Liberty Baking Co. v. Commissioner, 19 T.C. 776 (1953)

A taxpayer seeking relief from excess profits taxes under Section 722 of the Internal Revenue Code must demonstrate that the tax is excessive and discriminatory and establish a fair and just amount representing normal earnings to be used as a constructive average base period net income (CABPNI).

Summary

Liberty Baking Co. sought relief from excess profits taxes, arguing its tax burden was excessive and discriminatory due to factors like installing new equipment, converting its sales organization, and experiencing a strike. The Tax Court agreed that the mechanization program qualified as a change in the character of the business under Section 722(b)(4). The court determined that the taxpayer was entitled to use a CABPNI to determine excess profits tax liability. The court then calculated a CABPNI, making adjustments for the mechanization, strike, and other factors, ultimately granting the petitioner a CABPNI higher than the Commissioner's determination but lower than the amount the taxpayer sought.

Facts

Liberty Baking Co. transitioned from a predominantly hand-baking operation to a mechanized one between 1934 and 1938, investing significantly in new equipment. This mechanization reduced material waste and improved product quality. The company also experienced a strike by its bakers for approximately three months in 1936, incurring additional costs to maintain production. The company also converted from commission salesmen to independent contractors.

Procedural History

Liberty Baking Co. petitioned the Tax Court for relief from excess profits taxes under Section 722 of the Internal Revenue Code. The Commissioner had determined the company's average base period excess profits net income to be $1,970.17, and after applying the "Growth Formula" the net income was $3,640.70. The Tax Court reviewed the case to determine if the company qualified for relief and to calculate a fair CABPNI.

Issue(s)

1. Whether Liberty Baking Co.'s mechanization program constituted a change in the character of its business under Section 722(b)(4) of the Internal Revenue Code, thus making its excess profits tax excessive and discriminatory.
2. Whether the strike in 1936 was an unusual and peculiar event under Section 722(b)(1) that warrants an adjustment to the company's base period income.
3. What is the appropriate CABPNI to be used in calculating Liberty Baking Co.'s excess profits tax relief?

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Holding

1. Yes, because the mechanization program represented a significant change in the operation of the business, leading to increased efficiency and reduced costs.
2. Yes, because the strike was an unusual event that caused increased costs for salaries, room, board, and protection.
3. The appropriate CABPNI is $7,654.62, because this figure accurately reflects the company's normal earnings, adjusted for the impact of the mechanization, strike, and other relevant factors.

Court's Reasoning

The court reasoned that the mechanization program qualified as a "change in the character of the business" under Section 722(b)(4), citing *7-Up Fort Worth Co., 8 T. C. 52*. The court rejected the Commissioner's argument that the program was merely normal modernization, stating that the statute does not require a taxpayer to demonstrate relative superiority in the industry. Regarding the strike, the court acknowledged it as an unusual event under Section 722(b)(1) based on Section 35.722-3, Regulations 112, which includes strikes as

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