Davis Regulator Co. v. Commissioner, 36 B.T.A. 437 (1947)

A taxpayer cannot claim a tax credit for research and development activities conducted by a separate, predecessor corporation, even if the taxpayer later succeeds to the predecessor's property and business.

Summary

Davis Regulator Co. sought a tax credit under Section 721(a)(2)(C) for research and development extending over 12 months. The IRS denied the credit, arguing the research was conducted by a separate New York corporation, not the taxpayer (a New Jersey corporation). The Board of Tax Appeals upheld the IRS decision, emphasizing that the statute and related regulations explicitly require the research to be conducted by the taxpayer itself, not a predecessor. The Board rejected the argument that the New York corporation was a de facto predecessor, finding it was a distinct legal entity. Consequently, Davis Regulator Co. could not claim the credit.

Facts

Prior to the formation of the petitioner, Davis Regulator Co., a business was conducted under the same name by a New York corporation.
The New York corporation engaged in research and development of tangible property, patents, formulae, or processes.
The petitioner, Davis Regulator Co. was incorporated in New Jersey.
The petitioner claimed it was entitled to a tax credit for research and development "extending over a period of more than 12 months" under section 721 (a) (2) (C).

Procedural History

The Commissioner of Internal Revenue denied Davis Regulator Co.'s claim for a tax credit.
Davis Regulator Co. appealed the Commissioner's decision to the Board of Tax Appeals.

Issue(s)

Whether a taxpayer, not having existed for 12 months, can avail itself of the relief accorded by section 721 (a) (2) (C) for research and development "extending over a period of more than 12 months."
Whether the research and development performed by a predecessor New York corporation can be attributed to the successor New Jersey corporation for purposes of the tax credit under Section 721(a)(2)(C).

Holding

No, because Section 721(a)(2)(C) requires that the research and development be conducted by the taxpayer itself, and Davis Regulator Co. did not exist for the

required 12-month period to conduct such activities.
No, because the tax code requires the research and development be that of the taxpayer. Activities of the predecessor are not attributable to the new entity.

Court's Reasoning

The Board of Tax Appeals based its reasoning on the specific language of Section 721(a)(2)(C) and the corresponding Treasury Regulations. The regulation expressly requires that the research and development "must be that of the taxpayer." The Board considered the legislative history, finding support for the regulation's requirement that the research be performed by the taxpayer and not a predecessor. The Board noted that the New York corporation was a separate legal entity, and its activities could not be attributed to the New Jersey corporation. Furthermore, the Board dismissed the argument that the petitioner existed de facto prior to incorporation. The Board concluded that the New York corporation continued its activities until dissolution, and no attempts to form a corporate venture existed between the New York corporation's dissolution and the petitioner's incorporation. The Board emphasized that to establish the existence of a de facto corporation it must be shown that there is a law under which a corporation with the powers assumed might be incorporated; that there has been a bona fide attempt to organize a corporation in the manner prescribed by the statute, and that there has been actual exercise of corporate powers.

Practical Implications

This case clarifies that tax credits for research and development are generally not transferable between separate legal entities.
Taxpayers seeking to claim such credits must ensure that the qualifying activities are conducted directly by the entity claiming the credit.
When structuring corporate reorganizations or successions, careful consideration must be given to the potential impact on tax attributes and credits, ensuring that the surviving entity can independently satisfy the requirements for claiming such benefits.
Later cases have cited this decision to reinforce the principle that tax benefits are generally not transferable unless explicitly permitted by law. This case reinforces the importance of understanding the nuances of corporate tax law when structuring business transactions.

