General Retail Corporation (Delaware), Petitioner, v. Commissioner of Internal Revenue, Respondent, 29 T.C. 632 (1957)

The court held that, for excess profits tax purposes, a corporation that acquired assets from its parent company, which had been in business since before 1945, could not be considered a “new corporation” even if the subsidiary commenced its business after that date because the constructive ownership rules of the Internal Revenue Code applied to determine the parent’s stockholders owned the subsidiary’s stock.

Summary

The United States Tax Court addressed whether General Retail Corporation (Petitioner), formed in 1948 and acquiring assets from General Shoe Corporation (General), qualified for the preferential tax treatment of a “new corporation” under the Excess Profits Tax Act of 1950. The court determined that, under the relevant sections of the Internal Revenue Code, Petitioner was not a new corporation because General commenced its business before 1945. The court found that the constructive ownership rules, which attribute a corporation’s stock to its shareholders, applied. Since General owned all of Petitioner’s stock, and General had been in business since 1925, Petitioner was deemed to have commenced business before 1945, thereby precluding the preferential tax rate.

Facts

Petitioner was incorporated in Delaware on September 30, 1948, and its fiscal year ended October 31. The incorporators, including individuals who held positions at General Shoe Corporation, elected Petitioner’s initial directors and officers. On October 21, 1948, Petitioner issued 1,000 shares of stock to Sarah A. Jarman, who subsequently transferred the shares to General for $1,000. General Shoe Corporation was the sole shareholder. During November 1948, Petitioner acquired several retail stores from General for book value, and General extended credit to Petitioner. General commenced business in 1925 and continuously engaged in business. Petitioner sought to compute its excess profits tax as a new corporation.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Petitioner’s income (excess profits) tax for the fiscal year ending October 31, 1951, disallowing the tax treatment of a new corporation. Petitioner contested the Commissioner’s determination in the United States Tax Court. The Tax Court heard the case and issued a decision in favor of the Commissioner, determining that Petitioner was not entitled to compute its excess profits tax as a new corporation under the Internal Revenue Code.

Issue(s)

1. Whether Petitioner is entitled to compute its excess profits tax as a new corporation under section 430 (e) (1), I. R. C. 1939.

Holding

1. No, because the application of the constructive ownership rules of the Internal Revenue Code meant that the corporation was deemed to have commenced business before July 1, 1945, thereby precluding the preferential tax rate.

Court's Reasoning

The Tax Court focused on section 430 (e) (1), I. R. C. 1939, which provided preferential tax treatment to new corporations that commenced business after July 1, 1945. However, the court determined that Petitioner acquired a substantial part of its assets from General, which had been in business since 1925. The court stated that to determine whether the corporation qualified under section 430 (e) (1), I. R. C. 1939 it had to also consider section 430 (e), I. R. C. 1939 and section 430 (e) (1), I. R. C. 1939 which invoked section 430 (e). The court stated that Section 445 expressly requires for its application the use of the principle of section 503. The court reasoned that, under section 430 (e) , "the statute says in effect that corporations can qualify under section 430 (e) as having 'commenced business' only if they would likewise so qualify as described in section 445."

The court applied the principle of constructive ownership of stock outlined in Section 503 of the Internal Revenue Code. This section provided that stock owned by a corporation (General) is considered to be owned proportionately by its shareholders. Since General held all of Petitioner's stock, the court deemed the stock to be held by General's shareholders. Because General commenced business before 1945, the court concluded that Petitioner was also deemed to have commenced business before that date, thus disqualifying it from the preferential tax treatment.

Practical Implications

This case underscores the importance of considering the constructive ownership rules in tax planning, particularly in corporate reorganizations and acquisitions. The ruling highlights that the form of ownership, such as a parent-subsidiary structure, can significantly affect a corporation's eligibility for tax benefits. Legal practitioners should be mindful of the attribution rules when advising clients on transactions that could trigger the application of such rules. It is essential to scrutinize not only the date of incorporation but also the history and ownership structure of all related entities. Later cases dealing with "new corporation" status will likely cite this case. The case also serves as a reminder that seemingly straightforward statutory interpretations can be complex. Moreover, it emphasizes that the intent of the statute is best determined by the plain language and structure of the code.