5 T.C. 1025 (1945)

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Payments from a subsidiary to a parent corporation are not deductible as ordinary and necessary business expenses if they represent a distribution of profits rather than compensation for specific services rendered.

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Summary

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The Atlantic Monthly Company (Atlantic), the parent company, sought to deduct payments made by its wholly-owned subsidiary, Atlantic Monthly Press, Inc. (Press), arguing they were ordinary and necessary business expenses. The payments were made pursuant to a contract where Press agreed to pay Atlantic one-third of its gross royalty receipts for services rendered. The Tax Court disallowed the deduction, finding the payments were essentially a distribution of profits and not directly related to specific services beyond what was already compensated. This case highlights the scrutiny applied to transactions between related entities to ensure expenses are legitimate and not disguised profit distributions.

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Facts

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Atlantic formed Press to handle the book publishing aspect of its business. Press entered into a contract with Little, Brown & Co., where Little, Brown & Co. would publish books under the “Atlantic Monthly Press” name and pay royalties to Press. Atlantic and Press entered into an agreement where Press would pay Atlantic one-third of its gross royalty receipts, arguing that the Atlantic’s editorial staff devoted considerable time to developing Press, finding new manuscripts, and that the publication of the Atlantic Monthly benefited Press. Press deducted this payment as an ordinary and necessary business expense.

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Procedural History

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The Commissioner of Internal Revenue disallowed Press's deduction of the payment to Atlantic, leading to a deficiency assessment. Atlantic, as the parent company and transferee of Press's assets, challenged the Commissioner's decision in the Tax Court. The Tax Court consolidated the proceedings.

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Issue(s)

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Whether the payment by Press to Atlantic, equal to one-third of Press's gross royalty receipts, constitutes an ordinary and necessary business expense deductible under Section 23(a)(1)(A) of the Internal Revenue Code.

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Holding

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No, because the payment represented a distribution of profits rather than a payment for specific services rendered and was not an ordinary and necessary business expense.

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Court's Reasoning

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The court relied on *Welch v. Helvering, 290 U.S. 111*, and *Deputy v. Dupont, 308 U.S. 488*, for the definition of