6 T.C. 720 (1946)

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A corporation on the accrual basis cannot deduct expenses as ‘incurred’ when its liability to pay those expenses is contingent upon the recipients taking later action that benefits the corporation.

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Summary

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The Harrington Company, an accrual-basis taxpayer, voted additional compensation to its officers. However, the officers were expected to contribute these sums back to the company’s surplus via promissory notes. The Tax Court held that the company could not deduct the full amount of the compensation because its liability for those expenses was contingent on the officers’ contributions. Additionally, the court found the company liable for delinquency penalties because the initial tax returns filed were incomplete and did not constitute a valid request for an extension.

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Facts

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The Harrington Company, a manufacturer, experienced a period of financial hardship in the 1930s, during which its officers received little compensation. In 1940 and 1941, the company voted additional compensation to its officers, Roger Sherron and A.M. Harrington, to make up for past sacrifices and increased efforts. However, Sherron and Harrington then executed demand notes to the corporation, effectively contributing a portion of their compensation back to the company’s surplus. The company’s bookkeeping entries reflected these transactions as offsets. The company filed incomplete tax returns initially, citing sickness and national emergency, and later filed amended returns.

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Procedural History

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The Commissioner of Internal Revenue disallowed a portion of the company's deductions for officer compensation, arguing that the liability for these amounts was contingent. The Commissioner also imposed penalties for the late filing of complete tax returns. The Harrington Company petitioned the Tax Court, contesting both the disallowance of deductions and the imposition of penalties.

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Issue(s)

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1. Whether the amounts deducted by the petitioner as compensation of officers from its gross income for 1940 and 1941 represent business expenses paid or incurred during the respective calendar years.

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2. Whether the petitioner is liable for penalties for failure to file within the time required by law its corporation income and declared value excess profits tax return for the taxable year 1941 and its corporate excess profits tax return for the taxable year 1941.

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Holding

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1. No, because the corporation's liability for the full amount of the voted salaries was contingent upon the officers contributing a portion back to the company's surplus via promissory notes.

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2. Yes, because the initial, incomplete returns did not constitute valid returns or requests for an extension, and the company failed to demonstrate reasonable cause for the delay.

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Court's Reasoning

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The Tax Court reasoned that an expense is not

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