Difco Laboratories, Inc. v. Commissioner

10 T.C. 660 (T.C. 1948)

Docket No. 12168.

United States Tax Court.

Promulgated April 20, 1948.

John M. Hudson, Esq., for the petitioner.

Wesley A. Dierberger, Esq., for the respondent.

This proceeding involves a deficiency in excess profits tax for 1942 in the amount of $12,829.19, and an overassessment in income tax for the same year in the amount of $1,873.07.

At the hearing counsel for the respondent filed a motion for dismissal of the proceeding, in so far as it relates to income tax for 1942, for lack of jurisdiction. For that year the respondent determined an overassessment in income tax and a deficiency in excess profits tax. Error is alleged in the petition with respect to respondent's determination 661*661 of both the income tax overassessment and the excess profits tax deficiency for the year. The motion to dismiss was taken under advisement by the Tax Court and will be disposed of below.

The issues to be determined on the merits are:

(1) Were expenditures made for alterations and changes in a building used in petitioner's business deductible for Federal tax purposes as a business expense, or were they capital expenditures?

(2) Did the respondent err in determining that the petitioner had no capital addition, but a net capital reduction of its excess profits credit based on income during the year 1942 because of sale of stock?[1]

A stipulation of facts was filed. We adopt same by reference and find the facts therein set forth. Such part thereof as it is considered necessary to set forth is included with other facts found from evidence adduced in our findings of fact.

FINDINGS OF FACT.

Petitioner is a Michigan corporation, with its principal office and place of business at 920 Henry Street, Detroit, Michigan. It filed its income and excess profits tax returns for the year 1942 with the collector of internal revenue for the district of Michigan, at Detroit, Michigan. Petitioner

reported on the returns excess profits taxes in the amount of $308,322.17 and income taxes in the amount of $94,237.58. The taxes were paid in installments on March 12, June 14, September 14, and December 9, 1943. No part of the taxes has been credited or refunded to petitioner.

Pursuant to renegotiation of its contracts for the calendar year 1942, under the Renegotiation Act, petitioner on or about August 27, 1943, refunded to the United States the sum of $1,499.99, the balance of alleged excessive profits of 1942 in the amount of $15,000 after crediting thereto the tax upon such alleged excessive profits, which amount of alleged excessive profits was included in the computation of petitioner's taxable net income for 1942 upon which the taxes were paid.

Petitioner is engaged in the business of manufacturing chemicals. The manufacturing plant consists of six separately constructed buildings of from three to four stories in height, adjoining each other, which have been consolidated or integrated into a single operating unit. Prior to 1942 the basement level or floor of building No. 2 was about 22 inches lower than the basement level or floor of the adjoining building, No. 5. The shaft of the elevator serving both these buildings was located in building No. 5 and terminated at the basement level of that building.

Prior to 1941 petitioner conducted in the basement of building No. 662*662 2 an operation which was isolated from the rest of the plant and involved special equipment. The material manufactured there was very light and was easily handled from one level to another. The entrance to the basement of building No. 2 was through the basement of building No. 5. Prior to 1939 the basement of building No. 5 was used for storage.

In 1939 the petitioner had started in the basement of building No. 5 an operation involving the use of acid, and in such operation acid unavoidably was spilled on the floor. This resulted in the corrosion of the concrete floor so that, at two or three year intervals, the floor had to be replaced.

In 1942 petitioner obtained orders from the Government which so increased its volume of work that the space in the basements of buildings Nos. 2 and 5 had to be used. The materials produced were quite heavy and could not be readily handled by hand over the difference in the basement levels. There was equipment in the basement rooms of such buildings which could not be moved to other parts of the buildings and petitioner wished to make use of such equipment in order to have the fullest possible capacity with available facilities.

For more efficient operation and utilization of the basement rooms of buildings Nos. 2 and 5, petitioner in 1942 determined to lower the basement floor of building No. 5 to the same level as that of building No. 2 and to extend the elevator shaft to the new level so that the material produced therein could be taken in wheeled-trucks in the elevator and moved to the third floor to process them further.

On or about July 23, 1942, petitioner entered into a cost-plus contract with C. A. Johnson & Son, as the prime contractor, for the performance of the work necessary to level the basement floors of the two buildings. All work pertaining to the plumbing, heating, and sprinkler systems was performed by subcontractors, also upon a cost-plus basis.

