10 T.C. 1275 (1948)

In computing excess profits tax, a deduction claimed and allowed as a casualty loss in a prior tax year must be disallowed, even if the taxpayer now argues it should have been treated as ordinary and necessary expenses.

Summary

Schneider Grocery Co. claimed and was allowed a deduction for a flood loss in 1937. When computing its excess profits tax for 1943 and 1944, the Commissioner disallowed this deduction under Section 711(b)(1)(E) of the Internal Revenue Code. Schneider argued that the disallowed amount, or a portion of it, represented ordinary and necessary expenses, which should not be disallowed. The Tax Court upheld the Commissioner's determination, emphasizing that the statute requires disallowance of "deductions under section 23(f)" regardless of the underlying nature of the loss.

Facts

Schneider Grocery Co., an Ohio corporation, operated a chain of grocery stores. In 1937, a severe flood damaged four of its stores and a warehouse. The company incurred losses to inventory, equipment, and buildings. On its 1937 income tax return, Schneider claimed and was allowed a casualty loss deduction of $14,740.28 related to this flood damage.

Procedural History

The Commissioner determined deficiencies in Schneider's excess profits tax for 1943 and 1944. This determination was based on the disallowance of the 1937 flood loss deduction when computing Schneider's excess profits credit. Schneider petitioned the Tax Court, contesting the disallowance.

Issue(s)

Whether the Commissioner properly disallowed a deduction claimed and allowed to the petitioner in its 1937 return as a casualty loss from flood under section 711 (b) (1) (E) in determining petitioner's average base period net income for the purpose of computing excess profits tax for 1943 and 1944.

Holding

Yes, because Section 711(b)(1)(E) explicitly disallows deductions under Section 23(f) in computing base period excess profits income, and the petitioner took the disputed amount as a deduction under Section 23(f) in its 1937 return.

Court's Reasoning

The Tax Court focused on the plain language of Section 711(b)(1)(E) of the Internal Revenue Code, which states that deductions under Section 23(f) (the section concerning casualty losses) shall not be allowed when computing base period excess profits income. The court emphasized that the statute mandates the disallowance of the deduction itself, regardless of whether the underlying loss might arguably have been treated as an ordinary and necessary expense. The court stated, “The statute requires the disallowance not of *losses* in the nature of casualties, but of ‘*Deductions* under section 23 (f).'” Because the petitioner had claimed and been allowed the deduction under Section 23(f) in its 1937 return, the statute required its disallowance for excess profits tax computation purposes. The court noted the petitioner did not formally claim relief under section 713(f), the so called “growth formula,” which might have mitigated the impact of this decision.

Practical Implications

This case illustrates the importance of properly classifying deductions in the original tax year, as subsequent attempts to recharacterize them may be unsuccessful, especially when specific statutory provisions govern the computation of taxes like the excess profits tax. It underscores the principle that tax computations rely on the treatment of items in prior years. Taxpayers should carefully consider the implications of claiming deductions under specific sections of the tax code, as these classifications can have long-term consequences. While the specific tax (excess profits tax) is no longer relevant, the principle of adhering to prior-year tax treatments continues to apply. The case also highlights the need to properly plead all possible grounds for relief to the court; the court will generally not consider arguments that were not properly raised by the petitioner. Later cases citing Schneider Grocery Co. often relate to issues of consistency in tax treatment across different tax years.

