16 T.C. 1335 (1951)

To qualify for excess profits tax relief based on a change in business character, the change must occur or the taxpayer must be committed to it during the relevant base period.

Summary

Claussner Hosiery Co. sought a refund of excess profits taxes, arguing that a shift from silk to nylon hosiery manufacturing during the base period constituted a change in business character under Section 722(b)(4) of the Internal Revenue Code. The Tax Court denied the refund, finding that the company's transition to nylon hosiery production did not occur within the relevant base period because nylon yarn was not commercially available, and the company's use of it was limited to experimental purposes. The court emphasized that the change must be real and substantive within the base period to qualify for relief.

Facts

Claussner Hosiery Co. manufactured ladies' full-fashioned hosiery since 1922. Prior to 1940, the company primarily used silk yarn. In 1939, the company began experimenting with nylon yarn provided by DuPont. DuPont designated Claussner, along with 35 other mills, to receive nylon yarn for experimental purposes. Claussner received its first shipment in October 1939 but was restricted to using the yarn for testing and sample production. Commercial quantities of nylon were unavailable during the base period. The company sold no hosiery manufactured of nylon yarn during the base period.

Procedural History

Claussner Hosiery Co. filed claims for refunds of excess profits taxes for fiscal years 1942-1944, asserting entitlement to relief under Section 722 of the Internal Revenue Code. The Commissioner of Internal Revenue denied the claims. Claussner petitioned the Tax Court, arguing that the Commissioner erred in determining that it failed to establish its right to relief under subsections (b)(1), (b)(3)(A), and (b)(4) of Section 722. The Tax Court addressed the claim under Section 722(b)(4), concerning a change in the character of the business.

Issue(s)

Whether the petitioner is entitled to reconstruct its average base period net income under Section 722(b)(4) of the Internal Revenue Code, based on a change in the character of its business due to a change in the products furnished (from silk to nylon hosiery) during its base period.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

No, because the change from silk to nylon hosiery production did not occur during the relevant base period, as nylon was not commercially available and the company's use of it was limited to experimental purposes.

Court's Reasoning

The court reasoned that to qualify for relief under Section 722(b)(4), the taxpayer must demonstrate: (a) a change in the character of its business via a change in the nature of its product and (b) that such change occurred *prior* to the close of its base period. The court found that while a change from silk to nylon *could* be considered a change in the product furnished, the change did not occur during the base period. The court emphasized that the company did not manufacture nylon hosiery for sale during the base period. Nylon yarn was not commercially available until *after* the base period. The limited quantities of nylon were used solely for experimental purposes, and the hosiery produced was not sold but submitted to DuPont for testing. The court concluded that Claussner had not established a right to reconstruct its average base period net income, stating, "Our conclusion is that petitioner has not established that it is entitled to reconstruction of its average base period net income by application of section 722 (b) (4). Its claim for relief under that section is accordingly denied."

Practical Implications

This case clarifies the requirements for obtaining excess profits tax relief under Section 722(b)(4) based on a change in business character. It demonstrates that a mere intention or preliminary step toward a change is insufficient; the change itself must be implemented and affect the business during the relevant base period. The case highlights the importance of demonstrating that the shift in product or service was not merely experimental but a genuine alteration of the business's operations. This ruling instructs tax practitioners and businesses to carefully document the timing and nature of business changes when seeking tax relief under similar provisions. The case serves as a reminder that tax benefits are tied to actual economic activity and not just planned or anticipated changes.

© 2025 SCOTUSreports.com. All rights reserved.