***10 T.C. 1010 (1948)***

A corporation operating on a non-profit basis in one year is not entitled to an excess profits credit carry-over to a subsequent year when it changes its policy to operate for profit, if the initial non-profit status defeats the purpose of the excess profits tax statute.

**Summary**

Mesaba-Cliffs Mining Company, originally operating as a non-profit entity selling iron ore to its stockholders at cost, sought to utilize an excess profits credit carry-over from 1940 when calculating its 1941 excess profits tax. In 1941, the company changed its policy to sell ore to its stockholders at market value to leverage the excess profits tax provisions related to invested capital. The Tax Court denied the carry-over, reasoning that the company's initial non-profit operation did not align with the legislative intent of the excess profits tax statute, which was designed to aid businesses affected by fluctuating earnings and economic cycles.

**Facts**

Mesaba-Cliffs Mining Company was formed to mine and sell iron ore, primarily to its stockholders, who were steel producers. From 1932 until December 31, 1940, the company sold ore to its stockholders at cost. In 1941, the company changed its policy and began selling ore to its stockholders at market prices, exceeding the cost of production. This change was implemented to allow its stockholders to benefit from the company's invested capital when computing their excess profits tax. For 1940, the petitioner had an unused excess profits credit of $259,533.46. For 1941, the petitioner had a net income of $549,842.77.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in Mesaba-Cliffs Mining Company's excess profits tax for 1941, disallowing the excess profits credit carry-over from 1940. Mesaba-Cliffs petitioned the Tax Court for a redetermination of the deficiency.

**Issue(s)**

Whether a corporation, operating as a non-profit entity in one year and subsequently changing its policy to operate for profit, is entitled to an excess profits credit carry-over from the non-profit year to offset excess profits in the later year.

**Holding**

No, because the excess profits tax provisions are not intended to benefit corporations that voluntarily alter their operations to exploit the tax code without having experienced the economic hardships the law was designed to alleviate.

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## Court’s Reasoning

The Tax Court relied on the principle established in *Wier Long Leaf Lumber Co.*, emphasizing that the excess profits tax relief was intended for corporations actively engaged in production and facing fluctuating earnings due to business cycles, not for those manipulating their operations for tax advantages. The court noted that Mesaba-Cliffs operated as a non-profit entity until 1941, selling ore at cost. The change in 1941 was a voluntary decision to take advantage of the invested capital credit provisions of the statute. The court stated, “It is inconceivable, however, that Congress intended to include in the averaging of the excess profits tax a year in which the taxpayer did not have and, under its plan of operation, did not intend to have any profits.” The court concluded that the excess profits credit carry-over should be available only to taxpayers who maintain a normal, profit-seeking business during both the taxable period and the preceding or succeeding periods.

## Practical Implications

This case demonstrates that courts will scrutinize the underlying economic reality and purpose of a corporation’s operations when determining eligibility for tax benefits like the excess profits credit carry-over. It clarifies that the excess profits tax laws are intended to provide relief to businesses genuinely impacted by economic cycles and fluctuations, not to be used as a tool for tax avoidance through artificial changes in business practices. This decision informs how similar cases are analyzed by requiring consideration of the taxpayer’s intent and the consistency of their business operations over time. Later cases have cited *Mesaba-Cliffs* to emphasize that tax benefits are not automatically available but must align with the legislative intent behind the relevant provisions of the tax code.

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