28 T.C. 306 (1957)

A business's earnings depression due to competition is not considered a temporary economic circumstance that justifies relief under Section 722(b)(2) of the 1939 Internal Revenue Code.

Summary

Old Homestead Bread Co. sought excess profits tax relief under Section 722 of the 1939 Internal Revenue Code, claiming that its earnings were depressed during the base period due to an "unusual temporary economic circumstance" (competition from chain stores offering bread as a loss leader) and a strike. The Tax Court denied relief. The court held that the competition was not an unusual, temporary circumstance, but rather the normal, competitive environment of the industry. Furthermore, it found that any relief based on the strike was already accounted for under a different section of the law.

Facts

Old Homestead Bread Co. (the "taxpayer"), a wholesale baker in Denver, Colorado, faced intense competition from four other wholesale bakeries and two large chain grocery stores (Safeway and Miller) during the base period (1936-1939) and taxable years. These grocery chains operated their own bakeries and used bread as a loss leader, creating pressure on independent grocers who were the taxpayer's customers. To remain competitive, the taxpayer increased the size of its bread loaves without raising prices, indirectly reducing its profits. A strike also interrupted production for about 15 days in the fall of 1938.

Procedural History

The Commissioner of Internal Revenue denied the taxpayer's application for excess profits tax relief. The taxpayer appealed this decision to the United States Tax Court.

Issue(s)

1. Whether the taxpayer's earnings depression, caused by increased loaf sizes due to competition from chain stores, constituted a "temporary economic circumstance unusual" to the taxpayer, entitling it to relief under Section 722(b)(2) of the Internal Revenue Code of 1939.

2. Whether the strike qualified the taxpayer for relief under Section 722(b)(1), and if so, whether such relief was already accounted for under Section 713(e)(1).

Holding

1. No, because the earnings depression was due to competition, not a temporary

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economic circumstance.

2. No, because, assuming the strike qualified the taxpayer for relief under section 722(b)(1), any relief available did not exceed that provided under section 713 (e)(1).

Court's Reasoning

The court determined that the increased loaf sizes were a direct response to competition, not an unusual, temporary event. The court noted that competition is inherent in most businesses and that relief under Section 722(b)(2) is not granted for earnings depressions caused by it. The court distinguished this case from instances where relief was granted due to the loss of major customers or external events specifically affecting the business's customers, highlighting that the taxpayer's situation was rooted in its competition with other bakeries and the chains. The court stated, "Competition is present in almost every business." Regarding the strike, the court concluded that any potential relief under Section 722(b)(1) was already incorporated into the computation under Section 713(e)(1).

Practical Implications

This case emphasizes that the excess profits tax relief provisions were not intended to protect businesses from the ordinary risks of competition. Attorneys should be mindful of the distinction between normal market forces (competition) and external factors that may qualify for relief under the tax code. A business struggling with earnings decline must demonstrate a truly unusual and temporary circumstance, distinct from the competitive landscape, to qualify for Section 722 relief. This case serves as a precedent against granting relief where competitive forces drive business decisions, like the taxpayer's actions of increasing the size of bread loaves, regardless of how significant the competitive pressure.

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