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LIBSON SHOPS AND THE 1954 CODE

by

Thomas N. Tarleau* and Robert B. Hodes**

THE survival of a corporate net operating loss deduction is a problem which has vexed the courts, the Congress, the Internal Revenue Service and taxpayers ever since the loss carryover provisions were first enacted. The problem arises where, because of changes in ownership, business, capital structure or form, the corporation after suffering the loss has been modified before utilizing it. As a policy matter, the carryover allowance responds to the need for tax relief in two situations. First, it assists new enterprises by permitting losses which are often incurred in start-up periods to reduce taxes which would otherwise be borne by later profits. Secondly, by averaging profit and loss years over an effective nine-year period, the corporate tax applies to the actual net income of that period despite fluctuations between profit and loss years. However, these situations hardly comprehend the dynamism and variety of the economy. The economy and legal system of the country accommodate complexity, flexibility and innovation in the structure and ownership of business organizations to a degree which often frustrates attempts to legislate in terms of familiar, simple or static subjects. Companies are constantly bought and sold, recapitalized and reorganized; the business may be abandoned, or augmented; new activities, fresh capital, or new people may be added as required. Indeed, net operating losses often evidence the need for change. Furthermore, an available loss carryover deduction, worth about fifty cents on the dollar against future profits, is necessarily an element considered in whether and how

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1 The carryover and carryback of net losses was introduced into the tax structure by the Revenue Act of 1918, ch. 18, § 204(b), 40 Stat. 1061. See note 14 infra for the changes which have occurred in the periods over which these deductions may be spread.
2 When a loss business is modified, it is only the carryover provisions which are relevant prospectively to the new owners. Under § 172(b) of the 1954 Code, the carryback provisions must be utilized before the carryover provisions are utilized. Therefore, if a carryback does exist, the refund available will be regarded as equivalent to cash in any negotiations concerning the modification.
3 For example, assuming no adjustments are necessary, if a business loses $100,000 during its first year of operation and then in each of the succeeding five years it earns $20,000, at the end of this six year period it will not have had to pay any tax.
4 For example, assuming no adjustments are necessary, in each of the first three years a corporation earned $10,000, in the fourth it lost $80,000, and in each of the next succeeding five years it earns $10,000, that corporation would not have any tax liability. In the fourth year, a refund claim would retrieve the tax paid in the first three years, and the carryover of $10,000 would be utilized to eliminate the tax for each of the succeeding five years.
change is to occur. These realities result in the tendency to oppose lib-
eralization of the carryover provisions. Congress has been concerned
about the so-called “traffic” in loss deductions—the notion that tax
relief which is the product of legislative grace may somehow come to
be bought and sold between private persons bent on profit. The for-
mal evolution of which corporations are capable (which, under the
tax laws, is sometimes encouraged) often extends the circumstances
under which loss deductions are used very far beyond the elemen-
tary cases which Congress had in mind when the loss carryover pro-
visions were enacted. The question has been: “How far is too far?”
both from the point of view of policy and the interpretation of
existing statutes. At one extreme is the struggling new business, rely-
ing on the carryover deduction to secure its hoped for foothold in
profitability; at the other is the corporate shell having no value other
than the carryover which is bought solely for the purpose of afford-
ing new owners the benefit of tax shelter. Between these extremes
fall an almost infinite number of possibilities. It has not been easy
to devise formulas which are capable of discriminating between ob-
escure shades of difference.

The 1939 Code contained two principal provisions covering cor-
porate loss carryovers: Section 122, the underlying provision, cre-
ated the deduction and allowed it to “the taxpayer” which had in-
curred a net operating loss; section 129 denied the use of the carry-
over where the control of the business had been transferred for the
“principal purpose” of obtaining the tax benefit. The operation of

5 See Rudick, Acquisitions to Avoid Income or Excess Profits Tax: Section 129 of the
Internal Revenue Code, 58 HARV. L. REV. 196 (1944), with examples of advertisements
from the Wall Street Journal and New York Times for the buying or selling of corporations
whose only asset is a loss carryover.
6 Section 122(b) of the 1939 Code reads in part:
If for any taxable year . . . the taxpayer has a net operating loss, such net
operating loss shall be a net operating loss carry-back for each of the two
preceding taxable years. . . .
If for any taxable year . . . the taxpayer has a net operating loss, such net
operating loss shall be a net operating loss carry-over for each of the two suc-
ceeding taxable years. . . .

7 Section 129(a) of the 1939 Code reads in part:
If (1) any person or persons acquire . . . directly or indirectly, control of
a corporation, or (2) any corporation acquires . . . directly or indirectly,
property of another corporation, not controlled, directly or indirectly, immedi-
ately prior to such acquisition, by such acquiring corporation or its stock-
holders, the basis of which property, in the hands of the acquiring corporation,
is determined by reference to the basis in the hands of the transferor cor-
porations, and the principal purpose for which such acquisition was made is
evasion or avoidance of Federal income or excess profits tax by securing the
benefit of a deduction, credit, or other allowance which such person or cor-
poration would not otherwise enjoy, then such deduction, credit or other al-
lowance shall not be allowed.

Control was defined as ownership of 50% of the total voting stock of a corporation or
section 129 was unsatisfactory because it turned on the taxpayer's subjective intent and, thus, never provided sufficiently predictable results. Moreover, the Treasury believed that section 129 was too weak because the courts too often seemed ready to hold that business purposes outweighed the prohibited intent in sustaining challenged loss carryover deductions. The interpretation of section 129, now section 269 of the 1954 Code, is outside the scope of this paper; however, the section does inhibit the "traffic" in "carryovers" and sometimes disallows carryovers which escape the primarily objective restrictions of the cases and Code provisions discussed here.

