Jackman v. Commissioner, 28 T.C. 380 (1957)

Under Section 722(b)(2) of the Internal Revenue Code of 1939, a taxpayer could be granted excess profits tax relief if its average base period net income was an inadequate standard of normal earnings because its business was depressed by temporary economic circumstances unusual for that taxpayer.

Summary

The court considered whether a company, whose base period earnings were significantly depressed due to the sudden loss of major contracts with Ford and Chrysler, qualified for excess profits tax relief. The taxpayer argued that the discontinuation of their primary products by these automakers constituted temporary economic circumstances that unfairly lowered their average base period net income. The court agreed, finding that the loss of business from Ford and Chrysler constituted such circumstances and that the taxpayer was entitled to a constructive average base period net income calculation, although the amount requested by the taxpayer was deemed excessive.

Facts

The taxpayer manufactured brakeshafts and adjustable windshields, with a substantial portion of its sales going to Ford and Chrysler. In 1937, Ford and Chrysler informed the taxpayer that they would discontinue using these products in their upcoming models. This led to a drastic reduction in the taxpayer’s sales and net income during the base period years (1936-1939) used to calculate excess profits taxes. The company then invested in new machinery and began manufacturing new products to recover from the loss of business. The taxpayer filed for excess profits tax relief, arguing that the downturn in business during the base period was caused by temporary economic circumstances unusual in its case.

Procedural History

The Commissioner of Internal Revenue disallowed the taxpayer’s claims for excess profits tax relief under section 722 of the Internal Revenue Code of 1939. The taxpayer contested this disallowance, leading to the case being heard by the Tax Court.

Issue(s)

1. Whether the taxpayer’s average base period net income was an inadequate standard of normal earnings because its business was depressed by temporary economic circumstances under section 722(b)(2).

2. Whether the taxpayer’s commitment to purchase a tube mill represented a change in the character of its business.

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Holding

1. Yes, because the discontinuation of the taxpayer's primary products by Ford and Chrysler constituted temporary economic circumstances unusual in its case, entitling the taxpayer to excess profits tax relief.

2. Yes, the court also found that the commitment to purchase a tube mill represented a change in the character of the business, however the court determined that the benefit to the petitioner was limited due to market dynamics.

Court's Reasoning

The court analyzed whether the taxpayer's situation fell under section 722(b)(2), which provides relief when base period income is depressed due to temporary and unusual economic circumstances. The court emphasized the sudden and unexpected nature of the contract losses. The court determined that the sudden loss of major contracts with Ford and Chrysler was an 'economic event or circumstance… externally caused with respect to a particular taxpayer, which has repercussions on the costs, expenses, selling prices or volume of sales.' The court rejected the government's argument against relief. The court concluded that the loss of business was temporary, peculiar to the taxpayer, and unusual, as nothing comparable had occurred in the company's history.

Practical Implications

This case highlights the importance of considering the economic realities a taxpayer faced during the base period when evaluating claims for excess profits tax relief. The court's decision underscores that the loss of major contracts or the sudden shift in market demand could constitute temporary and unusual economic circumstances. For attorneys, it illustrates how to structure arguments emphasizing the suddenness, external cause, and unusual nature of events impacting a company's earnings. Additionally, the case is illustrative of how the IRS and Tax Court will review the evidence to determine the degree of relief that a taxpayer can obtain.

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