Radio Shack Corp. v. C.I.R., 21 T.C. 638 (1954)

When reconstructing income for excess profits tax relief under Section 722, taxpayers must avoid using post-1939 data or unsupported assumptions; reconstructions must be based on facts existing before December 31, 1939.

Summary

Radio Shack sought to increase its constructive average base period net income for excess profits tax relief under Section 722(b)(4) of the Internal Revenue Code, arguing the Commissioner's allowance was inadequate. The Tax Court rejected the taxpayer's reconstructions, finding they relied on unsupported assumptions about the growth of its mail order business and comparisons with another company based on arbitrary allocations and post-1939 data. While acknowledging that reconstructions require some conjecture, the court emphasized the need for a factual foundation and determined a constructive average base period net income higher than the Commissioner's allowance but lower than the taxpayer's claim.

Facts

- Radio Shack qualified for relief under Section 722(b)(4) due to changes in its business.
- The Commissioner allowed a constructive average base period net income of $9,000 for the fiscal year ended June 30, 1941, and $12,000 for subsequent years.
- Radio Shack argued its constructive income should be "not less than $24,500 to $26,972."
- Radio Shack attempted to show that if qualifying changes had happened two years earlier, its mail order and industrial business would have constituted 60% of its total business by 1939.

Procedural History

Radio Shack appealed the Commissioner's determination of its constructive average base period net income to the Tax Court, arguing that the Commissioner's allowance was inadequate and that its proposed reconstructions were valid. The Tax Court reviewed the evidence and arguments presented by both parties.

Issue(s)

1. Whether Radio Shack's proposed reconstructions of its average base period net income were adequately supported by factual evidence, excluding post-1939 data, to justify a higher relief amount under Section 722(b)(4).
2. Whether the Commissioner's application of the variable credit rule was appropriate in determining the constructive average base period net income for the fiscal year ended June 30, 1941.

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Holding

1. No, because Radio Shack's reconstructions relied heavily on unsupported assumptions about the growth of its mail order business and comparisons with another company based on arbitrary allocations and post-1939 data.
2. Yes, because the fiscal year ended June 30, 1941, did not represent a full year's operations at the level that the petitioner would have attained had it made its changes two years earlier, making the variable credit rule appropriate.

Court's Reasoning

The Court found Radio Shack's reconstructions unacceptable because they relied on the accountant's assumption that the mail order and industrial business would have grown to constitute 60% of total business by 1939, had changes occurred two years earlier. The court stated,

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