12 T.C. 709 (1949)

Section 107 of the Internal Revenue Code, regarding the allocation of income over multiple years, does not apply when the compensation received in the current year is less than 80% of the total compensation for continuous services rendered over several years.

Summary

The petitioners, a law partnership, received a payment in 1943 for legal services rendered in a receivership. They sought to allocate this income over prior years under Section 107 of the Internal Revenue Code. The Tax Court held that because the 1943 payment was less than 80% of the total compensation received for their continuous legal services in the receivership across multiple years, Section 107 did not apply, and the income could not be allocated. The court relied on the precedent established in *Ralph E. Lum*, emphasizing the need for the compensation received in the tax year to constitute a significant portion of the total compensation for the services rendered.

Facts

The law partnership of Morrison, Lloyd & Morrison was employed as solicitors and counsel for receivers of Fairview Cemetery Co. starting in 1936. The partnership provided continuous legal services to the receivers, filing periodic reports and accounts with the Court of Chancery of New Jersey. The partnership received compensation periodically, with varying amounts paid in different years. In 1943, the partnership received $19,792.16 for services rendered, which they sought to allocate over the years 1940, 1941, and 1942, claiming it was related to a reorganization plan substantially completed by January 1, 1943.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income and victory tax for 1943, disallowing the allocation of the $19,792.16 payment under Section 107 of the Internal Revenue Code. The petitioners challenged this determination in the Tax Court. The Tax Court consolidated the proceedings of multiple petitioners, including individual partners and estates of deceased partners.

Issue(s)

Whether the compensation received by the petitioners in 1943, as counsel for receivers, is subject to the provisions of Section 107 of the Internal Revenue Code, allowing it to be allocated over prior years.

Holding

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No, because the compensation received in 1943 was less than 80% of the total compensation received for the continuous legal services provided to the receivership over several years, making Section 107 inapplicable.

Court’s Reasoning

The Tax Court relied on its prior decision in *Ralph E. Lum, 12 T.C. 375*, which held that Section 107 is not applicable when the compensation received in the current year is less than 80% of the total compensation for the services rendered. The court emphasized that the petitioners were retained as counsel in 1936 and continuously provided legal services through 1946. The payment received in 1943 was for the aggregate of these services. The court stated, “We can not here, any more than in the *Lum* and *Moore* cases, divide the period or character of service so as to bring the amount received in the present tax year up to 80 per cent of the total compensation.” The court found no basis to segregate any part of the services to avoid the principle established in *Lum*.

Practical Implications

This case clarifies the application of Section 107 of the Internal Revenue Code regarding income allocation for services rendered over multiple years. It establishes that for Section 107 to apply, the compensation received in the current tax year must be a significant portion (at least 80%) of the total compensation received for those services. This decision impacts how attorneys and other professionals structure their billing and payment arrangements to potentially take advantage of income allocation provisions. It highlights the importance of documenting the scope and duration of services to support any claim for income allocation under Section 107. Later cases would likely cite this for the 80% rule of Section 107.

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