5 T.C. 88 (1945)

A stock distribution that is nontaxable to the recipient is not considered a distribution of earnings and profits and, therefore, cannot be included in a corporation's equity invested capital for excess profits tax purposes.

Summary

Prosper Shevenell & Son, Inc. sought to include prior stock distributions in its equity invested capital for excess profits tax purposes. The Tax Court held that because the prior stock distributions were nontaxable to the recipients, they were not considered distributions of earnings and profits and could not be included in the corporation's equity invested capital. This decision clarifies the application of Section 718 of the Internal Revenue Code regarding the inclusion of stock distributions in equity invested capital.

Facts

Prosper Shevenell & Son, Inc. made two stock distributions to its stockholders before the taxable year in question: one on April 1, 1920, for $50,000 and another on October 24, 1929, for $55,000. Both distributions were stipulated to be nontaxable to the recipients. The company sought to include these distributions in its equity invested capital for the taxable year ended November 30, 1941, to reduce its excess profits tax liability. The Commissioner of Internal Revenue disallowed the inclusion of these stock distributions.

Procedural History

The Commissioner determined a deficiency in Prosper Shevenell & Son, Inc.'s excess profits tax liability for the taxable year ended November 30, 1941. The company petitioned the Tax Court for a redetermination of the deficiency, arguing that the stock distributions should be included in its equity invested capital. The Tax Court ruled in favor of the Commissioner, upholding the deficiency determination.

Issue(s)

Whether the stock distributions made by Prosper Shevenell & Son, Inc. prior to the taxable year, which were nontaxable to the recipients, can be included in the company's equity invested capital for excess profits tax purposes under Section 718 of the Internal Revenue Code.

Holding

No, because Section 115(h) of the Internal Revenue Code states that if no gain was recognized by the recipient of stock distributions, the distribution is not considered a distribution of earnings and profits.

© 2025 SCOTUSreports.com. All rights reserved.

Court’s Reasoning

The Tax Court reasoned that Section 718(a)(3) of the Internal Revenue Code allows the inclusion of stock distributions in equity invested capital only to the extent that they are considered distributions of earnings and profits. Referring to Section 115(h), the court stated that distributions of stock are not considered distributions of earnings and profits if no gain to the distributee was recognized from the receipt of the stock. Because the parties stipulated that the stock dividends were nontaxable in the hands of the recipients, the court found that they could not be considered distributions of earnings and profits and, therefore, could not be included in equity invested capital. The court emphasized the express language of the statute, stating, “To the extent that a distribution in stock is not considered a distribution of earnings and profits it shall not be considered a distribution.”

Practical Implications

This case clarifies that the taxability of stock distributions to the recipient is a key factor in determining whether those distributions can be included in the corporation’s equity invested capital for excess profits tax purposes. It reinforces the principle that nontaxable stock distributions do not reduce earnings and profits, and thus do not increase equity invested capital. This decision guides the analysis of similar cases by emphasizing the statutory requirements under Sections 718 and 115(h) of the Internal Revenue Code. Later cases have cited this ruling to support the principle that the characterization of a stock distribution hinges on its tax treatment in the hands of the shareholder.

© 2025 SCOTUSreports.com. All rights reserved.