Sanford Cotton Mills v. Commissioner

14 B.T.A. 1210 (B.T.A. 1929)

Docket No. 12813.

Board of Tax Appeals.

Promulgated January 11, 1929.

John E. Hughes, Esq., and William Cogger, Esq., for the petitioner.

Shelby S. Faulkner, Esq., and C. R. Marshall, Esq., for the respondent.

This proceeding is for the redetermination of deficiencies in income and profits taxes for the calendar years 1920 and 1921 in the amounts of $13,431.46 and $729.45, respectively.

The allegations of error are: (a) That the respondent erred in reducing the deduction claimed by the petitioner on machinery to .0138285 per cent. (b) That the respondent erred in failing to allow depreciation at the rate of not less than 33 1/3 per cent on automobile trucks. (c) That the respondent erred in failing to allow sufficient depreciation on the buildings owned by petitioner. (d) That the respondent erred in disallowing a deduction of $14,951.69 claimed by the petitioner for repairs. (e) That the respondent erred in failing to assess petitioner's profits tax under the provisions of section 328 of the Revenue Act of 1918.

FINDINGS OF FACT.

The petitioner is a North Carolina corporation, having its office and mill at Sanford. Its business is the manufacture of cotton sheeting. It was organized in 1899. During the years involved in this proceeding the machinery in petitioner's mill consisted of pickers, carders, drawers, spinners, spoolers, warpers, slashers, drawing in machines, looms, finishing machines, folders, cotton gins, electric motors and pulleys. In 1920 this machinery was run from 7 a. m. to 11 p. m. with an intermission of only 40 minutes for luncheon. During that year petitioner operated two shifts, but the machinery was not stopped between shifts. The mill was located within 50 or 60 feet of the main line of the Seaboard Air Line Railroad. Eighteen passenger trains and more than that number of freight trains passed daily. The windows of the mill were open during the summer season from May until October. Smoke and cinders from passing trains got on the machinery. The major part of the machinery was put in the mill in 1900. In 1921 the mill was operated on a normal basis of 60 hours per week. A reasonable deduction on account of the exhaustion, wear and tear of the machinery during 1920 and 1921 was at the rate of 7½ per cent.

In 1920 and 1921 petitioner owned a brick mill building, brick warehouse and about 60 tenement houses. The respondent allowed a deduction on account of the depreciation of the brick buildings at the rate of 2 per cent and upon the tenement houses at the rate of 4 per cent. The main mill building was built in 1900 and was 75 feet by 288 feet. The warehouse building was built in 1908 with an addition which was erected in 1915. The brick buildings had a life of 40 years after March 1, 1913. A reasonable deduction on account of the exhaustion, wear and tear thereof is 2½ per cent.

Thirty-five or 40 of the tenement houses were built in 1900 and the balance subsequently. They were painted every 2 or 3 years and the roofs were replaced every 5 or 6 years. With ordinary repairs these tenement houses would have a useful life of 20 years after March 1, 1913. A reasonable deduction on account of exhaustion, wear and tear thereof is at the rate of 5 per cent.

On motor trucks which cost $7,400, the respondent allowed a deduction on account of the exhaustion, wear and tear thereof at the rate of 20 per cent. It was the petitioner's custom to use these trucks for approximately 2½ years and then trade them in on the purchase price of new trucks. The usual allowance on the old trucks was $1,000 on a truck costing $5,000. A reasonable deduction on account of the exhaustion, wear and tear of trucks would be at the rate of 25 per cent.

On July 1, 1920, the petitioner paid $2,000 for lumber which it purchased and used to repair the floor of the main building. The floor had rotted in places and some of the sleepers supporting it had rotted in places, and also some of the sleepers supporting the tenement houses had rotted. The further sum of $262.64 was paid for freight on this lumber.

On July 30, 1920, the petitioner purchased other lumber for $2,000, which it used in making repairs to its buildings. On September 3, 1920, a payment of $903.94 was made for this same lumber. This lumber was used in repairing floors and to patch it in places and not for the purpose of new floors.

On September 3, 1920, the petitioner expended $4,017.09 for hardwood flooring and $352.23 for freight thereon, and on November 4, 1920, the sum of $3,364.81 was expended for maple flooring and $459.84 for freight thereon. This lumber was used for patching and repairing the flooring in the main mill. The flooring in the main mill which was repaired by the lumber was originally pine, but the repairs were made with maple. While the repairs were expensive they did not amount to replacing the entire floor but merely replacing with maple the pine that had become decayed or worn. The top floor required constant repairs on account of the use to which it was put.

