1 T.C. 475 (1943)

A personal holding company cannot deduct, for the purpose of the personal holding company surtax, additional income and excess profits taxes paid in a taxable year if those taxes relate to prior years for which a reserve had already been established.

Summary

Root Glass Company, a personal holding company, sought to deduct additional income and excess profits taxes paid in 1936, relating to the 1932 and 1933 fiscal years, from its undistributed adjusted net income for the purpose of calculating its personal holding company surtax. Prior to 1936, Root Glass had established a reserve for federal taxes, including the taxes in question. The Tax Court held that the company was not entitled to deduct the taxes in 1936 because the establishment of the reserve in prior years constituted a setting aside of funds for that purpose, precluding a second deduction when the taxes were actually paid. The court reasoned that allowing the deduction would provide a double benefit for the same expense.

Facts

Root Glass Company, an Indiana corporation, operated on a fiscal year ending July 31. Prior to the fiscal year 1932, the company maintained a "Reserve for Federal Taxes and Contingencies." In fiscal year 1934, the company paid additional income taxes for the fiscal years 1927-1931, charging these to the reserve account. By July 31, 1935, the company established a new "Reserve for Federal Taxes" account, transferring balances from prior reserve accounts and crediting additional funds to it. In February 1936, Root Glass consented to the assessment of additional income and excess profits taxes for 1932 and 1933. It paid these taxes in April 1936 and charged them to the "Reserve for Federal Taxes."

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Root Glass Company's personal holding company surtax for the fiscal year ended July 31, 1936. The Commissioner disallowed Root Glass's deduction of $61,793.57, representing income and excess profits taxes paid in 1936 for the fiscal years 1932 and 1933. The case was brought before the United States Tax Court.

Issue(s)

Whether, in determining Root Glass Company's undistributed adjusted net income for the purpose of the personal holding company surtax for the taxable year 1936, the Commissioner erred in not allowing as deductions additional income and excess profits taxes for the fiscal years ended July 31, 1932, and July 31, 1933, which were paid by Root Glass Company during its taxable year ended July 31, 1936.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

No, because Root Glass Company had already set aside a reserve for the payment of these taxes in prior years. The court held that this earlier setting aside constituted the deduction, and a second deduction was not permissible.

Court’s Reasoning

The court emphasized that the surtax on a personal holding company is imposed on “undistributed adjusted net income.” The court noted that while the Revenue Act of 1936 allowed deductions for amounts used or set aside to retire indebtedness incurred prior to January 1, 1934, it did not explicitly require that such amounts be “irrevocably” set aside, unlike a 1937 amendment to the statute. The court rejected the petitioner’s argument that the 1937 amendment merely clarified existing law. The court found that the establishment of the reserve and the charges to surplus constituted a setting aside of funds to cover the income and excess profits taxes incurred for the fiscal years 1932 and 1933. By formally setting aside the funds and excluding them from surplus available for distribution as dividends, Root Glass was deemed to have taken its deduction in the year the reserve was established. The court cited Art. 351-4, Regulations 94, stating the company is not entitled to a second deduction of the same item in a later year when the tax was paid.

Practical Implications

This case clarifies the timing of deductions for personal holding companies regarding tax liabilities. It establishes that creating a reserve for taxes is considered

© 2025 SCOTUSreports.com. All rights reserved.