Lace Maker, Inc., 17 T.C. 800 (1951)

To qualify for relief from excess profits tax under Section 722(b)(2) of the Internal Revenue Code, a taxpayer must demonstrate that their base period earnings were depressed due to temporary economic circumstances that were unusual in their business or industry, not due to governmental actions.

Summary

Lace Maker, Inc., sought relief from excess profits tax, arguing that its base period earnings were depressed by the devaluation of the French franc and the reduction in U.S. import duties on French Levers laces. The Tax Court found that neither event constituted a temporary economic circumstance under Section 722(b)(2) of the Internal Revenue Code of 1939. The court reasoned that the events were not unusual, but rather normal occurrences in international monetary and trade policy and were a result of governmental action taken to implement national economic policies, which is not covered under the relief provision of the code. The court held for the respondent, denying Lace Maker, Inc., relief.

Facts

Lace Maker, Inc., a U.S. manufacturer of Levers laces, claimed its earnings were depressed during the base period (1936-1939) due to the devaluation of the French franc and the reduction of import duties on French Levers laces. The devaluation gave French manufacturers a price advantage, increasing their exports to the U.S. The reciprocal trade agreement between the U.S. and France, effective June 15, 1936, further reduced duties. Lace Maker, Inc. argued these factors constituted temporary economic circumstances unusual to its industry, leading to an excessive and discriminatory excess profits tax.

Procedural History

Lace Maker, Inc. filed a petition with the Tax Court seeking relief from excess profits tax under Section 722(b)(2). The Commissioner of Internal Revenue denied the claim. The Tax Court reviewed the case.

Issue(s)

1. Whether the devaluation of the French franc and the reduction in U.S. import duties constituted temporary economic circumstances unusual in the business of Lace Maker, Inc., or its industry, within the meaning of Section 722(b)(2) of the Internal Revenue Code of 1939?

2. Whether Lace Maker, Inc., established what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income?

Holding

1. No, because neither the devaluation nor the reduction in duty was unusual or temporary, but rather the result of interplay of worldwide economic conditions and governmental actions taken to implement national economic policies.

2. The court found it unnecessary to answer this question.

Court's Reasoning

The court first determined the events cited by Lace Maker, Inc. were not unusual, but a normal part of international monetary and tariff policy. The court referenced prior Tax Court cases such as Acme Breweries, Packer Publishing Co., and Norfolk & Chesapeake Coal Co. The court noted that these actions were governmental, and were intended to ameliorate worldwide economic conditions. The court found that they did not have a direct impact on Lace Maker, Inc.'s business, the duty change and the franc devaluation contributed to increased competition between the French and American manufacturers. Governmental actions, even when they have a direct impact on a taxpayer's business, are not the basis for relief under section 722. The court referenced prior cases, such as Lamar Creamery Co. and Harlan Bourbon & Wine Co., to support its conclusion that competition itself does not qualify as a temporary economic circumstance under Section 722.

Practical Implications

This case emphasizes that businesses seeking relief from excess profits taxes under Section 722(b)(2) must demonstrate that the economic circumstances affecting their base period earnings were both temporary and unusual. Moreover, the Lace Maker, Inc. case underscores that government actions, even those directly impacting a business, typically do not qualify as such circumstances. This ruling impacts how similar cases should be analyzed; the court's focus on the normal nature of currency fluctuations and duty changes provides guidance for evaluating other claims. Businesses cannot rely on general market competition, or changes to trade policy, to seek relief from excess profits taxes under this provision.