The work to be performed as described in the prime contract was as follows:

Provide all labor, material and equipment for demolishing the present basement floor in the westerly section of Building #5 (about 21' x 45') and constructing a new floor approximately 22"

below the present floor level of that section, or at the same level as the adjoining Stock Room floor. This work will include (among other items) breaking, excavating and hauling away all materials which are not to be used in the work, a new concrete floor 6" thick plus a separate topping of 1 to 2 cement and fine aggregate (minimum 1" thick) and approved steel mesh reinforcement, underpinning all walls, beams and foundations to the depth and thickness required, new steel columns in place of old columns, the lowering of underground drains where necessary, the cutting off of old foundation projections into the room, the making of a new elevator pit and a new drainage sump, the extension of the present stairway to the new floor level (at the west of the elevator instead of the north), and all of the shoring required to complete the work.

Provide temporary walkways so that we may have access at all times from the stairway to our basement rooms * * *.

663*663 All of the work described in the prime contract quoted above was performed in accordance with the contract. The work was completed in December 1942 at a total cost to petitioner of $15,011.37.

The total cost to petitioner of the work performed by the prime contractor was $10,523.16, of which $1,009.26 was for materials, $3,450.31 was for rental of equipment, $4,237.28 was for labor, and $1,826.31 was for overhead and profit.

The cost to petitioner of changing the location of the drainage sumps, the drainage pumps, and the draining piping was $2,347.38, of which $452.11 was for materials, $1,235.71 was for labor, and $659.56 was for contractor's overhead and profit. The cost to petitioner for dropping the sprinkler piping below the basement floor at the new level was $1,162.19, of which $443.29 was for materials, $590.75 was for labor, $22.50 was for engineering and $105.65 was for contractor's profit. The cost to petitioner for services of architects and engineers in connection with this job was $978.64. The notation on the statement for services rendered was: "Services in connection with alterations to Basement of Building, Detroit, Michigan."

The excavating on this job was expensive, because of its location. The basement of the building No. 5, as originally constructed, had been provided by lowering the floor, but not the entire area, below the bottoms of the original footings or base of the wall supports. The floor, before the 1942 job, was set back about 30 inches from the walls, so as to avoid endangering the stability of the supports in the original excavation of the basement. In carrying out the 1942 work, it was necessary to underpin or provide supports for the old footings or enclosing walls to extend them down to the new level of the lowered basement floor. This work was done in sections. Because of the nature of the building No. 5 basement, the earth removed by excavation had to be taken out through a basement window. The new columns were installed to furnish the support, at the lowered basement level, for the floor above, since the old columns extended only to the former base of the walls.

All the drainage pipe was replaced in connection with the lowering of the floor. The sprinkler system pipe was reused to a large extent. Incident to the lowering of the basement floor of building No. 5, new steel columns were put in to support properly the floor above.

Because of the corrosion resulting from the use of acids in the operations conducted in the basement of building No. 5, the new floor, installed in 1942, was replaced by an entirely new floor in 1945 at a cost of $805.90.

For the year 1942 petitioner computed its excess profits net income and its excess profits credit on the basis of the base period net income. The average base period net income for the purposes of the excess profits tax credit, as adjusted by the revenue agent, is $238,020.87, and 95 per cent thereof is $226,119.83.

664*664 Petitioner was incorporated under the laws of Michigan in 1913, with authorized capital stock, all common, of 7,500 shares, par value $100 per share. On December 31, 1939, there were 7,480 shares outstanding, all paid in. In December 1940 petitioner repurchased 201 shares of its stock, paying therefor $26,152.57, of which amount $20,100, the par value, was deducted from the capital stock account and $6,052.57, the premium, was deducted from paid-in surplus. In March 1941 petitioner repurchased 21 shares of its stock at $200 per share for $4,200, of which amount $2,100, the par value, was deducted from the capital stock account, and $2,100, the premium, was deducted from paid-in surplus. On December 31, 1941, petitioner had 7,258 shares of stock outstanding, fully paid in. The stock purchased in December 1940 and March 1941 was canceled upon purchase.

On February 25, 1942, petitioner issued 229 shares of its authorized and unissued stock at $200 per share, a total of $45,800, to eleven individuals. Certificates for such shares were issued by petitioner to and in the names of the respective persons. In payment for the shares issued, each of the persons executed his promissory note, and a contract, for the amount of the purchase price of his shares. Each note, the contract of even date therewith entered into between petitioner and the maker of the note, and the certificate for the shares issued to the maker of the note, were deposited with petitioner on the date of execution. On the back of each stock certificate the following endorsement was made:

This certificate of stock is issued to and held by _____ subject to the terms of an agreement between said _____ and Difco Laboratories, Inc., and may not be sold or transferred except in accordance with the terms of this agreement dated February 25, 1942.

