20 T.C. 110 (1953)

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A taxpayer seeking relief from excess profits tax under Section 722 of the Internal Revenue Code must demonstrate that its low base period earnings were the direct result of temporary economic circumstances unusual to its specific business or industry.

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Summary

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Mitchell & Co., a department store in Haverhill, MA, sought relief from excess profits tax, arguing its base period earnings were abnormally low due to the decline of the local shoe industry, its primary customer base. Mitchell & Co. claimed this decline stemmed from labor disputes and migration of shoe manufacturers, constituting temporary economic circumstances under Section 722(b)(2) or other factors under Section 722(b)(5) of the Internal Revenue Code. The Tax Court denied relief, finding the decline was a long-term trend caused by permanent economic factors like competition, higher labor costs, and market shifts, rather than temporary issues.

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Facts

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Mitchell & Co. operated a department store in Haverhill, Massachusetts, since 1905. Haverhill's economy heavily relied on the women's specialty shoe manufacturing industry. Starting in the early 20th century, Haverhill's shoe industry declined due to factors such as higher labor costs compared to other regions, competition from cheaper imports, and a westward shift in retail markets. Mitchell & Co.'s business suffered as a result of this decline, leading to low net income during the base period years (1936-1939). The company's two major competitors were The Sceva Speare Company and the Enterprise Stores, Inc.

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Procedural History

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Mitchell & Co. filed applications for relief under Section 722 of the Internal Revenue Code for fiscal years 1942-1946, seeking refunds of excess profits tax. The Commissioner of Internal Revenue denied these applications. Mitchell & Co. then petitioned the Tax Court for a determination of its eligibility for relief under either Section 722(b)(2) or 722(b)(5).

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Issue(s)

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1. Whether Mitchell & Co. is entitled to relief from excess profits tax under Section 722(b)(2) of the Internal Revenue Code, arguing that its low base period net income was due to temporary economic circumstances unusual in its experience.

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2. Alternatively, whether Mitchell & Co. is entitled to relief under Section 722(b)(5) of the Internal Revenue Code based on other factors resulting in an inadequate standard of normal earnings during the base period.

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Holding

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1. No, because the decline in Haverhill’s shoe industry was due to permanent economic factors, not temporary circumstances unusual to Mitchell & Co.

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2. No, because Mitchell & Co. failed to identify any “other factor” distinct from the factors already considered under Section 722(b)(2), or because those factors had already been rejected.

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Court’s Reasoning

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The court reasoned that while Mitchell & Co.’s success depended on the prosperity of the local shoe industry, the decline in that industry was not caused by temporary factors. The court identified several permanent economic factors, including: (1) expansion of western markets, (2) lower production costs outside Haverhill due to lower wages, (3) incentives offered by other localities to attract shoe manufacturers, (4) a trend towards larger, more efficient shoe manufacturing plants, and (5) competition from low-cost imported shoes. The court found no direct causal link between temporary labor disputes and Mitchell & Co.’s low base period earnings. The court also noted that Mitchell & Co. faced increased competition from other department stores during the base period, which the company failed to prove did not adversely affect its sales. Regarding Section 722(b)(5), the court stated that Mitchell & Co. had not identified any

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