18 T.C. 1083 (1952)

A taxpayer seeking excess profits tax relief must demonstrate that its average base period net income is an inadequate standard of normal earnings due to commencing or changing the nature of its business during the base period, and must establish a fair and just amount representing normal earnings to be used as a constructive average base period net income.

Summary

Godfrey Food Company sought relief from excess profits taxes under Section 722(b)(4) of the Internal Revenue Code, arguing that its average base period net income was an inadequate standard of normal earnings because it commenced business and changed the character of its business during the base period. The Tax Court denied the relief, holding that Godfrey Food failed to prove that a reconstructed base period net income would result in a greater excess profits credit than what the Commissioner had already allowed based on the invested capital method. The court emphasized that a taxpayer must convincingly demonstrate its normal earning capacity and that arbitrary percentages are not sufficient.

Facts

Godfrey Food Company, a retail grocery business, was incorporated on September 23, 1938, and began operations on November 1, 1938, with two stores. In May 1940, the company removed its president, Coonan, due to mismanagement and theft, which caused financial difficulties. The company continued operations, eventually expanding to three supermarkets and one grocery department. Godfrey Food sought excess profits tax relief for 1943, 1944, and 1945, claiming it commenced business and increased capacity during the base period, seeking to utilize a constructive average base period net income.

Procedural History

Godfrey Food Company filed claims for refund of excess profits taxes under Section 722(b)(4) of the Internal Revenue Code for the years 1943, 1944, and 1945. The Commissioner of Internal Revenue disallowed the claims. Godfrey Food Company then petitioned the Tax Court, contesting the Commissioner’s decision.

Issue(s)

Whether the Commissioner erred in disallowing Godfrey Food Company’s claims for excess profits tax relief under Section 722(b)(4) of the Internal Revenue Code for the taxable years 1943, 1944, and 1945, because the company commenced business and changed the character of its business during the base period.

Holding

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No, because Godfrey Food Company failed to establish a basis for a reconstructive average base period net income that would result in a greater excess profits credit than the credit already allowed by the Commissioner under the invested capital method.

Court's Reasoning

The Tax Court found that while Godfrey Food Company did commence business and change its business character during the base period, as defined by Section 722(b)(4), it failed to demonstrate that these factors resulted in an inadequate standard of normal earnings. The court criticized Godfrey Food's proposed reconstructions of base period income, particularly its reliance on an arbitrary percentage of sales (14 1/2%) to determine normal earnings. The court stated that "The reconstruction of base period income must be related to the taxpayer's individual business experience." The court emphasized the need to demonstrate a fair and just amount representing normal earnings, stating that "section 722 (a) contemplates that a taxpayer's normal earnings over the base period years will be expressed as a fixed amount and not as a percentage to be applied to sales from year to year." Because Godfrey Food failed to provide sufficient evidence to establish a reliable constructive average base period net income exceeding the Commissioner's allowance, the court upheld the disallowance of the claims for relief.

Practical Implications

The *Godfrey Food* case highlights the evidentiary burden on taxpayers seeking excess profits tax relief under Section 722(b)(4). It demonstrates that simply showing the commencement or change in character of a business is insufficient. Taxpayers must also provide concrete evidence establishing what their normal earning capacity would have been, absent the qualifying factors, and that this reconstructed income would yield a greater excess profits credit than what was originally allowed. The case cautions against relying on industry averages or arbitrary percentages, emphasizing the need for a reconstruction tailored to the specific taxpayer's business experience. This case is significant because it emphasizes the importance of presenting a detailed and well-supported reconstruction of base period income that is tied to the specific facts and circumstances of the taxpayer's business. Later cases cite *Godfrey Food* for the proposition that claims for relief must be supported by substantial evidence that rebuts the Commissioner's determination.

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