16 T.C. 690 (1951)

A taxpayer seeking relief from excess profits tax under Section 722 of the Internal Revenue Code must establish both qualification for relief under the statute and a fair and just amount representing normal earnings to be used as a constructive average base period net income.

Summary

Crowncraft, Inc., a California corporation formed after the base period, manufactured aircraft assembly jigs. It sought relief from excess profits tax for 1942 and 1943 under Sections 722(c)(2) and 722(c)(3) of the Internal Revenue Code, arguing its invested capital was an inadequate standard for determining excess profits. The Tax Court denied relief, holding that while the taxpayer may have met the requirements under Section 722(c), it failed to prove it would have been profitable during the base period (pre-1940). Without establishing a fair and just amount representing normal earnings, Crowncraft could not establish a constructive average base period net income as required by Section 722(a).

Facts

Crowncraft was organized in April 1941 to manufacture aircraft assembly jigs. Its organizers were Everett Gray, a manager with experience in institutional management, and Harvey Lemke, a skilled tool and die maker. At the time of Crowncraft's organization, there were no businesses in southern California exclusively manufacturing aircraft assembly jigs. Crowncraft secured contracts with several aircraft companies. By May 31, 1944, the business was continued as a partnership, Crowncraft Engineering Company, by Gray and Lemke, but the partnership terminated in July 1945 following cancellation of aircraft contracts by the U.S. Government.

Procedural History

The Commissioner of Internal Revenue determined excess profits tax deficiencies for 1942 and 1943 and denied Crowncraft's applications for relief under Sections 722(c)(2) and 722(c)(3). Crowncraft petitioned the Tax Court for review, seeking refunds for the excess profits taxes paid. The Tax Court upheld the Commissioner's determination, denying Crowncraft relief.

Issue(s)

Whether Crowncraft is entitled to relief from its excess profits tax liabilities for 1942 and 1943 under Section 722(c) of the Internal Revenue Code.

Holding

No, because Crowncraft failed to prove it would have made a profit, or even remained in business, during the base period years, and thus failed to establish a fair and just amount representing normal earnings as required by Section 722(a).

Court's Reasoning

The court emphasized that to qualify for relief under Section 722, a taxpayer must prove both qualification under one of the provisions of subsection (c) and a fair and just amount representing normal earnings for use as a constructive average base period net income under subsection (a). The court found that Crowncraft failed to establish that it would have been financially successful during the base period (pre-1940). The court noted that aircraft manufacturers were initially hesitant to subcontract jig construction, and it was only during the war emergency, with cost-plus-fixed-fee contracts, that subcontracting became prevalent. The court stated, "[E]very step of the way is shrouded with doubts as to its value, or indeed its plausibility, a serious question is immediately raised as to whether any relief is justified." The court found that the company grew with the war, was successful because of the war, and ceased with the ending of hostilities. Thus, the court concluded that Crowncraft had failed to demonstrate that it would have been profitable during the base period, precluding relief under Section 722.

Practical Implications

This case illustrates the stringent requirements for obtaining excess profits tax relief under Section 722 of the Internal Revenue Code. It highlights the importance of demonstrating not only that a taxpayer's circumstances during the excess profits tax period were atypical, but also that the taxpayer would have been profitable during the base period. Taxpayers seeking such relief must provide concrete evidence to support their claims regarding normal earnings, rather than relying on speculative assumptions. This case serves as a cautionary tale for businesses whose success is heavily reliant on temporary or emergency conditions, emphasizing that excess profits taxes were designed to capture profits arising from such circumstances.

