***Universal Milking Machine Co. v. Commissioner*, 25 T.C. 633 (1956)**

To qualify for relief under IRC §722 for excess profits tax, a taxpayer must demonstrate that its base period earnings were depressed due to a temporary and unusual circumstance, or that a change in business operations during the base period warrants an adjustment to compute normal earnings.

Summary

The Universal Milking Machine Co. sought relief from excess profits tax under Section 722 of the Internal Revenue Code of 1939, claiming its base period income was depressed due to a decline in railroad equipment sales and the introduction of new equipment. The Tax Court examined whether these factors qualified for relief under §722(b)(2) and (b)(4). The court held that the decline in railroad sales was part of a long-term trend, not a temporary event, and that the new equipment did not result in higher earnings than already allowed by the Code. The court also addressed procedural issues concerning the timeliness of refund claims, holding that it lacked jurisdiction to determine refund claims for years where no deficiency was determined, but had jurisdiction where a deficiency was determined. The court ultimately denied the taxpayer's claim for relief.

Facts

Universal Milking Machine Co. fabricated steel products, with a significant portion of its income coming from the railroad industry. The company experienced a base period decline in sales to railroads due to reduced railroad equipment maintenance expenditures. The company also introduced five new boring machines and a new small mill (No. 3) designed for intermediate-sized rings during the base period. The company sought relief from excess profits tax, arguing that its base period income did not reflect normal operations due to these events.

Procedural History

Universal Milking Machine Co. filed petitions with the Tax Court seeking relief from excess profits tax for 1940, 1941, and 1942. The Commissioner of Internal Revenue determined deficiencies for 1942 and overassessments for 1941 and 1942 (including a refund for the 1942 deficiency). The company also filed claims for refund based on abnormal deductions under section 711(b)(1)(J). The Commissioner claimed the refund claims for 1940 and 1941 were barred by the statute of limitations. The Tax Court considered the merits of the claims and ultimately addressed the claims under Rule 50 for 1942.

Issue(s)

1. Whether the decline in the taxpayer's base period sales to the railroad industry was due to a temporary and unusual circumstance warranting relief under IRC §722(b)(2).

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2. Whether the installation of new boring machines and the addition of small mill No. 3 during the base period warranted relief under IRC §722(b)(4).
3. Whether the Tax Court had jurisdiction to determine the merits of the taxpayer's refund claims under section 711(b)(1)(J) for 1940 and 1941.

Holding

1. No, because the decline in sales was part of a long-term trend, not a temporary and unusual circumstance.
2. No, because there was no such level of earnings to be considered.
3. No, because no deficiency was determined. For the taxable year 1942, the court had jurisdiction.

Court's Reasoning

The court examined the evidence presented by the taxpayer regarding the decline in railroad equipment sales and determined that the decline was part of a long-term trend. The court cited the "persistent long-term declining trend which commenced considerably prior to the base period." Therefore, the court found that the requirements of §722(b)(2) were not met. The court then considered the new equipment additions, finding that it was not satisfied that the taxpayer had sustained its burden of showing increased earnings specifically traceable to the new boring machines. The court also determined that the introduction of small mill No. 3 did not result in a level of earnings that would justify the tax relief sought under section 722(b)(4). The court concluded that the benefits of the new mill were considered when calculating net profits. Addressing the procedural issues regarding the refund claims, the court reaffirmed its position that it lacks jurisdiction to determine refund claims for years where no deficiency was determined. The court had jurisdiction over the 1942 claim.

Practical Implications

This case provides important guidance for taxpayers seeking relief from excess profits taxes. It underscores the importance of demonstrating that a decline in income was due to a temporary and unusual circumstance, rather than a long-term trend. Taxpayers seeking relief under section 722(b)(4) must specifically connect the addition of new equipment with increased earnings. Also, this case serves as a reminder that the Tax Court's jurisdiction over refund claims depends on whether a deficiency has been determined.

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