Rocky Mountain Pipe Line Company, Petitioner, v. Commissioner of Internal Revenue, Respondent, 26 T.C. 1087 (1956)

The Tax Court can grant excess profits tax relief to a new business under Section 722 of the Internal Revenue Code of 1939 if the business's average base period net income is an inadequate measure of its normal earnings, even if the business does not qualify for relief under the specific "push-back" rule for new businesses.

Summary
Rocky Mountain Pipe Line Co. sought excess profits tax relief under Section 722 of the Internal Revenue Code for the years 1940-1942. The company, a newly formed oil pipeline operator, argued its base period earnings did not reflect its normal earning capacity. Although the court found the company did not qualify under the "push-back" rule (which allows a business to reconstruct its earnings as if it had been operating for two additional years), it determined that the company's base period income was an inadequate reflection of normal earnings. The Court found the company was entitled to relief because Section 713 (f) did not fully correct the abnormality. The Court calculated relief based on the potential Lance Creek production and the probable demands of the refineries the company served.

Facts
Rocky Mountain Pipe Line Co. was incorporated in July 1938 to build and operate an oil pipeline from the Lance Creek field in Wyoming to Denver, Colorado. The company began operations in November 1938. Its primary customers were refineries in the Rocky Mountain area. The Lance Creek oil field saw increasing production in the late 1930s, and pipeline capacity was limited. The company sought relief from excess profits taxes, claiming its income in the base period (1936-1939) did not fairly represent its earning potential because of its recent start-up.

Procedural History
Rocky Mountain Pipe Line Co. filed claims for excess profits tax relief for 1940, 1941, and 1942 under Section 722 of the Internal Revenue Code. The Commissioner of Internal Revenue denied the claims. The company then brought the case before the United States Tax Court. The Tax Court reviewed the facts, the legal arguments, and the applicable sections of the Internal Revenue Code.

Issue(s)

Whether Rocky Mountain Pipe Line Co. qualified for relief under Section 722(b)(4) of the Internal Revenue Code, specifically the “push-back” rule, by demonstrating it would have reached a higher earning level with two more years of experience during the base period.
Whether, even if the company did not qualify under Section 722(b)(4), the company was still entitled to relief under Section 722 because its average base period net income was an inadequate standard of normal earnings.

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Holding

No, because the evidence did not support the contention that the pipeline would have been operating at full capacity at the end of the base period with two more years of experience.
Yes, because the court found that the company’s average base period net income did not accurately reflect its normal earnings, and relief was therefore appropriate.

Court's Reasoning
The court first addressed whether the company qualified for relief under the "push-back" rule. To determine if the company would have reached a certain earning level with two additional years of experience, the court examined factors like oil production in the Lance Creek field, refinery demand, and the company's operational capacity. The court concluded that Rocky Mountain Pipe Line Co. had reached a competitive position by the end of 1939 and wouldn't have earned more if it had started two years earlier. However, the court then addressed whether the taxpayer’s average base period net income provided a reasonable basis for determining the company's excess profits credit. The court found that the average base period net income, computed under Section 713 (f), did not fully correct the abnormality. Consequently, the court held the petitioner was entitled to relief.

Practical Implications
This case emphasizes that even if a new business does not meet all the requirements for a specific statutory rule (like the "push-back" rule), it may still be eligible for excess profits tax relief. A key takeaway for tax attorneys is the importance of demonstrating that the standard formula for calculating the tax liability does not accurately reflect the company's normal earning capacity. The court's approach highlights the need to present persuasive evidence to reconstruct a fair and just average base period net income, considering market conditions, production levels, and the business's operational capacity. This decision is a reminder that the Tax Court has the power to provide relief if the standard tax calculations produce an unfair result.

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