Farmers Cooperative Co. v. Commissioner, 8 T.C. 63 (1947)

A taxpayer seeking relief under Section 721 for abnormal income bears the burden of clearly demonstrating the existence and amount of abnormal income, and the proper allocation of such income to prior years.

Summary

Farmers Cooperative Co. sought relief from excess profits tax deficiencies for 1941 and 1942, claiming abnormal income in 1941 due to expenditures in prior years for hybrid seed corn development. The Tax Court denied relief, holding that the taxpayer failed to adequately demonstrate the existence of abnormal income as defined by Section 721(a)(2)(C) of the Internal Revenue Code, and to properly allocate any such income to prior years. The court also addressed deductions for patronage dividends, adjusting the percentage of earnings attributable to member sales by excluding unprofitable wholesale sales.

Facts

The Farmers Cooperative Co. made expenditures in prior years to develop hybrid seed corn, a process extending over more than twelve months. Sales in any given year were partly attributable to expenditures from prior years. The company classified sales as retail and wholesale, with only retail sales being profitable. The Commissioner determined excess profits tax deficiencies for 1941 and 1942. The company sought relief under Section 721, arguing that income in 1941 was abnormal due to prior development expenditures.

Procedural History

The Commissioner determined excess profits tax deficiencies for 1941 and 1942. Farmers Cooperative Co. petitioned the Tax Court for a redetermination of these deficiencies, claiming entitlement to relief under Section 721 of the Internal Revenue Code, and disputing the calculation of deductions for patronage dividends. The Tax Court upheld the Commissioner’s determination regarding Section 721 relief and adjusted the patronage dividend deduction.

Issue(s)

1. Whether the taxpayer had abnormal income in 1941 within the meaning of Section 721(a)(2)(C) as a result of expenditures made in prior years to develop its hybrid corn product.
2. Whether the Commissioner correctly calculated the deductions for patronage dividends, specifically regarding the inclusion of preferred stock dividends and the percentage of earnings attributable to sales to members.

Holding

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1. No, because the taxpayer failed to demonstrate the existence and amount of abnormal income and to properly allocate such income to prior years.
2. No, regarding preferred stock dividends, because the entire amount of dividends declared on preferred stock in 1942 accrued in that year and reduced the earnings available for patronage dividends. Yes, regarding the percentage of earnings from sales to members, with wholesale sales disregarded because they did not result in any profit.

Court's Reasoning

Regarding the abnormal income claim, the court stated that the taxpayer had the burden to clearly demonstrate the existence and amount of abnormal income, and to properly allocate such income to prior years. The court found that the taxpayer's presentation was unclear and failed to specify which income it contended fell within the class defined in 721(a)(2)(C). The court emphasized that it is not the Tax Court's role to develop a case for the petitioner. The court noted that the taxpayer appeared to incorrectly use income tax net income figures for their calculations, whereas Section 721 requires focusing on classes of gross income. Regarding patronage dividends, the court applied Section 115(b) of the IRC, presuming that dividends are distributed from the most recently accumulated earnings. It found that the entire amount of preferred stock dividends declared in 1942 accrued in that year, thus reducing earnings available for patronage dividends. Referencing A.R.R. 6967, the court determined that wholesale sales, which were unprofitable, should be disregarded when allocating profits between member and nonmember sales.

Practical Implications

This case underscores the importance of meticulous record-keeping and clear presentation when claiming relief under Section 721 for abnormal income. Taxpayers must specifically identify the class of income, demonstrate its abnormality according to the statutory definition, and provide a reasonable basis for allocating income to prior years. It highlights the taxpayer's burden of proof and the court's limited role in developing a taxpayer's case. Furthermore, it provides guidance on the calculation of patronage dividend deductions, particularly the treatment of preferred stock dividends and the allocation of earnings between member and non-member sales, emphasizing that unprofitable sales should be excluded from the allocation calculation. This case remains relevant for understanding the burden of proof in tax cases and the application of specific tax code provisions related to abnormal income and cooperative taxation. It also serves as a reminder that "the parties have the primary duty of presenting their cases, and they can not shift that duty to the Commissioner or complain if the Court does not exceed its proper function to make up for counsel's shortcomings."

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