## *G.M. Trading Corp. v. Commissioner*, 20 T.C. 916 (1953)

When reconstructing a taxpayer's base period net income for excess profits tax purposes, the court may use its own appraisal of the facts and testimony if the evidence does not support the computations submitted by either the taxpayer or the Commissioner, so long as the reconstruction is supported by the facts.

### Summary

G.M. Trading Corp. sought relief under Section 722(b)(4) of the Internal Revenue Code, claiming changes in its business character warranted a higher constructive average base period net income for excess profits tax purposes. The Tax Court, disagreeing with both the taxpayer's and the Commissioner's calculations, reconstructed the income itself based on its own evaluation of the evidence. The court determined a fair and just amount for the constructive average base period net income, emphasizing that Section 722 did not prescribe an exact criterion for reconstruction, and a degree of hypothesis and approximation was permissible. The court also applied the variable credit rule, finding that the business had not reached a normal level of sales and earnings by the end of the base period.

### Facts

G.M. Trading Corp. introduced a new product, Article No. 241, and established three branch warehouses during the base period. The corporation contended these changes in its business character entitled it to relief under Section 722(b)(4), resulting in a higher constructive average base period net income. The corporation presented various computations and expert testimonies to support a higher income figure; however, the court found the provided evidence insufficient to support the assumptions made in the corporation's computations, rejecting the sales and earnings indexes presented. The Commissioner also provided its own calculations.

### Procedural History

The case was heard by the United States Tax Court. The court reviewed the evidence and arguments presented by both G.M. Trading Corp. and the Commissioner. The court decided to reconstruct the corporation's constructive average base period net income based on its own evaluation of the facts. The decision was reviewed by the Special Division of the Tax Court.

### Issue(s)

1. Whether G.M. Trading Corp. was entitled to relief under Section 722(b)(4) of the Internal Revenue Code.

2. What was the correct constructive average base period net income for G.M. Trading Corp.

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3. Whether the variable credit rule was applicable.

**Holding**

1. Yes, G.M. Trading Corp. was entitled to relief under Section 722(b)(4) because the introduction of a new product and the establishment of branch warehouses constituted a change in the character of the business.

2. The court determined that $151,948 was a fair and just amount to be used as constructive average base period net income.

3. Yes, the variable credit rule was applicable.

**Court's Reasoning**

The court found that the evidence presented by G.M. Trading Corp. did not support its computations for a higher average base period net income. The court determined the index the corporation used to backcast sales was irrelevant, and the method using both sales and earnings indexes was contradictory. The court stated, "We have undertaken to evaluate the evidence and the arguments presented by the parties and to apply the relief provisions before us as fairly and accurately as possible." Recognizing that Section 722 did not prescribe a specific criterion for reconstruction, the court used its own evaluation of the facts, supported by the record, to determine a fair and just amount for the constructive average base period net income. The court also noted, "…a reconstruction must, to some extent, be based upon hypothesis and conjecture, and approximation, in short, where an absolute is not only not available but impossible of determination." The court further reasoned that after application of the 2-year push-back rule, the business was still in a state of continued growth and had not yet reached a normal level of sales and earnings, which justified the application of the variable credit rule.

**Practical Implications**

This case provides guidance on how courts will approach cases for tax relief, specifically regarding Section 722 of the Internal Revenue Code. The court's approach implies that even if neither the taxpayer nor the Commissioner's calculations are deemed acceptable, the court can independently assess the facts. Tax attorneys should be prepared to make their own calculations and present evidence, and anticipate the court may use its own assessment of facts to determine an equitable outcome, especially when considering the 2-year push-back rule. The case also emphasizes the importance of solid evidentiary support for any calculations used in reconstruction. Additionally, the case highlights that when a business hasn't reached a normal level of earnings during the base period, even after considering changes, the variable credit rule could still be applicable, meaning a complete picture of the business cycle during the relevant period is essential for a proper tax liability assessment.

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