30 T.C. 809 (1958)

To qualify for excess profits tax relief under Section 722(b)(4) of the 1939 Internal Revenue Code, a taxpayer must demonstrate a 'commitment' before January 1, 1940, to a course of action that resulted in a change to the character of its business, impacting its capacity for operation during the base period.

Summary

Watt & Shand, a department store, sought relief from excess profits taxes, claiming a change in the character of its business due to an expansion project that increased its store's capacity. The company argued that decisions made before January 1, 1940, to expand its store constituted a commitment to a course of action, entitling it to a higher constructive average base period net income. The Tax Court, however, ruled against Watt & Shand, finding insufficient evidence that the pre-1940 actions would have significantly increased base period earnings. The court focused on whether the company was truly 'committed' to the expansion before the specified date, examining the nature of the pre-1940 activities.

Facts

Watt & Shand, a department store, decided during the base period to expand its store to increase sales. Before January 1, 1940, the company took several steps: (1) officers decided to expand selling space; (2) they consulted with store designers; (3) employed an architect to draw up plans; (4) notified a tenant to vacate a portion of the building; and (5) the tenant agreed to leave. A construction contract was signed in February 1940, and the work was completed in October 1940. The expansion increased floor space and selling space.

Procedural History

Watt & Shand applied for excess profits tax relief under Section 722 of the Internal Revenue Code of 1939 for the years 1941-1945. The Commissioner of Internal Revenue denied the application. The Tax Court adopted the hearing commissioner's findings and addressed whether the taxpayer was committed to a change in character of the business before January 1, 1940, and what the constructive average base period net income should be, if any.

Issue(s)

1. Whether Watt & Shand was 'committed' to a course of action before January 1, 1940, that resulted in a change in the character of its business within the meaning of Section 722(b)(4) of the Internal Revenue Code of 1939.

2. If the answer to Issue 1 is yes, what amount, if any, of constructive average base period net income should be assigned to Watt & Shand?

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Holding

1. Yes, because the company's actions, including employing an architect, giving notice to a tenant to vacate, and the decisions leading to those actions, demonstrated a commitment to a course of action that led to the expansion.

2. No, because the company failed to prove that its base period earnings would have been substantially greater if the expanded space had been available earlier, and the evidence did not justify a higher constructive average base period net income than allowed under section 713(e).

Court's Reasoning

The court focused on the interpretation of

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