***30 T.C. 1114 (1958)***

To qualify for excess profits tax relief under Section 722(b)(4) of the Internal Revenue Code of 1939, a taxpayer must demonstrate a change in the character of the business during the base period and that its average base period net income does not reflect normal operation.

**Summary**

Lansburgh & Bro., a department store, sought excess profits tax relief under Section 722 of the Internal Revenue Code of 1939, claiming changes in its business character during the base period. The Tax Court determined that Lansburgh & Bro. qualified for relief due to changes in operation and capacity for production or operation, including conversions of service space to selling space and a reorganization of its basement store. The court found that these changes, considered together, justified relief, establishing a fair and just amount representing normal earnings to be used as a constructive average base period net income. However, the court also determined that the construction of a new building in 1941 did not qualify for relief because the company had not been committed to the project before January 1, 1940.

**Facts**

Lansburgh & Bro., a family-owned department store in Washington, D.C., operated during the base period (fiscal years ending January 31, 1937-1940). The store faced competition from other department stores and specialty stores. During the base period, the store consisted of several buildings, some of which were in need of modernization and expansion. The company made multiple changes to improve sales and operations, including converting service space to selling space, reorganizing the basement store, and modernizing the store front. In 1935, the company's general manager proposed constructing a new service building, but the board of directors did not commit to this plan until later. In 1941, the company constructed a new building, adding additional selling space.

**Procedural History**

Lansburgh & Bro. applied for excess profits tax relief under Section 722 of the Internal Revenue Code of 1939. The Commissioner of Internal Revenue denied the application and related claims for refund for the taxable years ended January 31, 1941 to 1946. The case was heard before a Commissioner of the Tax Court, who made findings of fact. Both the petitioner and respondent filed objections to the findings and requested additional findings. The Tax Court adopted the findings of fact and rendered its opinion.

**Issue(s)**

1. Whether Lansburgh & Bro. qualified for excess profits tax relief under Section

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722(b)(4) due to changes in the character of its business during the base period and changes in capacity for production or operation consummated after December 31, 1939, as a result of a course of action to which the petitioner was theretofore committed.

2. If qualified, whether Lansburgh & Bro. established a fair and just amount representing normal earnings to be used as a constructive average base period net income.

**Holding**

1. Yes, because the court found changes in the operation and capacity of the business, including the conversion of service space, the reorganization of the basement store, and store front modernization, qualified for relief under Section 722(b)(4).

2. Yes, because the court determined a fair and just amount representing normal earnings to be used as a constructive average base period net income, as a result of the application of the 2-year push-back rule.

**Court's Reasoning**

The court applied Section 722(b)(4), which allows for excess profits tax relief where there is a change in the character of the business during the base period. The court considered several changes, including the conversion of service to selling space, reorganization of the basement store, and store front modernization. The court determined that these changes, either separately or when considered together, qualified the petitioner for relief because they affected the normal earnings of the business during the base period. However, the construction of the new South building in 1941 did not qualify for relief because the company had not been committed to the project before January 1, 1940, in line with Regulations 112, section 35.722-3 (d). As stated in the regulations, "The taxpayer must also establish by competent evidence that it was committed prior to January 1, 1940, to a course of action leading to such change."

**Practical Implications**

This case provides guidance on what constitutes a qualifying change in the character of a business under Section 722, particularly what constitutes a commitment that qualifies for relief under the statute. The court's emphasis on concrete actions and commitments taken before a specific date is key. Lawyers dealing with similar excess profits tax claims should carefully document the timing of any commitments to new projects, including any financial planning and contracts. The decision highlights the importance of demonstrating a commitment to a course of action, not merely contemplating or planning, before a specific date. This case remains relevant for understanding the application of similar statutes or regulations

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requiring a specific commitment before a specific date. Furthermore, the case underscores the need to demonstrate the impact of any changes on the taxpayer's average base period net income, since the ultimate goal is to reconstruct what the company's earnings would have been had these changes been made earlier.

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