10 T.C. 642 (1948)

A successor corporation cannot exclude from its excess profits net income the recovery of bad debts that were deducted by its predecessor partnership before January 1, 1940, under Section 711(a)(1)(E) of the Internal Revenue Code.

Summary

Rice Drug Company, a successor corporation to a partnership, sought to exclude from its excess profits taxable income certain recoveries made in 1943 and 1944 on debts that the partnership had previously charged off as bad debts before January 1, 1940. The Tax Court held that Rice Drug Company could not exclude these recoveries under Section 711(a)(1)(E) of the Internal Revenue Code. The court reasoned that the exclusion applied only to the taxpayer who originally took the bad debt deduction, and Rice Drug Company, as a separate entity, did not suffer the initial loss. The court emphasized that the income was attributable to a profit made on an asset with a zero basis, akin to any gain made during the war years.

Facts

N. Rice Drug & Cigar Co., a partnership, charged off certain debts as bad debts prior to January 1, 1940, and took deductions for these debts from its gross income.

Rice Drug Company was incorporated on October 28, 1941, and began business on November 1, 1941, as N. Rice Drug & Cigar Co., later changing its name to Rice Drug Co.

During the fiscal years ended September 30, 1943 and 1944, Rice Drug Company recovered $14,319.76 and $8,831.08, respectively, through the collection of these previously charged-off debts.

The basis of these debts to Rice Drug Company was zero.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Rice Drug Company's excess profits taxes for the fiscal years ended September 30, 1943 and 1944.

Rice Drug Company petitioned the Tax Court, seeking to exclude the recoveries from its excess profits net income under Section 711(a)(1)(E) of the Internal Revenue Code.

Issue(s)

Whether, under Section 711(a)(1)(E) of the Internal Revenue Code, Rice Drug Company is entitled to exclude from its excess profits net income recoveries made by it in the taxable years on debts for which a deduction had been allowable to a partnership from which the petitioner acquired the accounts.

Holding

No, because Section 711(a)(1)(E) applies only to the taxpayer who originally took the bad debt deduction, and Rice Drug Company, as a separate entity, did not suffer the initial loss.

Court's Reasoning

The court reasoned that the general principle, supported by cases such as *Central Hanover Bank & Trust Co. v. United States*, indicates that a transferee of claims is not entitled to the same exclusion as the transferor. The court distinguished the recovery of a bad debt from the collection of a debt acquired with a zero basis.

The court stated,

