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Mr. Ellis examines the tax consequences arising when a taxpayer sells appreciated property to a controlled corporation in order to realize a capital gain for himself as well as to increase the basis of the property. He points out the dangers inherent in such a transaction and suggests precautions which should be taken to obtain favorable tax treatment. The author concludes that a taxpayer transferring appreciated property to a controlled corporation may achieve substantial tax benefits because of the relative ineffectiveness of sections 351 and 1239; however, it will be almost impossible for a taxpayer to recognize a loss on the transfer of depreciated property because of section 267.

I. INTRODUCTION

To a high bracket taxpayer, one of the most appealing methods of saving taxes is the sale of property to a controlled[1] corporation on a deferred payment basis. Such a sale has many potential tax advantages. As compared with other tax saving techniques, it is a relatively simple, uncomplicated transaction. Furthermore, since the buyer is a controlled corporation the seller may obtain substantial tax benefits without giving up any real control over the property transferred. For example, at the cost of a capital gains tax,[2] the seller may transfer appreciated property to his corporation which will obtain a stepped-up basis[3] that can be offset against future ordinary income of the corporation, either by way of increased depreciation deductions or by a decreased gain on the future sale of the acquired

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1. As used in this article, the term "control" refers simply to direct ownership of a majority of the outstanding voting stock. *Cf.* INT. REV. CODE of 1954, § 368(c).

2. A sale to a controlled corporation ordinarily has no tax advantage if the seller's gain would be taxed as ordinary income. Consequently, the seller must sell or exchange either a capital asset held more than six months, or a "§ 1231 asset." *See* INT. REV. CODE of 1954, §§ 1201, 1221, and 1231. However, property which the taxpayer holds for sale and which forms an integral part of the taxpayer's business perhaps will not be considered a capital asset even though the literal terms of § 1221 (definition of a capital asset) are met. *See, e.g.,* Corn Products Refining Co. v. Commissioner, 350 U.S. 46 (1955). But the courts have refused to apply this theory to the definition of a § 1231 asset. *See* E. I. du Pont de Nemours & Co. v. United States, 288 F.2d 904 (Ct. Cl. 1961). The courts likewise have refused to define the term "sale or exchange" in a manner different from the ordinary meaning of those words. *See* Commissioner v. Brown, 380 U.S. 563 (1965).

3. INT. REV. CODE of 1954, § 1012; *cf.* INT. REV. CODE of 1954 § 362(a).

asset. Furthermore, by electing installment sales treatment,[4] payment of the seller's tax on the gain may be deferred so that the timing of the corporation's tax savings and the seller's tax payments will coincide.

If the property has depreciated in value, the seller may seek to recognize a loss on the sale but at the same time retain control over the property as a hedge against future market value increases. The desired loss may be a capital loss[5] or an ordinary loss,[6] depending on the character of the asset transferred. Other incidental benefits, in either a gain or loss situation, include the deductibility by the corporation of interest on the installment obligations given to acquire the property,[7] and the possibility that accumulation of income to discharge the obligations may constitute a "reasonable need of the business" for purposes of avoiding the accumulated earnings tax.[8]

To the seller of appreciated property, the depreciation recapture provisions[9] and the imputed interest provisions[10] of the Internal Revenue Code may remove much of the tax profit from the sale. Nevertheless, sales to controlled corporations remain attractive in the case of non-depreciable property such as land, depreciable personal property with a substantial amount of pre-1962 depreciation, and depreciable realty that has been held for several years[11] or on which

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4. INT. REV. CODE of 1954, § 453.

5. Even if the loss is a capital loss, the taxpayer may offset up to $1,000 against ordinary income in the year of sale and in future years if he has no capital gains for those years (assuming the loss is otherwise deductible). INT. REV. CODE of 1954, §§ 165(f), 1211, and 1212.

6. INT. REV. CODE of 1954, § 165(c). Section 267 ordinarily will prevent deduction of a loss on sales to controlled corporations. *See* text accompanying note 149 *infra.*

7. INT. REV. CODE of 1954, § 163. If the seller uses the cash method, the corporation must actually pay the interest in order to obtain the deduction, even if the corporation uses the accrual method. INT. REV. CODE of 1954, § 267(a)(2) and (b)(1).

8. INT. REV. CODE of 1954, §§ 531-37. *But see* United Business Corp. of America v. Commissioner, 62 F.2d 754 (2d Cir. 1933). If the notes are considered stock, accumulations for the purpose of redeeming the stock perhaps would not be considered a "reasonable need of the business." Mountain State Steel Foundries, Inc. v. Commissioner, 18 CCH Tax Ct. Mem. 306 (1959).

9. INT. REV. CODE of 1954, §§ 1245, 1250. In general, § 1245 requires that a portion of the gain on the sale of personal property equal in amount to depreciation deductions taken in 1962 and thereafter be treated as ordinary income. Seetion 1250, in gencral, requires similar treatment on the sale of depreciable real property, although only as to post-1963 depreciation. *See* footuotes 11 & 12 *infra,* for other differences between § 1245 and § 1250.

10. INT. REV. CODE of 1954, § 483. Generally, § 483 requires that the seller treat a portion of each payment as interest, taxable as ordinary income, if the installment obligations do not provide for payment of at least 4% simple interest. The corporation, however, will obtain a deduction for any imputed interest (unless the provisions of INT. REV. CODE of 1954, § 267(a)(2) apply). Treas. Reg. § 1.483-2(a)(1)(ii) (1966).

11. The amount of depreciation recaptured by § 1250 decreases by one percentage point for each month during which the realty is held, after the 20th month. For-

straight-line depreciation has been taken.[12]

A typical fact situation illustrating the potential tax benefits arising from a sale to a controlled corporation can be readily described. Assume that an individual taxpayer in the 50 per cent bracket owns land suitable for a housing development. The land cost the taxpayer 150,000 dollars and developers have offered the taxpayer as much as 500,000 dollars for the property. The taxpayer has never developed property before[13] but would like to develop this particular piece of property himself. He realizes, however, that if he constructs houses on the property and otherwise develops the property himself at a cost of 250,000 dollars and is able to sell the entire property and the houses for 1,000,000 dollars, he will have recognized a gain of 600,000 dollars which will be taxed as ordinary income.[14] Consequently, he decides to form a new corporation with a minimum capitalization and then sells the undeveloped land to the corporation for 500,000 dollars. The corporation will give its note in the face amount of 500,000 dollars payable over five years, with five per cent interest, and will then develop the property and sell the houses. If everything goes as planned, the taxpayer will have a realized gain of 350,000 dollars on the sale of the undeveloped land. Hopefully this gain will be taxed as a capital gain and, under installment sales treatment, will give rise to a capital gains tax on 70,000 dollars each year for five years. The corporation then will borrow the 250,000 dollars required to construct the houses from a financial institution, will construct the houses and sell them for 1,000,000 dollars, realizing a gain of 250,000 dollars, on which a tax of roughly 120,000 dollars would be paid, thus leaving it with 130,000 dollars in cash after paying back the 250,000 dollar loan from the bank and the 500,000 dollars owed to the controlling shareholder.[15] At this point, the controlling shareholder might liquidate the corporation, obtaining the 130,000 dollars in cash and paying a capital gains tax on the difference between this amount and whatever amount he chose to contribute to

example, if a building has been held for five years before its sale, only sixty percent of the "additional depreciation" (*see* note 12 *infra*) would be subject to recapture (40 months x 1% = 40%; 100% − 40% = 60%). If held for ten or more years, there would be no recapture. There is no similar limitation in § 1245.

12. Under § 1250(b)(1), only depreciation in excess of the depreciation that would have been taken if the straight line method had been used is recaptured.

13. If the taxpayer previously developed property, his gain on the sale would be taxed as ordinary income because he then would be in the business of developing real property. Int. Rev. Code of 1954, § 1221(1). Thus there would be no particular tax advantage to the sale.

14. The taxpayer would be considered to hold the property primarily for sale to customers in the ordinary course of his business and hence § 1221(1) would require that the proceeds be taxed as ordinary income.

15. For purposes of simplicity, these computations ignore the interest payments that would have been made to the bank and the shareholder.

the corporation at the time it was organized.[16] Thus, after the transaction is completed, the taxpayer will have obtained 500,000 dollars in payments on his notes, on which he will have paid a tax of approximately 87,500 dollars. Furthermore, he will have received 130,000 dollars at liquidation, on which he will have paid a tax of approximately 32,500 dollars. After taxes, the taxpayer will have realized net proceeds of 510,000 dollars.

If the taxpayer instead had chosen to transfer the land to the corporation in a section 351 transfer, the corporation would have taken his basis (150,000 dollars) for the property, and, after spending 250,000 dollars to develop the land and construct the houses, would have had an increased basis of 400,000 dollars. Thus when the property subsequently was sold, a gain of 600,000 dollars would have been realized, on which a tax of 288,000 dollars would have been paid. After paying back the 250,000 dollar loan, the corporation would have been left with 462,000 dollars but the controlling shareholder would have taken no cash out of the corporation. If the 462,000 dollars had, over a five-year period, been distributed to him as a dividend rather than as payment on the corporation's notes, he would have paid a tax of 231,000 dollars (assuming a 50 per cent bracket taxpayer) on this amount, leaving him with only 231,000 dollars after taxes, as compared with 510,000 dollars under the sales method. Thus there is an after-tax difference to the controlling shareholder of 279,000 dollars if the property is sold to the corporation rather than being transferred to it at the time the corporation is organized in exchange for the corporation's stock.