On November 17, 1920, $495.63 was expended for wooden shingles. These shingles were used to patch the roofs of tenement houses. Shingles for this purpose were bought every year by the petitioner.

In 1902 the petitioner began to sell its products under a trade brand known as "The Father George Brand" and has continued to do so to date. From 1908 up to and including 1921 approximately 85 per cent of the petitioner's output was sold under this brand. The product sold is brown sheeting. It was sold to wholesale dry-goods merchants throughout the United States, in Cuba, and South America. The price of the product sold under this brand was approximately 1 cent a pound more than the same product without the brand. Since 1900 the product has been sold through a selling agency. This agency was paid a commission of 5 per cent on gross sales and as a part consideration for that commission the agency agreed to advertise the brand. The reputation of the brand had become established by 1910. By 1920 it was so well known to the trade that it was not necessary for salesmen to carry samples. This brand was designed by the petitioner's secretary and treasurer.

The petitioner also had a secret process for sizing and starch mixing for finishing its goods. This process was developed by the superintendent of the petitioner's mill and had been developed by 1913. It was used continuously since its development to and including 1921. It put a superior finish on petitioner's goods.

Nothing has appeared on petitioner's books at any time representing intangible assets nor was anything allowed by the respondent in computing invested capital on account of intangible assets.

Assessment under section 210 of the Revenue Act of 1917 for 1917 was allowed by the respondent and assessment under section 328 was allowed by the respondent for 1918 and 1919. For 1919 the petitioner's books showed a net income of $155,005.17. For 1920 the respondent has determined the petitioner's income to be $252,246.03. The tangible property in the petitioner's business amounted to more in 1920 than in prior years. Petitioner's invested capital for 1920 as determined by the respondent was $363,299.49.

OPINION.

TRAMMELL:

On the question of the payment on account of exhaustion, wear and tear of the machinery and buildings there is no controversy over any factor except the rate of depreciation. This is a question of fact and we have arrived at our findings of fact from all the testimony in the case.

On the question of the expenditures which the petitioner contends were for repairs, it is also a question of fact as to whether they were in fact repairs or whether they were for replacements, additions or improvements. On this question the testimony is convincing that what was done was in the nature of repairs and we have so held.

On the question as to whether the petitioner is entitled to assessment under section 328 of the Revenue Act of 1918, a more difficult problem is presented. The petitioner contends that there were abnormal conditions affecting its capital on account of the fact that it had a secret process and a trade-mark or trade brand which it had built up and developed in its business. It claims that expenditures in building up this trade-mark or trade brand and developing the secret process can not be allocated in order to determine what part represents capital and what part represents ordinary and necessary expense. The difficulty here on this question is that we have no definite evidence that any amounts were expended by the petitioner in developing either the trade-mark or trade brand or the secret process. With respect to the trade-mark, it appears that the agency which handled the product of the petitioner was required to do the advertising and there is no evidence of any expenditures on the part of the petitioner with respect thereto and the evidence is equally lacking on the question of the development of the secret process. This being true, the petitioner clearly does not come within the provisions of section 327 (a) of the Revenue Act of 1918.

On the question as to whether the petitioner comes within the provisions of section 327 (d) that is, whether there were abnormalities affecting the capital, we are of the opinion that the evidence does not warrant us in finding that there were such abnormalities which resulted in an undue hardship upon the petitioner as compared with corporations similarly circumstanced with respect to capital, income, and profits per unit of business or in other respects as set out in the statute.

While the evidence shows that a trade-mark or trade brand and the secret process were not included in invested capital and could not be included therein, and while there is evidence which might tend to show that these things had value, we can not determine from the evidence even the approximate value thereof and as a consequence we can not determine whether the exclusion thereof from invested capital constituted an abnormality. Clearly every exclusion from invested capital of assets does not constitute an abnormality, as contemplated in the statute. The effect of such exclusion upon invested capital must be shown. The capital excluded must in any event be substantial in amount.

The petitioner argues in his brief that the capitalization of earnings would indicate that these items excluded were of substantial value, but on this point we are not furnished with the earnings for prior years or the amount of tangible assets, nor are we furnished with other evidence from which a valuation of this property might be arrived at.

In view of the foregoing, it is our opinion that the petitioner has not established its right to assessment under the provisions of section 328 of the Revenue Act of 1918.

Judgment will be entered under Rule 50.