F. & R. Lazarus & Co. v. Commissioner, 21 T.C. 383 (1953)

A pro rata stock distribution of common on common is not considered a distribution of earnings and profits and is not includable in equity invested capital for excess profits tax purposes.

Summary

The case concerns a corporation, F. & R. Lazarus & Co., that sought to include a pre-1913 pro rata stock distribution of common on common stock in its equity invested capital for excess profits tax purposes. The company argued that this stock distribution should be considered a distribution of earnings and profits. The Tax Court, however, held that such distributions are not considered distributions of earnings and profits. The court also addressed the issue of goodwill acquired from a predecessor partnership and determined that, without sufficient evidence of the fair market value of assets and stock, no amount could be included for goodwill in the equity invested capital.

Facts

F. & R. Lazarus & Co. had made a pre-March 1, 1913, pro rata stock distribution of common stock on common stock. This was a key point for the court to address, because of its impact on equity invested capital. The company also sought to include an amount for goodwill acquired from its predecessor partnership in its equity invested capital. Evidence regarding the fair market value of assets and stock in relation to the goodwill was absent.

Procedural History

The case was initially heard by the Tax Court. The Tax Court previously addressed the issue of common on common stock distribution in Owensboro Wagon Co. and Geo. W. Ultch Lumber Co., where the court had held that distributions of common on common, whether pre- or post-March 1, 1913, were not distributions of earnings and profits. The Tax Court adhered to its earlier position, despite a reversal of the Owensboro Wagon Co. by the Sixth Circuit Court of Appeals.

Issue(s)

1. Whether a pre-March 1, 1913, pro rata stock distribution of common on common is properly included in the petitioner’s equity invested capital for excess profits tax purposes as a distribution of earnings and profits.
2. Whether any amount is properly includible in the petitioner’s equity invested capital to represent goodwill acquired from its predecessor partnership.

Holding

1. No, because the court held that such distributions are not considered

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distributions of earnings and profits.
2. No, because there was insufficient evidence to determine the fair market value of the assets and stock at the time the goodwill was acquired.

Court’s Reasoning

The court’s reasoning centered on the interpretation of Section 718 of the Internal Revenue Code of 1939, which defined equity invested capital. The key question was whether the stock distribution constituted a distribution of earnings and profits. The court referenced its prior holdings in Owensboro Wagon Co. and Geo. W. Ultch Lumber Co., where it had consistently held that common on common distributions do not qualify as distributions of earnings and profits, and therefore cannot be included in equity invested capital. The court acknowledged a reversal by the Sixth Circuit in Owensboro Wagon Co. but chose to reaffirm its prior position in good faith. On the goodwill issue, the court found that the petitioner failed to provide evidence of the fair market value of the assets acquired and stock issued. The court emphasized that equity invested capital is a statutory concept, and goodwill can be included as a part of paid-in capital only with proper valuation.

Practical Implications

The case underscores the importance of understanding the precise definition of

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