In view of the potential tax benefits, it is not surprising that the Commissioner, with but slight help from Congress, has developed a number of weapons to attack sales to controlled corporations. This article will examine these weapons and suggest possible methods of combating them.

II. Sale of Property That Has Appreciated in Value

A. *Section 1239*

The only statutory provision that specifically deals with sales at a gain to controlled corporations is section 1239.[17] This section causes gain on the sale of depreciable property[18] between an individual

16. Under § 358 of the Internal Revenue Code, his stock basis would be equal to the amount he transferred to the corporation in exchange for the stock.

17. Int. Rev. Code of 1954, § 1239.

18. Section 1239 will apply to depreciable property even though depreciation deductions with respect to the property have not in fact been taken. Twentieth Century-Fox Film Corp. v. Commissioner, 372 F.2d 281 (2d Cir. 1967). *See* Int. Rev. Code of 1954, § 167, for the definition of "depreciable property."

and a controlled corporation to be treated as ordinary income, even though a capital asset or a section 1231 asset is sold. For this purpose, "control" means ownership of more than 80 per cent in value of the outstanding stock, and an individual is considered to own stock owned by his spouse, his minor children, and minor grandchildren. For example, if a husband and wife each owned 50 per cent of a corporation's outstanding stock for section 1239 purposes each would be considered to own 100 per cent of the stock.

Because of its somewhat limited application, section 1239 has not been a particularly potent weapon in the Commissioner's hands. The purpose of enacting section 1239 was to prevent the corporation from obtaining a stepped-up basis against which future depreciation deductions could be taken, while the seller paid only a capital gains tax on the sale.[19] Since land is not depreciable, and since the "evil" at which the statute is aimed is a stepped-up basis for depreciation purposes, at the cost of only a capital gains tax to the seller, the statute was made inapplicable to land. This is somewhat surprising since essentially the same tax advantages which section 1239 seeks to deny can be obtained if land suitable for development is sold to a controlled corporation. The corporation can develop and sell the land, using the stepped-up basis to offset ordinary income received on the sales. Indeed, many of the sales cases discussed below involve just this situation. It is difficult to understand why Congress thought it more reprehensible to offset ordinary income by depreciation deductions than by sales of the assets, but whatever the reason, omission of non-depreciable property from section 1239 certainly leaves a broad gap in the statute's coverage.

Not only is the section limited to depreciable property, but the attribution rules contained in section 1239 also are extremely limited. Unlike other attribution provisions,[20] section 1239 does not treat an individual as owning stock actually owned by his parents, his brothers and sisters, his adult children, a trust of which he is the beneficiary, a partnership in which he is a member, or a corporation which he controls. Instead, an individual is treated as owning only stock owned by his spouse, minor children, and minor grandchildren. These limited attribution rules, coupled with the high, 80 per cent ownership requirements[21] make section 1239 relatively easy to avoid even when depreciable property is involved.

It is interesting to note that, as originally passed by the House of Representatives in 1951, section 1239 would have been much more

19. H.R. Rep. No. 586, 82d Cong., 1st Sess. 26 (1951).

20. *See, e.g.*, Int. Rev. Code of 1954, §§ 267(c), 318.

21. *Cf.* Int. Rev. Code of 1954, § 1235(d)(1), which requires only 25% ownership in order for sales of patents to a corporation to be denied capital gains treatment.

difficult to avoid. Under the House version, the ownership requirements were only 50 per cent and broad attribution rules would have included the omitted relationships discussed in the preceding paragraph.[22] However, the Senate Finance Committee rejected present section 1239 in its entirety.[23] When restored by the Conference Committee, it contained its present high ownership requirements and limited attribution rules, presumably as a compromise between members of the House and Senate.[24] Consequently, in its present form section 1239 generally can be avoided with no practical loss of control over the corporation.

However, a recent decision by the Fifth Circuit, *United States v. Parker*,[25] may make section 1239 more difficult to avoid. In *Parker* the selling shareholder owned exactly 80 per cent of a corporation's stock. A corporate employee owned the remaining 20 per cent. The employee's stock was subject to two restrictions: (1) an ordinary "right of first refusal" agreement between the employee and the corporation, requiring the employee to offer his stock for sale to the corporation before selling it to a third party; and (2) a provision requiring the employee to sell his stock to the majority shareholder at a particular price if the employee terminated his employment. The majority shareholder's stock also was subject to the right of first refusal but was not subject to the second restriction.

The Fifth Circuit first noted that section 1239 applies if the selling shareholder owns more than 80 per cent *in value* of the corporation's outstanding stock. The court then held that, while the majority shareholder did not own more than 80 per cent *in number* of the total outstanding shares, his stock exceeded 80 per cent of the total value because the remaining 20 per cent was subject to the two restrictions noted above. Not only did the above restrictions decrease the value of the stock held by the employee, but the court also held that, even without these restrictions, the majority shareholder's stock would represent more than 80 per cent of the total value of the outstanding stock simply by reason of the control element inherent in owning a majority of the outstanding stock.

The wording of section 1239 makes it difficult to quarrel with the result reached in *Parker*,[26] but the decision raises problems that un-

22. Internal Revenue Act of 1951, ch. 521, § 328(a), 65 Stat. 504.
23. S. Rep. No. 781, 82d Cong., 1st Sess. 69-70 (1951).
24. H.R. Rep. No. 1179, 82d Cong., 1st Sess. 77 (1951).
25. 376 F.2d 402 (5th Cir. 1967).
26. While the result reached is probably correct, it is questionable whether Congress gave a great deal of thought to the use of value as the determining factor under § 1239. The committee reports give no explanation as to why value was used, and the examples given in the reports all refer to the number of shares owned by the seller, not to the value of those shares. *See, e.g.,* H.R. Rep. No. 586, 82d Cong., 1st Sess. 120-21 (1951).

doubtedly will cause majority shareholders to think twice before deciding that section 1239 is inapplicable simply because they own 80 per cent or less of the total number of outstanding shares. For example, in *Parker* it was unnecessary to determine the exact dollar increase in value resulting from the control factor. Exactly 80 per cent of the stock was owned by the majority shareholder. Hence any value increase, no matter how slight, was sufficient to push him over the 80 per cent line drawn by section 1239. However, the control theory would be equally applicable where a shareholder owned only 51 per cent of the outstanding stock of the corporation.[27] In this situation, presumably an attorney would have to determine the exact dollar amount by which control increases the value of each share before deciding whether section 1239 is applicable. While the valuation problem is frequently encountered in estate tax cases, it is not necessarily a burdensome requirement there because predictability is not required. In the income tax area, however, a taxpayer wishes to have some degree of certainty as to the tax consequences of a proposed transaction. The desired certainty could not be obtained through a ruling because valuation is a question of fact, and the Internal Revenue Service normally will not issue advance rulings on factual questions.[28] Consequently, under *Parker* an attorney must attempt to predict the exact value increase resulting from control in a potential section 1239 transaction. This obviously will be difficult to do, at least with the degree of certainty that a taxpayer may require. Thus *Parker* should have a considerable *in terrorem* effect on sales by majority shareholders to their controlled corporations.[29]

While *Parker* at least implied that section 1239 would apply in any case where the taxpayer was within a few percentage points of the 80 per cent line, the Tax Court, in *Trotz v. Commissioner*,[30] has held that section 1239 was inapplicable where a taxpayer owned 79 per cent of the stock in his corporation. Here, as in *Parker*, an

27. While *Parker* literally could apply where the seller owns only 51% of the corporation's stock, the government's traditional opposition, in estate tax cases, to substantial value discounts for minority interests might limit practical application of the *Parker* theory to situations where close to 80% in number of the outstanding stock is owned by the selling shareholder.

28. Rev. Proc. 64-31, 1964-2 Cum. Bull. 947. *See* Note, *Federal Tax Rulings: Procedure and Policy*, 21 Vand. L. Rev. 78 (1967).

29. Not only will *Parker* be significant in § 1239 cases, but the theory of the case should be equally applicable to a wide variety of tax provisions that require a certain percentage of the value of outstanding stock to be owned by a particular person. For example, Int. Rev. Code of 1954, § 341 (collapsible corporations), § 541 (personal holding companies), and § 318 (attribution rules), all involve a given percentage of the total value of outstanding stock owned by a particular person. This is by no means a complete list of all Code provisions affected by *Parker*, but it does illustrate the potential ramifications of that case.

30. P-H 1967 Tax Ct. Rep. & Mem. Dec. ¶ 67,139.

unrelated employee owned the remaining stock and his stock was subject to the taxpayer's option to purchase at a fixed price if the employee left the company. The Tax Court first held[31] that section 1239 applied because the taxpayer in substance owned the employee's stock. This theory was based on the taxpayer's right to terminate the employee's relationship with the corporation at any time, thereby bringing the option into effect. On appeal, the Tenth Circuit rejected the Tax Court's "substantial ownership" theory,[32] holding that section 1239 required legal title to more than 80 per cent of the stock, not control over more than 80 per cent. However, the Tenth Circuit remanded the case so that the Tax Court could resolve the factual question of whether the 79 per cent interest which the taxpayer did own was worth more than 80 per cent in value of the outstanding stock. On remand the Tax Court held that the taxpayer's 79 per cent interest did not exceed 80 per cent in value of the outstanding stock.

The Tax Court's holding was based on a factual finding that the control factor added nothing to the value of the taxpayer's stock because a prospective purchaser would not be interested in acquiring the corporation as a going concern for reasons peculiar to the corporation's business. This would seldom be true, however. Normally the value of a going business is more than simply the value of its underlying assets. Presumably in the more normal case the Tax Court would hold that control does increase value, although the exact amount of that increase would be a question of fact in each particular case.

