13 T.C. 419 (1949)

For purposes of determining eligibility for special tax treatment on "back pay" under Section 107(d) of the Internal Revenue Code, mere financial difficulties, even when influencing business decisions, are not an event "similar in nature" to bankruptcy or receivership unless there is legally enforceable control of the corporation by an outside entity.

Summary

The Tax Court addressed whether payments to officer-stockholders of a closely held corporation qualified for special tax treatment as "back pay" under Section 107(d) of the Internal Revenue Code. The corporation, facing financial difficulties, deferred salary payments to its officers. The court held that the deferment, while prudent, was not caused by an event similar to a receivership because the corporation's officers maintained control, even though a major creditor exerted considerable influence. Therefore, the payments did not qualify for the beneficial tax treatment afforded to back pay.

Facts

R.L. Langer and C. Abbott Lindsey, along with their families, owned all the stock of Commodore Hotel Co. The company experienced financial losses from 1933 to 1942. In 1937, a resolution authorized monthly salaries for Langer and Lindsey, but payments ceased due to financial difficulties. The hotel was heavily mortgaged, and the creditor, Pacific Mutual Life Insurance Co., had to advance funds for taxes. In 1941, a new agreement reduced interest and extended the payment period. By 1942, the corporation started to realize operating income. In 1944 and 1945, the corporation paid Langer and Lindsey back salaries, which they sought to treat as taxable in the prior years under Section 107(d) of the Internal Revenue Code.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income taxes for 1944 and 1945, arguing that the back pay should be taxed at the current rates. The taxpayers petitioned the Tax Court, claiming the benefits of Section 107(d). The cases were consolidated, and the Tax Court ruled in favor of the Commissioner.

Issue(s)

Whether the corporation's financial difficulties, coupled with the influence of its major creditor, constituted an event "similar in nature" to bankruptcy or receivership under Section 107(d)(2)(A)(iv) of the Internal Revenue Code, thus entitling the officers to special tax treatment on back salary payments.

Holding

No, because the corporation's officers, despite the financial pressures and the creditor's influence, retained ultimate control over the corporation's operations. The absence of legally enforceable control by an outside entity prevented the situation from being analogous to a receivership under Section 107(d)(2)(A)(iv).

Court's Reasoning

The court acknowledged that the corporation faced significant financial challenges and that Pacific Mutual's forbearance from foreclosure was critical to the hotel's continued operation. However, the court emphasized that the decision to defer salary payments was made by the officers themselves, reflecting prudent management rather than external legal constraints. The court distinguished the situation from a receivership, where control is legally transferred to an outside entity. The court quoted Section 107(d)(2) which defines "back pay" as remuneration that would have been paid prior to the taxable year except for the intervention of bankruptcy, receivership, disputes as to liability or "any other event determined to be similar in nature under regulations prescribed by the Commissioner with the approval of the Secretary." The court reasoned that the 'essential characteristic of a bankruptcy or receivership' is 'legally enforceable control in another' party. Because no such legally enforceable control existed here, the financial difficulties were not deemed similar to a receivership. The court distinguished *Norbert J. Kenny, 4 T.C. 750*, where the creditor held a limited extent of control via contract.

Practical Implications

This case clarifies the narrow interpretation of what constitutes an event "similar in nature" to bankruptcy or receivership for the purposes of Section 107(d) of the Internal Revenue Code (now repealed but relevant for historical tax issues). It highlights that even substantial external influence from creditors or other parties does not qualify unless it translates into legally enforceable control over the employer's financial decisions. Taxpayers seeking to utilize preferential tax treatment for back pay must demonstrate a lack of control over the timing of their compensation due to a legally binding event, not merely financial constraints or persuasive pressures. Later cases have cited Langer for the principle that financial hardship alone does not trigger back pay provisions without a formal legal impediment to payment.

