3 T.C. 186 (1944)

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For the purpose of determining the taxable gain to a shareholder upon the liquidation of a corporation under Section 112(b)(7) of the Revenue Act of 1938, the corporation's earnings and profits include the excess of percentage depletion allowances over cost depletion allowances.

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Summary

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The Tax Court addressed whether excess percentage depletion allowances should be included in a corporation's earnings and profits when determining a shareholder's taxable gain upon liquidation under Section 112(b)(7) of the Revenue Act of 1938. The Cal-Tex Corporation was liquidated, and its assets were distributed to Wood, the sole shareholder. Wood elected to be taxed under Section 112(b)(7). The Commissioner argued that Cal-Tex's earnings and profits should include the excess of percentage depletion over cost depletion from 1933-1938. The court agreed with the Commissioner, holding that the excess depletion should be included in earnings and profits, thus increasing the taxable gain to Wood.

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Facts

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In 1931, Jacob Wood transferred an oil lease to Cal-Tex Corporation in exchange for its stock. From 1933 to 1938, Cal-Tex took depletion deductions on the percentage basis, which exceeded what would have been allowed using cost depletion by $71,188.87. In December 1938, Cal-Tex was liquidated, and its assets were distributed to Wood, who elected to be taxed under Section 112(b)(7) of the Revenue Act of 1938, a provision allowing shareholders to defer recognition of gain in certain corporate liquidations.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in Wood's 1938 income tax, arguing that the excess percentage depletion should be included in Cal-Tex's earnings and profits. Wood petitioned the Tax Court for a redetermination of the deficiency.

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Issue(s)

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Whether, for the purposes of Section 112(b)(7)(E)(i) of the Revenue Act of 1938, the earnings and profits of a corporation include the excess of percentage depletion allowances over the amounts which would have been allowed if depletion had been computed on the basis of cost.

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Holding

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Yes, because Section 112(b)(7) was not designed to completely restore a stockholder to the same income tax position in which he would have been if the corporation had not been formed, and there is nothing in the language of the statute to suggest that Congress intended to attribute a different meaning to "earnings and profits" than its ordinary meaning elsewhere in the statute.

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Court's Reasoning

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The court rejected Wood's argument that including the excess depletion in earnings and profits would defeat the purpose of Section 112(b)(7), which he claimed was to allow shareholders to return to the position they would have been in had they not incorporated. The court stated that Section 112(b)(7) was not designed to completely restore a stockholder to their pre-incorporation tax position and that the term

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