8 T.C. 236 (1947)

A corporation’s eligibility for excess profits tax relief hinges on whether it was in existence before January 1, 1940, and not on whether its base period income was limited due to a change in ownership.

Summary

The Tax Court considered two consolidated cases involving the application of excess profits tax relief under Section 722 of the Internal Revenue Code of 1939. In the first case, Flotill Products, Inc., sought relief under section 722(b)(4) arguing that the respondent had not properly applied the push-back rule. The court determined a fair and just reconstruction of the average base period net income was $140,000. In the second case, Flotill Sales Corporation, sought relief under section 722(c), claiming that it was not entitled to use the excess profits credit based on income because its principal source of income was an intangible asset and argued that the credit based on invested capital was an inadequate standard for determining excess profits. The court held that since Flotill Sales Corporation was in existence before January 1, 1940, it failed to qualify for relief under section 722(c).

Facts

Flotill Products, Inc., underwent a change in management and business character in 1939 when Tillie Weisberg acquired control. She increased tomato acreage, modernized equipment, and expanded sales activities. These changes significantly increased the company’s earnings. In computing the average base period net income for the excess profits tax, the IRS made partial allowances. Flotill Sales Corporation, which was formed prior to January 1, 1940, had its base period income affected by Section 740 as a result of transferring its business assets to Flotill Products, California. It contended that the credit based on invested capital was inadequate because its primary income source was an intangible asset.

Procedural History

The cases came before the Tax Court after disputes with the IRS regarding the computation of excess profits tax relief. The IRS had made partial allowances for Flotill Products and denied relief for Flotill Sales, leading to the filing of petitions. The Tax Court consolidated these cases for consideration.

Issue(s)

1. Whether the IRS properly applied the push-back rule in calculating Flotill Products’ average base period net income?

2. Whether Flotill Sales Corporation was eligible for excess profits tax relief under section 722(c), given its pre-1940 existence and the limitations on its base period income due to the sale of its assets?

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Holding

1. Yes, because the court determined that $140,000 was a fair and just amount of reconstruction based on the evidence, therefore applying the push-back rule correctly.

2. No, because Flotill Sales Corporation was in existence before January 1, 1940. The court held that Section 722(c) relief is only for corporations not in existence before January 1, 1940.

Court's Reasoning

In the Flotill Products case, the court determined that the IRS's initial computation of the company's average base period net income was too low, and the company's proposed reconstruction was too high. The court decided that a fair amount was $140,000. Regarding Flotill Sales Corporation, the court focused on the language of sections 712 and 722 of the Internal Revenue Code. Section 722(c) provides relief only for corporations "not entitled to use the excess profits credit based on income pursuant to section 713." The court emphasized that "only a taxpayer not entitled to use the income method under section 713 is eligible for relief under section 722 (c), and the sole test for determining that right is whether the taxpayer was "in existence before January 1, 1940." The court cited its prior ruling in Eveready Loan Co., which stated that a corporation is "in existence" from the date it is created until its corporate rights are legally terminated.

Practical Implications

This case underscores the significance of the date of incorporation in determining eligibility for certain excess profits tax relief provisions. The court's interpretation of

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