16 T.C. 587 (1951)

Abnormal income derived from increased sales volume due to heightened demand, even if related to research and development, cannot be attributed to prior years for excess profits tax relief under Section 721 if the increased demand is linked to wartime or defense-related economic factors.

Summary

Breeze Corporations sought a refund of excess profits tax for 1941, claiming its income from antenna mounts and armor plate was abnormal and attributable to prior research years under Section 721 of the Internal Revenue Code. The Tax Court denied the claim, holding that the increased income was primarily due to increased demand related to the defense program, not solely to prior research and development. The court emphasized that Treasury Regulations prevent attributing income to prior years if the increase resulted from heightened wartime or defense-related demand.

Facts

Breeze Corporations began manufacturing automotive parts in 1926, transitioning to aircraft parts around 1929. The company initiated research on antenna mounts in 1938 and face-hardened armor plate in 1939. By 1941, the company manufactured and sold various products, with the U.S. Government being its largest customer. Sales of antenna mounts significantly increased from $28,194 in 1940 to $4,644,403 in 1941, and armor plate sales went from almost nothing to $534,014 in 1941. The company claimed this income was attributable to prior years of research and development.

Procedural History

Breeze Corporations filed a claim for refund of excess profits tax for 1941. The Commissioner of Internal Revenue disallowed the claim. Breeze Corporations then petitioned the Tax Court for review of the disallowance.

Issue(s)

Whether the net abnormal income received by Breeze Corporations in 1941 from the sale of antenna mounts and armor plate was attributable to previous taxable years due to research and development, thus entitling it to relief under Section 721(a)(1) and (a)(2)(C) of the Internal Revenue Code, or whether the income was primarily the result of increased demand due to the defense program.

Holding

No, because the increased income was primarily the result of increased demand due to the defense program, and Treasury Regulations prevent attributing such income

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to prior years for excess profits tax relief.

Court's Reasoning

The court emphasized that Section 721(b) grants the Commissioner the authority to determine the amount of net abnormal income attributable to other years through regulations. Regulation 112, Section 35.721-3, states that income resulting from increased sales volume due to increased demand should not be attributed to other taxable years. The court found that the significant increase in sales of antenna mounts and armor plate in 1941 was directly linked to increased demand driven by the U.S. government's defense program. The court stated that "To the extent that *any* items of net abnormal income… are the result of… increased physical volume of sales due to increased demand… such items shall not be attributed to other taxable years." The court distinguished the case from others where relief was granted, noting that those cases did not involve secret developments exclusively for the government where demand was solely created by and could be sold only to the Government. The court concluded that without the government's demand, Breeze Corporations would not have had any net abnormal income in 1941.

Practical Implications

This case clarifies that increased sales due to wartime or defense-related demand take precedence over claims for excess profits tax relief based on prior research and development expenses. It reinforces the Commissioner's broad discretion in determining attributability of abnormal income under Section 721. It also highlights the importance of demonstrating that increased income is directly attributable to research and development, rather than general economic conditions. This decision limits the ability of companies to avoid excess profits taxes by attributing income from government contracts during wartime to earlier periods. Later cases will need to carefully analyze the direct cause of increased demand to determine whether it stems from research, development, or broader economic factors related to government spending or military needs.

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