17 T.C. 1222 (1952)

A taxpayer is not entitled to excess profits tax relief under Section 722 of the Internal Revenue Code where losses resulted from unfavorable contract terms, and the taxpayer fails to demonstrate a fair and just amount representing normal earnings after alleged business changes.

Summary

Dr. P. Phillips Canning Company sought relief from excess profits taxes under Section 722, arguing that unfavorable future delivery contracts and the development of new by-products (dairy feed and citrus oils) changed the character of its business during the base period. The Tax Court denied relief, holding that the unfavorable contracts didn’t qualify as an interruption of normal operations or temporary economic circumstances under Section 722(b)(1) and (2). Furthermore, the court found that the taxpayer failed to adequately demonstrate what its normal earnings would have been, especially regarding the citrus oil business, relying on post-1939 data, and the dairy feed operation, where only gross profits were presented as evidence.

Facts

Dr. P. Phillips Canning Co. was incorporated in 1937 to can citrus fruits, taking over the canning division of Dr. P. Phillips Company. The company innovated by creating dairy feed from citrus pulp waste using a steam-drying process, becoming the first commercial producer of steam-dried feed. It also sought to commercially produce citrus oils from fruit peelings. In the fall of 1937, the company entered into contracts to sell 480,000 cases of citrus products with a clause allowing buyers to cancel if they found lower prices elsewhere. The market declined, and buyers only accepted 48,000 cases, resulting in a loss for the company.

Procedural History

The Commissioner of Internal Revenue denied the company’s applications for relief from excess profits taxes for the fiscal years 1941, 1942, 1943, and 1944. The company petitioned the Tax Court, arguing it qualified for relief under various subsections of Section 722(b) of the Internal Revenue Code.

Issue(s)

1. Whether the unfavorable future delivery contracts constituted an interruption or diminution of normal operations under Section 722(b)(1) or a temporary economic circumstance under Section 722(b)(2), entitling the petitioner to excess profits tax relief.
2. Whether the development of dairy feed and citrus oil by-products represented a change in the character of the petitioner’s business under Section 722(b)(4), and if so, whether the petitioner provided sufficient evidence to determine a fair and just

constructive average base period net income.

Holding

1. No, because the contracts did not interrupt or diminish the petitioner's production, output, or operation, nor were they considered temporary economic circumstances.
2. No, because the petitioner failed to provide sufficient evidence of what its normal earnings would have been, particularly relying on post-1939 data for citrus oils and presenting only gross profit figures for dairy feed without demonstrating net earnings.

Court's Reasoning

The court reasoned that the unfavorable contracts, while potentially

