5 T.C. 1220 (1945)

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A taxpayer seeking excess profits tax relief under Section 722 of the Internal Revenue Code must demonstrate that the tax is excessive and discriminatory and that its average base period net income is an inadequate standard of normal earnings.

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Summary

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Monarch Cap Screw & Manufacturing Co. sought excess profits tax relief under Section 722 of the Internal Revenue Code for 1941. The Tax Court upheld the Commissioner’s denial of the application, finding that Monarch failed to prove the excess profits tax was excessive or discriminatory. The court determined that Monarch’s average base period net income was not an inadequate standard of normal earnings, as the company’s profits during the base period were comparable to, or exceeded, those of prior years, and the alleged factors depressing income were not temporary or unusual.

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Facts

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Monarch, an Ohio corporation, manufactured cap screws and bolts. In 1941, Monarch filed an excess profits tax return, later claiming relief under Section 722, asserting a constructive average base period net income. Monarch argued that a price war in the industry and a shift in its sales strategy (selling directly to users instead of through jobbers) depressed its earnings during the base period (1936-1939). The company had previously manufactured brake bands but shifted to cap screws in 1929. Monarch claimed the price war made 1936 the worst year, but acknowledged the industry was always highly competitive.

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Procedural History

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Monarch filed a protest and an application (Form 991) for relief under Section 722 for 1941. The Commissioner denied the application, stating that Monarch failed to establish that the tax was excessive and discriminatory. Monarch then petitioned the Tax Court, challenging the Commissioner's disallowance.

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Issue(s)

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1. Whether the Commissioner erred in disallowing Monarch's application for excess profits tax relief under Section 722.

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2. Whether Monarch demonstrated that the excess profits tax was excessive and discriminatory.

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3. Whether Monarch established that its average base period net income was an inadequate standard of normal earnings.

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Holding

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1. No, because Monarch failed to demonstrate that its tax was excessive and discriminatory or that its base period income was an inadequate standard of normal earnings.

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2. No, because Monarch's profits during the base period were comparable to or exceeded prior years, and the alleged factors depressing income were not

temporary or unusual.

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3. No, because Monarch’s operations during the base period were reasonably within the realm of normalcy, as established by the company’s experience.

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Court’s Reasoning

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The Tax Court emphasized that Section 722 is a general relief measure intended to aid corporations burdened by an abnormally low excess profits credit. The court noted that relief under Section 722 is available only where the taxpayer establishes that the excess profits tax is “excessive and discriminatory” and establishes a fair and just standard of normal earnings for the base period. The court found that Monarch’s profits during the base period were not significantly depressed compared to its historical performance. The court noted that the alleged price war was an ongoing condition, not a temporary economic event. The court also determined that changes in Monarch’s operations occurred before the base period and did not significantly impact base period earnings. The court cited *Blum Folding Paper Box Co., 4 T.C. 795*, for the principle that applications for relief must be presented fully to the Commissioner, and the Tax Court reviews the Commissioner’s determination based on the facts presented. The court stated,