Aside from a *Parker* or a *Trotz* situation, however, section 1239 can be avoided by giving a sufficient amount of stock in the corporation to adult children, parents, brothers, or sisters, in order to avoid the 80 per cent ownership requirement. This general method was approved by the Tax Court in *Drybrough v. Commissioner*,[33] against the Commissioner's contention that the gift of a 40 per cent interest in the corporation to an adult son shortly before the sale was a sham. Although the gift was made "principally, if not solely, because of the tax advantages to be derived,"[34] the court found that the gift was

31. Trotz v. Commissioner, 43 T.C. 127 (1965).

32. Trotz v. Commissioner, 361 F.2d 927 (10th Cir. 1966). In arguing that the word "owns" in § 1239 is not limited to ownership through legal title but includes "substantial ownership," the Service was, to some extent, taking a position inconsistent with its own published rulings. In Rev. Rul. 56-613, 1956-2 CUM. BULL. 212, the Service held that the word "ownership" as used in § 368(c) includes only ownership by way of legal title so that a parent corporation was not considered as "owning" stock to which its subsidiary held legal title. This, of course, was in a situation where the taxpayer desired to expand the definition of "ownership."

33. 42 T.C. 1029, *rev'd on other grounds*, 376 F.2d 350 (6th Cir. 1967).

34. *Id.* at 1048.

valid under local law so that "whether or not the transfer was motivated by tax savings, it was in substance what it purported to be in form. . . ."[35] In *Drybrough* there is no indication that the son ever returned the stock to his father after the sale. The Commissioner's sham argument would have considerably more strength in a situation where there would be a mere temporary loss of 80 per cent ownership. However, since a taxpayer will exercise practical control over the corporation whether he owns 51 per cent or 81 per cent of the voting stock, and normally would have a considerable degree of control over any donee, there should be little need for the donee to transfer the stock back to the controlling shareholder after the sale has been effected.

If the taxpayer has no adult children or other family members to whom stock can be given without attribution, he can instead transfer the stock to a trust, naming minor children or his wife as beneficiaries. While an outright transfer to a wife or minor child would be of no help since section 1239 would attribute ownership of the stock to the donor, the Fourth Circuit, in *Mitchell v. Commissioner*,[36] held that beneficial ownership is not within section 1239. In so holding, the court held invalid a provision of the regulations which states that beneficial ownership by a family member specified in section 1239 will cause attribution of the beneficially owned stock.[37] The court relied primarily on the legislative history of section 1239,[38] and on the fact that an individual cannot exercise the same degree of control over an independent trustee that he can over his minor children. The decision seems correct, and yet the attribution rules become almost meaningless if they may be avoided by the simple expedient of a transfer in trust.

In *Mitchell* the trustee was a bank, and the beneficiaries were the taxpayer's minor children. Suppose, however, that the taxpayer himself was the trustee, or that he appointed an independent trustee but named himself as the beneficiary. Would a different result be reached? Certainly the taxpayer could not himself serve as trustee and hope to avoid section 1239 because then he would retain legal title to the stock transferred in trust, and *Mitchell* holds that legal title is the important factor under section 1239. But carried to its logical extreme, *Mitchell* presumably would permit the taxpayer to name himself as beneficiary because the case holds that beneficial

35. *Id.*

36. 300 F.2d 533 (4th Cir. 1962).

37. Treas. Reg. § 1.1239-1 (1957).

38. As originally passed by the House of Representatives, the present § 1239 specifically provided that stock owned by a trust would be considered as owned proportionately by its beneficiaries. This provision, among others, was omitted by the Conference Committee from the final version of § 1239.

ownership is to be disregarded under section 1239. Moreover, the taxpayer as beneficiary would exercise no greater control over an independent trustee than would the taxpayer as grantor of the trust.

Finally, if the taxpayer does not wish to avoid section 1239 by the above methods, he may always do so simply by transferring non-depreciable property to the corporation.

In summary, section 1239, rather than actually inhibiting sales to a controlled corporation, instead serves primarily as a trap for the unwary. While taxpayers have, on occasion, been caught by this trap,[39] section 1239 should present no real problem for the sophisticated taxpayer, with the possible exception of a *Parker* situation.

B. *Section 351*

1. *Ownership Requirement.*—Because of the ease with which taxpayers have avoided section 1239, the Commissioner has largely resorted to other methods of combating sales to controlled corporations. Of these methods, section 351[40] has been used most often. However, because section 351 was not enacted for the specific purpose of inhibiting sales to controlled corporations, the Commissioner has frequently encountered difficulty in applying section 351 to the problem at hand.

Section 351 provides that, if taxpayers transfer "property" to a corporation solely in exchange for stock or securities, and immediately after the transfer the transferors of property "control" the corporation, then no gain or loss will be recognized to the transferors and the corporation will take the transferors' basis for the property received.[41] If property other than stock or securities is received, gain (but not loss) will be recognized in an amount generally equal to the value of such other property.[42]

"Control" is defined as ownership of at least 80 per cent of the outstanding voting stock, and at least 80 per cent of *each class* of any outstanding non-voting stock.[43] The definition of control for section

39. *See, e.g.*, Twentieth Century-Fox Film Corp. v. Commissioner, 372 F.2d 281 (2d Cir. 1967), where the taxpayer was so concerned with a collapsible corporation problem that he seemingly overlooked the existence of § 1239.

40. INT. REV. CODE of 1954, § 351.

41. INT. REV. CODE of 1954, §§ 351(a), 362(a). Prior to enactment of present § 351, the courts held that gain was recognized when a corporation was formed by transferring property that had appreciated in value. Livingston v. Commissioner, 18 B.T.A. 1184 (1930).

42. INT. REV. CODE of 1954, § 351(b). If the realized gain is less than the fair market value of the other property, only the realized gain will be recognized.

43. INT. REV. CODE of 1954, § 368(c). If there are two or more classes of non-voting stock, § 368(c) itself is not entirely clear whether 80% of each class must be owned or whether the shareholder's combined ownership of both classes must equal 80% of the total non-voting stock. The Internal Revenue Service has ruled that 80% of each class must be owned. Rev. Rul. 59-259, 1959-2 CUM. BULL. 115.

351 purposes is to be contrasted with the definition of that term in section 1239. Under section 351, *at least* 80 per cent must be owned, while section 1239 requires more than 80 per cent ownership. Furthermore, section 351 requires that 80 percent *in number* be owned, while section 1239 requires 80 per cent in value. However, the *Parker* case may render these distinctions meaningless. If a shareholder owns exactly 80 per cent in number, *Parker* seemingly holds that he necessarily owns more than 80 per cent in value, and so the shareholder would be within both sections.

This latter point is of more than academic interest. Under section 351, if property other than stock and securities is received by the transferor, then the transferor recognizes gain to the extent of the value of the "other property."[44] Normally the character of the property transferred would control whether the recognized gain would be taxed as capital gain or ordinary income. However, the Internal Revenue Service[45] and the Tax Court[46] have held that, if section 1239 is otherwise applicable, then any gain recognized on a section 351 transfer must be taxed as ordinary income. Prior to *Parker*, it might have been hoped that section 1239 could be avoided on a section 351 transfer if the transferor owned exactly 80 per cent of the stock, since section 1239 speaks of "more than" 80 per cent ownership. As mentioned above, *Parker* should put an end to any such hopes.

It is apparent that if section 351 applies to a purported sale between an individual and his controlled corporation the seller will not obtain the desired tax benefits. First, the corporation will not obtain a stepped-up basis for the acquired property, but instead will take the transferor's basis. Thus the corporation receives no greater depreciation deductions than the transferor would have received. In the case of non-depreciable property, the corporation will realize the same amount of gain on a subsequent sale of the transferred property as the transferor would have realized. Second, payments made on the notes given by the corporation to acquire the property may be treated as dividends to the transferor, taxable as ordinary income, rather than as the proceeds of a sale, taxable as capital gains. Thus the "seller" loses his capital gains on the transfer and the entire transaction, rather than being a tax bonanza, may turn into a positive disaster.

While the disadvantages of section 351 applying to a sale are readily apparent, it is also apparent that the Commissioner may have considerable difficulty in applying section 351 to a taxpayer who casts his transfer in the form of a sale. Of course if the requirements of section 351 are otherwise met, and the "seller" seeks to avoid that

44. *See* note 42 *supra*.
45. Rev. Rul. 60-302, 1960-2 CUM. BULL. 223.
46. Weaver v. Commissioner, 32 T.C. 411 (1959).

section simply by forming the corporation in a section 351 transfer and shortly thereafter "selling" the property to the newly-formed corporation, the Commissioner should have little difficulty in showing that the later sale was an integral part of the corporation's formation, so that the two steps (organization and sale) were effectively a single section 351 transfer. For example, in one early case[47] the taxpayers (husband and wife) formed a corporation by transferring 86,000 dollars in cash and receiving all of the outstanding stock in exchange. A few days after its organization, the corporation used 80,000 dollars of this cash to "purchase" land from the taxpayers. The Commissioner argued, and the court held, that in substance the land had been transferred to the corporation in exchange for its stock. Hence present section 351 applied to the transfer and the sellers' loss was denied.[48]

While the Commissioner will have little difficulty in a case such as this, where the terms of section 351 clearly are met and the only problem is consolidating two ostensibly separate transfers, the terms of section 351 often may present the Commissioner with a more formidable problem. Perhaps the most obvious problem is the somewhat stringent "control" requirement of section 351. If the seller does not own 80 per cent of the outstanding voting stock and 80 per cent of each class of outstanding non-voting stock, then by its terms section 351 is inapplicable to the sale. Thus if the seller owns 100 per cent of the voting stock, but only 79 per cent of the non-voting stock, section 351 cannot be used by the Commissioner to attack the sale.[49]

However, in some situations where control is technically absent at the time of sale the Commissioner might use the "step transaction" doctrine[50] to bring the seller within the terms of section 351. For example, in *Houcks v. Hinds*,[51] an attorney for the taxpayer organized a corporation by paying 1,000 dollars in exchange for all the outstanding stock. Shortly thereafter the corporation purchased assets of the taxpayer's partnership by giving a note for 582,000 dollars. At the time of the sale, all the stock in the purchasing corporation was still owned by the attorney. But about fifteen days later the attorney sold all of his stock to the partnership for 1,000 dollars. The tax-

47. Labrot v. Burnet, 57 F.2d 413 (D.C. Cir. 1932).

48. This case arose prior to enactment of present § 267, which would disallow the loss in *Labrot* even if § 351 was inapplicable. *See* text accompanying notes 149-55 *infra*.

