1 T.C. 128 (1942)

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A deficit credit is allowable to the full extent of the adjusted net income for the surtax on undistributed profits when a taxpayer has no accumulated earnings and no earnings of the current taxable year.

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Summary

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International Utilities Corporation, as transferee of American Equities Co., contested a deficiency in American Equities Co.'s 1936 income tax. The Commissioner disallowed a dividends paid credit, arguing the company had no accumulated earnings or current year earnings due to capital losses. The Tax Court, however, held that the newly enacted Section 501(a)(3) of the Revenue Act of 1942, which provided a deficit credit, applied retroactively to 1936. Because American Equities Co. had no accumulated earnings and, according to the Commissioner's original argument, no current year earnings, it was entitled to a deficit credit to the full extent of its adjusted net income, thus eliminating the surtax on undistributed profits.

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Facts

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American Equities Co. reported net income of $147,224.55 for 1936 but claimed deductions that resulted in no normal tax or surtax liability. The Commissioner increased the net income to $333,215.40 by disallowing certain losses. American Equities Co. had no accumulated earnings and profits as of December 31, 1935. During 1936, it sustained capital losses exceeding capital gains by $3,075,132.02, but only $2,000 of this amount was deducted when computing net income. The company distributed $323,066.03 to its stockholders in December 1936.

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Procedural History

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The Commissioner determined a deficiency in American Equities Co.’s 1936 income tax and held International Utilities Corporation liable as transferee. International Utilities Corporation initially contested the transferee liability and the statute of limitations, but later waived these arguments. The only remaining issue was the allowance of a credit in computing the surtax on undistributed profits.

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Issue(s)

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Whether American Equities Co. is entitled to a deficit credit under Section 26(f) of the Revenue Act of 1936, as amended by Section 501(a)(3) of the Revenue Act of 1942, in computing its surtax on undistributed profits for the year 1936.

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Holding

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Yes, because Section 501(a)(3) of the Revenue Act of 1942 provides a deficit credit that applies retroactively to 1936, and American Equities Co. had no accumulated earnings at the beginning of the tax year and, per the Commissioner’s determination, no earnings during the tax year.

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Court’s Reasoning

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The court based its decision on the newly enacted Section 501(a)(3) of the Revenue Act of 1942, which amended Section 26 of the Revenue Act of 1936 by adding subsection (f), the

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