***Bell Aircraft Corp. v. Commissioner*, 27 T.C. 365 (1956)**

Under section 456 of the Internal Revenue Code of 1939, income arising from a judgment can be attributed to prior years for excess profits tax purposes if the judgment is related to events that occurred in those prior years, even if the judgment itself was received in a later year.

Summary

Bell Aircraft Corporation received a judgment in 1952 related to costs incurred in the performance of contracts between 1941 and 1945. The company sought to exclude the judgment income from its 1952 excess profits tax calculation under Section 456 of the Internal Revenue Code of 1939, attributing it to the earlier years. The Tax Court agreed, holding that the income qualified as abnormal income under the statute and could be attributed to the years in which the expenses and contract work had occurred. The court rejected the Commissioner's arguments that the attribution was impermissible or resulted in impermissible tax avoidance by changing accounting methods.

Facts

Bell Aircraft, an accrual-basis taxpayer, was a major military aircraft manufacturer. From 1936 to 1940, the company incurred significant experimental and development costs. In 1939, Bell entered into fixed-price (FP) contracts and later cost-plus-fixed-fee (CPFF) contracts with the U.S. Army Air Corps for the P-39 Airacobra aircraft. The Commissioner initially required Bell to allocate the experimental and production tooling expenses to airplanes produced under both FP and CPFF contracts, increasing Bell's income for 1941 and 1942 and assessing additional taxes. Bell sought reimbursement of these costs under its CPFF contracts and, after the government recouped initial payments, sued in the Court of Claims. In 1951, the Court of Claims ruled in Bell's favor, awarding the company $2,286,819.95, which was included in Bell's 1952 gross income. During the years 1948 through 1951 the petitioner had income arising out of claims, awards, judgments or decrees, or interest on any of the foregoing, which was includible in its gross income for those years.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Bell Aircraft's 1952 income and excess profits taxes. Bell filed a petition with the Tax Court, disputing the inclusion of the judgment income in its excess profits tax calculation. The Tax Court ruled in favor of Bell, allowing the exclusion of the judgment income from its 1952 excess profits tax calculation.

Issue(s)

1. Whether income from a judgment, as defined under Section 456 of the Internal

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Revenue Code of 1939, constitutes abnormal income and is therefore excludable from excess profits tax calculations.

2. Whether the income from a judgment can be attributed to prior years for excess profits tax purposes.

Holding

1. Yes, the judgment income constituted abnormal income under Section 456(a)(2)(A) because it was "[i]ncome arising out of a claim, award, judgment, or decree, or interest on any of the foregoing."

2. Yes, the income from the judgment was attributable to the years 1941-1945, where the work and costs related to the judgment occurred.

Court's Reasoning

The court first determined that the judgment income was abnormal under Section 456 because it arose from a judgment. The court then turned to whether the income could be attributed to prior years. The court relied on Regulations 130, which state that items of net abnormal income are attributed "to other years in the light of the events in which such items had their origin." Regulations 130, Section 40.456-6(h), regarding income arising from a judgment, stated that allocation should be made "to the year or years during which occurred the exploitation, removal, or use, as the case may be, of the property right forming the subject matter of the claim, award, judgment, or decree."

The court found the judgment income was directly related to the costs incurred and work done under the CPFF contracts during the years 1941-1945. The court found that the petitioner's income was "in the light of the events in which such items had their origin." Therefore, the court held that the judgment income could be attributed to those prior years, despite the Commissioner's arguments, which the court rejected. The court also rejected arguments that the attribution was impermissible because it would change Bell's established accounting methods, noting that Bell had consistently used the accrual method. The court emphasized, "the recovery was for reimbursable costs incurred in the performance of contracts during 1941-1945 and not a recovery based solely by reason of the investment in assets."

Finally, the court refuted the government's argument that attributing the income to prior World War II excess profits tax years would not be relevant. The court correctly stated that only the Excess Profits Tax Act of 1950 would be applicable and not the World War II excess profits tax. Therefore, the petitioner was entitled to relief under section 456(c).

Practical Implications

This case provides a crucial precedent for taxpayers seeking to mitigate excess

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profits taxes by attributing judgment income to prior years. It clarifies the application of Section 456 of the 1939 Internal Revenue Code, which is relevant to how such abnormal income can be treated for tax purposes. This case emphasizes the importance of:

- Demonstrating a clear link between the income and events in prior years, as described in the regulations.
- Maintaining consistent accounting methods.
- Understanding the specific provisions of excess profits tax law and how it distinguishes between different time periods.

Attorneys can use this case to argue for the attribution of judgment income to prior years when the income stems from events that occurred in those years. This case may be distinguished if the judgment does not have as clear a link to specific prior years.

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