The note and contract executed by each such purchaser was identical in form, varying only as to the name, amounts, and signatures.

The contracts executed February 25, 1942, by each of the employees who received shares of stock of the petitioner were identical, varying only as to amounts and signatures, and provided in substance as follows: That the company had sold and issued to the purchaser the stock at $200 a share, payable on or before ten years, with interest at 5 per cent, according to a promissory note of the same date; that the stock was retained as collateral for payment, but the company had an option to purchase it; that cash dividends should be credited upon the note; that the company had an option, if the purchaser's employment by the company should permanently cease, to purchase the stock at not less than $200 a share; that the company had a right to purchase the stock, upon the same terms, if the purchaser, while still employed, desired to sell it; that if the company did not exercise its option, the purchaser should have the right to sell, after all indebtedness to the company had been paid.

665*665 The notes, dated February 25, 1942, given by each of the employees to the petitioner for the shares of stock were all identical in form, varying only as to the amounts and signatures, and provided, in substance, that on or before ten years the petitioner should be paid $200, with interest at 5 per cent, that the share of stock had been deposited as collateral, the holder of the note, upon default, to have the right to sell, and to purchase, the stock and apply the proceeds in payment of the note.

Of the total price for which the 229 shares of stock were issued, petitioner added $22,900 to the capital account and added $22,900 to paid in surplus.

Prior to 1940 the petitioner had issued stock to various employees in exchange for promissory notes and contracts similar in all material respects, except as to amount and name. All employees were not given the opportunity to acquire stock in this manner. Employees who were given the opportunity to acquire stock were chosen by the board of directors of the petitioner on the advice of the management on the basis of the employee's position, efficiency, and importance to the business of the petitioner.

In 1942 the makers of the notes made payments of principal thereon as follows:

Maker of note	Date of payment	Amount paid	
C. G. Predmore	Mar. 17	$ 190.00	
Do	June 5	190.00	
Do	Sept. 21	63.65	
Do	Nov. 24	190.00	$ 633.65
H. G. Dunham	Mar. 9	335.00	
Do	June 15	335.00	
Do	Sept. 14	112.00	
Do	Nov. 30	335.00	1,117.00
A. E. Pratt	June 12	200.00	
Do	Sept. 23	200.00	400.00
H. W. Schoenlein	Mar. 13	1,250.00	
Do	June 19	100.00	
Do	Sept. 23	100.00	
Do	Nov. 30	200.00	
Do	Dec. 31	300.00	1,950.00
R. A. Cowles	Mar. 9	90.00	
Do	Sept. 15	31.02	
Do	Nov. 24	200.00	321.02
M. E. Desk	June 12	150.00	
Do	Sept. 14	119.80	
Do	Nov. 30	150.00	419.80

Maker of note	Date of payment	Amount paid	
C. H. Leiber	Sept. 14	119.25	
Do	Nov. 30	150.00	269.25
N. Spevakow	Sept. 23	100.00	100.00
M. Markowski	Mar. 25	150.00	
Do	June 12	150.00	
Do	Sept. 14	121.60	
Do	Nov. 30	150.00	
Do	Dec. 31	419.09	990.69
D. M. Burnett		0.00	0.00
H. A. Burnett, Jr	June 22	200.00	200.00

666*666 Each of the above named purchasers, at the date of execution of his note and at all times subsequent thereto, owned net assets other than the stock so purchased of a value substantially in excess of the amount of his note given in payment for the stock. By March 11, 1947, seven of the purchasers of stock had paid their notes in full. By September 5, 1947, the remaining four of the purchasers, whose notes aggregated $20,800, face amount, had paid a total of $9,729.96 upon the principal of their notes, as well as a total of $4,068.03 interest.

Petitioner during 1942 made dividend payments at 5 per cent on the par value per share to the individuals and on the stock above referred to, in each of the months March, June, September, and November.

OPINION.

