14 T.C. 633 (1950)

When a corporation's ability to pay accrued salary is restricted due to extensive government control over its assets and operations, the delayed payment can be considered "back pay" subject to proration under Section 107(d) of the Internal Revenue Code.

Summary

Frederick Hagner sought to prorate a $38,000 salary payment received in 1944 over four years under Section 107 of the Internal Revenue Code. The Tax Court considered whether this payment qualified as "back pay" due to government restrictions on the corporation's ability to generate income from its patents. The court held that the extensive government control, which effectively impounded the corporation's assets, was analogous to a receivership. This qualified the payment as back pay, allowing Hagner to prorate the income over the relevant period, thus reducing his tax liability in 1944.

Facts

Archbold-Hagner, a corporation, agreed to pay Frederick Hagner a salary of $1,000 per month contingent upon the corporation receiving income from its patents. Hagner received monthly payments from 1941 to 1944. However, due to government restrictions on the use of Archbold-Hagner's patents, the corporation could not generate income until 1944. In October 1944, Hagner received a lump-sum payment of $38,000, representing accrued salary. The government had effectively impounded the corporation's assets and forbade their use without government consent.

Procedural History

Hagner sought to prorate the $38,000 payment under Section 107 of the Internal Revenue Code. The Commissioner of Internal Revenue denied the proration. Hagner then petitioned the Tax Court for relief.

Issue(s)

1. Whether the $38,000 payment to Hagner in 1944 qualifies as "back pay" under Section 107(d)(2)(A)(iv) of the Internal Revenue Code, because the delay in payment was due to an event similar in nature to bankruptcy, receivership, or government funding issues.

Holding

1. Yes, because the government's control over Archbold-Hagner's assets and its ability to generate income from its patents was so extensive that it was analogous to a receivership, thus qualifying the payment as "back pay" under

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Section 107(d)(2)(A)(iv).

Court’s Reasoning

The Tax Court reasoned that while subsections (i), (ii), and (iii) of Section 107(d)(2)(A) did not directly apply, subsection (iv) allowed for proration if the payment was precluded by an event similar to those listed in (i), (ii), and (iii). The court referenced Regulation 111, Section 29.107-3, which states an event is similar if the circumstances are unusual, of the type specified in (i), (ii), and (iii), operate to defer payment, and payment would have been made earlier absent such circumstances. Distinguishing the case from situations where restrictions were voluntarily accepted, the court emphasized that the government’s actions were mandatory. The court stated that “all of the corporation’s assets were in effect impounded by the Government for use by it or by the corporation only with the consent of the Government.” This level of control was deemed more akin to a receivership, justifying the “back pay” designation and allowing for proration.

Practical Implications

This case provides an example of how government intervention can create conditions analogous to those specifically enumerated in the Internal Revenue Code for “back pay” proration. It highlights that even if a situation doesn’t fit neatly into the listed categories (bankruptcy, receivership, etc.), the court may consider the economic realities and the extent of external control when determining eligibility for tax relief. Attorneys can use this case to argue for proration in situations where government actions significantly impair a company’s ability to pay its employees, even if a formal receivership isn’t in place. This case emphasizes the importance of analyzing the substance of the government’s involvement, not just the form.

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