5 T.C. 190 (1945)

When a corporation dissolves via merger during a tax year, the period from the start of the year to the dissolution date constitutes a short taxable year requiring income to be annualized for excess profits tax purposes.

Summary

Pepsi Cola Co. merged with Loft, Inc. on June 30, 1941, creating a short tax year from January 1 to June 30. The Commissioner determined an excess profits tax deficiency, annualizing income under Section 711(a)(3) of the Internal Revenue Code. Pepsi Cola argued against annualization, claiming the final return covered a 12-month period. The Tax Court upheld the Commissioner's determination that the merger created a short tax year requiring income to be annualized, but found that the Commissioner failed to prove an increased deficiency based on an alleged miscalculation of income for the latter half of 1940, and also failed to prove that a bad debt deduction was abnormal. The court ultimately redetermined the deficiency to match the original notice amount.

Facts

– Pepsi Cola Co. (the predecessor) was a Delaware corporation.
– Pepsi Cola Co. kept books on an accrual method and filed tax returns on a calendar year basis.
– On June 30, 1941, Pepsi Cola Co. merged into Loft, Inc., which then changed its name to Pepsi Cola Co. (the petitioner).
– Pepsi Cola Co. filed an excess profits tax return for January 1 to June 30, 1941.
– The parties stipulated that the excess profits net income during this period was $6,046,017.26.

Procedural History

– The Commissioner determined a deficiency in excess profits tax for the period January 1 to June 30, 1941.
– Pepsi Cola Co. petitioned the Tax Court, contesting the deficiency calculation.
– The Commissioner filed an amended answer demanding an additional deficiency.

Issue(s)

1. Whether the taxable period from January 1 to June 30, 1941, constitutes a taxable year of less than 12 months, requiring annualization of income under Section 711(a)(3)(A) and (B) of the Internal Revenue Code.
2. If so, whether the Commissioner affirmatively proved that Pepsi Cola was not entitled to the benefits of the computation under Section 711(a)(3)(B), as determined in the deficiency notice.
3. Whether the Commissioner proved that $324,231.06 in bad debt deductions was not restorable to income for 1939 under Section 711(b)(1)(J) and (K) of the Internal

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Revenue Code.

Holding

1. Yes, because the merger on June 30, 1941, terminated the predecessor corporation's taxable year, creating a short taxable year.
2. No, because the Commissioner did not provide sufficient evidence to prove that the excess profits net income for the last six months of 1940 was different or greater than the sum determined in the notice of deficiency.
3. No, because the Commissioner failed to show that the abnormal debts were a consequence of any one or more of the enumerated factors in the applicable statute.

Court's Reasoning

– The court relied on its prior decision in *General Aniline & Film Corporation, 3 T.C. 1070*, which held that the income of a corporation that dissolves during a taxable year must be annualized.
– Regarding the Section 711(a)(3)(B) computation, the court found that the Commissioner bore the burden of proving that the original determination of excess profits net income for the latter half of 1940 was in error. The court emphasized that bookkeeping entries are not determinative of tax liability, citing *Helvering v. Midland Mutual Life Ins. Co., 300 U.S. 216*.
– The court stated, "The deficiency as determined by respondent is prima facie or presumptively correct, and when he pleads new matter he accepts the burden of proving the alleged facts." The court also cited *Sam Cook, 25 B.T.A. 92*, and *Henderson Tire & Rubber Co., 12 B.T.A. 716*.
– Regarding the bad debt deduction, the court found that the Commissioner failed to demonstrate that the increase in bad debts charged off in 1939 was a consequence of factors listed in Section 711(b)(1)(K)(ii), such as an increase in gross income or a change in the business's operation. The court stated, "The proof of the positive is upon the respondent."

Practical Implications

– This case reinforces the principle that corporate mergers or dissolutions create short taxable years requiring income annualization for excess profits tax purposes.
– It clarifies the burden of proof when the Commissioner asserts a new matter leading to an increased deficiency; the Commissioner must provide sufficient evidence to support the assertion.
– The case demonstrates the importance of detailed record-keeping and the ability to substantiate income and deductions, especially when dealing with complex tax issues like excess profits taxes and abnormal deductions.
– This ruling emphasizes that even when a taxpayer uses a questionable methodology for calculations, the Commissioner still has the burden to prove that the resulting income figure is incorrect.

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