Arlington Mills v. Secretary of War, 14 T.C. 1 (1950)

In renegotiation cases under the Renegotiation Act, the Tax Court has de novo jurisdiction to determine the amount of excessive profits, and is not bound by the Secretary's initial determination of renegotiable sales or profits.

Summary

Arlington Mills challenged the Secretary of War's determination of excessive profits for the period ending August 31, 1942, under the Renegotiation Act. The Tax Court addressed issues including the scope of its jurisdiction, the inclusion of sales made under contracts predating a key statutory date, the treatment of sales of rejected goods ("seconds and shorts"), the deductibility of state income taxes, and ultimately, the amount of excessive profits. The Tax Court held it had de novo jurisdiction, certain sales were not exempt, state income taxes were deductible, and determined a different amount of excessive profits than the Secretary.

Facts

Arlington Mills sold yarn and cloth, some of which was eventually incorporated into goods sold to the government by other manufacturers. The Secretary of War determined Arlington Mills had made excessive profits on renegotiable sales. Some of Arlington Mills' contracts predated April 28, 1942, but deliveries and payments continued after that date. The government rejected some materials sourced from Arlington Mills due to quality issues, and these "seconds and shorts" were sold for civilian use. Arlington Mills paid income taxes to the State of Georgia.

Procedural History

The Secretary of War determined Arlington Mills had excessive profits. Arlington Mills petitioned the Tax Court for a redetermination. The case was initially heard by a Commissioner who made findings of fact. The Tax Court reviewed the Commissioner's findings and made its own determination.

Issue(s)

1. Whether the Tax Court's jurisdiction in renegotiation cases is limited to the amount of renegotiable sales determined by the Secretary.
2. Whether sales made under contracts entered into before April 28, 1942, but with deliveries and payments after that date, are subject to renegotiation under Section 403(c)(6) of the Renegotiation Act.
3. Whether sales of "seconds and shorts" (rejected goods sold for civilian use) are subject to renegotiation.
4. Whether state income taxes are deductible in determining profits on renegotiable sales.
5. What is the amount of excessive profits Arlington Mills realized during the relevant period?

Holding

1. No, because Section 403(e)(2) grants the Tax Court de novo jurisdiction to determine the correct amount of excessive profits, and this includes determining the amount of profits subject to renegotiation.
2. Yes, because Section 403(c)(6) applies to all contracts unless "final payment pursuant to such contract or subcontract was made prior to April 28, 1942," and final payment was not made prior to that date.
3. No, because only sales of material paid for out of appropriated Government funds are subject to renegotiation.
4. Yes, because the Tax Court previously held in *Albert & J. M. Anderson Mfg. Co.*, 12 T.C. 132, that similar taxes were deductible for 1942.
5. $850,000, because after considering all relevant factors, the court determined this amount represented excessive profits.

Court's Reasoning

The Tax Court reasoned that its de novo jurisdiction under Section 403(e)(2) allows it to determine the amount of profits subject to renegotiation, not merely to review the Secretary's determination. Regarding contracts predating April 28, 1942, the court emphasized the statute's focus on "final payment" under the *contract*, not individual shipments. The court followed its prior precedent in *W. Tip Davis Co.*, 12 T.C. 335, holding that only sales paid for with appropriated government funds are subject to renegotiation, thus excluding "seconds and shorts." The court cited *Albert & J. M. Anderson Mfg. Co.* for the deductibility of state income taxes. In determining the amount of excessive profits, the court considered numerous factors, including the petitioner's history, efficiency, contributions to the war effort, and the quality and quantity of its goods. The court stated that it had considered all "factors" and given them such weight as seemed appropriate under the circumstances in arriving at the determination of excessive profits.

Practical Implications

This case clarifies the scope of the Tax Court's jurisdiction in renegotiation cases, confirming its power to independently determine renegotiable sales and profits. It also provides guidance on applying the effective date provision of the Renegotiation Act and the treatment of rejected goods. The decision underscores the importance of establishing whether goods were paid for with appropriated government funds. The case highlights that the Tax Court's determination of excessive profits is a holistic assessment considering numerous factors specific to the contractor's operations and contributions. Later cases would cite Arlington Mills for the principle of de novo review in renegotiation cases and the factors considered in determining excessive profits.

