***A. C. Burton & Co. v. Commissioner, T.C. Memo. 1952-261***

When calculating excess profits tax credits, finance income derived from installment sales that are an integral part of an automobile dealership's business operations should be included in the base period net income.

**Summary**

A. C. Burton & Co. sought to include finance income from 1936 and 1937 in its base period net income for excess profits tax calculation, arguing that it was an integral part of its automobile dealership. The Commissioner argued that this income should be excluded because it was derived from a separate finance business allegedly transferred to Burton Finance Company. The Tax Court held that the finance income, being directly tied to the automobile sales, was part of the proprietorship's overall income and should be included in the base period net income.

**Facts**

A.C. Burton operated an automobile dealership as a sole proprietorship during the base period years 1936-1939. The business sold cars and handled installment paper, generating finance income. In 1940, A. C. Burton & Co. (the petitioner) acquired substantially all the properties of the proprietorship. Burton Finance Company was formed in October 1938. The petitioner, as an acquiring corporation, sought to use the earnings experience of its predecessor proprietorship to calculate its excess profits tax credit.

**Procedural History**

The Fifth Circuit Court of Appeals reversed the Tax Court's initial decision, determining that A. C. Burton & Company was an "acquiring corporation." The Commissioner then argued alternatively that the base period net income of the proprietorship should be reduced by reasonable salaries and finance net income from 1936 and 1937. The Tax Court addressed the alternative contentions after the Fifth Circuit's ruling.

**Issue(s)**

Whether finance income derived from installment sales in 1936 and 1937, as part of an automobile dealership's operations, should be included in the base period net income when calculating excess profits tax credits for an acquiring corporation.

**Holding**

Yes, because the finance income was an integral part of the automobile sales business and not a separate finance business; therefore, it should be included in the base period net income for excess profits tax calculation.

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## Court’s Reasoning

The court reasoned that Section 742 of the Code allows an acquiring corporation to use the earnings experience of its predecessor. The court found no requirement to compute average base period net income on a departmental basis. Although the Commissioner argued for excluding finance income as a separate business, the court emphasized that the finance income was directly tied to automobile sales under deferred payment plans. The proprietorship acquired installment notes in the normal course of trade, similar to acquiring used cars as trade-ins. The court emphasized that whether the proprietorship held the notes for finance charges or sold them for cash was a matter of business discretion, not a separate finance business operation. The court noted, “It was not a matter of operating a separate finance business. The finance income was properly part of proprietorship income just as income from the sale of used cars or income from maintenance and repair was proprietorship income and includible in computing base period net income.” Since the proprietorship always received some finance income, the court saw no reason to eliminate it for the years 1936 and 1937.

## Practical Implications

This case clarifies that income generated as a normal part of a core business operation, even if related to financing, should be included in calculating base period net income for excess profits tax purposes. This decision prevents the IRS from arbitrarily separating out integral parts of a business to reduce excess profits credit. It confirms that businesses are not required to compute income on a departmental basis for excess profits tax purposes when the income is interdependent. The case highlights the importance of demonstrating that financing activities are directly linked to core business operations, such as sales, rather than constituting a distinct, separate business. This ruling would influence how similar cases involving integrated business activities are analyzed, especially when determining tax credits or deductions related to those activities.

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