49. The Commissioner might argue that the "sale" actually constituted a contribution to capital, however. *See* text accompanying notes 140-48 *infra*.

50. The gist of the "step transaction" doctrine is that a single transaction may not be separated into two or more separate steps solely to avoid the tax consequences that would result if the transaction was consummated by a single step.

51. 215 F.2d 673 (10th Cir. 1954).

payer argued that section 351 was inapplicable because, at the time of the sale, the partnership owned no stock in the corporation. However, the court held that the sale of assets to the corporation and the succession to corporate ownership by the partnership were but two related steps in a single plan so that the control requirement was met. Consequently, section 351 applied to the sale.

In this area, application of the "step transaction" doctrine is probably not limited to cases where the seller never controlled the corporation until some time after the sale. If the taxpayer at one time controlled the corporation but, in anticipation of the sale, disposed of a sufficient amount of stock to avoid having control at the time of the sale, the "step transaction" argument is certainly available to the Commissioner. This is particularly true if the stock is disposed of by way of a gift to a member of the seller's family.[52]

While deliberate loss of control in anticipation of the sale probably would not effectively avoid the control requirement, consideration might be given to causing an existing controlled corporation to form a subsidiary, with the controlling individual shareholder then selling to the subsidiary rather than to the parent. In this situation the literal terms of section 368(c),[53] the control provision, would not be met because the seller would own no stock in the acquiring corporation (the subsidiary) and section 368(c) requires *ownership* of 80 per cent of the outstanding stock of the acquiring corporation. The attribution rules of section 318[54] are not applicable to section 351 so that the parent's ownership of the subsidiary's stock would not be attributed to the individual shareholder.[55] While the seller certainly would have practical control over the subsidiary, the Service has ruled that section 368(c) requires direct ownership, not practical control.[56] However, in *Burr Oaks Corp. v. Commissioner*,[57] a taxpayer attempted to avoid the control requirement in a manner similar to that outlined above, but the Commissioner successfully argued that the control requirement nevertheless was met. In this case, three taxpayers caused members of their family to form a corporation by trans-

52. *But cf.* Drybrough v. Commissioner, 42 T.C. 1029, *rev'd on other grounds*, 376 F.2d 350 (6th Cir. 1967).

53. INT. REV. CODE of 1954, § 368(c).

54. INT. REV. CODE of 1954, § 318.

55. Section 318 is inapplicable unless specifically incorporated by a particular Code section. *See* the opening words of § 318(a). Section 351 does not incorporate § 318.

56. Rev. Rul. 56-613, 1956-2 CUM. BULL. 212. This ruling involved the "control" requirement for purposes of a "B" reorganization (INT. REV. CODE of 1954, § 368(a)(1)(B)), not the "control" requirement of § 351. However, § 368(c) defines "control" for purposes of the reorganization provisions as well as for § 351, and it would be difficult for the Service validly to construe the same Code provision in two different ways.

57. 43 T.C. 635 (1965), *aff'd*, 365 F.2d 24 (7th Cir. 1966).

ferring approximately 4,000 dollars in cash to it in exchange for all of the corporation's stock. The three taxpayers then proceeded to "sell" undeveloped land to the corporation in exchange for the corporation's notes in a face amount of 330,000 dollars. The taxpayers argued that the transfer was not within section 351 because they owned no stock in the corporation and hence could not control it under section 368(c). However, the Tax Court held that the sale was an integral part of the corporation's organization, and hence the organization and "sale" should be considered a single transaction. The court further found that the notes given by the corporation actually constituted stock. Having made these two findings, the court was then able to bring the "sellers" within section 351 because the "transferors of property"[58] (*i.e.*, the members of the taxpayers' family and the taxpayers themselves) did in fact control the corporation.

Aside from a *Burr Oaks* argument, it is quite possible that the "sale" to the subsidiary would be treated by the Commissioner as a contribution of capital to the parent, followed by a transfer of the property by the parent to the subsidiary in exchange for the notes, and a distribution of the notes by the parent to the individual shareholder. Thus the parent would take the shareholder's basis for the property,[59] the subsidiary would take the parent's basis for the property,[60] the parent would pay no tax on receipt of the notes,[61] and distribution of the notes would be treated as a dividend distribution by the parent to the individual shareholder[62] taxable as ordinary income. While this recasting of the transaction might well be accepted by a court if the subsidiary was formed solely to permit the individual shareholder to avoid the "control" provision, the taxpayer would be in a better position if a valid business purpose could be established for the subsidiary's existence.

2. *Property Requirement of Section 351.*—In order for section 351 to apply, the controlling shareholder must transfer "property" to the corporation. While the definition of "property" has raised occasional problems,[63] there normally would be no such problems in the sales area. The problems that have arisen usually involve the question of whether intangible items such as "know-how" or secret processes constitute "property" and so may be transferred to a controlled corpo-

58. The term "property" under § 351 includes cash. Halliburton v. Commissioner, 78 F.2d 265 (9th Cir. 1935).

59. INT. REV. CODE of 1954, § 362(a).

60. *Id.*

61. INT. REV. CODE of 1954, § 351.

62. INT. REV. CODE of 1954, § 301.

63. *See, e.g.*, Fahs v. Florida Mach. & Foundry Co., 168 F.2d 957 (5th Cir. 1948); *cf.* Roberts Co. v. Commissioner, 5 T.C. 1 (1945).

ration at no tax cost under section 351.[64] Such items may not be depreciated because they have an indeterminate useful life.[65] Nor would secret processes, "know-how," and similar items normally be sold at a later date by the acquiring corporation. Since the primary purpose of a sale to a controlled corporation is to give the corporation a stepped-up basis against which future deductions can be taken, or which can be offset against the proceeds from later sales of the property, it is apparent that there would be little tax incentive to "sell" secret processes, "know-how," and similar items to a controlled corporation. Usually more tangible items such as land, buildings, machinery, and equipment would be "sold" to a controlled corporation. There is no question but that these latter items constitute "property" for section 351 purposes.

Not only does section 351 require that "property" be transferred to a "controlled" corporation, but the transferor also must control the corporation "immediately after" the transfer. The term "immediately after," like the definition of "property," has given rise to problems in cases where, as an integral part of the transfer, a transferor loses control of the corporation shortly after the transfer.[66] This normally would not be a problem in a sales case since it is unlikely that, as an integral part of the sale, the seller would lose control of the corporation.

3. *Stock, Securities, or "Other Property."*—As discussed above, the Commissioner may have difficulty in treating the sale as a section 351 transfer because the control provisions of section 351 are somewhat stringent. But the term "property" and the requirement that the transferor control the corporation "immediately after" the transfer will not present a problem in the normal sales case. Thus if the "control" requirement is met, the Commissioner's next problem is classifying the consideration received by the seller as "stock or securities" of the acquiring corporation.

If the acquiring corporation pays cash for the property it is clear that the "stock or securities" requirement would not be met and section 351 could not apply.[67] However, the acquiring corporation in most sales cases is seldom in a position to make an immediate cash

64. *See* Rev. Rul. 64-56, 1964-1 Cum. Bull. 133. Another problem has been the question of whether the stock was issued for services rather than for property. Fahs v. Florida Mach. & Foundry Co., 168 F.2d 957 (5th Cir. 1948). This problem obviously is not applicable in the sales area.

65. Treas. Reg. § 1.167(a)(3) (1960).

66. Commissioner v. National Bellas Hess, Inc., 220 F.2d 415 (8th Cir. 1955); American Bantam Car Co. v. Commissioner, 11 T.C. 397 (1948).

67. In such a situation, the Commissioner might treat the "sale" as a contribution to capital, with the cash being treated as a dividend. *See* text accompanying notes 140-48 *infra*.

payment for the property. And even in the rare case where the corporation is financially able to pay cash, the selling shareholder frequently will not want a lump sum payment because the entire tax on his gain would be due in the year of transfer, whereas deferred payment will permit the seller to elect the installment method of reporting his gain.[68] For these reasons, the corporation will almost always give a deferred payment obligation of some sort in exchange for the property. The corporate obligation given may be classified as a security, as stock, or as "other property" for section 351 purposes, and the classification will determine the tax treatment accorded the shareholder and, to some extent, the corporation.

