***27 T.C. 691 (1957)***

To qualify for excess profits tax relief under Section 721 of the 1939 Internal Revenue Code, a taxpayer must not only establish abnormal income but also demonstrate the portion attributable to prior years, typically by providing evidence of research or development expenditures made in those years.

**Summary**

The case involved Caldwell-Clements, Inc., a publisher seeking excess profits tax relief for 1943 based on abnormal income from its newly launched magazine, Electronic Industries. The company argued the income resulted from research and development efforts spanning several prior years. The U.S. Tax Court denied relief because the company failed to provide sufficient evidence to allocate the income to the prior years. The court emphasized the need to demonstrate the costs of research or development in those years, making it impossible to compute the net abnormal income attributable to the prior years under section 721.

**Facts**

Caldwell-Clements, Inc., a New York corporation, was established in 1935. The company's primary business was the publication of trade and technical magazines. In 1935, the company began planning for "Engineering Today" a trade magazine focused on electronics, but due to competitor activity, the company delayed publication until November 1942 when it launched "Electronic Industries." The magazine was an immediate financial success. The company sought relief from excess profits taxes for 1943, claiming abnormal income attributable to the preparatory work done before the magazine's launch. The company's records did not segregate or show the development expenses for "Engineering Today" before 1942, and the court found the only evidence of development costs to be an estimate, by the company president, without supporting documentation.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in the petitioner's excess profits tax for 1943. Caldwell-Clements, Inc. petitioned the United States Tax Court for a redetermination. The Tax Court considered the case and denied the petitioner's request for tax relief.

**Issue(s)**

1. Whether the petitioner could deduct a portion of its excess profits net income for 1943 as abnormal net income attributable to prior years pursuant to Section 721 of the 1939 Internal Revenue Code.

2. Whether the petitioner demonstrated the amount of research or development expenditures to allocate any net abnormal income to prior years to satisfy the

requirements for relief under Section 721 of the Internal Revenue Code.

**Holding**

1. No, because the petitioner failed to establish the cost of research or development of the magazine in each of the prior years.

2. No, because the petitioner failed to provide sufficient evidence to allocate the income to the prior years to satisfy the requirements for relief under Section 721 of the Internal Revenue Code.

**Court's Reasoning**

The court first explained the requirements for obtaining excess profits tax relief under Section 721, including establishing the class and amount of abnormal income, and the portion of net abnormal income attributable to other taxable years. The court determined that the primary issue was whether the petitioner could attribute its income to the preparatory work done before the magazine's launch. The court noted that the allocation of net abnormal income of the taxable year to prior years must be made based on expenditures. Because the petitioner's books did not identify development expenses prior to 1942, and because the president's testimony was based on guesswork and lacked supporting evidence, the court found the petitioner failed to meet its burden of proof, thus preventing the allocation of income to prior years. The court emphasized that the petitioner needed to provide the court with information that would enable the computation of the excess profits tax for each year. "In general, an item of net abnormal income of the class described in this section is to be attributed to the taxable years during which expenditures were made for the particular exploration, discovery, prospecting, research, or development which resulted in such item being realized and in the proportion which the amount of such expenditures made during each such year bears to the total of such expenditures."

**Practical Implications**

This case underscores the importance of meticulous record-keeping for businesses seeking tax relief. To claim relief for abnormal income related to research and development, taxpayers must maintain detailed records of expenses incurred in each relevant year. The court requires specific evidence—not just estimates or opinions—to allocate income to prior years. The decision emphasizes that it is essential for businesses to carefully document and categorize expenses related to product development and other activities that might generate abnormal income. Failing to do so can preclude a taxpayer from receiving excess profits tax relief under Section 721 of the Internal Revenue Code. Later cases would likely cite this decision for the requirement of providing adequate proof of expenses.