Eitel-McCullough, Inc. v. Commissioner, 9 T.C. 1132 (1947)

r
r

To qualify for excess profits tax relief under Section 721, a taxpayer must demonstrate that its abnormal income is directly attributable to a qualifying activity, such as research and development, and must provide a reasonable basis for distinguishing income derived from that activity from income derived from other sources, such as improved business conditions.

r
r

Summary

r

Eitel-McCullough sought excess profits tax relief under Section 721 of the Internal Revenue Code, claiming that its increased income in 1941 and 1942 was attributable to research and development of tangible property (vacuum tubes). The Tax Court denied relief, finding that the company failed to adequately prove that the income was primarily a result of its research and development efforts, as opposed to increased demand due to the war. The court emphasized that the taxpayer must demonstrate a clear link between the abnormal income and the qualifying activity, and must provide a reasonable basis for allocating income between different sources.

r
r

Facts

r

Eitel-McCullough, Inc. manufactured vacuum tubes. The company argued its income spiked in 1941 and 1942 due to research and development efforts. The Commissioner argued the increased income was due to increased wartime demand. The company's sales increased dramatically during those years, coinciding with increased military contracts for radar equipment using their tubes. While the company had engaged in research and development, the court found that the increased sales were primarily driven by wartime demand for their products. The company failed to provide sufficient evidence to separate income attributable to research and development from income attributable to increased demand.

r
r

© 2025 SCOTUSreports.com. All rights reserved.

Procedural History

r

Eitel-McCullough, Inc. petitioned the Tax Court for a redetermination of excess profits taxes for 1941 and 1942, after the Commissioner disallowed its claim for relief under Section 721. The Tax Court ruled in favor of the Commissioner, denying the claimed relief.

r
r

Issue(s)

r

1. Whether Eitel-McCullough, Inc. demonstrated that its increased income in 1941 and 1942 qualified as “abnormal income” attributable to research and development of tangible property under Section 721(a)(2)(C) of the Internal Revenue Code?

r

2. Whether the Commissioner properly disallowed portions of salaries paid to company officers as excessive compensation?

r
r

Holding

r

1. No, because Eitel-McCullough failed to adequately prove that its increased income was primarily due to research and development, rather than increased demand stemming from war-related contracts and improved business conditions.

r

2. No, in part. The court found the salaries paid to Eitel and McCullough to be reasonable, but determined a portion of the salary paid to Harrison was excessive.

r
r

Court’s Reasoning

r

© 2025 SCOTUSreports.com. All rights reserved.

The court emphasized that to qualify for Section 721 relief, a taxpayer has both an affirmative and a negative burden of proof. The affirmative burden requires showing abnormal income of the designated class (research and development) exceeding 125% of the average amount of gross income of the same class for the four previous years. The negative burden requires demonstrating that the increased income was not due to other factors, such as improved business conditions. The court found that Eitel-McCullough failed to meet both burdens. The court stated,

© 2025 SCOTUSreports.com. All rights reserved.