28 T.C. 1075 (1957)

When corporations consolidate, the surviving entity generally cannot use the pre-consolidation excess profits credit of the merged entity unless the income against which the credit is offset is produced by substantially the same businesses that incurred the losses.

Summary

Old National Bank in Evansville (petitioner) consolidated with two other banks. The issue was whether petitioner could use the consolidated banks' unused excess profits credits. The court held that petitioner could not, relying on *Libson Shops, Inc. v. Koehler*, which established that a carryover of losses or credits is only permissible if the income against which it is offset is produced by substantially the same business that incurred the loss or credit. The court also addressed the definition of "operating assets" for tax purposes, ruling that cash and loans are not operating assets under the relevant code sections. Finally, the court determined that the petitioner could not use the base period capital additions of a component corporation that calculated its excess profits credit using the growth formula.

Facts

Old National Bank in Evansville consolidated with North Side Bank in 1950 and with Franklin Bank and Trust Company in 1951. Franklin Bank and Trust Company had an unused excess profits credit of $9,286.72 at the time of the consolidation. The North Side Bank used the growth formula to compute its excess profits tax credit before consolidation. Petitioner sought to use the Franklin Bank's unused excess profits credit and the North Side Bank's base period capital additions in calculating its excess profits credit for 1951 and 1952. The petitioner did not apply the limitation in section 435(g)(10) to the capital additions from decreases in inadmissible assets. The Commissioner of Internal Revenue determined deficiencies in the income and excess profits tax for 1951 and 1952.

Procedural History

The U.S. Tax Court reviewed the Commissioner's determination of deficiencies in the income and excess profits taxes for the years 1951 and 1952. The court addressed the issues in the case based on the stipulated facts and legal arguments presented by both the petitioner and the respondent, the Commissioner of Internal Revenue.

Issue(s)

1. Whether the petitioner, in computing its excess profits tax, can apply the unused excess profits credit of a bank that was consolidated with the petitioner.

2. Whether the petitioner, in computing the net capital addition for the taxable year

© 2025 SCOTUSreports.com. All rights reserved.

by showing a decrease in inadmissible assets, can include cash and loans as operating assets within the meaning of section 435 (g) (10) (B) of the 1939 Code, and, in the alternative, whether the limitations of section 435 (g) (10) are applicable to section 435 (g) (9) (B).

3. Whether the petitioner, in computing its excess profits credit by the average income method, can use the base period capital additions of a corporation with which it was consolidated in a part II transaction, when that other corporation used the growth formula in computing its own average base period net income.

Holding

1. No, because under the principle in *Libson Shops*, the income against which the offset is claimed was not produced substantially by the same business which had the excess profits credit.

2. No, because the court held that cash and loans are not "operating assets" under section 435(g)(10)(B), and subsection 435 (g) (10) applies to banks.

3. No, because allowing the petitioner to use the North Side Bank's base period capital additions would be inconsistent with the rules for calculating excess profits credit under the average income method.

Court's Reasoning

The court first addressed the carryover of the unused excess profits credit. Citing *Libson Shops, Inc. v. Koehler*, the court stated, "The income against which the offset is claimed was not produced substantially by the same business which had the excess profits credit." The court found no indication that the carryover provisions were designed to allow averaging pre-merger losses with post-merger income from different businesses. The legislative history showed that Congress primarily was concerned with the fluctuating income of a single business.

Regarding the definition of "operating assets," the court stated, "We cannot agree that the wording of subsection 435 (g) (9) supports the petitioner's argument." The court concluded that the exceptions and limitations in subsection 435 (g) (10) apply to banks, because paragraph (B) of subsection 435 (g) (9) relates back to paragraph (A) and is thus subject to the exceptions and limitations. The court further found that cash and loans were not operating assets, as cash is not held for sale to customers and loans are not included as operating assets under the regulations, and that loans are considered inadmissible assets.

Finally, the court held that allowing the petitioner to use the North Side Bank's base period capital additions would be inconsistent because North Side Bank used the growth formula. Therefore, the regulation disallowing this was deemed valid. The court concluded, "It would be inconsistent to allow a taxpayer, computing its credit under the average income method, to use the base period capital additions of a

© 2025 SCOTUSreports.com. All rights reserved.

taxpayer which has chosen the benefits of the growth formula in its prior excess profits tax returns."

Practical Implications

This case clarifies several aspects of tax treatment related to corporate consolidations and the calculation of excess profits tax. Firstly, it reinforces the principle, articulated in *Libson Shops*, that carryovers of tax benefits are generally limited to situations where the post-merger income is generated by substantially the same business that incurred the losses or generated the credit. Secondly, the case provides a concrete definition of operating assets, indicating that, for banking institutions, cash and loans do not fall within this category for the purposes of calculating excess profits tax. Lastly, this ruling prevents the use of base period capital additions from a corporation using the growth formula when calculating the credit under the average income method, promoting consistency in applying tax regulations.

This case is significant for tax lawyers and accountants dealing with corporate mergers and acquisitions and the subsequent calculation of excess profits tax. It emphasizes the importance of understanding the specific rules and regulations governing the tax treatment of consolidated entities and the definitions of key terms like "operating assets." Furthermore, the case helps practitioners analyze similar cases based on the core principle established in *Libson Shops*.

© 2025 SCOTUSreports.com. All rights reserved.