22 T.C. 539 (1954)

To qualify for excess profits tax relief, a business must demonstrate that intangible assets, not included in invested capital, significantly contribute to its income, and that the invested capital method yields an inadequate excess profits credit.

Summary

The North Fort Worth State Bank (Petitioner) sought relief from excess profits taxes under Internal Revenue Code § 722(c)(1), arguing that its management's expertise and relationships with depositors constituted valuable intangible assets. The bank claimed these assets, along with a favorable lease, were not reflected in its invested capital and resulted in an inadequate excess profits credit. The Tax Court denied relief, finding the bank's evidence insufficient to establish that its claimed intangible assets differed significantly from those of comparable banks, and that the bank's favorable lease didn't impact the calculation. The court emphasized the need for concrete evidence to support claims of intangible assets contributing to income and that the bank's operations differed from others in order to grant the relief sought.

Facts

The North Fort Worth State Bank was chartered in 1941. It began business with a paid-in capital of $120,000. The bank specialized in small loans. The bank claimed that the competence and integrity of its management and the contacts made with depositors were intangible assets. The bank had a favorable lease on the building and fixtures used by the defunct Stockyards Bank. The bank's deposits increased steadily from 1941 to 1945. The bank sought relief from excess profits taxes for the years 1943, 1944, and 1945.

Procedural History

The Commissioner of Internal Revenue denied the Petitioner's applications for relief under Internal Revenue Code § 722(c)(1) for the tax years in question. The Petitioner brought the case before the United States Tax Court, waiving a claim under a different section, and arguing it was entitled to relief under § 722(c)(1).

Issue(s)

1. Whether the Petitioner's business was of a class in which intangible assets not includible under section 718 made important contributions to income.

2. Whether the excess profits credit allowable to the petitioner on the basis of its invested capital was an inadequate standard for determining its excess profits.

Holding

1. No, because the evidence did not establish that the bank's intangible assets made

important contributions to income.

2. No, because the Petitioner failed to demonstrate that the excess profits credit based on invested capital was inadequate compared to a constructive average base period net income.

Court's Reasoning

The court explained that the petitioner had to demonstrate that its business was of a class where intangible assets, not included in invested capital, contributed significantly to income, and that its excess profits credit based on invested capital was inadequate. The court noted that the bank's claim that its management's competency and contacts were intangible assets was vague. The court stated that, even assuming the claimed intangibles existed, the petitioner had not shown that it attracted deposits to a greater extent than other comparable banks. The court emphasized that the bank's loans and operations were similar to other banks. The court found that the favorable lease was not enough to warrant relief, and there was not enough evidence to show how much the favorable lease had benefitted the bank.

Practical Implications

This case is significant for businesses seeking tax relief based on intangible assets. It highlights the importance of providing concrete evidence to support claims that intangible assets make important contributions to income. Attorneys should advise clients to: (1) specifically identify the intangible assets; (2) demonstrate how these assets uniquely contribute to income; (3) show that the business is not comparable to others; (4) demonstrate the inadequacy of the invested capital method. The court's emphasis on the need for clear, specific evidence of the impact of intangible assets sets a high bar for taxpayers seeking relief under § 722(c)(1). This case suggests that merely asserting intangible assets, without specific evidence of their impact, will likely be insufficient to obtain relief.