DISNEY, Judge:

We shall first dispose of the respondent's motion to dismiss the proceeding, in so far as it relates to income tax for 1942, for want of jurisdiction. The respondent determined an overassessment of $1,873.07 in income tax and a deficiency of $12,829.19 in excess profits tax for that year. The petition contains allegation of error as to both the overassessment of income tax and the deficiency of excess profits tax. Section 272 of the Internal Revenue Code gives taxpayers the right to petition the Tax Court for a redetermination of deficiencies determined by the Commissioner in respect of the tax (income tax) imposed by Chapter 1 of the Code. It does not authorize a petition in any case other than where there has been a determination of a deficiency in respect of the tax imposed by this chapter.

Section 729 of the Internal Revenue Code, which is a part of chapter II of the code, provides as follows:

SEC. 729. LAWS APPLICABLE.

(a) GENERAL RULE.—All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

The effect of this provision is to permit the filing of petitions for redetermination of deficiencies of excess profits tax in the same manner as deficiencies in income tax. We find the following language in Will County Title Co., 38 B. T. A. 1396.

* * * In a long line of cases, of which Cornelius Cotton Mills, 4 B. T. A. 255, is a leading one, we have held that the determination of a deficiency is vital to our jurisdiction, and that we have no jurisdiction where the Commissioner determines that there is an overassessment. As the basic jurisdictional element of the determination of a deficiency is the same under both the income tax and excess profits tax provisions of the statute, the holdings in the income tax cases on the jurisdictional question here presented require a like holding here. We are accordingly of the opinion, and so hold, that we have no jurisdiction in this proceeding in so far as the petition is based on the Commissioner's determination of an overassessment of excess profits tax.

667*667 The income tax mentioned in the notice of deficiency and the excess profits tax are separately imposed, so that a determination of deficiency in one does not support any jurisdiction of this Court over a determination of an overassessment in the other. See Pioneer Parachute Co., 4 T. C. 27, and the cases cited therein. Respondent's motion to dismiss is accordingly granted.

Our first question on the merits is whether expenditures made for alterations and changes in a building used in petitioner's business are deductible for Federal tax purposes as business expenses, or were, on the other hand, capital expenditures? Petitioner argues that the expenditures here in question should be allowed under section 23 (a) (1) of the Internal Revenue Code as ordinary and necessary business expense; further, that Regulations 111, section 29.23 (a)-4, applies where it provides that "The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures." The leading case, says petitioner, in construing the statutes and regulations here involved, is Illinois Merchants Trust Co., Executor, 4 B. T. A. 103, where the rule was announced, as follows:

* * * In determining whether an expenditure is a capital one or is chargeable against operating income, it is necessary to bear in mind the purpose for which the expenditure was made. To repair is to restore to a sound state or to mend, while a replacement connotes a substitution. A repair is an expenditure for the purpose of keeping the property in an ordinarily efficient operating condition. It does not add to the value of the property, nor does it appreciably prolong its life. It merely keeps the property in an operating condition over its probable useful life for the uses for which it was acquired. Expenditures for that purpose are distinguishable from those for replacements, alterations, improvements or additions which prolong the life of the property, increase its value, or make it adaptable to a different use. The one is a maintenance charge, while the others are additions to capital investment which should not be applied against current earnings. * * *

Petitioner contends that under this rule the expenditure here in question clearly is an ordinary business expense, chargeable against operating income of the current year, because no part

thereof was for replacements, improvements, or additions which prolonged the useful life of the property or increased its value or made the property adaptable to a different use.

The respondent, in his brief, relies on the above cited quotation from the Illinois Merchants Trust Co. case, along with the following quotation from Union Pacific R. R. Co. v. United States, 99 U. S. 402:

Theoretically, the expenses chargeable to earnings include the general expenses of keeping up the organization of the company, and all expenses incurred in operating the works and keeping them in good condition and repair; whilst expenses chargeable to capital include those which are incurred in the original 668*668 construction of the works, and in the subsequent enlargement and improvement thereof.

The Supreme Court quotation was also cited with approval in the Illinois Merchants Trust Co. case.

Applying these principles to the facts in the instant appeal, we find that prior to 1941 petitioner conducted in the basement of building No. 2 an operation which was isolated from the rest of the plant and involved special equipment. The material manufactured there was light and was easily handled from one level to another. The entrance to the basement of building No. 2 was through the basement of building No. 5. Prior to 1939 the basement of building No. 5 was used for storage. In 1942 petitioner obtained orders from the Government which so increased its volume of work that the space in the basement of buildings Nos. 2 and 5 had to be used. The materials produced in 1942 were quite heavy and could not be readily handled by hand over the difference in the basement levels. There was equipment in the basement rooms of such buildings which could not be moved to other parts of the buildings and petitioner wished to make use of such equipment in order to have the fullest possible capacity with available facilities. To that end petitioner determined to adjust the levels of the two basements, so that ordinary factory wheeled-trucks could pass readily from one room to the other. Concurrently, the elevator shaft was extended to the adjusted level of the basements, so that the material produced therein could be taken in wheeled-trucks in the elevator and moved to the third floor to further process them.

