2 T.C. 166 (1943)

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Earnings accumulated after a capital impairment caused by distributions exceeding earnings and profits cannot be considered as replacing the impairment when determining if a deficit in accumulated earnings and profits exists for tax credit eligibility.

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Summary

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Mercantile Bridge Co. sought a tax credit under Section 501 of the Revenue Act of 1942, arguing it had a deficit in accumulated earnings and profits due to prior distributions that impaired its capital. The Tax Court ruled against Mercantile Bridge Co., holding that subsequent earnings could not retroactively offset the prior capital impairment to create a deficit in accumulated earnings and profits. The court emphasized that the statute focused on actual accumulated earnings and profits, not a hypothetical deficit created by subtracting prior capital distributions from later earnings.

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Facts

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Mercantile Bridge Co. was organized in 1907 with $400,000 capital.

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From 1919-1922, distributions to stockholders exceeded earnings and profits by $30,061.16, impairing capital.

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From 1923-1929, earnings and profits exceeded dividends by more than $30,061.16.

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Operating losses from 1931-1934 totaled $20,794.32.

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The company claimed a deficit in profit and loss of $24,632.51 on December 31, 1935, and $22,373.70 on December 31, 1936, based on the idea that earnings replaced the capital impairment.

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Without considering subsequent earnings as replacing impaired capital, accumulated earnings were $5,428.65 on December 31, 1935, and $7,687.46 on December 31, 1936.

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Procedural History

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The case was initially heard, then remanded to the Tax Court specifically to consider the applicability of Section 501 of the Revenue Act of 1942.

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The Tax Court then held a further hearing to address the issue.

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Issue(s)

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Whether the Mercantile Bridge Co. had a deficit in

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