Camloc Fastener Co. v. Commissioner, 10 T.C. 1030 (1948)

Payments made to settle a lawsuit arising from the breach of an exclusive sales contract are deductible as ordinary and necessary business expenses, especially when the settlement does not involve the acquisition of a capital asset.

Summary

Camloc Fastener Co. settled a lawsuit with Skipwith, its former exclusive sales agent, for breach of contract. The IRS disallowed the deduction of the settlement payment, arguing it was a capital expenditure to acquire a capital asset (Skipwith's alleged lien on a patent). The Tax Court held that the settlement payment was an ordinary and necessary business expense because Skipwith never actually owned an interest in the patent, and the payment was to resolve a dispute arising directly from the company's business operations. The court also rejected the IRS's attempt to tax the settlement amount as income to Summers, an individual involved with the company, finding no basis for such a determination.

Facts

Lee Skipwith was the exclusive sales agent for Camloc Fastener Co. under a contract. This contract allegedly gave Skipwith a lien on the company's patent to secure payment of obligations. Camloc terminated the contract, and Skipwith sued for damages. The lawsuit was settled with Camloc paying Skipwith $84,748.33. A portion of the payment was for unpaid commissions. The settlement agreement used language suggesting Skipwith was selling his "title, right and interest" in the patent.

Procedural History

Camloc Fastener Co. deducted the settlement payment as a business expense on its tax return. The Commissioner of Internal Revenue disallowed the deduction. The Commissioner also assessed a deficiency against Summers, arguing that the settlement payment constituted income to him. Camloc and Summers then petitioned the Tax Court for review of the Commissioner's determinations.

Issue(s)

1. Whether the $84,748.33 paid by Camloc to Skipwith in settlement of a lawsuit for damages was an ordinary and necessary business expense deductible by Camloc, or a capital expenditure.
2. Whether Summers received taxable income when Camloc paid Skipwith $84,748.33 in settlement of the lawsuit.

Holding

1. No, because the payment was in compromise of a suit for damages brought by Skipwith due to the termination of the exclusive sales contract, and Skipwith had no

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actual interest in the patent; this constituted an ordinary and necessary business expense.
2. No, because the payment was made by the corporation on its own behalf and in settlement of its own liability, and Summers acted only as an agent for the corporation.

Court’s Reasoning

The Tax Court reasoned that the settlement payment was not for the purchase of a capital asset because Skipwith never had any ownership interest in the Camloc patent. The contract with Skipwith only gave him a lien to secure payments due under the agreement, not a property right. The court emphasized that

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