19 T.C. 548 (1952)

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To qualify for excess profits tax relief under Section 722 of the Internal Revenue Code, a taxpayer must demonstrate that its average base period net income was an inadequate standard of normal earnings due to specific, unusual events or changes in business character.

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Summary

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Triangle Raincoat Company sought relief from excess profits taxes for 1941-1943, arguing that a strike in 1936 and changes in its business character (adding woolen garments and altering production capacity) made its base period income an inadequate measure of normal earnings. The Tax Court denied relief. It found that the strike did not significantly impact overall profitability and that the addition of woolen garments was a normal business evolution, not a fundamental change. The court also determined the production changes were routine, not resulting in significantly increased capacity. Thus, the company failed to prove its base period income was an inadequate standard.

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Facts

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Triangle Raincoat Co. manufactured raincoats, snow suits, and reversible topcoats. In August 1936, a strike occurred, impacting production. In 1935, the company began manufacturing woolen garments to stabilize business year-round. During 1937-1939, the company made physical changes to its factory including rearrangement and additions of machinery and equipment.

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Procedural History

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Triangle Raincoat Co. filed claims for relief from excess profits taxes under Section 722 of the Internal Revenue Code for the years 1941, 1942, and 1943. The Commissioner of Internal Revenue rejected the application. Triangle Raincoat Co. then petitioned the Tax Court for review of the Commissioner's determination.

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Issue(s)

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1. Whether the 1936 strike caused the taxpayer's average base period net income to be an inadequate standard of normal earnings under Section 722(b)(1) of the Internal Revenue Code?

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2. Whether the introduction of woolen garments constituted a change in the character of the taxpayer's business due to a difference in products furnished under Section 722(b)(4) of the Internal Revenue Code?

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3. Whether changes to the factory floorplan and equipment between 1937 and 1939 constituted a change in the character of the taxpayer's business due to a difference in capacity for production or operation under Section 722(b)(4) of the Internal Revenue Code?

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Holding

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1. No, because the strike did not significantly diminish the taxpayer's overall profitability during the base period; 1936 was in fact the most profitable year from 1927-1940.

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2. No, because adding woolen garments was a normal evolution of the business given its practice of offering different types of outer garments and its search for off-season products.

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3. No, because the changes were routine operating adjustments and did not establish an increase in productive capacity.

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Court’s Reasoning

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The court reasoned that the strike’s impact was not significant enough to warrant relief under Section 722(b)(1). While acknowledging the strike was an unusual event, the court emphasized that the taxpayer failed to demonstrate that it caused an inadequate standard of normal earnings. The court noted that 1936, the year of the strike, was the company’s most profitable year. As to the change in business character claims under Section 722(b)(4), the court applied Treasury Regulations which specify that the change must be

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