The 1939 Code did not specifically define the extent to which a loss carryover deduction survived a corporate reorganization, such as a merger, consolidation, or tax-free acquisition of assets. Before *Libson Shops, Inc. v. Koebler* the survival of loss carryovers under the 1939 Code seemed to depend upon two factors: The first was business versus tax avoidance purpose under section 129. The second was the corporate entity question. Section 122 provided: "If . . . *the taxpayer* has a net operating loss, such net operating loss shall be a net operating loss carryback [or] . . . carry-over, [for two years . . .]" (Emphasis added.) Therefore, it seemed essential, if a carryover was to survive a corporate reorganization, that the corporation which had incurred the loss be the survivor in the reorganization. There were undecided issues, of course, particularly over the question of whether it made any difference which company was the technical survivor after a statutory merger. There was a notion that the surviving company succeeded to the corporate personalities of its component companies by operation of law. This rather metaphysical question was much litigated because it seemed harsh that substantial tax results should depend on an insubstantial evolution of a purely fictional legal personality. However, it was generally understood that a practical merger, such as a tax-free acquisition of assets for voting stock, having the same general consequences as a statu-

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*See note 12 infra.*

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*333 U.S. 382 (1957).*
tory merger, sacrificed the loss carryover deduction unless the loss corporation was the acquiring entity.\footnote{11}

In 1954 Congress, dissatisfied with the working of the 1939 Code,\footnote{12} modified it and introduced elaborate and detailed formulas regulating corporate utilization of carryovers where the carryover had been transferred, or where the taxpayer concerned had undergone specified changes\footnote{13} in ownership and business. The 1954 changes reflect the dual attitude which has affected most official considerations of this subject. On one hand the principle of permitting a business to offset the income of good years by the accumulated losses of poor ones has been generally approved. The number of years over which

\footnote{11} In New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934), the assets of a loss corporation were transferred to the taxpayer in exchange for stock and voting trust certificates. These stock certificates were exchanged by the loss corporation with its shareholders for their old stock. The taxpayer sought to utilize the old corporation's prior losses against income, but this was held to be improper. The court held that the two corporations were not identical, but were distinct; therefore, they were not the same taxpayer as required by the statute (the Revenue Act of 1921). Under New Colonial the form of the transaction determined tax attributes. For example, where a loss corporation was merged into another corporation, the carryover would be lost because of the change in form. On the other hand, had the other corporation been merged into the loss corporation, the loss carryover would have survived.

\footnote{12} H. R. REP. No. 1337, 83d Cong., 2d Sess. 42 (1954):

Under present law where a controlling interest in a corporation is acquired for the purpose of avoiding or evading tax liabilities the Internal Revenue Service may disallow the benefits of a deduction, credit, or allowance which would otherwise be enjoyed by the acquiring person or corporation. This provision has proved ineffectual, however, because of the necessity of proving that tax avoidance was the primary purpose of the transaction. It has also been so uncertain in its effects as to place a premium on litigation and a damper on valid business transactions.


"Section 122 of the 1939 Code, the underlying provision allowing carrybacks and carryforwards, was carried forward in \S\ 172 of the 1954 Code without major substantive change. Section 129 of the 1939 Code, the then major statutory provision regulating transactions where the "principal purpose" was tax avoidance, was carried forward in \S\ 269 of the 1954 Code with only a minor addition. Sections 381 and 382 of the 1954 Code were new and provided specifically for the use of a loss carryover after specified tax-free reorganizations, and the regulation of such carryovers after such a reorganization if specified changes in ownership and business accompanied the reorganization. See text accompanying notes 19, 26-28 infra."
net operating loss carryovers may be deducted is now the greatest it has ever been,\textsuperscript{14} and the utilization of the carryover after a reorganization is in certain circumstances made easier.\textsuperscript{15} However, because Congress has constantly objected to the use of carryovers for tax avoidance, the 1954 changes also limit the availability of carryovers after specified transactions.

The 1954 amendments attempted to clarify ambiguities and mark predictable limits.\textsuperscript{16} As with all complex legislation the 1954 Code introduced some new and different ambiguities and elusive boundaries,\textsuperscript{17} but it seemed a step forward. Then in 1958, with \textit{Libson Shops},\textsuperscript{18} a new factor was interposed. Briefly, the Supreme Court told us (and Congress) that the 1939 Code, which had been so intricately patched and augmented, meant something quite different from what it had seemed to mean in 1954.

The entity question was brought to the Supreme Court in \textit{Libson Shops} and was before Congress in connection with section 381 of the 1954 Code. In section 381 Congress provided that a net operating loss deduction was one of nineteen tax attributes that followed the assets of a corporation in a tax-free reorganization or liquidation.\textsuperscript{19}

\textsuperscript{14}The number of years over which a net loss may be averaged has not remained constant. Revenue Act of 1918, ch. 18, § 204(b), 40 Stat. 1061 (carryover one year; carryback one year); Revenue Act of 1921, ch. 136, § 204, 42 Stat. 231 (carryover extended to two years; carryback eliminated); Revenue Act of 1924, ch. 234, § 206, 43 Stat. 260 (same); Revenue Act of 1926, ch. 27, § 206, 44 Stat. 17; Revenue Act of 1928, ch. 852, § 117(b), 45 Stat. 825; Revenue Act of 1932, ch. 209, § 117(b), 47 Stat. 207 (carryforward reduced to one year); National Industrial Recovery Act, ch. 90, § 218(a), 48 Stat. 209 (1933) (carryover eliminated); Revenue Act of 1938, ch. 289, §§ 26(c), 27(c), 52 Stat. 467 (carryover allowed for two years); Revenue Act of 1939, ch. 247, § 211, 53 Stat. 867 (this became § 122 of the 1939 Code and provided for a two year carryover); Revenue Act of 1942, ch. 619, § 153, 56 Stat. 847 (carryback of two years added); Revenue Act of 1950, ch. 994, § 215, 64 Stat. 937 (carryover extended to five years; carryback reduced to one year); the 1954 Code kept the carryover of five years and extended the carryback to three years.

\textsuperscript{15}Under the 1939 Code, no provision explicitly regulated the transfer of carryovers after reorganizations. Section 381(c)(1) specifically provides that these carryovers are transferable subject, of course, to §§ 269 and 382.

\textsuperscript{16}For example, § 382 of the 1914 Code specifically denotes certain transactions which will prevent or reduce the use of carryovers. Section 269 was strengthened to provide for a presumption of tax avoidance if the price paid for stock was disproportionately high.

\textsuperscript{17}For example, the exact relationship between §§ 269 and 382 was not made clear. If a transaction runs afoul of § 382(b), does this mean that § 269 does not apply? If this is the result, then a taxpayer by using § 382(b) could sacrifice 20% of the carryover and utilize the remaining amount in a transaction which might have been covered by § 269, which would have disallowed the entire amount.

\textsuperscript{18}353 U.S. 382 (1937), affording, 229 F.2d 220 (8th Cir. 1960).

\textsuperscript{19}Section 381 of the 1954 Code provides in part:

\textbf{General Rule:} In the case of the acquisition of assets of a corporation by another corporation—

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2); or

(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection
The availability of the carryover deduction no longer depended upon which particular corporate entity survived, provided the requirements of the Code provisions governing reorganizations and liquidations were satisfied.  

