31 T.C. 373 (1958)

A taxpayer is entitled to excess profits tax relief if a change in the character of the business, to which the taxpayer was committed prior to January 1, 1940, resulted in an inadequate reflection of normal earnings during the base period.

Summary

The Hecht Company sought excess profits tax relief under Section 722 of the Internal Revenue Code of 1939, arguing that a new building construction changed the character of its business and that its base period net income was not representative. The Tax Court held that The Hecht Company was entitled to relief because it had committed to constructing a new building before January 1, 1940, leading to a change in business character. The court determined the constructive average base period net income, considering the impact of the new building on earnings and also addressing a claim for relief based on changes in capital structure. The court determined the constructive average base period net income for each of the years in question and granted additional relief due to changes in the ratio of the company's nonborrowed capital to total capital during the base period.

Facts

The Hecht Company, a department store operator, sought excess profits tax relief for fiscal years ending January 31, 1941 through 1946. The company had plans to construct a new building in its Washington, D.C. store. The company had committed to constructing a new building, which, when completed, added 73,334 square feet of selling space. The company had engaged architects, made appropriations for construction, purchased land, and sought necessary permits before January 1, 1940. The IRS disallowed the relief, arguing that the company's base period net income was adequate.

Procedural History

The Hecht Company filed applications for excess profits tax relief. The Commissioner of Internal Revenue disallowed the relief. The Hecht Company then brought the case before the United States Tax Court.

Issue(s)

1. Whether The Hecht Company was committed to changes in the character of its business, specifically the construction of a new building, before January 1, 1940.

2. Whether the new construction would increase the company's net income during the base period.

Holding

1. Yes, because the court found that the company had taken significant steps towards the building's construction before the cut-off date, including engaging architects, purchasing land, and making appropriations.

2. Yes, because the court determined that the new construction would have increased the company's net income during the base period.

Court's Reasoning

The court examined Section 722(b)(4) of the Internal Revenue Code of 1939. The Court noted that the law allowed for relief if the company changed the character of the business before or during the base period. The court emphasized that a commitment to change could be demonstrated through contracts, expenditure of money, or other actions evidencing intent. The court found that The Hecht Company's actions before January 1, 1940, constituted a clear commitment to construct the new building, even though the specific size of the building underwent some revisions. The court also determined that the new construction would have increased the company's net income during the base period.

Practical Implications

This case provides guidance on what constitutes a

