22 T.C. 380 (1954)

A corporation that transfers its business to a related entity and subsequently has unused excess profits credits cannot carry those credits back to offset taxes from prior profitable years if the transfer effectively duplicates the benefits of the credit.

Summary

The Wheeler Insulated Wire Company (Connecticut) was a wire manufacturer acquired by Sperry Securities Corporation, which then transferred Connecticut's assets to another subsidiary, The Wheeler Insulated Wire Company, Incorporated (petitioner). Connecticut was left with minimal assets and operations. The court addressed whether Connecticut could carry back unused excess profits credits from the post-transfer years to its pre-transfer profitable years. The Tax Court held that Connecticut could not carry back the unused excess profits credits, reasoning that Congress did not intend to allow a corporation to claim these credits when its business operations were transferred to a related entity, effectively duplicating the tax benefit. The court found that the transfer circumvented the purpose of the excess profits tax credit, which was intended to provide relief during periods of financial hardship within the same business entity.

Facts

Wheeler Insulated Wire Company (Connecticut) manufactured wire and electrical appliances until June 1943. Sperry Securities Corporation (later the petitioner), acquired all of Connecticut's stock on May 28, 1943. On June 14, 1943, Connecticut transferred most of its assets to the petitioner, retaining only cash, accounts receivable, U.S. Treasury notes, and certain other minor assets. The petitioner, which then had only two employees, took over all manufacturing operations. The petitioner changed its name to The Wheeler Insulated Wire Company, Incorporated. Connecticut's activities after the transfer were minimal, primarily holding cash and government notes. Connecticut reported minimal income and deductions in the following years. The Commissioner of Internal Revenue assessed deficiencies against the petitioner as the transferee of Connecticut, disallowing net operating loss carry-back and excess profits credit carry-back.

Procedural History

The Commissioner determined tax deficiencies against The Wheeler Insulated Wire Company, Incorporated, as the transferee of Connecticut. The petitioner contested these deficiencies in the United States Tax Court. The Tax Court reviewed the case based on stipulated facts, including the corporate restructuring and the resulting tax implications. The court considered the issue of the carry-back of net operating losses and unused excess profits credits. The court sided with the Commissioner, holding that the carry-back was not allowed under the circumstances of the corporate transfer. The dissent disagreed with the majority opinion.

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Issue(s)

1. Whether Connecticut's excess profits tax payments in 1944 for the fiscal year ending August 31, 1943, could be deducted in calculating a net operating loss in the fiscal year ended August 31, 1944, which could then be carried back to the taxable year ended August 31, 1942.

2. Whether Connecticut could carry back unused excess profits credits from its fiscal years ended August 31, 1944, and August 31, 1945, to the taxable years ended August 31, 1942, and August 31, 1943, respectively.

Holding

1. No, because, the Court followed precedent in holding that the excess profits tax payments were not deductible in computing the net operating loss carryback. The Court cited *Lewyt Corporation* and *Hunter Manufacturing Corporation*.

2. No, because Congress did not intend for a corporation to carry back unused excess profits credits when the business was transferred to a related entity, resulting in a duplication of the tax benefit, and circumventing the intention of the law to provide relief for financial hardship within the same business. The Court held that Connecticut had no real business after the transfer and the credit was not allowable in this situation.

Court's Reasoning

The court focused on the intent of Congress in enacting the excess profits tax credit provisions. The court noted that the legislative history of section 710(c) of the Internal Revenue Code (dealing with excess profits tax) and related sections indicated that the credit was designed to provide relief in "hardship cases," where business earnings declined. The court reasoned that the transfer of Connecticut's business to the petitioner, another subsidiary, did not represent a decline in earnings but a shift in the entity earning the income. The court highlighted that Connecticut's continued existence was essentially nominal, holding mostly cash and government notes after the transfer. The court stated, "Congress had no reason or intention to allow a corporation thus denuded of its business and business assets to carry back unused excess profits credits to earlier years, during which it had excess profits net income from its business, while that business continued to earn excess profits net income in the hands of a related corporation." The court distinguished the case from situations involving normal liquidations of remaining assets or annualized income. The Court cited its previous ruling in *Diamond A Cattle Co.*.

Practical Implications

This case provides guidance on the application of excess profits tax carry-back rules after corporate restructurings. It indicates that courts will scrutinize such transactions to ensure that the carry-back benefits are not used to avoid taxes in

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ways that circumvent the intent of the law. The decision underscores that the carry-back provisions are intended to alleviate financial hardship within the same business entity. Tax practitioners should advise clients that transferring the business to a related entity might not allow the carry-back of unused tax credits. When advising clients considering corporate restructuring, it is important to consider whether the transfer effectively results in the same business operations and whether the intent is to duplicate tax benefits. Later cases have cited this one to illustrate that the spirit of the tax law must be followed, and that the transfer of a business to a related entity can result in the disallowance of tax benefits if the purpose of the transfer is to avoid tax liabilities.

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