Superior Glass Company v. Commissioner, T.C. Memo. 1944-126

A taxpayer's basis in property is its cost to the taxpayer, and the commencement of a new business during the base period for excess profits tax purposes can justify relief under Section 722 if normal operations were hindered.

Summary

Superior Glass Company sought to increase its equity invested capital and depreciation basis by including a purported contribution to capital based on the fair market value of assets acquired through foreclosure, exceeding the actual cost. The Tax Court held that the company's basis was limited to its actual cost. However, the court also found that Superior Glass was entitled to relief under Section 722 of the Internal Revenue Code because it commenced business during the base period, and its average base period net income did not reflect normal operations. The court estimated a constructive average base period net income, acknowledging the inherent imprecision but necessity of such estimations under the Code.

Facts

Victory Glass Company failed and its assets were acquired through foreclosure by first mortgage bondholders. They then formed Superior Glass Company. Superior Glass acquired the assets for $38,163.38, consisting of preferred stock and assumed liabilities. Superior Glass claimed the assets had a fair market value significantly higher ($107,590.78) and sought to include the difference in its equity invested capital and depreciation basis. Superior Glass commenced operations on February 1, 1937.

Procedural History

Superior Glass Company petitioned the Tax Court seeking a determination that it was entitled to relief under Section 722 of the Internal Revenue Code and to increase its equity invested capital. The Commissioner opposed the petition. The Tax Court reviewed the case.

Issue(s)

1. Whether the basis of the assets acquired by Superior Glass should include the excess of their fair market value over the actual cost to the company.
2. Whether Superior Glass was entitled to relief under Section 722 of the Internal Revenue Code due to commencing business during the base period and having a distorted average base period net income.

Holding

1. No, because the taxpayer's basis is the cost of the property to the taxpayer, and no provision of the Internal Revenue Code allowed for a transferor's basis to be

passed on to the petitioner in excess of the actual cost.
2. Yes, because the company commenced business during the base period, and its earnings during that period were not representative of normal operations, justifying a constructive average base period net income calculation.

Court’s Reasoning

The court reasoned that the basis of property is its cost to the taxpayer, citing Section 113(a) of the Internal Revenue Code. Superior Glass’s cost was $38,163.38. The court rejected the argument that the company was entitled to use a transferor’s basis because no transferor had a basis exceeding that amount and no applicable provision allowed for such a transfer. Regarding Section 722 relief, the court acknowledged that Superior Glass commenced business during the base period. The court noted, “The company was new; the predecessor had been a failure. The new owners of the common stock were making their first venture in the glass business…The new owners, the common stockholders, knew that their business, to succeed, would have to differ from that of the former company.” The court relied on testimony that sales would have been higher had the business started earlier and that costs declined with increased production to determine a constructive average base period net income.

Practical Implications

This case reinforces the fundamental principle of tax law that the basis of property is generally its cost to the taxpayer. It also illustrates the application of Section 722 (now largely obsolete, but illustrative of similar tax relief provisions) for businesses with atypical base period earnings due to commencement of business. The case highlights the importance of providing clear and convincing evidence to support claims for tax relief, including expert testimony and statistical data. Even with imperfect information, the Tax Court is willing to make estimations when the Code authorizes a departure from actual figures, emphasizing that relief provisions are designed to provide an approximation where an absolute cannot be determined. It also shows that a change in ownership and a fresh start can be considered a ‘new’ business for tax purposes, even if the underlying operations are similar to a predecessor.

