33 T.C. 289 (1959)

Income from sales of tangible property resulting from research and development extending over more than 12 months is not considered abnormal income under the excess profits tax provisions, and interest on income tax deficiencies related to excess profits tax adjustments is deductible.

Summary

In 1959, the U.S. Tax Court heard the case of Polaroid Corporation versus the Commissioner of Internal Revenue. The case concerned the determination of Polaroid's excess profits tax liability for the years 1951, 1952, and 1953, specifically whether income from the sales of stereo products and Polaroid Land equipment qualified as "abnormal income." The court also addressed whether interest paid on income tax deficiencies, which arose from an excess profits tax refund, should reduce the interest credited to Polaroid on the refund. The court ruled that the income from the sale of Polaroid's products did not constitute abnormal income and that the interest on the deficiencies was related to the refund interest, and therefore deductible.

Facts

Polaroid Corporation, a Delaware corporation, was primarily engaged in research and development and the sale of optical products. Polaroid developed and sold stereo products and the Polaroid Land camera and related equipment, which produced instant photographs. Polaroid's income from the sale of these products increased significantly during the years in question. The company also received an excess profits tax refund, resulting in an income tax deficiency for the same years. The Commissioner of Internal Revenue determined deficiencies in Polaroid's income and excess profits tax for 1951, 1952, and 1953, disallowing Polaroid's claim for a refund for 1951, and the corporation subsequently contested these rulings.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Polaroid's income and excess profits tax. Polaroid contested these deficiencies and filed a petition in the United States Tax Court. The Tax Court heard the case, reviewed the facts, and considered the relevant statutes and regulations. The court rendered a decision in favor of the Commissioner of Internal Revenue.

Issue(s)

1. Whether Polaroid's income from the sale of stereo products and/or Polaroid Land equipment constituted abnormal income under the relevant provisions of the Internal Revenue Code (I.R.C.).
2. Whether interest charged on income tax deficiencies arising from an excess profits tax refund could be deducted from the interest credited to Polaroid on

that refund, in calculating net abnormal income.

Holding

1. No, because income from the sale of tangible property resulting from research and development that extended over more than 12 months is not considered abnormal income.
2. Yes, because the interest charged on the income tax deficiencies related to the excess profits tax refund.

Court’s Reasoning

The court examined whether the income from Polaroid’s products was “abnormal income” within the meaning of I.R.C. § 456. The court found that the income in question was derived from sales of tangible property arising out of research and development extending over more than 12 months. The court cited the legislative history of I.R.C. § 456, which specifically excluded this type of income from the definition of abnormal income. The court stated, “But Congress intentionally excluded income from the sale of property resulting from research, whether or not constituting invention, as a potential class of abnormal income when it enacted section 456.” The court also addressed whether the income from Polaroid’s inventions should be considered a “discovery,” and, therefore, qualify as abnormal income under the tax code. The court stated that, although Polaroid’s inventions may have been new, startling, or even revolutionary, Congress did not intend for the term “discovery” to include what is normally thought of as patentable inventions. The court also examined whether the interest paid on the income tax deficiencies, which were a result of a refund of excess profits taxes, could be deducted from the interest credited to Polaroid on that refund. The court concluded that the interest was related, stating that the income tax and the excess profits tax “are related in some aspects,” particularly in how one tax calculation impacted the other. The interest on the one was due to the petitioner by reason of the same fact that caused interest on the other to be due from petitioner, namely, allowance of petitioner’s claim under Section 722.

Practical Implications

This case is important for understanding the definition of “abnormal income” for tax purposes. The court’s ruling clarifies that income from the sale of tangible property resulting from research and development extending over a long period does not qualify as abnormal income, even if it results from revolutionary inventions. Lawyers and accountants should analyze the nature and source of the income to determine its tax treatment. The case also highlights the relationship between different types of taxes and the potential for offsetting interest payments. In cases involving excess profits tax refunds and related income tax deficiencies, it may be possible to offset interest payments.

