11 T.C. 1000 (1948)

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A taxpayer can re-examine and correct net income reported in a base period year for the purpose of ascertaining its excess profits credit, specifically regarding depreciation deductions, under Section 713 of the Internal Revenue Code.

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Summary

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Leonard Refineries sought to adjust its 1940 net income to reflect a more accurate depreciation deduction when calculating its excess profits tax credit for 1943 and 1944. The Tax Court held that Leonard Refineries could recompute its 1940 net income by correcting excessive depreciation on certain assets. However, the court also ruled that the Commissioner was entitled to a corresponding correction of Leonard Refineries' income tax liability for 1939 and 1940 via an adjustment of the excess profits tax liability under Section 734 of the code. This decision clarified the interplay between income tax and excess profits tax calculations, emphasizing the ability to correct past errors for accurate tax assessment.

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Facts

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Leonard Refineries, engaged in refining and marketing petroleum products, used the straight-line depreciation method. The company acquired McClanahan Refineries in 1939, including a refinery in St. Louis located on leased land. Leonard Refineries initially depreciated the St. Louis plant assets based on the lease term. The company removed salt from crude oil and maintained equipment rigorously. In 1941 and 1942, the IRS audited the depreciation deductions and proposed revised rates. In 1939, the company acquired the land under the refinery and planned to operate beyond the terms of the lease.

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Procedural History

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The Commissioner determined deficiencies in Leonard Refineries' income tax for 1943 and excess profits tax for 1943 and 1944. Leonard Refineries contested the excess profits tax deficiencies, claiming a higher excess profits credit based on a corrected 1940 income. The Tax Court reviewed the case to determine the proper excess profits credit and the validity of the depreciation deductions.

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Issue(s)

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1. Whether Leonard Refineries could redetermine its net income for a base period year (1940) to ascertain its excess profits credit under Section 713 of the Internal Revenue Code.

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2. Whether the depreciation deductions taken by Leonard Refineries in 1940 were excessive and erroneous, justifying a correction of its net income for that year.

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3. Whether, if the depreciation deductions were excessive, the Commissioner was entitled to correct Leonard Refineries' prior income tax liability by adjusting its excess profits liability under Section 734 of the code, and if so, for which years.

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Holding

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1. Yes, because no excess profits tax provision in the code specifically requires that the excess profits credit under Section 713 be computed by the use of net income figures used by the taxpayer in its income tax returns for base period years.

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2. Yes, in part, because the depreciation on seven assets at the St. Louis plant was incorrectly based on the lease term, not the assets' physical lives, but only after the company acquired the land.

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3. Yes, because Section 734 of the code entitles the respondent to a corresponding correction in petitioner’s prior income tax liability by an adjustment in petitioner’s excess profits tax, and such adjustment applies to both 1939 and 1940.

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Court’s Reasoning

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The Tax Court reasoned that Section 713 of the Internal Revenue Code does not mandate using the same net income figures from prior income tax returns when computing excess profits credit. Citing Regulation 112, section 35.734 (2)-c, the court affirmed that either the Commissioner or the taxpayer could insist on the correct treatment of an item in determining the excess profits credit. Regarding depreciation, the court emphasized that a

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