***Tankport Terminals, Inc. v. Commissioner*, 22 T.C. 744 (1954)**

Under Section 722(b)(4) of the Internal Revenue Code of 1939, a business that commenced or changed its character during the base period for excess profits tax calculation may be entitled to relief if its average base period net income is an inadequate measure of normal earnings, and if it did not reach its potential earning level by the end of the base period.

Summary

The case involved Tankport Terminals, Inc., a company that began operating a deepwater storage terminal for petroleum products during the excess profits tax base period. Tankport sought relief under section 722(b)(4) of the Internal Revenue Code, claiming that its excess profits tax was excessive and discriminatory because its business commenced during the base period, and its average base period net income did not reflect its potential earnings had it begun operations earlier. The court found that, even if Tankport had started operations two years earlier, its capacity and earnings would have been limited by market conditions. The court calculated a constructive average base period net income and granted relief, illustrating how to determine tax liability under the statute.

Facts

Tankport Terminals, Inc. was formed in 1937 to operate a deepwater storage terminal. The company acquired property, constructed pipelines, and acquired storage tanks. Tankport's operations included cleaning and preparing tanks and constructing loading and unloading facilities. Tankport's main business was storing bulk liquid products, mainly petroleum. The terminal began operations with existing tanks, but was under construction and expansion throughout the base period. Tankport had to deal with various operational challenges, including a freezeup of a pipeline storing bunker fuel oil that disrupted operations, and delays in acquiring new tanks due to WWII. Tankport's revenue was limited by construction and operational issues. Tankport sought relief from excess profits tax under section 722 (b) (4) of the Internal Revenue Code of 1939.

Procedural History

Tankport Terminals, Inc. filed excess profits tax returns for the fiscal years ending April 30, 1944, 1945, and 1946, and claimed relief under section 722. The Commissioner of Internal Revenue denied the claims. Tankport petitioned the Tax Court, arguing that its excess profits tax was excessive and discriminatory because it had commenced business during the base period, and its income did not reflect normal earnings. The Tax Court considered the evidence, made factual findings and determined that Tankport was entitled to relief under section 722(b)(4).

Issue(s)

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1. Whether Tankport qualified for excess profits tax relief under section 722 of the Internal Revenue Code, due to commencing business or changing its capacity during the base period and not reaching the earning level it would have had two years earlier.
2. If Tankport qualified, what was Tankport's constructive average base period net income.

Holding

1. Yes, Tankport was entitled to tax relief because it commenced business during the base period.
2. The court determined a fair and just amount representing normal earnings, which was used as a constructive average base period net income for computing Tankport's excess profits credit.

Court's Reasoning

The court analyzed section 722(b)(4), which provides excess profits tax relief if a taxpayer's average base period net income is an inadequate standard of normal earnings because the taxpayer commenced business or changed the character of its business during the base period. The court considered evidence of the demand for storage space for fuel oil during the base period years. The court determined that Tankport began business during the base period. The court concluded that even if Tankport had started operations two years earlier, its capacity would have been less than what it argued. The court found that Tankport would have had a capacity of not more than 420,000 barrels, rather than 500,000 barrels, and would have rented approximately 350,000 barrels throughout the last base period year. Based on these findings, the court determined a constructive net income of $47,000 for Tankport's fiscal year ended April 30, 1940, which was backcast to determine the base period net income and ultimately, relief from taxes under Section 722.

The court emphasized that the taxpayer must establish that the average base period net income is an inadequate standard of normal earnings. The court stated: "To qualify for relief under section 722 the petitioner must establish that Tankport's excess profits tax computed without the benefit of section 722 is excessive and discriminatory and further must establish what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income."

Practical Implications

This case provides guidance on the application of Section 722(b)(4) for businesses that started or changed their operations during the base period for excess profits tax purposes. It is important to consider the actual constraints on a business's capacity to earn income. The case illustrates the methodology for determining a taxpayer's constructive average base period net income when the taxpayer started business in

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the base period. Attorneys should consider the specific economic environment, including the dynamics of supply and demand, when presenting their case. The case underlines the importance of providing evidence that the taxpayer’s base period net income is not representative of its normal earning capacity.

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