14 T.C. 1034 (1950)

National prohibition, while economically impactful, was not a 'temporary economic event' unusual to the brewing industry for excess profits tax relief under Section 722(b)(2) of the Internal Revenue Code.

Summary

Acme Breweries sought excess profits tax relief for 1941 under Section 722 of the Internal Revenue Code, arguing that national prohibition and a shift in sales strategy constituted temporary economic events that depressed their business during the base period (1936-1939). The Tax Court denied relief, holding that national prohibition was not a 'temporary' event, and the shift to packaged beer sales was not a significant 'change in character' of the business to warrant relief. This case clarifies what constitutes a qualifying event for excess profits tax relief, emphasizing the need for the event to be both temporary and unusual.

Facts

Acme Breweries, a California corporation, manufactured and sold beer and baker's yeast. It was incorporated in 1920 but began operations in 1921. Due to national prohibition, it produced 'near beer' until April 1933, when it resumed brewing beer. Acme argued that national prohibition depressed its business during the base period years (1936-1939). Additionally, Acme asserted that a strategic shift towards packaged beer sales, starting in 1933, further warranted tax relief. Before prohibition, Acme's stockholders produced approximately 10% of California's beer. After prohibition ended, Acme's sales steadily shifted from draft to packaged beer, with packaged beer accounting for 80% of sales by 1939.

Procedural History

Acme Breweries filed for excess profits tax relief and a refund for 1941, claiming that its average base period net income was an inadequate standard of normal earnings due to prohibition and changes in business strategy. The Commissioner of Internal Revenue denied the application. Acme then petitioned the Tax Court for review.

Issue(s)

1. Whether national prohibition constituted a 'temporary economic event unusual' to the brewing industry, thus entitling Acme to excess profits tax relief under Section 722(b)(2)?

2. Whether Acme's change to engage in the beer brewing business in 1933 and its subsequent shift from draught beer to packaged beer sales constituted a 'change in the character of the business' immediately prior to or during the base period, thus entitling Acme to relief under Section 722(b)(4)?

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Holding

1. No, because national prohibition, while impactful, was not a ‘temporary’ event within the meaning of the statute, nor was it considered ‘unusual’ given the history of state-level prohibitions.

2. No, because commencing the beer business in 1933 was not ‘immediately prior’ to the base period, and the shift in sales strategy was not a fundamental change in the character of the business.

Court’s Reasoning

Regarding the ‘temporary’ nature of national prohibition, the court reasoned that the Eighteenth Amendment and the Volstead Act were intended to last for an indeterminate period, making them fundamentally not temporary. The court stated that the fact that the law was later repealed does not retroactively make it a temporary event. Further, the court noted that the brewing industry had a history of dealing with prohibition at the state level, so a national prohibition was not an “unusual” event. The court also stated the following, “legislative event of national prohibition in January, 1920, nor the resulting economic consequences constituted a temporary economic event unusual in the brewing industry or the business of petitioner”.

Regarding the change in the character of the business, the court found that commencing beer production in 1933 was not ‘immediately prior’ to the base period of 1936-1939. The court also reasoned that the shift in sales strategy was not a ‘change in the character of the business’ because Acme was always in the beer business; it simply changed its marketing approach. The court stated that “there was no such change as envisaged by subsection (b)(4), for there was no departure from the general character of the petitioner’s beer business.”

Practical Implications

This case provides a strict interpretation of Section 722 of the Internal Revenue Code, emphasizing the importance of establishing that an event was both temporary and unusual to qualify for excess profits tax relief. It also shows the difficulties in arguing that a shift in marketing focus constitutes a fundamental change in the character of a business. The case serves as a cautionary tale for taxpayers seeking relief based on past events, highlighting the need for solid evidence and a clear demonstration of how those events directly and negatively impacted their base period earnings. Later cases have cited Acme Breweries for its interpretation of ‘temporary’ and ‘unusual’ events within the context of Section 722 relief claims.

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Footnotes

- *. Decrease.↩

- 1. SEC. 722. GENERAL RELIEF — CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

  (a) General Rule. — In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. In determining such constructive average base period net income, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring or existing after December 31, 1939 * * * .

  (b) Taxpayers Using Average Earnings Method. — The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because —

  * * * *

  (2) the business of the taxpayer was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which such taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry,

  * * * *

  (4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. If the business of the taxpayer did not reach, by the end of the base period, the earning level which it would have reached if the taxpayer had commenced business or made the change in the character of the business two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time. For the purposes of this

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subparagraph, the term “change in the character of the business” includes a change in the operation or management of the business, a difference in the products or services furnished, a difference in the capacity for production or operation, a difference in the ratio of nonborrowed capital to total capital, and the acquisition before January 1, 1940, of all or part of the assets of a competitor, with the result that the competition of such competitor was eliminated or diminished. * * *↩

- 2. Monarch Cap Screw & Mfg. Co., supra;East Texas Motor Freight Lines, 7 T. C. 579; 7- Up Fort Worth Co., 8 T. C. 52; Fish Net & Twine Co., <span normalizedcite="8 T.C. 96“>8 T. C. 96; Lamar Creamery Co., 8 T. C. 928; National Grinding Wheel Co., 8 T. C. 1278; Irwin B. Schwabe Co., <span normalizedcite="12 T.C. 606“>12 T. C. 606; El Campo Rice Milling Co., 13 T. C. 775; Stonhard Co., 13 T. C. 790; and Harlan Bourbon & Wine Co., 14 T. C. 97↩.

- 3. Wherein it was held that a change in 1934 was not within the time prescribed by the statute.↩

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