Meanwhile, in the courts, the entity question was being considered under the 1939 Code because the several Libson Shops companies had been merged before adoption of the 1954 Code. In Libson Shops a group of individuals owned seventeen companies, sixteen of which operated ladies' specialty stores in a chain, and the seventeenth managed the rest. Three of the companies had net operating loss carryovers. The seventeen companies were merged into one, and the taxpayer claimed tax deductions for the unused carryovers against the income of the single successor company. Section 129 was held to be inapplicable because there was no finding that tax evasion or avoidance was the principal purpose of the merger. The principal point argued in the case, whether the post-merger corporation was "the taxpayer" under section 122, was never reached by the Court. The Court focused instead on a second argument raised in the government's brief: whether Congress ever intended that the losses from one business might, because of a merger (however legitimately motivated and accomplished), be used to offset the profits of another.

with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1), the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

By keying its application to § 368 tax free reorganizations and §§ 334 and 332 liquidations, § 381 thereby incorporates all of the rules and regulations regulating these provisions. See BITTKER, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS §§ 9.40 - 9.44, 12.01 - 12.12 (1964). The intricacies of these provisions are beyond the scope of this article, and it will be assumed herein when discussing §§ 381 and 382 that these provisions have been satisfied.


In support of its denial of the carry-over, the Government argues that this statutory privilege is not available unless the corporation claiming it is the same taxable entity as that which sustained the loss. In reliance on New Colonial Co. v. Helvering, 292 U.S. 435, and cases following it, the Government argues that separately chartered corporations are not the same taxable entity. Petitioner, on the other hand, relying on Helvering v. Metropolitan Edison Co., 306 U.S. 522, and cases following it, argues that a corporation resulting from a statutory merger is treated as the same taxable entity as its constituents to whose legal attributes it has succeeded by operation of state law. However, we find it unnecessary to discuss this issue since an alternative argument made by the Government is dispositive of this case.

Id. at 386.

The Government contends that the carry-over privilege is not available unless there is a continuity of business enterprise. It argues that the prior year's loss can be offset against the current year's income only to the extent that this income is derived from the operation of substantially the same business which produced the loss. Only to that extent is the same "taxpayer" involved.
It concluded that Congress had not so intended; therefore, the three stores’ prior losses could not be used to offset post-merger profits of the successful units. In footnote 9 the Court indicated that it was not passing on single corporation cases where the carryover was sought to be used by the company which had in fact incurred the loss.  

*Libson* was clearly a new departure. The crucial question under the 1939 Code was now not the entity problem which section 381 of the 1954 Code had solved. Instead, the question was whether there was a “continuity of business” which the Court found to be the heart of the *Libson* case. The Court said:

The requirement of a continuity of business enterprise as applied to this case is in accord with the legislative history of the carry-over and carry-back provisions. Those provisions were enacted to ameliorate the unduly drastic consequences of taxing income strictly on an annual basis. They were designed to permit a taxpayer to set off its lean years against its luscious years, and to strike something like an average taxable income computed over a period longer than one year. There is, however, no indication in their legislative history that these provisions were designed to permit the averaging of the pre-merger losses of one business with the post-merger income of some other business which had been operated and taxed separately before the merger. What history there is suggests that Congress primarily was concerned with the fluctuating income of a single business.

The question, therefore, is the extent to which the 1954 legislation disposed of the continuity of business question posed by *Libson Shops*. Section 381 of the 1954 Code had been supplemented by two provisions which dealt with continuity on somewhat different terms than did the Court. First, under section 382 (b) the survival of loss carryovers in corporate reorganizations depended upon the fraction of the surviving corporation owned by the former owners of the loss corporation. The available loss carryover was reduced pro rata if the continued equity interest was less than twenty per cent. For
example, if the stockholders of the loss company owned only ten per cent of the surviving company (whether the survivor was technically their old corporation or some other entity), then only half of the carryover was available.

Second, section 382 (a), unlike section 382 (b), dealt with changes outside the scope of section 381: it provided that if, by purchase, fifty per cent or more of the stock of a corporation had changed hands and a trade or business substantially the same as that previously conducted had not continued, then the carryovers would be disallowed. The legislative history and the subsequent regulations make

the first taxable year of the acquiring corporation ending after the date of transfer, and

(B) the stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the “loss corporation”), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 per cent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable year of the acquiring corporation ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

(2) REDUCTION OF NET OPERATING LOSS CARRYOVER.—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

(B) five.

2 Section 382(a) of the 1954 Code provides in part:

(1) IN GENERAL.—If, at the end of a taxable year of a corporation—

(A) any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

(i) the beginning of such taxable year, or

(ii) the beginning of the prior taxable year,

(B) the increase in percentage points at the end of such taxable year is attributable to—

(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,

the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

A percentage point change in ownership is not equivalent to a per cent change in ownership. Thus, if A owns ten shares out of 100 shares outstanding, he owns 10% of the stock and ten percentage points. If A later acquires ten additional shares, he has increased his holdings by 100%, but has increased his percentage points by only ten.
it clear that the "business" referred to in section 382 (a) means the specific economic activity of the company, in terms of product, facilities, customers, location, etc. However, the committee reports indicate that the subsequent addition of a different business would not upset the carryover, provided the old business is continued. There is no requirement that the continued business be the one in which the loss was incurred, merely that it be the one which was being conducted before the stock purchase.

Although both sections 382 (a) and 382 (b) deal with essentially the same subject, the survival of the carryover in the face of substantial changes in interest, the philosophies of the two provisions are different and somewhat inconsistent. A one-half change in interest in a single continuing corporation by purchase of stock requires continuation of the loss business under section 381 (a); whereas under section 381 (b) a greater change of interest in a tax free reorganization requires no continuation of the business. These disparate treatments of essentially the same material further exemplify the hazards of attempts to discover solutions in this field.

The conjunction of the Libson Shops decision with the 1954 amendments produced understandable confusion because to a certain

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If, as a result of such an increase, the corporation shifts from one type of business to another, discontinues any except a minor portion of its business, changes its location, or otherwise fails to carry substantially the same trade or business as was conducted before such an increase, then the condition in subparagraph (C) is met.

Treas. Reg. § 1.382(a)-1 (h) (5) & (6) provide:

(5) In determining whether a corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in the ownership of its stock, all the facts and circumstances of the particular case shall be taken into account. Among the relevant factors to be taken into account are changes in the corporation's employees, plant, equipment, product, location, customer, and other items which are significant in determining whether there is, or is not, a continuity of the same business enterprise. These factors shall be evaluated in the light of the general objective of section 382 (a) to disallow net operating loss carryovers where there is a purchase of the stock of a corporation and its loss carryovers are used to offset gains of a business unrelated to that which produced the losses. However, the prohibited utilization of net operating loss carryovers to offset gains of a business unrelated to that which produced the losses is not dependent upon considerations of purpose, motive, or intent, but rather is established by the objective facts of the particular case. The principles set forth in this subparagraph shall be applied in accordance with the rules set forth in the following subparagraphs of this paragraph.