4. *Securities or "Other Property?"*—The taxpayer initially may argue that, while the "sale" may be a section 351 transfer, still the notes constitute "other property" rather than stock or securities.[69] If this argument is successful then it may make little difference to him that the sale is treated as a section 351 transfer because the tax results are essentially the same.[70] The "seller" will recognize a gain equal to the difference between his basis for the property transferred and the value of the corporate notes (*i.e.* the "other property").[71] The gain will be a capital gain if section 1239 is inapplicable[72] and if the capital gain requirements are otherwise met. Section 483[73] may treat a portion of the deferred payments as interest, taxable as ordinary income to the seller, but this is true whether section 351 applies or not.

While the major tax benefits will be obtained whether the transfer is considered a sale or a section 351 "boot" transaction, there is more than a semantic difference between the two theories. Of most importance is a possible loss of the installment method of reporting gain if the "sale" is treated as a section 351 transfer. Some commentators have suggested that a section 351 "boot" transfer is not eligible for installment sales treatment,[74] although no reasons have been given for this position. There is nothing in the installment sale provision itself[75] which states that it could not be used in connection with sec-

68. *See* note 4 *supra.*

69. *See, e.g.,* Gooding Amusement Co. v. Commissioner, 236 F.2d 159 (6th Cir. 1956).

70. This is not true if the "seller" is attempting to recognize a potential loss. *See* text accompanying notes 149-55 *infra.*

71. INT. REV. CODE of 1954, § 351(b).

72. If § 1239 does apply, the Service has ruled that gain recognized under § 351(b) will be taxed as ordinary income. Rev. Rul. 60-302, 1960-2 CUM. BULL. 223.

73. INT. REV. CODE of 1954, § 483.

74. Goldstein, *Corporate Indebtedness to Shareholders*, 16 TAX L. REV. 1, 54 (1960).

75. INT. REV. CODE of 1954, § 453(b). If personal property is transferred, the sales price must exceed $1,000, the property must not be inventory, and payments in the year of transfer must not exceed 30% of the selling price. If real property is transferred,

tion 351, as long as its requirements are met. Also, the provision applies not only to sales but also to "other dispositions." The latter term seems sufficiently broad to cover a section 351 transfer.

Even if the installment sales provision cannot be elected on a "boot" transfer, the taxpayer might argue that the corporate notes have no readily ascertainable value so that gain is reported only as payments are actually made on the notes and only after the actual payments exceed the transferor's basis for the property transferred. This treatment was first permitted by the Supreme Court in *Burnet v. Logan*[76] and since has become a recognized principle of tax law. It is usually permitted if the note is non-negotiable, at least if the taxpayer uses the cash method,[77] although the Fifth Circuit takes the position that a promise to pay may have a readily ascertainable value even if represented by no note at all.[78] Also, the Internal Revenue Service has stated that, "except in rare and extraordinary cases," it will require valuation of contracts and claims to receive even indefinite amounts of income.[79] Consequently, a taxpayer seeking to defer his tax payment by using the *Logan* theory must be prepared to litigate the question.

Another possible disadvantage to a section 351 "boot" transfer as opposed to a sale involves the corporation's allocation of basis to the property transferred. If the seller sells a single item of property to the corporation, the corporation's basis for that property equals the face amount of the note given in exchange.[80] However, if the sale is treated as an integral part of the corporation's formation so that it is within section 351, then the corporation takes the transferor's basis for all the property transferred, increased by the gain recognized by the transferor. This gain presumably must be allocated among all of the properties received by the corporation,[81] both the property "sold"

the transfer must constitute a "casual sale or other casual disposition," and payments in the year of sale must not exceed 30% of the selling price.

76. 283 U.S. 404 (1931).

77. *See, e.g.,* Williams v. Commissioner, 28 T.C. 1000 (1957). *But see* Kuehner v. Commissioner, 214 F.2d 437 (1st Cir. 1954); Loyer v. Commissioner, 199 F.2d 452 (6th Cir. 1952).

78. Cowden v. Commissioner, 289 F.2d 20 (5th Cir. 1961).

79. Rev. Rul. 58-402, 1958-2 Cum. Bull. 15. *But cf.* Treas. Reg. § 1.421-6(c)(2) (1966), where the Service's position is that non-qualified stock options granted to a corporate employee almost never have a readily ascertainable value. *See also* Treas. Reg. §§ 1.1001-1(a) and 1.453-6(a)(2) (1967).

80. Int. Rev. Code of 1954, § 1012.

81. The Code and Regulations are silent as to the manner of allocation. The gain might be allocated by using the ratio of the basis of each item of property transferred to the total basis of all the property, or the ratio might be based on fair market value of the property rather than basis. There are no cases directly on point, although Runkle v. Commissioner, 39 B.T.A. 458 (1939), used basis to allocate gain on a later sale of stock received in a § 351 transfer between long-term and short-term gain. This seems erroneous because property with a high basis may have a low value, yet the greatest portion of the gain will be allocated to this property if basis is used,

to it and the property transferred at the time the corporation was organized. Since the taxpayer planning a later "sale" normally would organize the corporation by transferring property as to which a stepped-up basis was unimportant while holding back for future sale the property as to which a stepped-up basis is desired, allocation of the gain among all the properties could materially reduce the corporation's tax benefits. On the other hand, if the corporation is organized by transferring cash, and a single asset, such as land, is later sold for future development by the corporation, there would be no allocation of gain problem if the "sale" later is treated as a section 351 "boot" transfer.

While possible non-availability of the installment method and possible basis allocation problems under a section 351 "boot" transfer may remove some of the tax benefits from the "sale," the major benefits are retained. This suggests the possibility of planning the sale so that, even if section 351 later is held to apply, the corporate notes will be considered "boot" rather than stock or securities. While simple to state, this is difficult to accomplish because of the problems in distinguishing between a debt instrument that constitutes a "security" and one that constitutes "other property."

In Revenue Ruling 56-303[82] the Service held that notes ranging in duration from two to four years, with an average duration of two and one-half years, received by a parent corporation on the sale of land to its subsidiary, constituted "other property." In this ruling both the "seller" and the "buyer" were corporations. Consequently, the same tax stakes were not involved as would be with an individual seller. At least one of the tax motives for an individual's sale of property to his controlled corporation is to withdraw future earnings as capital gains rather than as dividends. The corporation obviously did not have this motive since dividends, under section 243,[83] would have been taxed at an effective rate of roughly eight per cent,[84] while the gain recognized on receipt of the notes was taxed at the 25 per cent capital gains rate. Nevertheless, the ruling states that the subsidiary did plan to subdivide and sell the property, so obtaining a stepped-up basis was certainly an important motive for casting the transaction as a taxable transfer. The sale produced

when in fact other property with a low basis and a high value may have permitted the gain to be realized.

82. 1956-2 CUM. BULL. 193.

83. INT. REV. CODE of 1954, § 243.

84. Section 243 permits a corporation to exclude from gross income 85% of the dividends it receives from other corporatious. Hence only 15% of any dividend will be taxed, and the 1956 corporate tax rates were 52%, resulting in the entire dividend being taxed at an effective rate of roughly 8% (52% x 15%). Under present § 243, a corporation may elect to exclude 100% of any dividends received, if certain requirements are met.

significantly greater tax benefits than if a non-taxable section 351 transfer had been made, with the subsidiary then distributing its development proceeds as dividends.[85] Although the Service subsequently revoked Revenue Ruling 56-303[86] and now refuses to issue advance rulings on the "boot" question,[87] the ruling should retain considerable precedential value because it was not revoked on substantive grounds. Instead, the revocation was made simply as a matter of procedure when the Service announced that it would no longer issue advance rulings on the securities question.[88]

In Revenue Ruling 59-98[89] the Service held that bonds ranging in duration from three to ten years, with an average duration of six and one-half years, constituted "securities." Here, however, the Service emphasized that the bonds were held by non-stockholders and were secured by a mortgage on the corporate property. Also, the ruling involved an "E" reorganization rather than a sale to a controlled corporation.

Although these two rulings might indicate that two and one-half year notes will be "boot," while six and one-half year notes will constitute "securities," the problem is not that simple. As the Tax Court has stated:

> The test as to whether notes are securities is not a mechanical determination of the time period of the note. Though time is an imporant factor, the controlling consideration is an over-all evaluation of the nature of the debt, degree of participation and continuing interest in the business, the extent of the proprietary interest compared with the similarity of the note to a cash payment, the purpose of the advances, etc.[90]

Taxpayers generally have not met with a great deal of success in pursuading courts that notes received in a purported sale actually constitute section 351 "boot."[91] On the other hand, cases abound

85. Each dollar of recovered basis on future sales by the subsidiary could be received tax-free by the subsidiary and, in effect, would be taxed at the 25% capital gains rate when distributed to the parent, leaving the parent with 75¢ out of each dollar of stepped-up basis after taxes. Had the transfer been tax-free, the subsidiary would have paid a tax of 52¢ (1956 rates) on each dollar received in excess of its parent's basis for the property, and the parent would have paid roughly 8¢ in taxes, after applying the § 243 exclusion, when the remaining 48¢ was distributed to it, leaving about 39½¢ after taxes.

86. Rev. Rul. 63-28, 1963-1 CUM. BULL. 76.

87. Rev. Proc. 64-31, 1964-2 CUM. BULL. 947.

88. *Id.*

89. 1959-1 CUM. BULL. 76.

