21 T.C. 888 (1954)

To obtain relief under Section 722 of the Internal Revenue Code, a taxpayer must demonstrate that a change in the character of its business, or a commitment to such a change prior to January 1, 1940, resulted in an inadequate standard of normal earnings, and what a fair and just amount representing normal earnings would be.

Summary

The Pittsburgh and Weirton Bus Company sought relief from excess profits taxes for the years 1940-1945 under Section 722 of the Internal Revenue Code. The company argued that it was entitled to a constructive average net income because it had changed the character of its business, eliminating competition, and committed to expand services. The Tax Court denied relief, finding that the company failed to prove that a fair and just amount representing normal earnings would exceed its average base period income as determined under the growth formula. The court also held that the company was not committed, before January 1, 1940, to establish new routes or improve service.

Facts

Pittsburgh and Weirton Bus Company, a Pennsylvania corporation, operated bus services in the vicinity of Weirton, West Virginia, Steubenville, Ohio, and Pittsburgh, Pennsylvania, since 1931. The company used the calendar year and accrual method of accounting. During the base period (1936-1939), the company's income varied, and the average base period net income was determined to be $44,489.25 for 1940, and $54,991.88 for subsequent years, under the growth formula. The company acquired the franchise and equipment of S. & W. Bus Company in 1937 and the intrastate rights of the Blue Ridge Bus Company in 1939. Surveys were prepared by the company in 1939 regarding additional or improved service, including new routes, though applications to the Public Service Commission were not made until 1940 and 1941. The company owned 20 buses during most of the base period, employing around 30-40 people. The principal employer in the area was the Weirton Steel Company.

Procedural History

The Pittsburgh and Weirton Bus Company filed claims for refunds under Section 722 of the Internal Revenue Code for the calendar years 1940 through 1945. The Commissioner of Internal Revenue denied the claims. The case was brought before the United States Tax Court. The Commissioner also sought a determination of deficiency in excess profits tax for 1944 which the Tax Court could not consider.

Issue(s)

1. Whether the petitioner is entitled to relief under Section 722 (b)(4) of the Internal Revenue Code, based on a change in the character of its business during the base

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period?

2. Whether the petitioner is entitled to relief under Section 722 (b)(4) of the Internal Revenue Code, based on a commitment to a change in its capacity for operations prior to January 1, 1940?

3. Whether the petitioner is entitled to relief under Section 722 (b)(5) of the Internal Revenue Code?

Holding

1. No, because the petitioner failed to establish that its average base period net income was an inadequate standard of normal earnings because of a change in the character of its business, and failed to show what would be a fair and just amount representing normal earnings to exceed its average base period net income under the growth formula.

2. No, because the petitioner failed to show a commitment prior to January 1, 1940, to establish new routes or improve existing service.

3. No, because the petitioner failed to establish any qualifying factors other than those claimed to qualify it under section 722 (b)(4).

Court's Reasoning

The court first addressed whether the company's elimination of competition qualified as a change in the character of its business, and then whether the company acquired the franchises of other bus companies, but concluded that it was not of sufficient importance. The court emphasized that even if a qualifying factor exists, relief is not automatic. The petitioner must demonstrate that its average base period net income is an inadequate standard and what would be a fair and just amount. The Court noted that the petitioner had a period of approximately 23 months before the commencement of its last base period year in which to reach a normal level of operations after the change. The court then analyzed whether the bus company was committed to a course of action to which it was committed. The court determined that the company's actions, such as the surveys and the petitions for improved service, did not constitute a commitment to a course of action prior to January 1, 1940. The court found that the promises made to the residents were indefinite and that the actions of the company were insufficient to qualify for relief.

The court then considered whether the petitioner qualified for relief under 722(b)(5). The court held that the petitioner had failed to establish any qualifying factors other than those claimed to qualify it under section 722 (b)(4).

Practical Implications

This case provides guidance to attorneys and businesses seeking relief under the

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excess profits tax provisions. The ruling underscores the importance of detailed documentation and a clear demonstration that the taxpayer's actions are not just a mere consideration, but an unequivocal commitment to a course of action. Moreover, the case emphasizes the need to show that the taxpayer's average base period net income does not accurately represent normal earnings. The court's focus on the lack of a definitive commitment and supporting data demonstrates the high evidentiary bar for proving entitlement to relief under Section 722.

In future similar cases, taxpayers seeking relief must be prepared to provide substantial evidence. Evidence should include detailed financial data, as well as a specific timeline of events demonstrating a firm commitment to the planned changes.

The case also highlights the importance of timing. Because the company's plans were to be executed after January 1, 1940, the court focused on whether it was committed to those plans before that date. This emphasis on the timing of the commitment makes the case useful for taxpayers involved in transactions where there are tax consequences of their actions.

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