Lever Brothers Co. v. Commissioner, 19 T.C. 959 (1953)

Under the Internal Revenue Code, a taxpayer can qualify for excess profits tax relief if substantial base period changes in management and operations led to increased earnings, even if those changes did not fully reach their potential during the base period.

Summary

Lever Brothers Co. sought excess profits tax relief, arguing that its base period income was depressed by temporary economic circumstances and substantial changes in management and operation. The court found that the company's earnings were depressed and that significant changes in management and operations, including the adoption of a new toothpaste formula and revised sales strategies, occurred. These changes substantially increased earnings, and the court concluded that the company was entitled to relief under the Internal Revenue Code because the earnings would have been materially higher at the end of the base period had the changes been implemented earlier. The court determined a constructive average base period net income based on these factors.

Facts

Lever Brothers Co. (petitioner) experienced depressed earnings during the base period (1934-1939), attributed to negative publicity about its toothpaste, customer complaints, and unfavorable sales policies. The petitioner reorganized its sales force, revised its formula to address customer complaints, and changed advertising strategies. A key management change was the hiring of Luckman, who progressively assumed greater responsibilities, ultimately becoming general manager. The company implemented new strategies in response to criticism of its toothpaste and the loss of its advertising medium, the Amos 'n' Andy radio show. The company also adjusted its sales practices, including withdrawal from fair trade agreements and adoption of the del credere plan.

Procedural History

The case was heard before the Tax Court. The petitioner sought excess profits tax relief under the Internal Revenue Code of 1939. The Commissioner of Internal Revenue (respondent) argued against the relief. The Tax Court reviewed the evidence and arguments related to the factors affecting the petitioner's earnings. The court considered both the temporary economic circumstances and the changes in management and operations. The court ultimately decided in favor of the taxpayer, determining a constructive average base period net income.

Issue(s)

1. Whether the petitioner's base period earnings were depressed due to temporary economic circumstances under section 722 (b) (2) of the Internal Revenue Code of

1939.

2. Whether there were substantial base period changes in the management and operation of the business within the meaning of section 722 (b) (4) of the Internal Revenue Code of 1939.

Holding

1. No, because the court found it unnecessary to determine whether the petitioner qualified for relief under this subsection since the court found the petitioner did qualify under the other subsection.

2. Yes, because there were substantial base period changes in management and operations, specifically including changes in management, toothpaste formula and advertising policies that resulted in increased earnings.

Court's Reasoning

The court first established that the petitioner's base period earnings were indeed depressed, providing statistical evidence to support this. The court found that the petitioner qualified for relief under section 722 (b) (4) of the Internal Revenue Code of 1939. The court considered the changes in management, particularly the role and influence of Luckman. The court also analyzed the operational changes, focusing on the adoption of a new toothpaste formula (Formula 99) to address customer complaints. The court discussed the changes in sales practices. The court emphasized the importance of advertising. The court integrated the changes in management and operations. The court stated that the changes were