KRIS v. Commissioner, 11 T.C. 1111 (1948)

Under Section 722 of the Internal Revenue Code, a taxpayer may be eligible for excess profits tax relief if its average base period net income is an inadequate measure of normal earnings due to circumstances such as commencing business or changing the character of the business during the base period, with the “push-back rule” potentially adjusting the commencement or change date.

Summary

The case concerns KRIS, a radio station, seeking excess profits tax relief under Section 722 of the Internal Revenue Code. The station argued that its base period net income was an inadequate measure of normal earnings due to its commencement of business and a subsequent change in operational capacity. The Tax Court acknowledged these qualifying factors, applying the “push-back rule,” which effectively advanced the dates of these events. However, after analyzing the evidence, the court found that the radio station failed to demonstrate that its reconstructed 1939 income, as determined by applying the push-back rule, would have been greater than its actual income. Consequently, the court denied the relief because KRIS could not establish a “fair and just amount” representing normal earnings exceeding its existing average base period net income.

Facts

KRIS, a radio station, commenced business on April 1, 1937, during the base period for excess profits tax calculations. It also changed its operational capacity, increasing its transmission power from 500 watts to 1000 watts day and night, a change that was deemed to have occurred on December 31, 1939, under the “commitment rule” because it was the result of actions the company took before January 1, 1940. KRIS computed its average base period net income under the “growth formula.” The station sought relief under Section 722 of the Internal Revenue Code, arguing that its average base period net income was an inadequate standard of normal earnings. KRIS contended, after the application of the commitment and push-back rules, that additional revenues would have been realized from NBC, which, in turn, would have stimulated national “spot” revenue in the form of time purchased adjacent to the NBC programs.

Procedural History

The case was heard before the United States Tax Court. KRIS filed for excess profits tax relief, which the Commissioner of Internal Revenue denied. KRIS then petitioned the Tax Court to review the Commissioner’s decision. The Tax Court reviewed the evidence, heard arguments, and ultimately issued a decision denying the relief. The decision was reviewed by the Special Division.

Issue(s)

1. Whether KRIS commenced business during the base period or changed the character of the business and if the average base period net income does not reflect the normal operation for the entire base period of the business?

2. If the answer to Issue 1 is affirmative, whether KRIS's reconstructed 1939 income, considering the "push-back rule", would have been greater than its actual 1939 income?

Holding

1. Yes, because KRIS commenced business during the base period and changed its operational capacity, qualifying under Section 722(b)(4).

2. No, because the court found that KRIS did not prove that its reconstructed 1939 net income, applying the push-back rule, would have exceeded its actual income. Therefore, it failed to establish that its average base period net income was an inadequate standard of normal earnings.

Court's Reasoning

The court applied Section 722(b)(4) of the Internal Revenue Code, which provides relief if a business's average base period net income is an inadequate standard of normal earnings due to commencing business or changing the character of the business. The court found that KRIS met the qualifying factors of commencing business and changing the character of the business. Specifically, the court considered the "push-back rule" in determining the earning level. The court focused on whether KRIS's reconstructed net income, as determined under the push-back rule and considering economic conditions during the base period, would have exceeded its actual 1939 income. The court scrutinized the revenue that would have been realized from NBC and national "spot" revenue. The court cited the manager's testimony that revenue was based on the 1930 census information. The court then determined that the evidence did not support the conclusion that the company's 1939 net income did not reflect the earning level it would have reached if it had commenced business earlier and made the change in capacity before the actual dates. The court also considered that the manager said it takes 8 or 10 years for a radio station to reach its full potential; however, the 2-year pushback was the factor that the court had to consider in its decision.

The court stated, "…the push-back rule providing that if petitioner's business 'did not reach, by the end of the base period, the earning level it would have reached if * * * [petitioner] had commenced business or made the change in * * * character * * * two years before it did so, it shall be deemed to have commenced the business or made the change at such earlier time.'"

Practical Implications

This case is critical for understanding the application of the "push-back rule" in excess profits tax relief claims. The court's approach emphasizes the necessity of providing detailed evidence supporting a higher reconstructed income under the hypothetical scenarios created by the rule. Legal professionals dealing with similar cases must: (1) gather evidence of business commencement dates and changes in character, and (2) provide evidence that supports that, under the push-back rule, the company would have realized net income in 1939 greater than its actual net income for that year. The case also illustrates the importance of considering the economic conditions that actually existed during the base period when reconstructing income. The court's focus on this economic condition illustrates that these reconstructions must be realistic and supported by evidence.

The case also highlights the importance of the facts in the particular case. Even though the court had to consider the 2-year pushback rule, it would not accept that it had any effect because, at the time, advertising agencies used the 1930 census information.

