7 T.C. 1271 (1946)

When determining eligibility for income averaging under Section 107 of the Internal Revenue Code (as amended in 1942), the 75% compensation threshold is calculated based on the taxpayer's total compensation under their employment contract, not just the compensation attributable to a single project within that contract.

Summary

J. Mackay Spears, a civil engineer, sought to apply Section 107 of the Internal Revenue Code to a $30,000 payment he received in 1941. This payment represented his share of the profits from a construction project completed in 1927. Spears argued that because this $30,000 was more than 75% of the total compensation he received for *that specific* project, he should be able to average the income over the period of the project. The Tax Court disagreed, holding that the relevant figure for the 75% calculation was his *total* compensation under his employment contract with the Highway Engineering & Construction Co., which included salary and profits from multiple projects. Because the $30,000 was less than 75% of his total compensation under that contract, he could not use Section 107.

Facts

From 1924 to 1929, Spears worked for Highway Engineering & Construction Co. as a superintendent. His compensation included a fixed salary and 10% of the net profits from each project he supervised.
In 1925, he bid on and secured a contract for a construction project known as Temple Terrace in Florida, completing it in 1927.
The company faced litigation related to payments for the Temple Terrace project. Spears assisted in this litigation.
In 1941, the company finally settled the litigation, and Spears received $30,000 as his 10% share of the profits from the Temple Terrace project.
Spears' total compensation for the Temple Terrace project was $34,678.75, including his salary allocated to the project ($4,678.75) and the $30,000 payment in 1941.

Procedural History

Spears computed his 1941 income tax by applying Section 107 of the Internal Revenue Code.
The Commissioner of Internal Revenue determined that Section 107 was inapplicable and assessed a deficiency.
Spears petitioned the Tax Court, alleging the Commissioner's determination was erroneous.

Issue(s)

Whether Section 107 of the Internal Revenue Code, as amended by Section 139 of the Revenue Act of 1942, applies to the $30,000 payment received by Spears in 1941, allowing him to average the income over the period of the Temple Terrace project.

Holding

No, because the $30,000 payment, while representing more than 75% of the income from *that specific project*, was less than 75% of his *total* compensation under his employment contract with Highway Engineering & Construction Co. from 1924-1929.

Court's Reasoning

The court reasoned that Section 107 is intended to provide relief when a taxpayer receives a large amount of compensation for personal services rendered over a period of years, which would otherwise be subject to higher surtaxes.
To qualify for this relief, the amount received in one year must be at least 75% of the "total compensation for personal services" covering a period of at least 60 months.
The court emphasized that Spears was employed on a full-time basis and did not have separate contracts for each individual project. His "total compensation for personal services" was his entire salary plus his share of the profits from the projects he supervised. The court cited *Harry Civiletti, 3 T.C. 1274* and *Paul H. Smart, 4 T.C. 846* to support its holding that compensation cannot be artificially severed to meet the 75% requirement. The court stated, "The amount of his compensation charged to or derived from a specific project was but a part of his 'total compensation for personal services.'" Because the $30,000 was less than 75% of his total compensation under the 1924 contract, Section 107 did not apply.

Practical Implications

This case clarifies how the 75% compensation threshold in Section 107 (as it existed in 1941) should be calculated. It confirms that the calculation should be based on the taxpayer's overall employment arrangement, rather than isolating individual projects. This prevents taxpayers from artificially structuring their compensation to take advantage of income averaging provisions. Legal professionals should consider the taxpayer's entire employment history and compensation structure when analyzing the applicability of similar income-averaging provisions. It emphasizes the importance of a comprehensive view of the employment relationship, preventing taxpayers from isolating specific aspects to gain tax advantages. This ruling impacts tax planning and litigation strategies related to income averaging, especially in situations involving ongoing employment relationships spanning multiple projects or assignments.