14 T.C. 572 (1950)

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Compensation for services rendered separately and distinctly from regular employment duties over a prolonged period can be taxed under Section 107(a) of the Internal Revenue Code, allowing for tax calculation as if the income were received ratably over the service period.

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Summary

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E.A. Terrell, president and general manager of Terrell Machine Co., received additional compensation for extraordinary services related to a patent dispute. The Tax Court addressed whether this compensation qualified for special tax treatment under Section 107(a) of the Internal Revenue Code, which applies to compensation for services rendered over 36 months or more. The court held that Terrell's services were distinct from his regular duties, thus qualifying the compensation for taxation as if it were received ratably over the period the services were rendered.

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Facts

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E.A. Terrell was the president and general manager of Terrell Machine Co., primarily manufacturing textile machinery. He held a B.S. in engineering and possessed expertise in textile machinery inventions and patents. The company held a one-half interest in the "Reynolds inventions." When a licensee, Saco-Lowell Shops, infringed on these patents, Terrell performed extensive services beyond his ordinary duties, including preparing claims, examining patents, providing expert opinions to counsel, preparing exhibits, assisting attorneys, and testifying as an expert witness. The board of directors resolved to pay Terrell $29,996.67 for these additional services after the successful resolution of the patent dispute.

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Procedural History

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Terrell reported the $29,996.67 on his 1944 tax return and computed his tax liability under Section 107(a) of the Internal Revenue Code. The Commissioner of Internal Revenue determined a deficiency, arguing that Section 107(a) did not apply and that the amount was merely additional compensation. Terrell petitioned the Tax Court for review.

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Issue(s)

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Whether the $29,996.67 received by Terrell for services related to the patent dispute qualifies for taxation under Section 107(a) of the Internal Revenue Code, as compensation for personal services rendered over a period of 36 months or more, distinct from his regular employment duties.

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Holding

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Yes, because the services Terrell rendered in connection with the patent dispute were extraordinary and entirely distinct from his regular duties as an officer of the corporation, thus qualifying the compensation for taxation under Section 107(a).

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Court’s Reasoning

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The Tax Court emphasized that Section 107(a) was enacted to alleviate the hardship of taxing compensation for long-term projects in a single year. The court found that Terrell’s services were “a special task, separate and distinct from all others, and especially from his regular duties as president and general manager of the corporation.” The court noted that the success of the interference proceeding and lawsuit was largely due to Terrell’s extraordinary services. The court distinguished this case from situations where services are inseparable from regular duties, stating, “The record shows that the personal services were sufficiently distinct and separate from the petitioner’s duties and services as an officer of the corporation to regard

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them separately for the purpose of section 107 (a).” The court quoted the Senate Finance Committee report, stating,

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