(6) A corporation has not continued to carry on a trade or business substantially the same as that conducted before any increase in the ownership of its stock if the corporation is not carrying on an active trade or business at the time of such increase in ownership. Thus, if the corporation is inactive at the time of such an increase and subsequently is reactivated in the same line of business as that originally conducted, the corporation has not continued to carry on a trade or business substantially the same as that conducted before such increase in stock ownership.
extent the scope and meaning of the decision itself was not clear. As to the future of *Libson Shops*, there are three chief possibilities:

1. The 1954 legislation superseded *Libson Shops*; therefore, the doctrine has only one historical significance except for undecided cases under the 1939 Code; or

2. *Libson Shops* has full force; therefore, the Code provisions only limit loss carryover deductions which survive the *Libson Shops* test; or

3. *Libson Shops* survives in part and is superseded in part under the 1954 Code.

The threshold question is the meaning of *Libson Shops*. What was meant by the Court when it limited the application of carryovers to profits of the "same business" which actually incurred the losses? What were the decisive elements of continuity? The facts of the case gave a partial, negative answer. First, the type of economic activity was not significant because all the Libson shops were, and continued to be, in the "same business" as that phrase is used in plain English. Second, identity of ownership was not decisive since the stockholders of all the Libson corporations were substantially the same. Third, the form of corporate entity was not decisive; in fact, that basis for decision was expressly brushed aside by the Court. Two comments by the Court confused the situation somewhat. First, the Court said that the matter would have been different if the corporations had chosen to file consolidated income tax returns, apparently overlooking the absence of any common parent corporation, which disqualified the group from filing consolidated returns. Second, in footnote 9, the Court noted that it was not passing upon single corporation cases where a taxpayer sought to apply its own loss carryover to profits earned after a change in business or ownership. Was the Court merely stating the obvious, suggesting that the *Libson Shops* rule was limited to cases involving corporate reorganizations, or was it not warning corporate taxpayers who had shifted the benefit of carryovers without reorganizing to take heed?

Many of the cases which followed and relied upon *Libson Shops* did little to clarify or explain what had been cryptic or problematic in the decision. One group is typified by *Mill Ridge Coal v. Patterson*, the earliest case to follow *Libson Shops*. The taxpayer had

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99 See note 21 supra.
100 *Libson Shops, Inc. v. Koehler*, 353 U.S. at 38.
102 See note 23 supra.
103 264 F.2d 713 (5th Cir.), cert. denied, 361 U.S. 816 (1959).
been a dormant corporate shell whose only "asset" was a net operating loss carryover. The taxpayer sought to utilize this carryover against the profits of a new enterprise. The new business had been contributed by persons who had purchased the company after it had incurred the losses. The only connection between the former business and the one before the court was the corporate entity. The carryover was disallowed on the authority of *Libson Shops*. However, *Libson* was probably used instead of section 129 of the 1939 Code because that section required proof that the principal purpose of the purchase was tax avoidance. *Mill Ridge* and similar cases²⁴ did not analyze the difficult outer limits of the *Libson Shops* rationale nor did they amplify its inner meaning. Such cases did dispel any notion which might have been attributable to footnote ⁹ that the continuity of the corporate entity prevented the application of the *Libson Shops* rule.

A more interesting group of cases dealt with *Libson Shops*’ application to corporate taxpayers which were not obvious shells. As in war, the early communiques tend to be misleading, and in some of these cases there was a tendency to use, or at least speak of, pre-*Libson Shops* standards when that case came to be applied. For example, in *Kolker Bros., Inc.*⁹⁶ a corporation in the retail grocery and liquor business had lost money. The president and principal stockholder of the corporation was a minority stockholder in another company in the hotel provision supply business. The retail corporation purchased the assets of the hotel supply corporation for cash (largely borrowed) and began to make money in its hotel supply business. After a few months the losing retail business was sold. The issue was whether the taxpayer could carry over its net operating loss for prior years from the retail grocery business and deduct it from the income earned in the hotel supply business. The Commissioner, relying on *Libson Shops* and *Mill Ridge*, denied the deduction. The Tax Court, on the basis of footnote 9, held in favor of the

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²⁴ For example, in Commissioner v. Virginia Metal Products, Inc., 290 F.2d 675 (3d Cir. 1961), the shares of Winfield, the loss corporation, were acquired by Virginia, which caused the assets of Winfield to be sold and then placed its assets in the shell and continued its prior business. Here again § 129 of the 1939 Code was held to be inapplicable, and the same corporate entity which had incurred the loss was seeking the deduction. The taxpayer relying on footnote 9 argued that the continuity prevented the application of *Libson Shops*. The Court rejected this argument at 677 by holding: "The taxpayer’s hopeful reliance on footnote 9 . . . is misplaced. The Supreme Court was simply confining its decision to the facts before it. But the thrust of that decision easily includes such a case as this." The court cited: *Bookwalter v. Hutchens Metal Products, Inc.*, 281 F.2d 174 (8th Cir. 1960); *Mill Ridge Coal v. Patterson*, supra note 33; and *Patten Fine Papers, Inc. v. Commissioner*, 249 F.2d 776 (7th Cir. 1957).

²⁵ See note 23 supra.

³⁶ 35 T.C. 299 (1960).
The Tax Court indicated that *Libson Shops* should not apply in a case such as *Kolker*, where the corporation with the loss carryover was applying it to later profits. The Tax Court also held that the hotel supply business and the retail grocery business were mere variations on the purveying of edibles so that the loss and profits came from the same business. As a result the Tax Court concluded that although there had been a change in the character of the business, there had been none in its "essential nature," so that *Libson* did not apply.

The Second Circuit first dealt with the *Libson Shops* problem in *Norden-Ketay Corp. v. Commissioner*.* A firm of investment bankers bought ninety-five per cent of the stock of a coal mining company. The mining assets were sold at a loss which augmented a net operating loss for the same year (1951). The company partially liquidated by distributing most of the sale proceeds and remained dormant for two years. It then purchased on credit three closely held companies in the electronics business and liquidated them; the former stockholders of the three companies purchased newly issued stock of the old mining company, which later sought to apply the carryover to profits from the electronics businesses. This was disallowed. The court's reasoning echoes the second holding in *Kolker* in that the decisive factors were said to be the absence of continuity of enterprise, *i.e.*, the difference between coal mining and electronics, and the absence of continuity of stock ownership. The court observed that the only link between the coal company and the taxpayer before it was the corporate entity, which was not, according to the "basic teaching" of *Libson Shops*, enough to preserve the loss deduction. The court did not attempt any further analysis of the "basic teaching" of *Libson Shops*; so we must draw our conclusions from the facts.

