Robert V. Rountree v. Commissioner, 8 T.C. 1 (1947)

A corporation with a short taxable year due to its dissolution cannot compute its excess profits tax under Section 711(a)(3)(B) of the Internal Revenue Code if it cannot establish its adjusted excess profits net income for a full twelve-month period.

Summary

The petitioners, as transferees of Crystal Products, Inc., sought to calculate the excess profits tax using Section 711(a)(3)(B) of the Internal Revenue Code, which provides an exception for short taxable years. Crystal Products had a short year due to its organization and dissolution within four months. The Tax Court held that the corporation could not use Section 711(a)(3)(B) because it could not establish its adjusted excess profits net income for a twelve-month period, as required by the statute. Therefore, the general rule under Section 711(a)(3)(A) applied.

Facts

Crystal Products, Inc., was organized in April 1942 and dissolved four months later. The company sought to compute its excess profits tax for this short taxable year under Section 711(a)(3)(B) of the Internal Revenue Code. The Commissioner determined a deficiency using Section 711(a)(3)(A). Petitioners, as transferees of the corporation's assets, challenged this determination, arguing that Section 711(a)(3)(B) should apply.

Procedural History

The Commissioner assessed a deficiency against Crystal Products, Inc., for its excess profits tax. The petitioners, as transferees of the corporation's assets, contested the deficiency in the Tax Court. The Tax Court reviewed the Commissioner's determination and upheld the deficiency.

Issue(s)

Whether a corporation with a short taxable year due to its dissolution can compute its excess profits tax under Section 711(a)(3)(B) of the Internal Revenue Code when it cannot establish its adjusted excess profits net income for a full twelve-month period.

Holding

No, because Section 711(a)(3)(B) requires the taxpayer to establish its adjusted excess profits net income for a twelve-month period, and Crystal Products could not meet this requirement due to its short existence.

Court's Reasoning

The court reasoned that the plain language of Section 711(a)(3)(B) requires the taxpayer to establish "its adjusted excess profits net income for the period of twelve months." The court emphasized that the exception in Section 711(a)(3)(B) allowing use of the twelve-month period ending with the close of the short taxable year applies only if the taxpayer "has disposed of substantially all its assets" prior to the end of such a 12-month period. Since no such 12-month period existed, the general rule under Section 711(a)(3)(A) applied. The court also examined the legislative history, noting that Section 711(a)(3)(B) was intended to provide relief to corporations with a business history of an entire year, allowing them to compute their tax based on actual experience rather than a mechanical computation. The court quoted from the Ways and Means Committee Report, stating that the amendment was to "provide that a taxpayer having a short taxable year may compute its excess-profits tax for the short period with reference to its actual adjusted excess-profits net income for a 12-month period." Because Crystal Products lacked such a history, the exception was inapplicable.

Practical Implications

This case clarifies the requirements for utilizing the exception in Section 711(a)(3)(B) for computing excess profits tax for short taxable years. It highlights the importance of being able to establish adjusted excess profits net income for a twelve-month period. The case underscores that the exception is intended for businesses with an established operating history allowing them to demonstrate actual income experience over a full year. Attorneys advising corporations with short taxable years must determine whether the corporation can meet the twelve-month income requirement to qualify for the exception. This ruling emphasizes the importance of consulting legislative history to interpret the intent and scope of tax code provisions. Later cases would cite this decision when interpreting similar provisions related to short taxable years and the computation of tax liabilities. This case has implications for corporate tax planning, particularly when considering the timing of corporate formations or liquidations.

