58th Street Plaza Theatre, Inc. v. Commissioner, 16 T.C. 469 (1951)

A taxpayer is not entitled to excess profits tax relief under Section 722(b)(5) of the Internal Revenue Code when its base period income was affected by the general economic depression in a manner similar to other businesses in comparable situations, and its profit cycle was not materially different from the general business cycle.

Summary

58th Street Plaza Theatre, Inc. sought relief from excess profits tax, arguing that its income during the base period was an inadequate standard of normal earnings due to economic duress that compelled it to modify a lease agreement. The Tax Court denied the relief, holding that the general economic depression, which affected the taxpayer similarly to other businesses, did not qualify it for relief under Section 722(b)(5). The court reasoned that granting relief in such a case would be inconsistent with the principles underlying the specific tests outlined in Section 722(b)(3), which addresses businesses depressed by industry-wide conditions.

Facts

In 1920, 58th Street Plaza Theatre, Inc. entered into a lease agreement with Saks & Co. for rental income of $300,000 annually. Due to the Great Depression, Saks & Co., part of the Gimbel group, experienced significant financial losses. In 1935, the Gimbel group proposed that the Theatre purchase a lot from them for $1,000,000 and reduce the rent on the leased property by $50,000 annually for 4.5 years. The Theatre agreed to this modification to prevent the bankruptcy of the Gimbel group, including Saks & Co.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the taxpayer’s excess profits tax. The taxpayer petitioned the Tax Court for relief under Section 722(a) and (b)(5) of the Internal Revenue Code. The Tax Court reviewed the case and upheld the Commissioner’s determination, denying the taxpayer’s claim for relief.

Issue(s)

Whether a taxpayer whose base period income was adversely affected by the general economic depression, similarly to other taxpayers in comparable businesses, and whose profit cycle did not materially differ from the general business cycle, is entitled to excess profits tax relief under Section 722(b)(5) of the Internal Revenue Code?

Holding

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No, because the taxpayer's situation was not unique or materially different from other businesses affected by the general economic depression. Relief under Section 722(b)(5) is not intended for businesses affected by general economic downturns that impacted many taxpayers similarly.

Court's Reasoning

The court reasoned that Section 722(b)(5) is intended for taxpayers who cannot meet the specific tests laid down in subsections (b)(1), (2), (3), and (4). Relief under Section 722(b)(5) should be consistent with the principles underlying the specific tests in the other subsections. Granting relief in this case would be inconsistent with Section 722(b)(3), which addresses businesses depressed by conditions generally prevailing in an industry, subjecting them to a profits cycle differing from the general business cycle. Here, the taxpayer's business cycle did not materially differ from the general business cycle; its difficulties stemmed from the general economic downturn. The court emphasized that "to be entitled to any relief under section 722 the taxpayer must show '(3) Depression due to a profits cycle differing from the general business cycle.'" The court rejected the taxpayer's argument that it was only "indirectly or secondarily" affected by the depression. The court also distinguished the case from Philadelphia, Germantown & Norristown R. R. Co., noting that the 1935 agreement established a new standard of normal earnings, superseding the original 1920 lease.

Practical Implications

This case clarifies that Section 722(b)(5) is not a blanket provision for relief from excess profits tax simply because a business suffered during the base period. To qualify for relief, the taxpayer must demonstrate that its circumstances were unique and that its business cycle differed materially from the general business cycle. This ruling limits the scope of Section 722(b)(5), preventing it from being used as a general escape clause for businesses negatively affected by broad economic conditions. Later cases have cited this decision to emphasize the requirement of demonstrating a business cycle distinct from the general economic trend when seeking relief under Section 722(b)(5). It serves as a reminder that general economic hardship alone is insufficient to warrant excess profits tax relief; a unique and specific adverse impact must be shown.

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