The irrelevance of the corporate entity was further emphasized in two 1964 cases in the Second Circuit, which like *Libson Shops* involved retail stores. In *Julius Garfinckel & Co. v. Commissioner* the court held that *Libson Shops* is not rendered inapplicable by the fact that the surviving corporation which seeks the deduction is the same corporation that incurred the losses. The court pointed out that the *Libson* decision turned not on the survivorship of the corporate entity but on the continuity of business enterprise. The decision fur-

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37 *Id.* at 305 (1960).
38 319 F.2d 902 (2d Cir. 1963).
39 *Id.* at 901.
40 *Id.* at 901-06.
41 *Id.* at 906.
42 135 F.2d 744 (2d Cir. 1964).
ther declared that, although it was difficult to state just what constituted sufficient continuity of enterprise, Libson Shops controlled the case at bar, the only difference being that the owners of that loss corporation had less stock than the one hundred per cent ownership of the Libson Shops loss corporation. The result of the Garfinckel case was emphasized in Allied Central Stores, Inc. v. Commissioner. The several department store corporations, all one hundred per cent owned by a parent, were merged into the petitioner, the loss corporation, and the loss was denied on the authority of Libson Shops.

The Tax Court's 1964 decision in the Humacid case and the Florida District Court's 1963 decision in Foremost Dairies are perhaps the most helpful of the 1939 Code cases in suggesting the real meaning of Libson.

The Humacid Company was organized in 1951 to develop an idea for a lining for oil well drill holes. Huntsinger owned twenty-five per cent of the stock in Humacid and was its principal creditor. The company incurred losses. In 1953 and 1954 Huntsinger acquired all of the stock and debt of Humacid and caused a family partnership controlled by him to transfer to the company the operating assets of an oil well service business. The court held, on the authority of Libson Shops, that Humacid was not entitled to carry over the losses previously incurred by it and to deduct them from profits earned by the business formerly conducted by the partnership. The taxpayer urged two reasons why Libson should not prevent the utilization of the carryover: (1) there was no significant change in economic activities as between the loss business and the newly contributed business, and (2) there was no significant change in ownership since by reason of Huntsinger's creditor position he effectively owned all of the company prior to his acquisition of the balance of the stock and the contribution of the partnership business.

As to petitioner's first point the court found that the two businesses were not the same. The court further concluded, relying upon the facts of Libson Shops and Garfinckel, that the doctrine of Libson Shops "has nothing whatsoever to do with changes in the nature of the business, or the economic activities, of a corporation claiming a deduction for a net operating loss."

43 319 F.2d 501 (2d Cir. 1964).
45 Foremost Dairies, Inc. v. Tomlinson, 12 Am. Fed. Tax R.2d 5426 (M.D. Fla. 1963), aff'd, 341 F.2d 580 (5th Cir. 1965). The court of appeals decision does not add to the analysis of the district court, for it holds that the district court properly applied Libson Shops.
47 Id. at 906.
Judge Fay was more troubled by the claim that there had been no substantial change in stock ownership since the losses were incurred; some of the difficulty was caused by the dictum in *Norden-Ketay* which suggested that continuity of equity was a decisive factor in applying *Libson Shops*. First noting that there was complete identity of stock ownership in *Libson Shops* and *Garfinckel*, the court also rejected the argument that the creditor of an insolvent corporation was the substantial owner for *Libson Shops* purposes. It does not seem, however, that the case would have been decided otherwise even if Huntsinger had owned all the stock from the beginning, in view of the language of the opinion which precedes the discussion of continuity of equity: “It seems to us that what the Supreme Court had in mind in *Libson Shops, Inc.* was something more in the nature of an economic concept prohibiting separate business units from combining so that profits from one separate enterprise might be offset against the losses of another.” It concluded that under these facts the gains derived from the business of the former partnership “did not arise from the same business unit which produced the losses.”

In *Foremost Dairies* both the profit and the loss corporations, Foremost Dairies and Maxson Food System respectively, were engaged in the processing and distribution of food. In 1946-48 Maxson lost money. In 1949 Foremost was merged into Maxson, and the latter immediately changed its name to Foremost. The court rejected the argument that continuation of the loss corporation prevented the application of *Libson*. In analyzing the scope of *Libson* the court said:

The Court is of the opinion that the continuity of business enterprise theory in *Libson Shops* means that where a loss corporation and a gain corporation are merged, pre-merger losses may be offset against post-merger gains only to the extent that the business which was previously operating at a loss is now operating at a profit. Furthermore, the business referred to in the sentence above does not mean the formal legal entity but rather the bundle of assets which previously constituted the pre-merger business unit.

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48 *Norden-Ketay Corp. v. Commissioner*, 319 F.2d 902, 905 (2d Cir. 1963):

[T]he second major factor in determining the existence of continuity of business enterprise [is] . . . continuity of stock ownership. Where there is continuity of ownership, there might well be justice in allowing a loss carry-over even though there has been a complete change in the nature of corporate activity. The purposes of the statute are ultimately directed toward granting a legitimate tax advantage to the shareholders behind the corporate entity.


50 *Id.* at 908.


52 *Id.* at 5429.
Because the assets attributable to Maxson did produce profits in one year, the court allowed the loss deduction to those profits.\(^{63}\)

Any effort to state a positive rationale for Libson is necessarily speculative because few of the cases express positive rules. Rather, most of the cases, like Libson itself, tend to give us only a negative application: The facts in the case before the court for some unannounced reason do or do not violate the intent of Congress in allowing loss carryovers. One recalls Judge Friendly's remark in the Garfinckel opinion, speaking of the variety of cases which appeared to involve the Libson rule:

We would indeed be hard put to devise a formula that would determine just where in this spectrum the Libson Shops line would fall. We can make only the unilluminating statement that in a transaction in which a 58% owner of a loss corporation causes it to acquire a wholly owned profit corporation, with a consequent increase in its ownership of the survivor to 95%, the discontinuity between the before and the after seems sufficient to cause the case to be attracted by Libson Shops. If we have misunderstood that opinion, we would be even more than usually willing to be corrected, since there is much appeal in Garfinckel's 58% ownership of DePinna during the years of the losses, although the Commissioner counters that in Libson Shops there was complete identity in stock ownership before and after merger.\(^{54}\)

Before attempting an analysis of the role of Libson Shops under the 1954 Code, a working theory is required. We suggest the following: where business units were so separated that the investment committed to one of them was insulated from economic burden of losses incurred by the other, then no transaction may be relied upon to bring the resulting loss carryovers into conjunction with gains from the other in order to obtain tax relief from those losses which might have been secured if the units had been separated while the losses were incurred, either actually or by the filing of consolidated returns.

