33 T.C. 899 (1960)

To obtain excess profits tax relief under Section 722 of the Internal Revenue Code, a taxpayer must demonstrate that the business, comprising both the taxpayer and its component corporation, meets the statutory requirements for relief, focusing on the combined financial performance and the impact of any changes.

Summary

Pure Transportation Company (petitioner), a subsidiary of Pure Oil, sought excess profits tax relief under Section 722 of the Internal Revenue Code of 1939, arguing its component, Wabash Pipe Line Company, was depressed during the base period. The U.S. Tax Court denied the relief. The court reasoned that because Pure Transportation and Wabash were essentially a single business, the petitioner needed to demonstrate the impact on the combined entity. Pure Transportation's failure to include its own base period earnings in the reconstruction of Wabash's earnings, coupled with a lack of proof that Wabash was depressed due to temporary economic conditions or that it failed to reach a normal earning level, resulted in the denial of the tax relief. The court emphasized that Section 722 relief requires a holistic view of the business, treating the component's operations as part of the acquiring corporation's business.

Facts

Pure Oil, engaged in petroleum production and refining, formed Pure Transportation Company (petitioner) to transport crude oil via pipelines. Wabash Pipe Line Company (Wabash) was formed as a subsidiary of Pure Oil to transport oil from newly discovered fields. Wabash's pipeline connected with Illinois Pipe Line Company, a non-affiliated entity. Wabash's participation rate in the through rates for transporting oil was initially high due to its position as the sole carrier from the Illinois fields but decreased over time due to competitive factors and the discovery of additional oil fields and pipelines. Pure Transportation sought excess profits tax relief under Section 722, claiming Wabash's business was depressed. Pure Transportation submitted financial data on Wabash but did not reconstruct its own earnings.

Procedural History

The Commissioner of Internal Revenue disallowed Pure Transportation's applications for excess profits tax relief for 1943, 1944, and 1945. Pure Transportation petitioned the United States Tax Court for a review of the Commissioner's decision. The Tax Court considered the case, received evidence, and issued findings of fact and an opinion. The Tax Court ruled in favor of the Commissioner.

Issue(s)

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1. Whether the business of Wabash Pipe Line Company was depressed during the base period due to temporary economic circumstances under Section 722(b)(2).

2. Whether, because Wabash commenced business and changed its capacity, it failed to reach, by the end of the base period, the earning level it would have reached if operations or capacity changes occurred two years earlier, under Section 722(b)(4).

3. Whether Pure Transportation established that its average base period net income was an inadequate standard of its normal earnings.

Holding

1. No, because the business of Pure Transportation (including Wabash) was not depressed in the base period due to temporary economic circumstances.

2. No, because Pure Transportation did not establish that Wabash's earnings would have been higher if operations or capacity changes had occurred earlier.

3. No, because Pure Transportation failed to establish a 'fair and just amount' representing normal earnings for its combined business.

Court's Reasoning

The court found that Pure Transportation and Wabash were essentially one business and therefore, the analysis under Section 722 required a combined view. Since Pure Transportation failed to reconstruct its own earnings, it could not establish that its overall business was depressed. The court noted that "a taxpayer seeking 722 relief must treat his business as a whole." The court considered the effect of the competition that had arisen, which reduced Wabash's participation rate. The court also reasoned that the 2-year push-back rule did not apply under Section 722(b)(2) and there was no evidence to support claims that the pipeline capacity was a limiting factor on Wabash's earnings. The Court cited *Irwin B. Schwabe Co.*, noting that the acquiring corporation should be treated as if the component corporation's business were a part of its own. The court emphasized that a reconstruction of Wabash was erroneous unless it considered the effect on the petitioner.

Practical Implications

This case highlights the importance of a comprehensive approach when seeking tax relief under Section 722 for acquiring corporations and their components. Attorneys must meticulously account for the combined financial data of the acquiring corporation and its component, including its own earnings during the base period, and demonstrate that the overall business, was adversely affected. Simply focusing on the component's performance without considering the parent company's performance will not suffice. Furthermore, claims of depression due to temporary economic circumstances must be supported with evidence showing the unusual nature of the circumstances and their impact on the combined business. The case

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underscores that the court will not simply accept arithmetic calculations, but will examine the economic realities of the business. If a change in business, such as construction or a change in capacity, is claimed, the attorney must demonstrate how the earning level of the combined business would be affected. Finally, the court held that in cases arising under 722(b)(2), the two-year pushback rule is not applicable.

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