11 T.C. 67 (1948)

A deduction is not considered abnormal in class for excess profits tax purposes simply because the taxpayer's accounting method requires it to be taken in a specific year.

Summary

Colonial Amusement Co. sought to reduce its excess profits tax by arguing that certain deductions in its base period years were abnormal. The company claimed that officers' salaries paid in 1936 for services rendered in 1935, and costs of premiums distributed to movie patrons, should be classified as abnormal deductions. The Tax Court rejected both arguments, holding that the salary payments were not abnormal simply because the company's cash-basis accounting required the deduction in 1936, and that the premium costs were part of an established promotional strategy and therefore not abnormal in class. The court emphasized that Colonial Amusement failed to prove the deductions met the criteria for abnormality under Section 711(b)(1)(J) and (K) of the Internal Revenue Code.

Facts

Colonial Amusement Co. operated several movie theaters in Philadelphia. In 1935, the company accrued salaries to its officers but did not fully pay them until 1936. The IRS determined that Colonial Amusement was operating on a cash basis, requiring the company to deduct the unpaid salaries in 1936 when they were actually paid. Additionally, Colonial Amusement distributed premiums (dishes, books, etc.) to movie patrons on certain nights to boost attendance. The company deducted the costs of these premiums. The IRS challenged the company's attempt to classify these deductions as "abnormal".

Procedural History

The Commissioner of Internal Revenue assessed deficiencies in Colonial Amusement's excess profits taxes for 1942 and 1943. Colonial Amusement petitioned the Tax Court, arguing that it was entitled to relief under Section 711(b)(1)(J) and (K) of the Internal Revenue Code because certain deductions in its base period years (1936-1940) were "abnormal".

Issue(s)

1. Whether the deduction of officers' salaries accrued in 1935 but paid in 1936 was an abnormal class of deduction under Section 711(b)(1)(J)(i) of the Internal Revenue Code.

2. Whether the deductions for the cost of premiums distributed to movie patrons were abnormal in class under Section 711(b)(1)(J)(i) of the Internal Revenue Code.

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Holding

1. No, because the fact that the company's accounting method required the deduction in 1936 does not make it an abnormal class of deduction.

2. No, because the distribution of premiums was an established practice of the company and thus not abnormal in class.

Court's Reasoning

The court reasoned that the $14,730.28 in officers' salaries paid in 1936 but accrued in 1935 was not an abnormal class of deduction. The court stated that "the fact that petitioner was on a cash basis, as determined by respondent, requiring the deduction to be taken in the year in which the salaries were paid, does not, we think, justify placing the deduction in a separate classification." The court distinguished this case from situations where the *type* of expense was truly different. Regarding the premiums, the court cited *Frank Shepard Co.*, 9 T.C. 913, holding that while a deduction might be abnormal in its initial year, its continuation in subsequent years establishes a "definite course of conduct rendering such deductions normal in the later years." Since Colonial Amusement had been distributing premiums for some time, the deductions were not considered abnormal. Furthermore, the court pointed out that Colonial Amusement failed to provide evidence showing compliance with Section 711(b)(1)(K)(ii), specifically failing to establish that the abnormality or excess was not a consequence of increased gross income or changes in the business.

Practical Implications

This case clarifies the definition of

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