Surface Coating Materials, Inc. v. Commissioner, 17 T.C. 61 (1951)

The introduction of a few new products that fit into an existing business line and do not materially change that business does not constitute a "difference in the products furnished" for purposes of excess profits tax relief under Section 722(b)(4) of the Internal Revenue Code.

Summary

Surface Coating Materials, Inc. sought excess profits tax relief under Section 722(b)(4) of the Internal Revenue Code, arguing that the introduction of three new products (Wetwal, Wax, and Stonpach) during the base period (1936-1939) changed the character of its business, resulting in an inadequate reflection of normal earnings. The Tax Court denied the relief, holding that these products were merely additions to the existing product line, did not materially alter the business, and that the company failed to demonstrate that its base period earnings were abnormally low due to their introduction.

Facts

Surface Coating Materials, Inc., already in business before 1940, marketed products used in building maintenance. During the base period (1936-1939), it introduced Wetwal and Wax in 1936, and Stonpach in 1937. Wax was a new product, while Wetwal and Stonpach had similarities to existing products (Bondite and Concretite, respectively). The company claimed these new products changed its business character, entitling it to excess profits tax relief. Sales of the three new products constituted only about 3% of total sales during the last three years of the base period.

Procedural History

The Commissioner of Internal Revenue rejected the company's claim for excess profits tax relief. Surface Coating Materials, Inc. then petitioned the Tax Court for a redetermination of its excess profits tax liability for 1941 and 1942.

Issue(s)

Whether the introduction of Wetwal, Wax, and Stonpach during the base period constituted a change in the character of the petitioner's business, specifically a "difference in the products furnished," within the meaning of Section 722(b)(4) of the Internal Revenue Code.

Holding

No, because the three new products were merely additions to the existing product line and did not materially alter the character of the business. The court further held that the company failed to demonstrate that its base period earnings were abnormally low due to the introduction of these products.

Court’s Reasoning

The Tax Court reasoned that the introduction of a few new products that fit into the general line of products being sold and do not materially change that business does not represent a “difference in the products…furnished” within the meaning of Section 722(b)(4). The Court noted that these products were related to old products, were only a few of many introduced during the base period, and did not affect the type of customers solicited, open new markets, change sales policies, or materially affect earnings. Quoting from legislative history, the court emphasized that Congress contemplated a greater change than that shown by the petitioner. The Court distinguished the case from *Lamar Creamery Co., 8 T. C. 928*, where the introduction of a new product fundamentally changed the taxpayer’s business. The Court also found that the petitioner had not justified its proposed adjustments to base period sales, particularly its claim that 1939 sales were abnormally low due to confusion between Stonpach and Resurfacer. The court stated, “The introduction of a few new products which fit into the line constituting the business and do not materially change that business does not represent ‘a difference in the products * * * furnished.'”

Practical Implications

This case provides a narrow interpretation of what constitutes a change in the character of a business for the purposes of Section 722(b)(4) excess profits tax relief. It emphasizes that simply introducing new products is insufficient; the change must be substantial and materially alter the nature of the business. Taxpayers seeking relief under this provision must demonstrate a significant shift in their business operations beyond the addition of new items to an existing product line. This case is crucial for understanding the limits of Section 722(b)(4) and the burden of proof required to demonstrate eligibility for relief. Later cases cite this case when distinguishing minor product additions from fundamental business overhauls.

