12 T.C. 140 (1949)

For excess profits tax purposes, when property is transferred to a corporation in exchange for stock, the corporation's basis in the property is the same as it would be in the hands of the transferors, not necessarily the fair market value of the stock issued.

Summary

American Radio Telephone Co. sought to increase its excess profits credit by claiming a higher equity invested capital based on the purported value of property (radio equipment) paid in for stock. The Tax Court held that the company's basis in the property was limited to the transferors' original cost basis, which was substantially less than the par value of the stock issued. The court rejected the company's reliance on an inflated appraisal and upheld the Commissioner's determination, limiting the excess profits credit.

Facts

In 1924, Roy Olmstead and Alfred Hubbard transferred radio broadcasting equipment to American Radio Telephone Co. in exchange for all of its stock, with a par value of $100,000. Olmstead and Hubbard had acquired the equipment earlier that year. Olmstead provided the funds, estimated between $10,000 and $15,000, while Hubbard managed the purchase and construction. The company sought to use the $100,000 par value of the stock as its equity invested capital for excess profits tax purposes. The Commissioner argued that the equipment's cost basis to Olmstead and Hubbard was significantly lower.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in American Radio Telephone Co.'s excess profits tax for 1943, 1944, and 1945, disallowing the company's claimed excess profits credit based on invested capital. The company petitioned the Tax Court for review, arguing that the property paid in for stock justified a higher credit. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether, for the purpose of computing the excess profits credit under Section 718(a)(2) of the Internal Revenue Code, the basis of property paid into a corporation for stock is determined by its fair market value or by the transferor's cost basis in the property?

Holding

No, because Section 718(a)(2) dictates that the basis of property paid in for stock is the same as it would be in the hands of the transferors (i.e., their cost basis), regardless of the stock's par value or a later appraisal.

Court's Reasoning

The Tax Court relied on Section 718(a)(2) of the Internal Revenue Code, which specifies that property paid in for stock is included in equity invested capital "in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange." The court emphasized that the relevant basis is the transferors' (Olmstead and Hubbard's) cost basis. The court discredited the company's appraisal evidence, finding it unreliable and contradicted by direct testimony from Olmstead and other witnesses who estimated the actual cost of the equipment. The court directly quoted Ralphs-Pugh Co., stating that equity invested capital is based on the cost basis of the assets to the transferor, not the potential value of the assets transferred. Because the company failed to prove that Olmstead and Hubbard's cost exceeded $15,000, the court upheld the Commissioner's determination.

Practical Implications

This case illustrates that a corporation's equity invested capital for excess profits tax purposes is tied to the transferor's basis in the contributed assets, not the fair market value or an inflated appraisal. This decision underscores the importance of accurate record-keeping to establish the cost basis of assets transferred to a corporation in exchange for stock. Later cases applying this ruling would scrutinize the evidence presented to determine the original cost basis of transferred property, giving less weight to appraisals, especially those prepared for purposes other than determining cost. The case highlights the importance of tracing the cost basis of contributed property back to its original acquisition, and establishes precedence for the scrutiny of valuations in determining a company's tax burden.