Emporium World Millinery Company, Petitioner, v. Commissioner of Internal Revenue, Respondent, 32 T.C. 292 (1959)</p>

To qualify for excess profits tax relief under I.R.C. § 722(b)(2), a taxpayer must prove that its base period earnings were depressed due to temporary economic circumstances that were unusual for the taxpayer.

Summary</p>

Emporium World Millinery Co. (Petitioner) sought excess profits tax relief, arguing that the trend of "hatlessness" in women's fashion depressed its base period earnings. The Tax Court denied relief, holding that the decline in hat sales was not caused by a temporary and unusual economic circumstance, but rather by a fashion trend that existed throughout and before the base period. The court found multiple factors contributed to the industry's difficulties, not just the decline in hat sales, which was not considered a temporary circumstance. Further, the court rejected the petitioner's proposed method of calculating the impact of hatlessness on advertising expenses, finding it lacked evidentiary support.

Facts</p>

Emporium World Millinery Co., an Illinois corporation, operated leased millinery shops across the United States. The company sought excess profits tax relief for the years 1941-1945 under I.R.C. § 722, claiming that its base period earnings were depressed due to the "hatlessness" fashion trend. The company's primary evidence included a decline in industry-wide millinery sales during its base period, attributing a portion of its advertising expenses to combating this trend.

Petitioner filed applications for relief under I.R.C. § 722 for the years 1941-1945, which were subsequently denied by the Commissioner of Internal Revenue. The petitioner then brought the case to the United States Tax Court.

1. Whether the petitioner's business was depressed during the base period because of a temporary economic circumstance, specifically the "hatlessness" fashion trend, as contemplated under I.R.C. § 722(b)(2).
2. Whether the petitioner's proposed method for calculating the impact of "hatlessness" on base period income was acceptable.

1. No, because the court found hatlessness was not a temporary economic circumstance, but a fashion trend.
2. No, because the court found the proposed method of calculation was unsupported by evidence and unacceptable.

The court determined that the "hatlessness" trend was not a temporary economic circumstance unusual to the taxpayer, as required by I.R.C. § 722(b)(2). The court observed that hatlessness was not a temporary event, but rather a fashion trend that had begun to affect the millinery industry well before the base period and continued throughout the period. The court highlighted other factors contributing to the industry's economic challenges, including the general depression, labor troubles, and increasing costs of operation. The court rejected the petitioner's claim that it could calculate the impact of hatlessness by attributing a portion of its advertising expenses to combating the trend. The court noted a lack of evidence that the advertising was specifically directed against hatlessness.

This case emphasizes the need for specific, substantial evidence to establish the existence of a "temporary economic circumstance" under I.R.C. § 722. Counsel should be prepared to provide strong documentation that the claimed circumstance was both temporary and unusual for the specific taxpayer and that it directly and materially affected the taxpayer's base period earnings. The court's rejection of the advertising expense reconstruction provides guidance on the type of evidence needed, e.g., clear records demonstrating the causal link between advertising and the claimed economic circumstance. Additionally, the case highlights the importance of demonstrating that the identified circumstance was the primary cause of the business's depression and not a secondary factor. The holding provides a strong precedent for denying relief when the alleged cause is, in reality, an ongoing business or economic condition rather than a discrete, unusual, and temporary event.

