29 T.C. 1268 (1958)

Section 722 of the Internal Revenue Code, concerning the excess profits tax, provides for a constructive average base period net income that is computed separately and used “in lieu of” the standard average base period net income; it cannot be added to the standard average base period net income.

Summary

The United States Rubber Company (U.S. Rubber) sought relief under Section 722 of the Internal Revenue Code of 1939 for excess profits taxes, arguing that a change in the character of its business during the base period warranted a higher “constructive average base period net income.” U.S. Rubber acquired Fisk Rubber Corporation, altering its business. The company computed its average base period net income under Section 742(h) using the growth formula and then sought to add an adjustment under Section 722. The Tax Court held that the method provided in Section 722 for computing a constructive average base period net income is to be used instead of the method under Section 742(h), not in addition to it. The court denied U.S. Rubber’s claim, emphasizing that Section 722 requires a separate, de novo calculation and cannot be combined with methods under the growth formula.

Facts

U.S. Rubber, a manufacturer of rubber products, acquired all operating assets of Fisk Rubber Corporation on December 30, 1939. This acquisition eliminated competition and was considered a change in the character of U.S. Rubber’s business. U.S. Rubber also underwent changes in the ratio of non-borrowed capital to total capital. U.S. Rubber computed its average base period net income, benefiting from the growth formula under Section 742(h). The company sought relief under Section 722, wanting to retain the Section 742(h) calculation and add an adjustment reflecting the Fisk acquisition and the capital ratio change.

Procedural History

U.S. Rubber filed applications for relief under Section 722 for the years 1941-1945. The Commissioner of Internal Revenue denied the applications in whole. The case was submitted to the United States Tax Court based on stipulated facts. The Tax Court sided with the Commissioner, leading to the present appeal.

Issue(s)

1. Whether U.S. Rubber’s average base period net income, computed without Section 722, was an inadequate standard of normal earnings due to the change in business character.

2. Whether U.S. Rubber could compute its tax credit by combining the growth formula under Section 742(h) with an additional adjustment under Section 722.

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Holding

1. Yes, because the Commissioner conceded the company's change in business character.

2. No, because Section 722 requires a separate calculation of the constructive average base period net income which is used in place of the average base period net income otherwise determined under subchapter 2E, not in addition to it.

Court's Reasoning

The court found that the Commissioner correctly recognized the change in the character of U.S. Rubber's business due to the Fisk acquisition and capital ratio changes. However, the court focused on the interpretation of Section 722(a). The court cited prior cases that established that the constructive average base period net income under Section 722(a) is computed separately and used

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