***Bemis Bros. Bag Co. v. Commissioner, 28 T.C. 335 (1957)***

To obtain relief from excess profits taxes under Section 722, a taxpayer must demonstrate that its average base period net income is an inadequate measure of normal earnings, often by applying the "2-year push-back rule" to establish a constructive average base period net income.

**Summary**

Bemis Bros. Bag Co. sought relief from excess profits taxes for 1943 and 1944. The company, having commenced business during the base period, argued that its operating losses during the base period didn't reflect normal operations. The court agreed, finding the taxpayer met the requirements of Section 722(b)(4) because its business did not reach its full earning potential by the end of the base period. The court then determined a constructive average base period net income, using the "2-year push-back rule" to simulate earnings had the business started earlier. The court rejected some of the taxpayer's proposed figures due to lack of evidentiary support, but ultimately granted relief based on a reconstruction of normal earnings.

**Facts**

Bemis Bros. Bag Co. began its business in May 1938, during the relevant base period for calculating excess profits tax. The initial period was marked by experimentation, development, and product modifications to meet customer specifications, leading to losses. By the end of 1939, the company started to receive substantial orders. The company sought relief under Section 722 of the Internal Revenue Code, arguing its base period net income was an inadequate measure of normal earnings.

**Procedural History**

The case was brought before the Tax Court of the United States. The court considered the taxpayer's claim for excess profits tax relief under Section 722(b)(4) and assessed whether its base period income was an inadequate measure of normal earnings. The court heard arguments, reviewed evidence, and ultimately found that the taxpayer was entitled to relief.

**Issue(s)**

1. Whether Bemis Bros. Bag Co. established that its excess profits tax was excessive and discriminatory, and that its average base period net income was an inadequate standard of normal earnings because it commenced business during the base period and the average base period net income did not reflect the normal operation for the entire base period of the business, as required by Section 722 (b)(4).

2. If so, what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income?

## Holding

1. Yes, because the court found that the company met the requirements of Section 722 (b)(4).

2. The court determined that $36,760 would be a fair and just amount, representing the constructive average base period net income.

## Court's Reasoning

The court applied Section 722 of the Internal Revenue Code, which provides relief from excess profits taxes. The key provision, Section 722(b)(4), addresses situations where a taxpayer commenced business during the base period and the average base period net income does not reflect normal operations. The court emphasized the "2-year push-back rule," which simulates the earnings the company would have made if it had started its business two years earlier. The court found that Bemis Bros. Bag Co.'s base period income was an inadequate standard of normal earnings, as the business was still in its development stage during that period. The court rejected the taxpayer's proposed reconstruction of earnings because it was not fully supported by the evidence. The court reconstructed the normal earnings, taking into account business statistics and the expanding market for vitamin products. The court also applied the "variable credit rule" to compute an unused excess profits credit adjustment for the year 1941.

## Practical Implications

This case is significant for understanding how to establish entitlement to relief from excess profits tax under Section 722. Attorneys should note the importance of demonstrating that a business did not reach a normal level of operation within the base period. To succeed in such cases, taxpayers must present a solid factual basis for their proposed reconstruction of normal earnings. Furthermore, this case illustrates how the "2-year push-back rule" is used to create a hypothetical scenario of earlier business commencement to determine the taxpayer's excess profits credit. The case also shows the court's willingness to adjust and refine the parties' proposed figures based on its assessment of the evidence and the facts presented. This case also highlights the application of the "variable credit rule" which is pertinent when a business is still in a state of development. The court's approach emphasizes a practical, fact-intensive analysis.