90. Camp Wolters Enterprises, Inc. v. Commissioner, 22 T.C. 737, *aff'd*, 230 F.2d 555 (5th Cir. 1956).

91. *See, e.g.*, Gooding Amusement Co. v. Commissioner, 236 F.2d 159 (6th Cir. 1956), where this argument was dismissed by the court and the notes were considered stock. *But see* Lloyd-Smith v. Commissioner, 116 F.2d 642 (2d Cir. 1941), where the Commissioner successfully argued that two-year unsecured notes received in a § 351 transfer were "boot."

under the reorganization provisions[92] in which courts have held that corporate notes did not constitute "securities." However, in these cases the parties, with that agility found so frequently in tax controversies, have reversed the roles assumed in sales cases. The Commissioner is seeking "other property" classification in order to make section 354(a)[93] inapplicable to the reorganization and force the taxpayer to recognize gain. The taxpayer is seeking "security" classification to avoid recognition of gain. While it certainly can be argued that the definition of "security" should remain the same no matter which party is seeking that classification, the issue in the reorganization cases is whether the notes give their holders a sufficient proprietary interest in the issuing corporation to satisfy the "continuity of interest"[94] requirement of a tax-free reorganization.[95] While some commentators have indicated that the "continuity of interest" doctrine could be a requirement of section 351,[96] to date there are no cases so holding. Consequently, it is not inconceivable that a different test would be applied in a section 351 "security" case than in a reorganization case,[97] although the courts do not seem to have done so.[98]

Ignoring this possible difference between a reorganization "security" question and a section 351 "security" question, it seems that a corporate obligation is less likely to be considered a security if it is of short duration,[99] is unsecured,[100] bears no interest,[101] or bears

92. INT. REV. CODE of 1954, § 368.

93. INT. REV. CODE of 1954, § 354(a), provides in general that no gain or loss shall be recognized if securities in a corporation that is a party to a reorganization are exchanged for securities in that corporation, or in another corporation that is a party to the reorganization.

94. For a succint definition of the "continuity of interest" requirement in a reorganization, see Treas. Reg. § 1.368-1(b) (1955).

95. *See, e.g.,* Neville Coke & Chem. Co. v. Commissioner, 148 F.2d 599 (3d Cir. 1945).

96. B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 75-76 (2d ed. 1966).

97. For a plausible argument to the effect that, even within the reorganization area, different tests should be applied in determining whether a note *given up* by a creditor in a reorganization constitutes a security, than are applied in testing a note *received* by the same creditor, see S. SURREY & W. WARREN, FEDERAL INCOME TAXATION 1570 (1962).

98. Camp Wolters Enterprises v. Commissioner, 22 T.C. 737, *aff'd* 230 F.2d 555 (5th Cir. 1956).

99. Turner v. Commissioner, 303 F.2d 94 (4th Cir. 1962) (one-year notes held not securities for § 351 purposes); Cortlandt Specialty Co. v. Commissioner, 60 F.2d 937 (2d Cir. 1932) (notes of 14-month duration and less held not securities for reorganization purposes); Rev. Rul. 56-303, 1956-2 CUM. BULL. 193 (notes with an average duration of two and one-half years held not securities for § 351 purposes).

100. Lloyd-Smith v. Commissioner, 116 F.2d 642 (2d Cir. 1941). *But see* Camp Wolters Enterprises, Inc. v. Commissioner, 22 T.C. 737, *aff'd,* 230 F.2d 555 (5th Cir. 1956) (unsecured notes held securities).

101. Turner v. Commissioner, 303 F.2d 94 (4th Cir. 1962).

the earmarks of an installment sales contract rather than a note.[102] Of these factors, the duration of the note certainly seems to be the most important. Thus an attorney, in handling a sale to a controlled corporation, might use short-term notes in the hope that, even if the sale is treated as a section 351 transfer, nevertheless the notes will be considered "other property." In doing so, he would find support in many reorganization cases and in Revenue Ruling 56-303,[103] but it certainly should be recognized that this factor alone will not control the tax consequences of the transaction. The notes might be considered securities despite their short duration; the notes might be ignored and the transaction treated as a contribution to capital[104] or, as discussed below, the notes might be considered stock.

5. *Stock or Securities?*—If the taxpayer is unable to sustain his argument that the notes constitute "other property," or if the facts do not warrant even making such an argument, he still may contend that the notes are securities rather than stock. The Commissioner normally will contend that the notes are stock rather than either "boot" or securities, because treating the notes as securities rather than stock may not be quite so advantageous to the Government. If the notes are considered securities, the corporation will not obtain a stepped-up basis for the property received,[105] the transferor having recognized no gain on the transfer,[106] but the corporation will retain its deduction for interest payments on the notes,[107] and payments of principal will be taxable as capital gains to the transferor[108] (unless section 1239 applies). However, if the notes are considered stock, then not only will the corporation lose its stepped-up basis, but it also will lose its interest deduction and payments of both interest and principal will be taxed as dividends to the transferor,[109] to the

102. Brown v. Commissioner, 27 T.C. 27 (1956).

103. 1956 CUM. BULL. 193.

104. *See* text accompanying notes 140-48 *infra.*

105. INT. REV. CODE of 1954, § 362(a).

106. INT. REV. CODE of 1954, § 351(a).

107. INT. REV. CODE of 1954, § 163; *See* Truck Terminals, Inc. v. Commissioner, 314 F.2d 449 (9th Cir. 1963).

108. INT. REV. CODE of 1954, § 1232; *See* Baker Commodities, Inc. v. Commissioner, 48 T.C. 374 (1967). Under § 1232(a)(2) even principal payments made within six months of the transfer will be taxed as long-term capital gains.

109. The payments will be a dividend either by directly applying §§ 301 and 316 or by treating the payments as stock redemptions that fail to qualify for capital gains treatment under § 302(b)(1), (2), and (3). The courts generally have not found it necessary to decide which theory applies. *See, e.g.,* the decision in Gooding Amusement Co. v. Commissioner, 236 F.2d 159 (6th Cir. 1956). The particular theory could be important if the taxpayer disposes of all his stock in the corporation prior to the last payment on the "note." In such a situation, if § 302 is the relevant theory, the final payment on the note would terminate the taxpayer's entire interest in the cor-

extent of the corporation's earnings and profits[110] (and earnings and profits will be increased as a result of the corporation's loss of a stepped-up basis). Thus it becomes extremely important to the seller, if all else fails, to sustain an argument that the notes should be treated as securities rather than stock. If successful he will at least have salvaged his capital gain and the corporation's interest deduction.

The debt versus equity question has been the subject of innumerable cases, because the problem can arise in a number of ways completely divorced from a sale transaction. The question may be placed in issue when the corporation seeks a deduction for interest payments on the "notes,"[111] when it uses a stepped-up basis on a later sale of the property,[112] when the "debt" is discharged,[113] when the "debt" becomes worthless and the holder seeks a bad-debt deduction,[114] or when the "seller" treats the proceeds of the "sale" as capital gains.[115] While the various settings in which the issue may arise are numerous, the tests applied by the courts to resolve the issue generally are the same.[116] Consequently, the cases discussed below are not limited to sales cases.

At various times courts have attempted to find a single factor that would resolve, or at least be of primary importance in resolving, the debt-equity problem. For a period of time[117] the ratio of debt to equity seemed to be of paramount importance. Emphasis on this particular factor, to the exclusion of others, evidently resulted from the Supreme Court's observation in *Kelley Co. v. Commissioner* to the effect that

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poration and so should qualify for capital gains treatment under § 302(b)(3). If this is correct, the note might even be prepaid. Also, if § 302 is the relevant theory, a taxpayer might give all his stock in the corporation to his wife or children and then cause the corporation to prepay the outstanding notes. Since § 302(c) permits waiver of the family attribution rules, capital gains treatment might be obtained on the prepaid principal, even though the notes were considered stock, because again the shareholder's entire interest would be terminated. Section 302(c)(2)(B)(ii) might apply to prevent waiver of the family attribution rules in this situation, however. Also, the Commissioner would certainly look with disfavor on any such attempt and could be expected to strongly argue that the § 301 theory should govern.

110. INT. REV. CODE of 1954, § 316.

111. John Kelley Co. v. Commissioner, 326 U.S. 521 (1946). *See also* Mountain States Steel Foundries v. Commissioner, 18 CCH Tax Ct. Mem. 306 (1959).

112. Gunn v. Commissioner, 25 T.C. 424 (1955).

113. Jennings v. United States, 272 F.2d 842 (7th Cir. 1959).

114. Gilbert v. United States, 248 F.2d 399 (2d Cir. 1957).

115. Morgan, Inc. v. Commissioner, 30 T.C. 881 (1958).

116. For a case in which three of the above problems existed and were resolved by applying the same tests, see Perrault v. Commissioner, 25 T.C. 439 (1955).

117. The period of time has been defined by one commentator as 1946-56. Caplin, *The Caloric Count of a Thin Corporation*, N.Y.U. 17TH INST. ON FED. TAX. 771, 777 (1959).

> As material amounts of capital were invested in stock, we need not consider the effect of extreme situations such as nominal stock investments and an obviously excessive debt structure.[118]

The Tax Court in particular seemed to place almost total reliance on this factor in resolving debt-equity cases. Thus ratios from 12:1[119] to 1250:1[120] caused ostensible debt to be reclassified as equity. The numerous "thin capitalization" cases have been exhaustively discussed elsewhere[121] and will not be explored in detail here. It should be pointed out, however, that excessive reliance on the debt-equity ratio was not only unrealistic but also produced inconsistent results. Thus in one case[122] a ratio of 12:1 caused "debt" to be considered stock, while in another case[123] a ratio of 39:1 did not prevent debt from being considered true debt rather than equity. Thus a test that originated as an admirable effort to inject a modicum of certainty into an uncertain field probably resulted in creating even more uncertainty. Consequently, the Tax Court at least has clearly abandoned the debt-equity ratio as the talisman that will resolve debt-equity cases and now views it simply as a single factor to be considered in conjunction with other factors. For example, in one recent case[124] the Tax Court did not reclassify debt as equity despite a ratio of 700:1.