Under this formulation, the reach of Libson Shops does not depend on type of business activity, continuity of stock ownership, or tax avoidance intent, nor on the form of transaction or structure whereby the carryover is brought together with the profits. Instead, the focus is entirely on the exposure of an investment in an enterprise to the loss sought to be deducted. At least, this generalization accounts for the disallowance of the carryovers in cases involving the

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\(^{63}\) Libson Shops prohibits one economic entity from utilizing the loss carryovers of another entity; one can wonder why, then, the Treasury, in Treas. Reg., § 1.1502-31(d) and in its Proposed Reg. § 1.1502-21, allows carryover loss deductions when a consolidated return is filed. The only explanation which can legitimately account for this apparent inconsistency is that under the statutory authority of §§ 1501-04 of the 1954 Code such separate investment units as qualify may utilize these net operating loss carryovers.

\(^{54}\) Julius Garfinckel & Co. v. Commissioner, 335 F.2d 744, 748-49 (2d Cir. 1964).
merger or consolidation of corporations under common ownership" and comprehends numerous classes of cases "where new stockholders have poured profitable assets into a loss corporation that had abandoned or nearly abandoned its business." This generalization would justify the result in Humacid, where a separate partnership business was contributed to the loss corporation by one who may or may not have been the previous owner of both, and in Foremost, where two corporations having no prior connection with each other were merged. It would not justify Kolker Brothers, where the family wholesale business was purchased with borrowed capital by the family retail corporation which had the loss carryover, since that capital had not been exposed to the losses of the retail business. So one who is persuaded by the suggested formulation of the Libson Shops rationale must also approve the Service's nonacquiescence in Kolker.

This formulation is consistent with the Service's 1963 ruling (63-40) that Libson Shops did not prevent a corporation which had incurred a net operating loss, attributable in part to the sale of its assets, from utilizing that loss against profits from businesses purchased with the proceeds of the sale. There the investment which made possible the profits was the translation of that which had been subject to the losses. This ruling is consistent with the Norden-Ketay case because there the investment in the loss business was paid out to the stockholders before the capital for the purchased profitable business was supplied in the form of credit by the sellers.

The proposed theory suggests that a parent corporation with a loss ought to be able to merge or liquidate a profitable subsidiary and apply the loss against future profits of the subsidiary, since among the assets exposed to the parent's losses was the investment in the former subsidiary. On the other hand, it suggests that a profitable parent could not, under Libson Shops, merge or liquidate a loss subsidiary and enjoy the carryover, since the parent's assets had been insulated from the subsidiary's losses.

It would also seem that under the 1939 Code as explained in Libson Shops one hundred per cent of the stock of a loss corporation could change hands and the assets of that company be reinvested in a new profitable business to which, insofar as Libson Shops is concerned,
the loss carryover should be allowed. Revenue Ruling 63-40 suggests, however, that a substantial change in stock ownership might invoke *Libson Shope* in such a case. But as we have noted, *Libson* was not concerned with either change in ownership or type of business activity. What is denounced is the injection of a new investment in business assets, as in *Norden-Ketay*. Perhaps the Service shied away from seeming to approve the utilization of the carryover in a type of case which ordinarily involves the prohibited intent of section 129 of the 1939 Code.

While it cannot be safely asserted that the formula proposed would necessarily be applied with mathematical precision, we are satisfied that it expresses the philosophy behind *Libson Shope* as applied in that case and others in which it has been mentioned. What then is the part that rule plays under the 1954 Code? Was it replaced, supplemented, or only modified?

Conventional legal logic would seem to compel the conclusion that section 382 supersedes the *Libson* rule for 1954 Code cases, for in the interpretation of statutes, specific legislative action takes precedence over judicial inference as to legislative intention, and certainly section 382 deals with much the same subject matter as the *Libson Shope* rule. This argument in holding *Libson Shope* repealed is not enough because it conceals some of the difficulties in applying logic to this situation in quite the manner proposed.

Congress could not have intended (in the psychological sense) to repeal *Libson Shope* because the case was undecided in 1954. However, this timing factor is not enough to show that *Libson* survived under the 1954 Code; Congress knew of the difficulties in implementing section 129 of the 1939 Code. It deliberately regulated the survival of net operating loss carryovers in the context of various corporate modifications by the amendment of section 129 and the enactment of sections 381 and 382. Because Congress was unaware of the *Libson Shope* rule, we may conclude that if Congress intended that there be such a rule, it would have been included in the 1954 amendments. Therefore, the failure to do so is some evidence that what was enacted was intended to be exclusive.

This argument has particular force in the light of sections 381 and 382 (b). Before 1954, the Code did not specifically allow carryover deductions to follow assets transferred in a reorganization like the one in *Libson Shope*. Section 381 for the first time allows the loss deduction to follow assets without regard to corporate identity, and the limitations of section 382 (b) specifically refer to transactions

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62 Ibid.
under 381(a). It would seem, therefore, that Congress must have conceived of transactions coming within section 381 as being regulated for the first time by the 1954 Code, so that the specific limitations enacted must have been thought of as standing alone. Against this analysis, however, is the fact that both sections 382(a) and 382(b) also affect carryovers which do not depend upon section 381 at all, i.e., where the loss corporation is the one claiming the deduction.

Another argument can be drawn from the place of the Libson Shops rule within the architecture of the statute. Libson Shops was an interpretation of section 122 of the 1939 Code, the underlying carryover provision, which was not substantively amended by the 1954 Code. The Court found that the words of that section meant that all carryovers were limited when applied to enterprises which were different from those in which the losses were incurred.

Since all carryover deductions are derived from section 122, it is noteworthy that the court did not find in the co-existing limitations of section 129 of the 1939 Code an obstacle to its interpretation of the fundamental meaning of section 122. It can, therefore, be argued that the limitations of section 382 (and 269) of the 1954 Code bear only upon carryovers which have survived the inherent limitations of section 172 of the Code which were disclosed by the Libson Shops decision.

The preceding discussion has shown that the policies and reach of Libson Shops and section 382 of the 1954 Code are different. Libson Shops would disallow some deductions which are not touched by section 382, would not disallow other carryovers which are not touched by section 382, and would not disallow other carryovers which are specifically disallowed by that section. For example, under section 382(a) a corporation which has undergone the specified change in stock ownership, at the cost of continuing the loss business activity for a limited period, is not prevented by section 382(a) from applying the loss from that activity to a newly added enterprise. Libson Shops was not concerned with change in stock ownership or continuation of the particular business but rather with the relationship of the investment in the loss enterprise to that in the enterprise to which the loss is sought to be applied. So this rule might,

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60 The actual words interpreted in Libson Shops, "the taxpayer," were, however, not carried from § 122 of the 1939 Code to § 172 of the 1954 Code. Although no specific reason was given for this deletion in the committee reports, the change may have been made to allow corporations under § 381 of the 1954 Code to utilize the deduction; or it may have been purely a drafting technique to have § 172 conform to other deduction sections, e.g., §§ 162, 163 and 164 of the 1954 Code. In either event, it does not appear that this change was meant to change the substantive meaning of § 122 of the 1939 Code.
as in the *Humacid* case, result in the disallowance of a carryover deduction against an added business which was not disallowed by section 382 (a).