For more efficient operation and utilization of the basement rooms of buildings No. 2 and No. 5, petitioner in 1942 determined to lower the basement floor of building No. 5 to the same level as that of building No. 2 and to extend the elevator shaft to the new level.

From the above quoted Illinois Merchants Trust Co. case, we note the following: "Expenditures for that purpose [repairs] are distinguishable from those for replacements, alterations, improvements or additions which prolong the life of the property, increase its value, or make it adaptable to a different use." (Italics supplied.)

The fact that the basement of building No. 5 was lowered 22 inches, along with the other alterations connected therewith, was for the purpose of adjusting the levels of the two basements so that factory wheeled-trucks could pass readily from one room to the other brings the instant case within the rule above stated. It is clear that the lowering of the floor and elevator, particularly, was to make the basement adaptable to a different use.

In the case of Black Hardware Co. v. Commissioner, 39 Fed. (2d) 460; certiorari denied, 282 U. S. 841, the petitioner owned a three-story brick building in Galveston, Texas. The lower floor

was raised 669*669 approximately four and one-half feet to protect it against flood tide. The court held that the improvements did not prolong the life of the building, nor did it increase its value, but it became more valuable for the use of the petitioner in his business. The Board's opinion was affirmed in that the expenditures for the improvements and betterments should be added to petitioner's capital investment. So, in the instant case, the lowering of the floor and the elevator, along with the other changes, may not have prolonged the life of the building and may not have increased its value, but it did become more valuable for the use of the petitioner in its business and, therefore, as in the Black Hardware Co. case, the expense should be added to petitioner's capital investment. American Bemberg Corporation, 10 T. C. 361, is distinguishable, being a case of repairs.

From the cases cited in petitioner's brief it is apparent that he claims the expense as a repair. The Illinois Merchants Trust Co. case, supra, distinguishes repairs from replacements, as follows: "To repair is to restore to a sound state or to mend, while a replacement connotes a substitution." There is no semblance of "mending" or "restoring to a sound state" of the floor here in question. The old floor was completely replaced by a new one some 22 inches lower than the original. The extending of the elevator to the lower level could not be considered mended or restored, for, as for that part of the elevator, it had not previously been in existence. True, some of the material used in the process of lowering the floor was salvaged from the old floor, but, applying the facts here to the definition above quoted, we hold that the expense of lowering the floor was a replacement and thereby classified as a capital expenditure.

The issue of excess profits credit based on income actually resolves itself into a question of whether the full amount of $45,800 for which the 229 shares of stock were sold on February 25, 1942, constitutes a capital addition for 309 days during the taxable year 1942. The respondent contends that only the cash actually paid to the petitioner, pursuant to the contracts and notes given by the purchaser, and not the value of the notes, constitutes a capital addition under section 713 (a) of the Internal Revenue Code, as amended (resulting, considering previous stock reductions, in a net capital reduction. Section 713 (a) (1) (B) provides, in substance, that the excess profits credit for any taxable year, computed under this section, shall be increased by 8 per cent of the net capital addition as defined in subsection (g). The pertinent part of subsection (g) as follows:

(g) ADJUSTMENTS IN EXCESS PROFITS CREDIT ON ACCOUNT OF CAPITAL CHANGES.—For the purposes of this section —

(1) The net capital addition for the taxable year shall be the excess, divided by the number of days in the taxable year, of the aggregate of the daily capital 670*670 addition for each day of the taxable year over the aggregate of the daily capital reduction for each day of the taxable year.

