10 T.C. 102 (1948)

Reasonable compensation for services is deductible, but bonuses must be fixed and not contingent, and deductions must be properly classified and not a consequence of business changes for excess profits tax purposes.

Summary

E. B. & A. C. Whiting Co. sought to deduct significant compensation paid to its president, Thomas Unsworth, and claimed entitlement to disallowances of losses under Section 711(b)(1)(J) of the Internal Revenue Code. The Tax Court determined a reasonable compensation amount for Unsworth, disallowed a bonus that was not definitively accrued, and denied the loss disallowance claim, finding the losses were a consequence of changes in the company's business. This case clarifies the requirements for deducting executive compensation and the limitations on claiming abnormal deductions for excess profits tax calculations.

Facts

E. B. & A. C. Whiting Co. processed and sold brush-making materials. Thomas Unsworth, the company's president and treasurer, managed most raw material purchases and sales. The company developed a new product, Tulatex, using waste material. During the tax years in question, Unsworth also oversaw the company's subsidiaries and traveled extensively to secure raw materials. The company's profits increased significantly, leading to substantial bonuses for Unsworth.

Procedural History

The Commissioner of Internal Revenue disallowed a portion of the compensation paid to Unsworth and denied the company's claim for loss disallowances under Section 711(b)(1)(J). The Tax Court reviewed the Commissioner's determinations, considering the reasonableness of the compensation and the validity of the loss disallowance claim.

Issue(s)

1. Whether the Commissioner erred in disallowing a portion of the compensation paid to the company's president and treasurer.
2. Whether an additional bonus amount, authorized but not accrued, is deductible as compensation.
3. Whether the company is entitled to disallowances of losses under the provisions of Section 711(b)(1)(J) of the Internal Revenue Code.

Holding

1. No, the Commissioner did err in part. $90,000 was a reasonable compensation. The excess was unreasonable.

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2. No, because the bonus was indefinite in amount, contingent upon the company’s financial condition, and never definitively accrued on the corporate books.
3. No, because the losses were a consequence of changes in the type, manner of operation, size, and condition of the company’s business.

Court’s Reasoning

The court determined reasonable compensation by assessing Unsworth’s unique abilities and additional services, but considered that his services also benefited the company’s subsidiaries. The court held that bonuses must be fixed and unconditional to be accruable. The Court emphasized the bonus was not fixed, stating the Board authorized “a sum up to but not to exceed $50,000,” and that the statute does not allow

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