***Fine Realty, Inc. v. Commissioner, T.C. Memo. 1949-233***

A retroactive agreement for management fees, even if formalized during the taxable year, is deductible as an ordinary and necessary business expense if the services were actually rendered during that year and the compensation is reasonable.

**Summary**

Fine Realty, Inc. sought to deduct management expenses, including retroactive payments to Colony Management Company, a partnership formed by its officers. The Commissioner disallowed a portion of these deductions, arguing the retroactive payments were not ordinary and necessary business expenses because the partnership agreement was formalized mid-year. The Tax Court held that the retroactive payments were deductible because the services were actually performed throughout the year by the individuals who comprised the partnership and the compensation was deemed reasonable.

**Facts**

Fine Realty, Inc. operated a theater. Initially, M.S. Fine, the president and treasurer, received $50 per week for buying and booking films. On July 12, 1943, Fine Realty entered into a management agreement with Colony Management Company, a partnership of Fine, Berman, and Stecker, to manage the theater for $400 per week. The agreement was made retroactive to November 1, 1942, the beginning of Fine Realty's fiscal year. Fine Realty paid Colony Management Company $14,400 retroactively, covering 36 weeks at $400 per week. Fine Realty did not claim deductions for bookkeeping fees or for the amounts previously paid to Fine for booking films.

**Procedural History**

The Commissioner disallowed a portion of the management expense deductions claimed by Fine Realty. Fine Realty petitioned the Tax Court for review of the Commissioner's determination.

**Issue(s)**

Whether retroactive payments made to a management company under an agreement formalized during the taxable year, but made retroactive to the beginning of that year, constitute ordinary and necessary business expenses deductible under Section 23(a)(1)(A) of the Internal Revenue Code.

**Holding**

Yes, because the services for which the retroactive payments were made were actually rendered during the taxable year by the individuals comprising the management company, and the compensation was reasonable. Citing *Lucas v. Ox*

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*Fibre Brush Co., 281 U.S. 115*.

**Court’s Reasoning**

The Tax Court relied on *Lucas v. Ox Fibre Brush Co.*, which held that compensation for past services is deductible in the year paid, even if the services were rendered in prior years, as long as the payment is reasonable. The court distinguished the Commissioner’s argument that Colony Management Company was not in existence for the entire year, noting that the individuals who formed the partnership provided the management services throughout the year, regardless of the formal partnership agreement. The court emphasized that Fine, Stecker, and Berman rendered the same services before and after the formal agreement. The court found that the management fee of $400 per week was not excessive, given the company’s increased profits, stating, “[T]he retroactive payments of management fees to the beginning of the fiscal year are deductible, and that this is true even though it be assumed there was no oral partnership existing prior to the signing of the written partnership agreement.”

**Practical Implications**

This case clarifies that retroactive compensation agreements can be deductible, even if formalized during the taxable year, as long as the services were actually performed and the compensation is reasonable. Attorneys should advise clients that the timing of the formal agreement is less important than the actual performance of services. This ruling underscores the importance of documenting the services rendered and demonstrating their reasonableness in relation to the company’s profits. Later cases applying this ruling would likely focus on whether the services were actually provided during the period covered by the retroactive agreement and whether the compensation is reasonable in light of the services performed and the company’s financial performance.

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