roughly it means that no person should have a tax advantage arising from fortuitous circumstances unconnected with his special merits;

(2) certainty -- a person should know beforehand exactly what the tax advantages and liabilities are of any transaction he may wish to undertake;

(3) simplicity -- the provisions of the Code should be as simple as possible, consonant with the objectives of equity and certainty.

These criteria are all to be understood *ceteris paribus*.

The $25,000 surtax exemption we discovered to be the most important tax motive for corporate fragmentation. [Cf. the figures in the Ackerman taxicab case, supra.] The provision clearly reflects the traditional Congressional desire to foster small business, and so it has. But it has also led to large businesses taking advantage of the exemption by making themselves small -- that is, by dividing up into many small enterprises. The situation would become much worse in this respect if we followed the suggestion [made by H. A. Leggett, FTP, p. 610] to graduate the corporate income tax still further, adding several surtax brackets and progressing well above the present $25,000 limit.

Let us go to the opposite extreme and ask what would happen if the present surtax exemption itself were abolished. This would eliminate the favored position of small and growing businesses, which elimination is perhaps not desirable. But if it is in the national interest to discriminate in favor of certain types of activity, the tax instrument still remains a rather crude and inefficient way to accomplish this objective -- simply because it discriminates poorly, allowing undesired businesses to sneak in under the umbrella. Elimination of the surtax would abolish at a stroke the major tax reason for multiple incorporation. In its place we might substitute a direct subsidy to former legitimate beneficiaries of the exemption. At least we would then know who was getting what, and how much. [Cf. Dan Throop Smith's preference for subsidies over concealed discrimination, quoted in Hellmuth, FTP, p. 916.] (We understand that this proposal is politically impossible.)

The $60,000 accumulated income allowance has been another potent incentive toward corporate multiplication. The penalty tax on improperly accumulated income -- i.e., on income undistributed and just sitting in the corporation for no apparent business purpose -- is needed to stop "wholesale tax avoidance". [H. J. Rudick, FTP, p. 648.] It is a necessary bulwark to the progressive personal income tax. The provisions have the drawback of being quite imprecise, involving as they do questions of intent and propriety. The $60,000 provision of the 1954 Code was perhaps inserted as a counterweight, insuring freedom from tax trouble for improper accumulations, providing you don't accumulate too much. Its effectiveness is problematical. Rudick believes the penalty tax has not, by and large, led to undue distributions of corporate income, either by small or by large businesses. [Rudick, FTP, p. 641 ff.] It has, however, led to undue multiplication of businesses, a practice which tends to nullify the whole provision. Blocking the path to evasion is the shadowy IRC § 1551, which is hardly an ideal instrument. One simple proposal is to abolish the $60,000 allowance (recommended by J. K. Hall, FTP, p. 686), while rewriting the Code to provide clear and certain criteria for the applicability of the penalty tax. How this is to be done is itself not very clear. Rudick proposes that the penalty tax be abolished, but that if improperly accumulated, undistributed income should be taxed as income of the individual shareholders. [Rudick, FTP, p. 649. See C. S. Shoup, FTP, pp. 394-404, for a discussion of criteria for the taxation of undistributed income.] A more radical suggestion comes from J. K. Hall, who wishes to integrate the tax structure by requiring private corporations to be treated as partnerships for tax purposes. [Hall, FTP, p. 690.] The accumulated earnings provision is of course directed at the private corporation, so that Hall's