Similarly, disallowance under section 382 (b) depends upon a loss of stock ownership in the surviving corporation by owners of the component loss corporation after a reorganization, whereas in the *Libson Shops* case one hundred per cent continuity of stock ownership in a merger did not shield the carryover.

How then do these differences between the *Libson* rule and the limitations of section 382 affect what we have called the conventional argument that section 382 must be interpreted as having repealed *Libson* because it is a specific enactment with respect to the same subject matter?

There are, to say the least, competing answers. Since the two rules do not reach the same cases (except by coincidence) it can be argued that the particular rules of section 382, like the rules of section 269, supplement *Libson Shops* rather than replace it. However, because each case under section 382 raises the *Libson Shops* issue, it can be argued that the differences are consistent with the conclusion that section 382 is exclusive. In actual cases, a holding that *Libson Shops* survived under the 1954 Code may give some rather startling results. For example, where after a reorganization the owners of the loss corporation own only ten per cent of the surviving corporation, one-half of the carryover disappears under section 382 (b), and if, e.g., a B-type reorganization were used, *Libson Shops* would destroy any loss which could not be offset against the profits of enterprise of the loss corporation or profits from the proceeds of the disposition of that enterprise. In the *Libson Shops* situation itself, the carryover would survive section 382 (b) in full (because of the 100 per cent continuity of stock ownership) but would nevertheless be applicable only to profits from the stores which produced the loss in the first place. Similarly, under section 382 (a) a carryover could survive because of the continuance of the loss business but under *Libson Shops* would be applicable only to profits from that business or to a new one derived from the investment of the old one. The resulting pile-up of obstacles to the utilization of loss carryovers is not very tidy, which no doubt favors the argument that Congress intended section 382 to be exclusive. But section 269 applies to most of the cases covered by section 382 and disallows some but not all of the losses which escape the 1954 limitations, thereby detracting somewhat from the force of an argument based on neatness.

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64 See note 72 infra and accompanying text.
Because the limitations of section 382 do not actually cover the same ground as the Libson Shops rule, the differences are deep enough to give weight to an argument that the 1954 amendments should not be held to have displaced Libson Shops. The Government so argued in Maxwell Hardware Co. v. Commissioner,\(^6\) the principal case thus far in which the application of Libson Shops under the 1954 Code has been contested.\(^6\) The Government chose an appealing case, from its point of view. The Maxwell Hardware Corporation had sustained a $1,000,000 loss in the hardware business. Two real estate developers who had no previous connection with the company purchased non-voting preferred stock in the loss company, the proceeds of which were used to set up and operate a separate real estate department from which the profits were sought to be offset by the hardware carryover. The hardware business was discontinued. Under an agreement the real estate department had to be continued for six years and thereafter if it were discontinued at the election of either the common stockholders or the preferred stockholders, ninety per cent of the value of its assets had to be used to redeem the preferred stock. The effect of the agreement was that the preferred stockholders were put in a position to obtain on the ultimate redemption of the preferred stock, assuming profits in the real estate department, what they invested plus the real estate profits, shielded from income tax to the extent of the carryover. Section 269 did not apply because of the amount of stock obtained by the real estate men, nor did section 382(a) because it was non-voting stock. Thus the question was squarely presented: did Libson Shops apply?

The Tax Court held that it did, saying: “We cannot credit to Congress the issuance of an invitation to indulge in a practice which the stated purpose of the enactment is to control, the ‘trafficking’ in net operating loss carryovers.”\(^7\) In further detail the court noted the

\(^6\) 343 F.2d 713 (9th Cir. 1965), reversing, Arthur T. Beckett, 41 T.C. 386 (1963).

\(^6\) Two other cases have applied Libson under the 1954 Code. Although they split as to its application under the 1954 Code, neither elaborately analyzed the reasons for its decision. In Jackson Oldsmobile, Inc. v. United States, 237 F. Supp. 779 (M.D. Ga. 1964) the court allowed the taxpayer to take the carryover deduction for years 1953 and 1954 despite the influx of new capital into the corporate shell. The court at 781 said, with respect to Libson Shops' application under the 1954 Code: “Several courts have now applied the Libson Shops doctrine to 1954 Code years where a taxpayer has sought to carry forward pre-1954 losses. . . . We are of the opinion, however, that the Libson Shops doctrine, even if applicable, does not prohibit the taxpayer in this case from deducting the 1953 and 1954 losses.” In Euclid-Tennessee, Inc. v. Commissioner, 352 F.2d 991 (6th Cir. 1965), the court held that the taxpayer had not continued the loss business as required by § 382(a). As to Libson Shops' application to the 1954 Code, the court said: “We cannot and do not read Libson into the 1954 Code, but its broad principles may be relevant except as the 1954 Code, under limited conditions, permits what the 1939 Code, construed by Libson, forbade.” Supra at 994.

time difference between the 1954 Code amendments and the Libson Shops decision as showing that Congress could not have intended to reverse the case. Judge Scott was also impressed by the fact that Libson dealt with section 122, which was not "substantively" amended by the 1954 Code.

The Court of Appeals for the Ninth Circuit reversed. It concluded:

Libson Shops, decided under the 1939 Act, is no longer law. It has been superseded by the 1954 Internal Revenue Code which, in Section 382, dealt specifically and differently with the concept of continuity of business enterprise upon which the Libson Shops decision was based.

Taxation is peculiarly a matter of statutory law, and in applying that law to the determination and computation of income and deductions, the Courts do not make moral judgments. There is nothing perfidious or invidious in enjoying a statutory deduction from reportable income. It is not a matter of conscience but of statute and the determination of Congressional intent. In our opinion, Congress had quite plainly said that net operating loss deductions should be allowed unless the special circumstances interpreted within the letter and spirit of Section 382(a) and 269 obtain. The conditions disallowing the deduction have not been established here. It is of much more importance that businessmen, accountants, lawyers and revenue agents should retain confidence that plain statutory language means what it says and what it reasonably implies than that a particular deficiency assessment should be sustained. We cannot, within the statutory framework applying a fair and reasonable interpretation to the language used, disallow to Maxwell Hardware the net operating loss deduction.

