W.B. Knight Machinery Co. v. Commissioner, 6 T.C. 519 (1946)

A taxpayer seeking excess profits tax relief due to abnormal income must demonstrate that the abnormality is not solely attributable to factors like increased demand or higher prices resulting from general economic improvements.

Summary

W.B. Knight Machinery Co. sought relief from excess profits tax, claiming abnormal income due to increased sales commissions. The Tax Court addressed whether the increased income was solely due to wartime economic conditions (increased demand, higher prices) or other factors, such as the procurement of a significant, multi-year contract. The Court found that while some income increase stemmed from general economic factors, a portion was attributable to the specific contract, warranting allocation of that portion over the contract's duration. The court, lacking precise data, apportioned one-third of the net abnormal income to improved business and the remaining two-thirds to procurement and servicing, allocating the latter over the contract's five-year term.

Facts

W.B. Knight Machinery Co. experienced a significant increase in sales commissions during the tax year. The company attributed this increase to a multi-year contract, arguing it represented abnormal income. The Commissioner argued the increase was due to generally improved economic conditions resulting from World War II, specifically increased demand and higher prices.

Procedural History

The Commissioner assessed excess profits tax, which the taxpayer contested. The case was brought before the Tax Court to determine whether the income qualified as "abnormal income" eligible for relief under Section 721 of the Internal Revenue Code.

Issue(s)

1. Whether the increase in the taxpayer's income was solely attributable to generally improved business conditions, such as increased demand and higher prices.
2. If not, what portion of the increased income can be considered "abnormal income" attributable to other factors, such as the procurement of a multi-year contract, and thus eligible for allocation over the life of the contract for excess profits tax purposes?

Holding

1. No, because the court found that factors other than improved business

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conditions contributed to the increased income.
2. A portion of the increased income was attributable to the specific, multi-year contract, and thus could be allocated over the contract's duration for excess profits tax relief.

Court's Reasoning

The Court acknowledged that the excess profits tax was intended to capture increased profits resulting from wartime economic expansion. However, the regulations did not entirely eliminate relief for abnormal income. Quoting the regulation, the court stated that relief is authorized when the abnormality is due to causes other than "high prices, * * * increased demand * * * or decreased competition." The court found the increased income was not solely due to improved business but also to the procurement of a specific contract requiring several years for its performance. The court reasoned that "merely because some work remains to be done under a contract, an equal division among all the years of its performance is not necessarily called for." The court apportioned one-third of the

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