* * * * * * *

(3) The daily capital addition for any day of the taxable year shall be the aggregate of the amounts of money and property paid in for stock, or as paid-in surplus, or as a contribution to capital, after the beginning of the taxpayer's first taxable year under this subchapter and prior to such day. In determining the amount of any property paid in, such property shall be included in an amount determined in the manner provided in section 718 (a) (2). * * *

The question here then, in the final analysis, is whether the notes given by the purchasers constitute "property" as expressed in section 713 (g) (3). The word "property," as used in the above statute, is not limited in any way in its meaning. There are no distinctions drawn either as to real or personal property, as to tangible or intangible property, or any other. Our attention has not been directed to, and we have not found, a definition of the term "property" within the statute here considered. Black's Law Dictionary (3d Ed.), gives the following definition of intangible property:

Used chiefly in the law of taxation, this term means such property as has no intrinsic and marketable value, but is merely the representative or evidence of value, such as certificates of stock, bonds, promissory, notes, and franchises. [Citing many cases.]

It would, therefore, appear that the statute is sufficiently broad to include the notes here in question.

The respondent argues that "A question somewhat similar to the issue raised in this case has been considered in connection with the determination of invested capital under the excess profits tax laws that existed in 1917 and 1918," and that promissory notes, of face value, actually and in good faith paid for stock, not void under state law, were includible in invested capital; but in this the petitioner in general agrees, and cites such cases as Langley & Michaels Co., 9 B. T. A. 1020; Sheridan Heat Co., 10 B. T. A. 211; Hewett Grain & Provision Co. of Escanaba, 14 B. T. A. 281; Boston Oldsmobile Co., 16 B. T. A. 114; Columbus Brick Tile Co., 26 B. T. A. 794, and Bowers v. Max Kaufmann & Co., 18 Fed. (2d) 69, holding in general that invested capital, as used in the statute then under consideration, included notes given in payment for stock of the corporations.

Respondent calls our attention to section 21.21 of chapter 195 of the General Corporation Act of Michigan, but does not seriously contend that it affects this case. He merely says that "The Michigan law makes the transaction in the instant case incomplete by prohibiting the delivery of the stock until it is fully paid for." He also says that "Apparently the stock in the instant case was not only issued but was delivered * * *." Then he asks the question, "what effect the transaction had under the Michigan statute?" Due to the fact that 671*671 the stock here in question was issued and delivered and the validity of such acts is not challenged under the statute, we see no applicability of the respondent's argument. The stock was not void under state law. Respondent also cites Liberty Mirror Works, 3 T. C. 1018, and Palomar Laundry, 7 T. C. 1300, but these cases are distinguishable from the instant case. The Liberty Mirror Works case considers the point as to whether the amounts of debts forgiven and canceled by nonstockholder creditors in prior years should be included in the taxpayer's equity invested capital, while the Palomar Laundry case considers the question as to whether the value of preferred stock issued to brokers as a commission is excluded in the computation of invested capital. As we view the question, neither of these cases supports the contentions advanced by the respondent.

The respondent also challenges the petitioner's position on the ground that he has not established the value of the notes, as required under sections 718 (a) (2) and 113 (a) of the Internal Revenue Code.[2] Respondent's contentions here are without merit. The unadjusted basis here is cost, and, therefore, under Regulations 112, section 35.718-1, it is the fair market value of the stock issued for the notes. Petitioner has established that the stock here in question had a fair market value of $200 a share, due to the fact that the petitioner had some months previously purchased some of its own stock at $200 a share, and in 1942 paid dividends of 20 per cent on $100 par value. There

is no evidence to the contrary. This sets the same value for the notes given for stock. Our conclusion as to value is corroborated by the fact that the signers of the notes, at all times subsequent to the purchase of the said stock, have owned net assets other than the stock purchased of a value substantially in excess of the amount of their notes given in payment for said stock; furthermore, that by March 11, 1947, seven of the purchasers had paid their notes in full and the remaining four, whose notes aggregated $20,800 face amount, had 672*672 paid $9,729.96 upon the principal of their notes, as well as $4,068.03 interest. We believe the evidence in this case is more convincing than that considered to establish face value in Harding Glass Co., 15 B. T. A. 621. We, therefore, hold that respondent did err in determining that petitioner had a net capital reduction of its excess profits credit based on income.

Reviewed by the Court.

Decision will be entered under Rule 50.

[1] If this question is answered in the affirmative, the parties have stipulated that the capital reduction of the petitioner as of January 1, 1942, is the amount of $30,352.57.

[2] SEC. 718. EQUITY INVESTED CAPITAL.

(a) DEFINITION.—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b) —

* * * * * * *

(2) PROPERTY PAID IN.—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115 (1) for determining earnings and profits.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) BASIS (UNADJUSTED) OF PROPERTY.—The basis of property shall be the cost of such property; except that * * *.