The Tax Court has not so far been persuaded by the Ninth Circuit analysis. In the recent Clarksdale Rubber case, it dealt again with the question of Libson Shops under the 1954 Code and further explored the niche which it had unsuccessfully sought to carve out in Maxwell Hardware. The loss corporation in Clarksdale Rubber, in order to solve financial problems, leased its operations and facilities to a sister subsidiary of the purchaser of its stock, later acquiring them back and operating at a profit against which it deducted previous carryovers. The Tax Court rejected the application of Libson Shops for two reasons. First, it felt that even under the 1939 Code the Libson doctrine would have been inapplicable because the business which supplied both the gains and losses was the same despite the interval of inactivity and the change of ownership. The court actually held that since the new owners had purchased one hundred per cent

68 Id. at 416.
69 Id. at 417-18.
70 Maxwell Hardware Co. v. Commissioner, 343 F.2d 713, 722-23 (9th Cir. 1965).
of the taxpayer’s stock the case fell under section 382(a). Therefore, the loss was not disqualified because the same business activities had been continued. The Tax Court reasoned that where section 382 was not applicable, *Libson Shops* applied under the 1954 Code. Thus in *Clarksdale Rubber*, because there was more than a fifty percentage point change in stock ownership, section 382 rather than *Libson* applied. This reasoning leads to the absurd implication that in such a case a carryover might be saved by section 382 (by continuing a loss business) which might otherwise be lost under *Libson*, where less than the requisite amount of voting stock changed hands, as in *Maxwell Hardware*.

The transition from *Libson Shops* to *Maxwell Hardware* describes a downward course for the career of the *Libson* rule, but the Internal Revenue Service has been proceeding in a different direction.

In 1958, shortly after *Libson*, the Service stated in Revenue Ruling 58-603 that it would not apply the case “under the Internal Revenue Code of 1954 as to a merger or any other transaction described in section 381(a).” In response to the *Maxwell Hardware* opinion, however, it has stated in a 1965 ruling that *Libson Shops* “retains vitality” under the 1954 Code in interpreting the application of section 172. The ruling suggests that the ambit of section 382 is limited to certain situations involving abuses that were specifically brought to the attention of Congress. Thus, says the Service, it will apply *Libson Shops* in any loss carryover case under the 1954 Code not contemplated by the announcement in Revenue Ruling 58-603, C.B. 1958-2, 147, where there has been both a 50 percent or more shift in the benefits of a loss carryover (whether direct or indirect and including transactions having the effect of shifting the benefit of the loss by shifting assets, stock, profit interests or other valuable rights) and a change in business as defined in section 382(a) and regulations thereunder. The Service will not rely on *Libson Shops* under the 1954 Code in any loss carryover case where there has been less than a 50 percent change in the beneficial ownership of the loss or where there has been no change in business as defined in section 382(a) and the regulations thereunder.

From this language, the retained vitality of *Libson Shops* is difficult to discern. The exception for cases contemplated by Revenue Ruling 58-603 eliminates the application of *Libson Shops* to most corporate mergers, liquidations and other tax free reorganizations.

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74 Ibid.
That the doctrine will be invoked where there has been more than a fifty per cent change in the ownership of the loss corporation combined with a change in business under section 382(a) is curious because there is no particular connection between those conditions and the Libson Shops rule. Perhaps these conditions can be interpreted to mean that the Service would litigate another case like Maxwell Hardware, where different investment units have been brought together but where the transaction avoids all the limitations of section 382, in the hope of persuading another circuit to line up with the Tax Court.

Although the view of the Tax Court and the Service are superficially the same, in that Libson is recognized as having some force within the interstices of the provisions of sections 269 and 382, there are, however, differences between the interpretations of the present vitality of Libson put forth by the Tax Court and the Service. The Tax Court's view is that if the conditions for the invocation of section 382 are present (purchase of half the stock of a corporation or execution of a reorganization) then Libson Shops will not apply, and the availability of the carryover will depend on continuance of the old business under 382(a) or the per cent of equity of the stockholders of the loss company under section 382(b). If these threshold conditions are not present, then apparently Libson Shops applies as before. The Service's view is consistent with the Tax Court insofar as reorganizations and liquidations are concerned, but for other transactions the Service indicates that a change in business activity within the meaning of section 382(a), coupled with more than a fifty per cent change in the beneficial interest in the carryover, invokes the Libson Shops rule. It does not seem useful to measure one view against the other because both seem to be quite wrong. Libson Shops, after all, was an interpretation of section 122 of the 1939 Code, the underlying section of the statute which still creates (section 172) the loss carryover deduction; it was a finding that Congress intended certain limits on the utilization of that deduction, when a different investment unit than the one which had incurred the loss intended to use the deduction. The inherent limitation thus necessarily applied to all carryovers, whether or not they happened to have been involved in reorganizations, corporations whose stock was sold, or corporations which underwent no significant changes at all. Under the "interstitial" analyses of the Tax Court and the Service, the identical words of section 122 would be understood to have different significance depending upon the particular circumstances to which they are applied. It can be logically
argued that section 382 furnishes additional and different limitations upon carryovers which survive Libson Shops, in the same way that Libson Shops has been interpreted as coexisting with section 269. It can be argued with the Ninth Circuit that the 1954 limitations are intended to be comprehensive and, therefore, replace Libson Shops. But there seems to be no logical room for the view that Libson Shops retains vitality for some but not all carryovers. Since neither the Tax Court nor the Service is prepared to press the notion that Libson Shops retains its full place as a modifier of all carryovers arising under section 172, it seems valid to conclude that the result expressed in the Maxwell Hardware case will ultimately prevail.

But it should not be expected that the last has been heard from Libson Shops. In Clarksdale Rubber the Tax Court firmly rejected the Ninth Circuit's burial of Libson Shops; instead it adheres to Judge Scott's "interstitial" view. And TIR 773 holds that Libson Shops applied in instances not specifically contemplated by sections 381 and 382. Government litigators, when it comes to the actual argument and briefing of cases can be expected to deploy all authorities, including section 269, Libson Shops and whatever else is available, notwithstanding the more generous concessions in the published rulings, so there will be no lack of opportunities for courts in circuits other than the Ninth to reconsider the position. Moreover, the Tax Court's "interstitial" view is likely to create some more of the fog and disorder which the 1954 legislation was intended to dispel. If the ingenuities which produced the Maxwell Hardware transaction are multiplied and a certain degree of confusion is maintained, it would not be surprising if Congress could be persuaded to look again at the loss carryover problem. In that case it might well consider replacing the disparate and often inconsistent policies of sections 269, 381 and 382 with a unified concept which comprehends the whole spectrum of factual combinations. Libson Shops may well be the source of that concept.