WLS, Inc. v. Commissioner, 33 T.C. 155 (1959)

A taxpayer is entitled to a reconstruction of its average base period net income for excess profits tax purposes if it can demonstrate a change in the character of its business during the base period that significantly impacted its earning potential, and the average base period net income does not adequately reflect the normal operation of the business.

Summary

WLS, Inc., a radio broadcasting company, sought relief from excess profits taxes under Section 722 of the Internal Revenue Code of 1939. WLS argued that a significant upgrade to its transmitting facilities in November 1938 constituted a change in the character of its business, leading to increased coverage and advertising revenue not fully reflected in its base period earnings. The Tax Court agreed, holding that WLS was entitled to a reconstructed average base period net income (CABPNI) to more accurately reflect its normal earnings potential. The court then calculated the CABPNI, rejecting WLS's proposed method but finding a fair and just amount based on an index more representative of the radio industry.

Facts

WLS operated radio station WLS, the "Prairie Farmer Station," in Illinois, providing agricultural service programs. From 1931 to 1938, WLS used a part-time transmitter in Downers Grove, Illinois. Dissatisfied with its performance, WLS built a new, more efficient 50 kw transmitter in Tinley Park, Illinois, completed in November 1938. This new transmitter significantly increased the station's coverage and signal strength. In 1938 and 1939 WLS's advertising sales increased. WLS sought relief from excess profits taxes for 1940-1945, contending that the new transmitter constituted a change in the character of its business, entitling it to a reconstructed base period income.

Procedural History

WLS initially sought relief from excess profits taxes through applications to the Commissioner, which were denied. The Commissioner also denied claims for refunds. The case was heard by a Commissioner of the Tax Court, whose findings of fact were adopted by the court with some modifications. The Tax Court determined that WLS was entitled to a reconstructed average base period net income and calculated a CABPNI.

Issue(s)

1. Whether the construction and use of the Tinley Park transmitter constituted a "change in the character of the business" under Section 722(b)(4) of the Internal Revenue Code of 1939?

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2. If a change in the character of business occurred, what is a fair and just amount to be used as a constructive average base period net income (CABPNI)?

Holding

1. Yes, because the new transmitter significantly increased WLS's coverage and economic utility to advertisers, leading to increased revenue.

2. The court found the CABPNI to be $215,000, rejecting WLS's proposed amount and using a different index for reconstruction that more accurately reflected the economic conditions of the radio industry during the base period.

Court's Reasoning

The court relied on Section 722(b)(4), which provides relief if the taxpayer changed the character of their business, and their base period income did not reflect normal operations. The court found that WLS qualified for relief because the new transmitter substantially increased the station's coverage and signal strength, making it more attractive to advertisers and leading to increased income. The court cited that the new transmitter "materially increased coverage in area and population, provided a stronger station signal, and eliminated directional characteristics." Although WLS did not increase its rates, the court found that contracts, including increased broadcasting time and eliminating rental payments, led to increased earnings, especially in revenue from

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