1948 Tax Ct. Memo LEXIS 127

For the purpose of calculating excess profits tax credits, deductions are not considered abnormal simply because they lack a counterpart in the excess profits tax year; they must be shown to be unusual or unexpected in the normal operation of the business.

Summary

Wm. Wrigley Jr. Co. sought to exclude certain excise taxes, a bad debt, and sales promotion expenses from its base year income (1936-1939) when calculating its excess profits tax credit. Wrigley argued these were abnormal deductions under Section 711(b)(1)(J) of the Internal Revenue Code. The Tax Court held that the excise taxes were not abnormal in class, the bad debt was abnormal, and the sales promotion expenses should not be classified separately from other sales expenses. The court reasoned that not all deductions lacking counterparts in excess profit years are automatically abnormal, and the sales promotion expenses were too intertwined with regular sales activities to warrant separate classification.

Facts

Wrigley paid excise taxes from 1932-1938 but not in later years. It also incurred a bad debt from advances to the Alexander Corporation, unrelated to customer accounts. Wrigley also incurred various sales promotion expenses during the base years. Wrigley sought to classify and exclude these expenses from base year income for excess profits tax calculation. The sales promotion expenses included items like bonuses and premiums, aimed at developing future markets.

Procedural History

Wrigley challenged the Commissioner’s determination of its excess profits tax. The case was brought before the Tax Court of the United States.

Issue(s)

1. Whether the excise taxes paid by Wrigley during the base years were abnormal in class under Section 711(b)(1)(J)(i) of the Internal Revenue Code.
2. Whether the bad debt deduction from advances to Alexander Corporation was an abnormal deduction under Section 711(b)(1)(J)(i).
3. Whether the sales promotion expenses should be classified separately from other sales expenses and considered abnormal in amount under Section 711(b)(1)(J)(ii).

Holding

1. No, because excise taxes were imposed on the petitioner during 1932-1938, making the deduction not abnormal in class.

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2. Yes, because the bad debt arose in a manner distinct from ordinary customer debt and was thus an abnormal deduction.
3. No, because the sales promotion expenses were too closely related to other sales expenses to warrant separate classification for the purpose of calculating excess profit credits.

Court's Reasoning

The court reasoned that Section 711(b)(1)(J) was intended to eliminate truly abnormal deductions that distort the base year income, but not every deduction without a counterpart in the excess profits tax year qualifies. Regarding excise taxes, the court found that because Wrigley paid such taxes for seven years, they were not an unexpected part of doing business. The court allowed the bad debt deduction because the advances to Alexander Corporation were unusual and unrelated to normal sales. However, the court denied separate classification for sales promotion expenses, finding their purpose too intertwined with direct sales efforts. The court emphasized that these expenses likely had an impact on current sales, and separating them would defeat the purpose of the excess profits tax, which aimed to tax income exceeding normal levels. The court stated, "Congress, endeavoring to impose the excess profits tax upon that part only of the income of the excess profits tax years which exceeded the normal income of the taxpayer, used the average of the base period years as the norm."

Practical Implications

This case clarifies that for a deduction to be considered "abnormal" for excess profits tax credit calculations, it must be shown to be truly unusual or unexpected in the context of the taxpayer's business operations. The mere absence of a similar deduction in later years is insufficient. Taxpayers must demonstrate that the deduction arose from circumstances outside the normal course of their business. This decision highlights the importance of comprehensive documentation of expenses and their relationship to a company's core business activities when claiming abnormality for tax purposes. Later cases cite this one for its interpretation of

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