The Textile Supply Co. v. Commissioner, 20 T.C. 1081 (1953)

A taxpayer seeking excess profits tax relief under Section 722(b)(4) of the Internal Revenue Code for commencing business during the base period must provide persuasive evidence, beyond mere conclusions, to establish a fair and just amount representing normal earnings to be used as a constructive average base period net income.

Summary

The Textile Supply Co. sought relief from excess profits tax, arguing that its business commenced during the base period and changed in character, resulting in an excessive and discriminatory tax. The Tax Court denied relief, finding that even assuming the company met the conditions of Section 722(b)(4), it failed to demonstrate that its tax burden was excessive or to establish a fair constructive average base period net income. The court emphasized that the taxpayer's evidence was insufficient to prove the level of earnings it would have reached had it commenced business two years earlier, as required by the "2-year push-back rule."

Facts

The Textile Supply Co. commenced business during the base period (1936-1939). The company argued it changed the character of its business in 1939 through operational and management changes, as well as product differences. It sought to establish a constructive average base period net income to reduce its excess profits tax liability. The company primarily sold supplies to textile mills, with Callaway Mills being a significant customer from the start.

Procedural History

The Textile Supply Co. applied to the Commissioner of Internal Revenue for relief under Section 722 of the Internal Revenue Code. The Commissioner denied the application. The Textile Supply Co. then petitioned the Tax Court for review.

Issue(s)

Whether The Textile Supply Co. provided sufficient evidence to establish that the tax computed without the benefit of Section 722 results in an excessive and discriminatory tax and to establish a fair and just amount representing normal earnings to be used as a constructive average base period net income, thus entitling it to relief under Section 722(b)(4) based on commencing business during the base period and changing the character of its business?

Holding

No, because the taxpayer's evidence, including the testimony of its witness and the sales data presented, was insufficient to persuasively demonstrate the level of

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earnings it would have achieved by the end of the base period had it commenced business two years earlier, as required by the “push-back rule” under Section 722(b)(4).

Court’s Reasoning

The court emphasized that the taxpayer had the burden of proving both that the tax was excessive and discriminatory and what a fair and just amount representing normal earnings would be. Applying the “2-year push-back rule,” the court required the taxpayer to demonstrate the earnings level it would have reached in 1939 had it commenced business in 1937. The court found the taxpayer’s evidence lacking. The testimony of the taxpayer’s witness, Nixon, was deemed a mere conclusion, not supported by all the facts of record. The court also criticized the method used to project sales, stating, “Such a procedure is outside of the push-back rule.” The court noted that actual sales in 1939 were significantly lower than the projected sales used to calculate the constructive income. Furthermore, the court highlighted that post-1939 events could not be considered to determine normal earnings of base period years, citing Section 722(a) and previous cases. The court stated that “persuasive reasons, supported by adequate evidence, must be shown in order to reconstruct base period net income under the ‘push back’ rule.”

Practical Implications

This case reinforces the high burden of proof on taxpayers seeking excess profits tax relief under Section 722. It emphasizes that a mere assertion of hardship or potential earnings is insufficient. Taxpayers must provide concrete, persuasive evidence, grounded in the specific facts of their business and the relevant economic conditions, to establish a fair and just constructive average base period net income. The case highlights the importance of contemporaneous documentation and reliable projections when seeking to apply the “push-back rule.” The ruling serves as a cautionary tale to meticulously document the factual basis for any claim under Section 722 and to avoid relying on speculative or unsubstantiated projections of past performance.

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