12 T.C. 949 (1949)

Reasonable compensation for services rendered is deductible, and a taxpayer on an accrual basis must eliminate prior year's taxes from its earnings and profits when determining equity invested capital.

Summary

Atlumor Manufacturing Co. disputed deficiencies assessed by the Commissioner of Internal Revenue. The primary issues concerned the deductibility of officer salaries, the calculation of excess profits tax credit based on invested capital, and eligibility for relief under Section 721 for abnormal income. The Tax Court held that the full amount of compensation paid to officers was deductible as reasonable, that prior year's taxes must be eliminated from accumulated earnings for invested capital calculation, and that the company failed to prove entitlement to relief for abnormal income. This case clarifies the requirements for deducting compensation expenses and calculating excess profits tax credits.

Facts

Atlumor, a furniture manufacturer, had an oral agreement with its vice president, Moore, and its plant manager, Welmers, to pay them a percentage of net profits in addition to their base salaries. Due to initial concerns about Salary Stabilization Board regulations, the company did not accrue these percentages in 1943 and 1944. In 1945, the board of directors resolved to pay Moore and Welmers the accrued percentages for 1943, 1944, and 1945, paying the 1945 amount in cash and issuing promissory notes for the prior years. The company deducted the entire amount on its 1945 return, which the Commissioner disallowed. Atlumor sought relief under Section 721, claiming abnormal income due to developing a new furniture line.

Procedural History

The Commissioner of Internal Revenue determined deficiencies against Atlumor for the fiscal years 1943, 1944, and 1945. Atlumor petitioned the Tax Court for a redetermination of these deficiencies. The Tax Court addressed the issues of compensation deductions, excess profits tax credit, and Section 721 relief.

Issue(s)

1. Whether the Commissioner erred in disallowing deductions for salaries paid to the vice president and general manager in 1945, or if portions of those salaries are deductible in 1943 and 1944.

2. Whether the Commissioner erred in computing the excess profits tax credit by excluding the entire amount of prior year's taxes from invested capital at the beginning of the tax year.

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3. Whether the petitioner is entitled to relief under Section 721(a)(2)(C) for 1943 due to abnormal income.

Holding

1. No, the Commissioner erred because the entire amount of compensation was a reasonable allowance for services rendered in 1945.

2. No, the Commissioner did not err because a taxpayer on an accrual basis must eliminate prior year's taxes from its earnings and profits when determining equity invested capital.

3. No, the petitioner is not entitled to relief because it failed to prove that its income qualified as abnormal income under Section 721.

Court's Reasoning

The court reasoned that the compensation paid to Moore and Welmers was a reasonable allowance for services rendered, based on the agreements made before the services were performed. The court cited *Lucas v. Ox Fibre Brush Co.*, 281 U.S. 115, supporting the deductibility of reasonable compensation. Regarding the excess profits tax credit, the court relied on *United States v. Anderson*, 269 U.S. 422, which allows for the accrual of taxes even before assessment, provided all events fixing the amount and liability have occurred. The court stated, "Earned surplus is not properly computed until provision for all liabilities has been made." The court found Atlumor failed to prove its entitlement to relief under Section 721 because it did not adequately demonstrate that its increased income was due to the

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