***25 T.C. 1268 (1956)***

A taxpayer is entitled to relief under the excess profits tax provisions if it can demonstrate that changes in the character of its business during the base period resulted in an inadequate standard of normal earnings.

**Summary**

The Crowell-Collier Publishing Company sought relief from excess profits taxes, arguing that changes in its business during the base period (1936-1939) rendered its average base period net income an inadequate measure of normal earnings. The company discontinued publishing a magazine (Country Home) and changed its printing method to gravure. The Tax Court ruled in favor of Crowell-Collier, holding that both the discontinuance of the magazine and the printing method change constituted a change in the character of its business, entitling it to a higher constructive average base period net income (CABPNI) and relief from the excess profits tax. The court also denied relief related to research and development expenses and certain abnormal deductions.

**Facts**

Crowell-Collier published several national magazines. During the base period years, the company discontinued its Country Home magazine, which had consistently lost money. It also transitioned from letterpress printing to a substantial use of gravure printing, leading to significant cost savings. The company sought relief from excess profits taxes for the years 1943, 1944, and 1945 under Sections 722 and 721 of the Internal Revenue Code of 1939, claiming that these changes made its base period income an inadequate measure of its normal earnings.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in the company's excess profits tax. Crowell-Collier filed a petition with the U.S. Tax Court seeking overassessments and refunds. After a hearing, the Tax Court considered the company's claims under sections 722, 721, and 711 of the Internal Revenue Code. The Court ultimately found in favor of the petitioner in part, granting relief under section 722.

**Issue(s)**

1. Whether the discontinuance of Country Home magazine constituted a change in the character of the business, entitling the company to relief under section 722 (b)(4) of the 1939 Code.

2. Whether the shift to gravure printing constituted a change in the character of the business, entitling the company to relief under section 722 (b)(4) of the 1939 Code.

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3. What should be the determination of the petitioner's constructive average base period net income resulting from both or either of the qualifying factors.

4. Whether the company was entitled to eliminate abnormal income resulting from gravure research and development under section 721.

5. Whether the company was entitled to eliminate certain abnormal expenses incurred during the base period under section 711.

**Holding**

1. Yes, because the discontinuance of the magazine reduced losses and was a significant change in the character of the business.

2. Yes, because the change to gravure printing fundamentally altered the production process and resulted in significant cost savings, constituting a qualifying change in the character of the business.

3. The Court determined a constructive average base period net income (CABPNI) for the company, taking into account the two changes in business character.

4. No, because the company failed to provide sufficient evidence to support its claim of research and development expenses under section 721.

5. No, because the company's claimed abnormal expenses were not sufficiently distinct to warrant separate classification under section 711.

**Court's Reasoning**

The court considered the requirements for relief under section 722 (b)(4), which allows relief if a taxpayer's base period net income is an inadequate standard of normal earnings due to changes in the character of the business. The court found that the discontinuance of Country Home and the adoption of gravure printing both qualified as changes. The court found that the gravure printing was a "substantially different process of manufacturing" and the introduction of substantially different equipment. "As a direct result of the change petitioner's normal earnings were increased over what they would have been had the change not been made." The court then determined the company's CABPNI, considering the income adjustments related to these changes. The court denied relief under section 721 because the evidence of research and development expenses was insufficient. The court found that most of the company's claimed research and development expenses were actually training of personnel. The court denied relief under section 711 because the expenses claimed were not sufficiently "abnormal." "We do not think that either of these expenditures is entitled to a separate classification for they are not shown to differ substantially from many other items in other groupings of expenditures."

**Practical Implications**

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This case underscores the importance of carefully documenting the nature and impact of business changes for tax purposes, especially during the base period for excess profits tax calculations. Taxpayers should maintain detailed records to demonstrate that changes, such as discontinuing unprofitable operations or adopting new technologies, significantly alter a business's character and justify adjustments to their tax liability. "There is a fundamental difference between petitioner's letterpress and its high-speed multicolor gravure printing, which relates to both the process and the equipment." This case also highlights the need for robust evidence when claiming deductions, especially for research and development expenses. Finally, the case offers insight into how courts interpret the term "abnormal" in the context of expense deductions for tax purposes. Similar cases involving changes in business operations or significant capital investments should be analyzed with an understanding of this precedent.

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