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

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

Summary

58th Street Plaza Theatre, Inc. sought relief from excess profits tax under Section 722, arguing that its standard of normal earnings was inadequately represented during the base period due to circumstances forcing it to modify a lease agreement, reducing its income. The Tax Court denied relief, holding that the taxpayer's situation stemmed from the general economic depression, affecting businesses broadly, and that its profit cycle wasn't shown to be materially different from the general business cycle. The court reasoned that granting relief based solely on the impact of a general depression would be inconsistent with the intent of Section 722.

Facts

In 1920, 58th Street Plaza Theatre, Inc. (Petitioner) leased property to Saks & Co. (Gimbel group) for $300,000 annually. Due to the economic depression, the Gimbel group experienced significant losses in the early 1930s. In 1935, the Gimbel group requested that Petitioner purchase lot No. 617 for $1,000,000 and reduce the rental on the leased property by $50,000 annually for 4.5 years, beginning January 1, 1936. This proposal was intended to reduce the Gimbel group's debt and prevent bankruptcy. Petitioner agreed to this modification.

Procedural History

The Commissioner of Internal Revenue determined that 58th Street Plaza Theatre, Inc. was not entitled to relief under Section 722 of the Internal Revenue Code. The taxpayer then petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether a taxpayer, whose base period income was affected only by the general economic depression similarly to other businesses and whose profit cycle was not materially different from the general business cycle, is entitled to relief under Section 722(b)(5) of the Internal Revenue Code?

Holding

No, because Section 722(b)(5) was not intended to provide relief where the taxpayer's circumstances were indistinguishable from the general economic

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downturn affecting businesses broadly, and the taxpayer's profit cycle mirrored the general business cycle.

Court's Reasoning

The court reasoned that Section 722(b)(5) was intended to provide relief for taxpayers unable to meet the specific tests laid down in subsections (b)(1), (2), (3), and (4). The court found that granting relief in this case would be inconsistent with subsection (b)(3), which addresses businesses depressed by conditions generally prevailing in their industry. The court quoted Senate Report 1631, stating that to be entitled to relief under Section 722, the taxpayer must show "(3) Depression due to a profits cycle differing from the general business cycle." The court emphasized that the taxpayer did not demonstrate that its business cycle differed materially from the general business cycle. The court also dismissed the taxpayer's argument that it was only indirectly affected by the depression through its tenant, stating that such reasoning could be extended to argue that the tenant was also only indirectly affected.

Practical Implications

This case clarifies that Section 722 relief is not available solely based on the impact of a general economic depression. To qualify for relief, a taxpayer must demonstrate unique factors affecting their business that distinguish their situation from the general economic downturn. Specifically, this case highlights the importance of showing that the taxpayer's profits cycle differed materially in length and amplitude from the general business cycle. This case serves as precedent against claiming Section 722 relief based merely on adverse economic conditions shared by many businesses, and emphasizes the need to demonstrate specific, atypical factors that negatively affected a taxpayer's base period income. Later cases applying Section 722 would cite this ruling to deny relief where the taxpayer's difficulties were primarily linked to broader economic trends.

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