More recently the Tax Court has been placing primary reliance on "the intent of the parties."[125] Unfortunately, determining the parties' intent is not really an independent test but is simply the end result of applying the various factors that have always been applied by the courts in determining whether debt actually constitutes equity for tax purposes. Thus the important question to be discussed is what factors will a court look to in determining the parties' intent (*i.e.*, in determining whether equity is masquerading as debt)?

While the form of the debt instrument is not controlling, it is obvious that the instrument should have all the outward appearances of true debt in order to withstand scrutiny by the Internal Revenue Service. Thus adequate interest should be provided, there should be a fixed maturity date, the maturity date should not be unreasonably distant, the note language and book entries should indicate the existence of a debt, and the face amount of the debt should not exceed

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118. 326 U.S. 521, 526 (1946).
119. Bachrach v. Commissioner, 18 T.C. .79 (1952), *aff'd*, 205 F.2d 151 (2d Cir. 1953).
120. Swoby Corp. v. Commissioner, 9 T.C. 887 (1947).
121. *See* Caplin, *supra* note 117.
122. Bachrach v. Commissioner, 18 T.C. 479 (1952), *aff'd*, 205 F.2d 151 (2d Cir. 1953).
123. Scott v. Commissioner, 14 CCH Tax Ct. Mem. 1029 (1955).
124. Baker Commodities, Inc. v. Commissioner, 48 T.C. 374 (1967).
125. *Id.*

the value of the property transferred to the corporation. In addition, payment of principal and interest should not be contingent on the corporation's future earnings, and the obligations should not be subordinated to the claims of general creditors. The last two factors are particularly important. It becomes difficult to distinguish the "debt" from stock if payment is dependent on the corporation's future success or if payments can be made on the "debt" only after satisfaction of "outside" creditors' claims. However, subordination of the debt to the claims of a single creditor may not be fatal, if obtaining money from that creditor was necessary to continue the corporation's existence and if that creditor would not loan money without subordination. Under these circumstances subordination becomes a neutral factor and the existence of other factors will determine the classification of the instrument.[126]

In addition to the terms of the instrument (which the taxpayer's attorney can, to some extent, control), other factors, if present, are extremely helpful, although the attorney may have no control over these factors. If income-producing property is transferred, such as rental property, so that the corporation may pay the debt without disposing of the transferred property, the debt is less likely to be treated as stock. In *Sun Properties, Inc. v. Commissioner*,[127] the note provided for no interest, the transferee made no down payment, and the property transferred (a warehouse) was virtually the sole asset of the corporation. Despite these equity indicia, the note was held to be a valid debt, primarily because the warehouse was being leased at the time of the sale and the debt could be discharged from the rentals received. In *Aqualane Shores, Inc. v. Commissioner*,[128] the *Sun Properties* case was distinguished primarily on the point that the property in *Sun Properties* was income producing.

The debt should not, if possible, be held in the same proportion as the stock. This, of course, will be impossible if the corporation has only a single shareholder, but it might be noted that even though the disproportion is only among members of a single family, disproportionate holding may still be helpful. For example, in *Curry v. Commissioner*,[129] members of a partnership transferred property to a corporation in exchange for a note. The note and stock were held by members of a single family but in disproportionate amounts (two of the note-holding partners, for example, owned no stock in the corporation although they were wives of two substantial stockholders). Despite the family relationship, the Tax Court placed consider-

126. *Id.*
127. 220 F.2d 171 (5th Cir. 1955).
128. 269 F.2d 116 (5th Cir. 1959).
129. 43 T.C. 667 (1965).

able reliance on the disproportionate ownership of stock and debt in upholding the sale. On the other hand, in *Zephyr Mills, Inc. v. Commissioner*,[130] disproportionate holdings within a single family were considered to be of no significance. It also should be noted that disproportionate holdings, even outside a single family, will not guarantee debt treatment. In *Reed v. Commissioner*,[131] all of the corporate debt was held by a 55 per cent shareholder. Shareholders holding the other 45 per cent of the corporation's stock held no debt but the debt nevertheless was considered equity.

The taxpayer's argument is further strengthened if the asset transferred is not the sole or primary asset of the corporation, and if the business could be conducted without owning the transferred asset. Thus it is preferable, if possible, to sell the asset to a corporation which is a going concern. This primary asset factor has frequently been relied upon by the Commissioner in land development cases where a corporation was formed and, shortly thereafter, "purchased" undeveloped land from its shareholders and proceeded to develop and sell the land. Since the corporation was considered to be a "meaningless shell" without the land, the "sale" closely resembled a capital transfer.[132] On the other hand, taxpayers have occasionally been successful despite the existence of this factor,[133] although cases in which taxpayers have successfully sold a primary asset to the corporation did not involve land development.[134]

As previously discussed, "thin capitalization" is no longer the determining factor it once was. Nevertheless, it obviously is helpful to the taxpayer if the debt-equity ratio is not extremely high. While numerous decisions discuss the debt-equity ratio, there has been little discussion of the applicable rules in determining the amount of debt and the amount of equity. It appears that courts ordinarily look to the fair market value of property transferred in exchange for stock (rather than the adjusted basis of that property or the stock's par value) to determine the amount of equity. As far as debt is concerned, the courts generally look to the face amount of the outstanding debt. In most cases the courts have ignored debt owed to third parties in determining the debt-equity ratio, although in at least one case[135] the Tax Court has looked at the corporation's entire debt obligations, including those owed to third parties, in determining whether

130. 18 CCH Tax Ct. Mem. 794 (1959).

131. 242 F.2d 334 (2d Cir. 1957).

132. *See, e.g.*, Aqualane Shores, Inc. v. Commissioner, 269 F.2d 116 (5th Cir. 1959).

133. Sun Properties, Inc. v. Commissioner, 220 F.2d 171 (5th Cir. 1955).

134. *But see* Rev. Rul. 56-303, 1956-2 Cum. Bull. 193, *revoked by*, Rev. Rul. 63-28, 1963-1 Cum. Bull. 76.

135. Dobkin v. Commissioner, 15 T.C. 31 (1950).

the corporation was thinly capitalized where the "outside" debt was guaranteed by the stockholders.

It also should be noted that the courts, in viewing the fair market value of property transferred, will look to intangible as well as tangible assets. Thus if the assets of a going business are sold to the corporation, goodwill may exist and be acquired by the corporation. This intangible asset may offset an otherwise high ratio of debt to equity. In *Perrault v. Commissioner*,[136] partnership assets were transferred to a controlled corporation and the debt-equity ratio, considering only the tangible assets, was 516:1. However, the Tax Court held that the corporation was adequately capitalized when the substantial goodwill acquired by the corporation was considered. Furthermore, even where capitalization has been extremely thin, this has not automatically caused debt to be considered equity,[137] but neither has a low ratio automatically prevented the debt from being considered equity.[138]

Some factors that have been relied on in interest deduction or bad debt cases are inapplicable to sales cases. For example, if the corporation has been organized for some time and then distributes debt obligations as dividends, the Commissioner has attempted to treat the obligations as stock on the ground that there was no investment to permit the obligation to be considered debt.[139] This factor would not be present in a sales case where additional property obviously must be transferred to the corporation in order to have the sale.

On the basis of the above summary, it is apparent that no single factor will resolve the debt-equity question. No factor has consistently either caused debt to be considered equity or required that debt be considered true debt. Nevertheless, the taxpayer obviously is in a stronger position if he can combine as many favorable factors as possible in his sale, particularly when a valid business purpose can be established for the existence of these factors.

C. *Contribution to Capital*

While section 351 has been the method most frequently used by the Commissioner in combating sales to controlled corporations, it is apparent from the above discussion that section 351 may be inapplicable to a particular transaction for any number of reasons. Thus the corporation might pay cash for the property, the seller might not control the corporation within the meaning of section

136. 25 T.C. 439 (1955).
137. Morgan, Inc. v. Commissioner, 30 T.C. 881 (1958).
138. Huffstutler v. Commissioner, 12 CCH Tax Ct. Mem. 1422 (1953) (5:1 ratio).
139. Kraft Food Co. v. Commissioner, 232 F.2d 118 (2d Cir. 1956).

368(c), or the seller might own no stock at all in a corporation controlled by his family members. In these and other circumstances the Commissioner generally is precluded from using section 351 and instead may contend that the "sale" actually constitutes a contribution to the corporation's capital coupled with a dividend distribution. If the Commissioner is successful, the corporation will lose its stepped-up basis for the property[140] and payments by the corporation will be treated as dividends to the extent of its earnings and profits.[141]

The Commissioner will encounter the least difficulty with a contribution to capital theory if the shareholder organizes the corporation by contributing cash and, shortly thereafter, the corporation "buys" property from the shareholder, using the cash received upon organization for the purchase. This method was unsuccessfully attempted in one early case[142] and since that time most taxpayers have not been quite so obvious. A more difficult question is presented when a corporation that is a going concern "purchases" property from a controlling shareholder for cash or when a non-shareholder sells property to the corporation, either for cash or notes.

