25 T.C. 1183 (1956)

To obtain relief under Section 722 of the Internal Revenue Code of 1939, a taxpayer must demonstrate that its constructive average base period net income exceeds its invested capital credits.

Summary

Empire Liquor Corporation sought relief from excess profits taxes under Section 722 of the 1939 Internal Revenue Code, claiming entitlement under subsections (b)(2) and (b)(4). The company, a wholesale liquor distributor, argued that industry-wide price wars depressed its business and that it commenced business during the base period. The Tax Court held that Empire Liquor did commence business during the base period, qualifying it for the 2-year push-back rule, but failed to establish a constructive average base period net income exceeding its invested capital credits. The court found no evidence of a temporary, unusual economic event and denied the company relief.

Facts

Empire Liquor Corporation was formed in New York in November 1937 to engage in the wholesale liquor business, commencing operations in December 1937. Its base period was from 1937 to 1940. The company applied for relief from excess profits taxes for the years ending November 30, 1943, and November 30, 1944, which were disallowed by the Commissioner of Internal Revenue. Originally intended to distribute domestic brands, Empire switched its focus to imported brands due to difficulties obtaining desired domestic liquor supplies. The company also sought to develop an importing business. The company's officers had experience in the liquor business. Empire Liquor's sales to retailers and wholesalers, as well as its inventory and import data, were presented as evidence.

Procedural History

Empire Liquor Corporation filed applications for relief and claims for refund of excess profits taxes. The Commissioner of Internal Revenue disallowed these claims. The case was brought before the United States Tax Court.

Issue(s)

1. Whether Empire Liquor Corporation qualified for relief under Section 722(b)(2) of the Internal Revenue Code of 1939.

2. Whether Empire Liquor Corporation qualified for relief under Section 722(b)(4) of the Internal Revenue Code of 1939.

3. If relief was warranted under either (b)(2) or (b)(4), whether the corporation established an adequate constructive average base period net income.

Holding

1. No, because Empire Liquor did not provide evidence of a temporary economic event that was unusual in the liquor industry.

2. Yes, because Empire Liquor commenced business during the base period.

3. No, because the court found the most favorable constructive average base period net income would not exceed the company's invested capital credits.

Court's Reasoning

The court first addressed the claim under Section 722(b)(2). It found that the evidence did not support Empire's claim that the liquor industry experienced a temporary economic event during the base period; instead, the court found only evidence of keen competition, which it held was normal in the liquor industry. Next, the court evaluated the (b)(4) claim, concluding Empire Liquor had indeed commenced business during the base period. This finding allowed the company to apply the 2-year push-back rule. However, after reviewing the company's base period performance, the court determined that the company's estimated constructive average base period net income would not exceed its invested capital credits. The court emphasized that a taxpayer using invested capital credits cannot claim relief under Section 722 if its constructive average base period net income does not exceed its invested capital credits, citing *Sartor Jewelry Co., 22 T.C. 773*, and other cases.

Practical Implications

This case underscores the stringent requirements for obtaining relief from excess profits taxes under Section 722. Taxpayers seeking relief under (b)(2) must demonstrate that their business was depressed due to a temporary economic event that was unusual in the industry. This case demonstrates that mere competition is not enough. Under (b)(4), while commencing business during the base period allows for the 2-year push-back rule, the taxpayer must still prove that its constructive average base period net income is greater than its invested capital credits to receive tax relief. This case highlights the critical importance of demonstrating the magnitude of the economic effect of the relevant event, and the necessity of a rigorous analysis of base period performance when constructing a claim for tax relief.

