*11 T.C. 626 (1948)*

In renegotiating war contracts, the reasonableness of compensation paid to officers and employees is a key factor in determining whether a company realized excessive profits, and such compensation must be commensurate with the actual services rendered during the fiscal year in question.

**Summary**

Quartz Laboratories, Inc. was formed to manufacture crystals for radio and radar sets under renegotiable war contracts. The company paid its officers and an expediter a total of $139,098.82 in compensation during the fiscal year 1943. The Secretary of War determined this compensation to be unreasonable and asserted that Quartz had excessive profits of $60,000 for that year. The Tax Court upheld the Secretary's determination, finding that the compensation paid was not justified by the services rendered, particularly given the relative simplicity of the manufacturing process and the limited time some individuals devoted to the company. The court emphasized that compensation must reflect the value of services provided within the specific fiscal year under review.

**Facts**

- Quartz Laboratories, Inc. was organized in September 1942 to produce crystals for military radios and radar.
- The company's initial capital was $5,000, primarily invested by George L. Williams and his wife, Aileen M. Williams.
- Ralph Hukill served as president, George L. Williams as secretary/treasurer, and their wives as vice presidents; John Ziegler provided technical expertise, and John Cashman worked as an expediter.
- The officers initially agreed to take 25% of gross sales as compensation, later reducing it to about 17%.
- During fiscal year 1943, Quartz held contracts with Hallicrafters Co. and Detrola Corporation for 90,152 crystals.
- The company borrowed capital during the year, averaging $21,990 in daily borrowed capital.

**Procedural History**

The Secretary of War determined that Quartz Laboratories, Inc. had excessive profits for the fiscal year ending September 30, 1943. Quartz, through its trustee in bankruptcy, petitioned the Tax Court for a redetermination of the excessive profits. The Tax Court upheld the Secretary's determination.

**Issue(s)**

Whether the compensation paid by Quartz Laboratories, Inc. to its officers and John H. Cashman for their services during the fiscal year 1943 was reasonable, and

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whether the company therefore had excessive profits subject to renegotiation under the Renegotiation Act of 1943.

**Holding**

No, because the compensation paid was unreasonable in view of the actual services rendered, and the company's profits were therefore excessive.

**Court's Reasoning**

The court reasoned that the compensation paid to the officers, Ziegler, and Cashman was not justified by the services they provided. Several factors influenced this decision:

- The court relied heavily on the testimony of a Signal Corps expert who stated that the 171-B crystal manufactured by Quartz was relatively simple to produce and that the company's standing in the industry was "ordinary."
- The court found that Ralph Hukill, the president, lacked significant prior experience and that his high compensation was not based on his qualifications.
- The services provided by Aileen Williams were deemed insufficient to justify her compensation.
- John Cashman, who was already employed by Hallicrafters, received disproportionately high compensation from Quartz for expediting services, part of which were already being provided by the Signal Corps and Hallicrafters itself.
- The court emphasized that the reasonableness of compensation must be evaluated within the specific fiscal year, rejecting the petitioner's argument that services rendered in later years should be considered. Citing the Renegotiation Act, the court stated that the Board "shall exercise its powers with respect to the aggregate of the amounts received or accrued *during the fiscal year*."

**Practical Implications**

This case provides a practical framework for analyzing the reasonableness of compensation in the context of war contract renegotiation or similar scenarios where profits are subject to review. It highlights the importance of:

- Documenting the specific services rendered by officers and employees.
- Ensuring that compensation aligns with the complexity of the work and the individual's qualifications and experience.
- Considering industry standards and practices in determining reasonable compensation levels.
- Focusing on services provided within the specific fiscal year under review.

The case also suggests that agreements to split war contract profits may be

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scrutinized if they result in disproportionately high compensation relative to the value of services provided. This decision serves as a reminder that businesses operating under government contracts must maintain transparency and justify their compensation practices to avoid allegations of excessive profits.

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