As to the non-shareholder situation, it is clear that a contribution to capital is not precluded simply by the fact that the seller is not a shareholder. The Supreme Court has held that a non-shareholder may make a contribution to capital,[143] and the 1954 Code recognizes this fact.[144] Of course the problem ordinarily will arise only if members of the seller's family control the acquiring corporation. Otherwise there would be little reason for a person to cast a contribution to capital in the form of a sale. But where members of the "seller's" family do control the corporation, the Commissioner has successfully treated the "sale" as a contribution to capital. In *Foresun, Inc. v. Commissioner*,[145] a corporation controlled by the "seller's" husband and other family members "purchased" real property from the taxpayer by making a down payment of 25,000 dollars and giving a note for 200,000 dollars. However, no payments were ever made on the note; there were no valid business reasons for the "sale"; the corporation was thinly capitalized, and payments of principal and interest on the note were subordinated to the claims of a first mortgage. Under these circumstances, the Tax Court found that the "sale" constituted a contribution to capital.

Despite the *Foresun* case, the Commissioner normally is not in a particularly strong position when arguing that a sale by a non-sharc-

140. Int. Rev. Code of 1954, § 362(b).
141. Int. Rev. Code of 1954, §§ 301, 312.
142. Labrot v. Burnet, 57 F.2d 413 (D.C. Cir. 1932).
143. Brown Shoe Co. v. Commissioner, 339 U.S. 583 (1950).
144. Int. Rev. Code of 1954, § 362(c)(1).
145. 41 T.C. 706 (1964).

holder actually was a contribution to capital. Even when a family member controls the corporation, few non-shareholders would be willing to give away valuable property—most would insist on receiving a valid evidence of indebtedness and would fully enforce their rights as creditors if the corporation could not make payments on the indebtedness as called for. This intent, if proved, should permit the note to be treated as true debt rather than equity.

Also, the Commissioner may encounter some conceptual difficulties in properly classifying payment of principal and interest on the notes if the seller owns no stock in the corporation and the sale is treated as a contribution to capital. The term "dividend" is defined by the Code as "a distribution of property made by a corporation *to a shareholder*. . . ."[146] This problem was not encountered in *Foresun* because no payments were made on the notes in that case.

While a non-shareholder normally is in a strong position, here, as in the section 351 area, a transfer of all the seller's stock shortly before the sale would not necessarily permit the seller to be considered a non-shareholder. For example, in *Owen Company v. United States*,[147] a father transferred a part of his stock to his sons in exchange for their corporate debentures, and transferred the remainder of his stock to a trust. While the father consequently owned no stock, the corporation nevertheless was denied a deduction for payments of interest to the father on the debentures received from his son.

Where the "seller" is a controlling shareholder, the Commissioner's contribution to capital argument becomes considerably stronger. There is certainly nothing unusual about a shareholder contributing property to his controlled corporation, and payments made by the corporation may be characterized as dividends whether cash is immediately paid or whether notes are given.

There have been comparatively few contribution to capital cases involving attempted sales, although there are innumerable cases involving "loans." Whether a sale or a loan is involved, the question of whether a contribution to cquity capital has in fact been made should be governed by the same factors. The question is:

> whether the so-called creditors placed their investment at the risk of the business, or whether there was an intention that the alleged [debt] be repaid in any event regardless of the fortunes of the enterprise.[148]

Factors relevant in answering this question generally are the same as those involved when the question is "stock or security" under section 351. If the form of the instrument indicates a true debt, if the corporation's capital structure is not excessively "thin," and if prin-

146. INT. REV. CODE of 1954, § 301(a) (emphasis added).
147. 180 F. Supp. 369 (Ct. Cl. 1960).
148. Leach Corp. v. Commissioner, 30 T.C. 563, 578-79 (1958).

cipal and interest are payable in all events and are not subordinated to the claims of general creditors, then the shareholder is in a strong position on the contribution to capital question. This is particularly true if the debt is not held pro-rata by the shareholders and if the assets sold to the corporation are not absolutely necessary to the conduct of business.

III. SALES AT A LOSS—SECTION 267

As discussed above, the seller of property that has appreciated in value is primarily seeking to give his controlled corporation a stepped-up basis for the property while recognizing a capital gain. However, there also are potential tax advantages to be derived from selling property that has depreciated in value to a controlled corporation. If the sale is recognized for tax purposes, the seller could take an immediate deduction for the difference between his adjusted basis for the property and the amount paid for it by the corporation.[149] This deduction would be capital or ordinary, depending on the nature of the property transferred. By selling to a controlled corporation, the seller retains substantial ownership of the property so that he or the corporation may obtain the benefits of future value increases.

To some extent the problems with sales of potential loss property are the same as with sales of appreciated property. If the Commissioner can successfully bring the sale within section 351, the loss will not be recognized, even if "boot" is received. However, the Commissioner is forced to rely on section 351 with sales of appreciated property largely because section 1239—the only Code provision specifically dealing with sales of such property to a controlled corporation—has proved to be highly ineffectual. In the loss area, Congress has enacted a much more potent provision to discourage such sales—section 267 of the Internal Revenue Code. Consequently, the Commissioner seldom, if ever, must use section 351 to disallow a loss on sales to controlled corporations.

Sections 267 and 1239 are superficially similar.[150] Both sections deny a tax benefit arising from sales to controlled corporations. However, section 1239 defines "control" as more than 80 per cent ownership, while section 267 requires only 51 per cent ownership. In determining whether these ownership requirements are satisfied, both provisions look to the value of stock owned, not to the number of shares.[151] But section 267 treats an individual as owning stock owned

149. INT. REV. CODE of 1954, §§ 165, 1001.

150. Section 267, however, is not limited to sales to controlled corporations. It also applies to sales between related individuals, related corporations, trusts and fiduciaries, trusts and beneficiaries, etc. Also, § 267 is not limited to losses but also applies to expenses and interest.

151. In connection with § 267, use of value rather than number of shares was

by his brothers, sisters, wife, parents, and lineal descendants (whether minors or adults). An individual also is treated as owning stock owned by a trust or estate of which he is a beneficiary, a partnership of which he is a member, or a corporation in which he is a shareholder. As previously mentioned, section 1239 attributes only stock owned by an individual's wife, minor children, and minor grandchildren. Finally, section 267 applies to both depreciable and nondepreciable property while section 1239 is limited to depreciable property.

The low control requirement, coupled with broad attribution rules, has made section 267 a considerably more effective provision than section 1239 and has largely eliminated the tax advantages from sales of loss property to controlled corporations. Thus the uncertainty that has arisen with sales of appreciated property is not present in the loss area. Furthermore, the courts have not hesitated to construe the provisions of section 267 liberally. Thus deductions have been denied where the individuals in question held legal title to no stock in the corporation but were regarded as the beneficial owners[152] (a concept that has been rejected under section 1239)[153] and where the seller, as a result of the sale, lost control of the corporation.[154] The courts also have literally construed section 267 when literal construction resulted in denial of a deduction, even though the particular factual situation was probably not the type situation Congress had in mind when section 267 was enacted. For example, in *Commissioner v. Whitney*,[155] a loss on a sale of property by a partnership consisting of thirteen unrelated individuals was denied where the sellers collectively controlled the purchasing corporation only by virtue of the partnership attribution rules of section 267. Consequently, to the dismay of many taxpayers, section 267 has proved to be a highly effective provision in contrast to section 1239.

IV. SUMMARY

Congress has given little help to the Commissioner in combating sales of appreciated property to controlled corporations. Section 1239, partly through its limited coverage and partly through court inter-

clearly the result of conscious thought on the part of Congress. As first passed by the House, the predecessor of § 267 would have been based on number of shares but this was changed by the Senate (although the change was described as "slight"). S. REP. No. 558, 73d Cong., 2d Sess. 27 (1934).

152. Tri-Borough Transp. Corp. v. Commissioner, 5 CCH Tax Ct. Mem. 105 (1947) (title to the stock was held by a son and nephew of one of the individuals).

153. Drybrough v. Commissioner, 42 T.C. 1029, *rev'd on other grounds*, 376 F.2d 350 (6th Cir. 1967).

154. Drake, Inc. v. Commissioner, 145 F.2d 365 (10th Cir. 1944).

155. 169 F.2d 562 (2d Cir. 1948).

pretation, has proved to be ineffective. As a result, the Commissioner has been forced to resort to section 351 in an effort to inhibit sales of appreciated property by controlling shareholders. However, section 351 was not enacted for this purpose and its terminology frequently makes it inapplicable to a particular sale. Furthermore, even if section 351 applies there still remain troublesome questions as to whether the consideration received constitutes stock, securities, or "boot." As a result, there is presently a considerable degree of uncertainty as to the tax consequences of a sale of appreciated property to a controlled corporation.

By contrast, there is little question but that a loss on the sale of property that has depreciated in value to a controlled corporation will be disallowed. This has resulted both from the broad terminology of section 267, the counterpart of section 1239 in the loss area, and also from the courts' willingness to construe section 267 in accord with the purpose for which the section was enacted.

The reasons for the differences in the broad terminology of section 267 and the limited terminology of section 1239 are not readily discernible. Both provisions are aimed at what Congress evidently considers tax abuse. Yet, having made its tax abuse determination, Congress effectively dealt with that abuse in the area of losses on sales to controlled corporations but merely made a passing swcep at sales of appreciated property. It would appear that if Congress considers sales of appreciated property to controlled corporations to be an area of tax abuse, section 1239 should be amended by decreasing the percentage ownership requirements to 51 per cent, by broadening the attribution rules to include more family members as well as trusts, partnerships, and controlled corporations, and also by making the section applicable to non-depreciable property.