Hershey Creamery Co. v. Commissioner, 46 B.T.A. 450 (1946)

Payments made to the government for violations of price ceilings under the Emergency Price Control Act, even if made in compromise of a claim, are generally not deductible as ordinary and necessary business expenses because allowing the deduction would frustrate sharply defined national policies.

Summary

Hershey Creamery Co. paid $7,709 to the Office of Price Administration (OPA) for alleged violations of price ceilings, under threat of a lawsuit and revocation of its slaughtering license. The company sought to deduct this payment as an ordinary and necessary business expense. The Board of Tax Appeals disallowed the deduction, holding that the payment, even if made in compromise, was essentially a penalty for violating a war measure designed to prevent inflation and thus against public policy. This decision highlights the principle that deductions cannot frustrate sharply defined national policies.

Facts

Hershey Creamery Co. was charged with violating price ceilings established by the OPA. To avoid a suit for treble damages and the potential revocation of its slaughtering license, Hershey Creamery agreed to pay $7,709 to the OPA as the amount of the alleged overcharges. The company then attempted to deduct this payment on its federal income tax return as an ordinary and necessary business expense.

Procedural History

The Commissioner of Internal Revenue disallowed the deduction claimed by Hershey Creamery. Hershey Creamery then petitioned the Board of Tax Appeals, arguing that the payment was not a penalty but rather civil damages, and that it was made under duress to protect its business. The Board of Tax Appeals upheld the Commissioner’s disallowance, leading to this decision.

Issue(s)

Whether a payment made to the Office of Price Administration (OPA) for alleged violations of price ceilings, in compromise of a threatened lawsuit, is deductible as an ordinary and necessary business expense under Section 23(a) of the Internal Revenue Code.

Holding

No, because allowing the deduction would frustrate the sharply defined national policy of preventing inflation during wartime, as embodied in the Emergency Price Control Act.

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Court’s Reasoning

The court reasoned that while deductions for ordinary business expenses are generally allowed, this principle is narrowed when allowing a deduction would frustrate sharply defined national or state policies. Citing *Commissioner v. Heininger, 320 U.S. 467*, the court emphasized that penalties for violating statutes are generally not deductible. The court distinguished the case from situations where payments are made to consumers who have a right of action, noting that in this case, the government, not the consumer, was authorized to bring the action. The court highlighted that the Emergency Price Control Act was a vital war measure intended to prevent inflation, making its policy “sharply defined.” The court dismissed Hershey Creamery’s argument that the payment was merely a compromise, stating that the company had the opportunity to contest the charges judicially but chose instead to pay the demanded amount. The court referenced *Commissioner v. Longhorn Portland Cement Co., 148 F.2d 276*, which disallowed the deduction of a penalty paid for violating antitrust laws, as further support for its decision.

Practical Implications

This case clarifies that payments for violations of regulations enacted to enforce a strong public policy (especially during wartime) are generally not deductible, even if made in compromise. It underscores the importance of considering the underlying policy behind a regulation when determining the deductibility of payments related to its violation. Attorneys should advise clients that payments made to resolve alleged violations of laws designed to protect the public interest, such as environmental regulations or consumer protection laws, may not be deductible. This decision serves as a cautionary tale for businesses considering settling with regulatory agencies, emphasizing the need to evaluate the potential tax implications carefully. Later cases have cited this ruling to support the denial of deductions where doing so would undermine public policy.

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