14 T.C. 643 (1950)

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When the government restricts a company’s use of its patents, preventing it from generating income to pay employee salaries, payments of accrued salaries, when the restrictions are lifted, can be treated as “back pay” for tax purposes, allowing for proration over prior years.

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Summary

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Frederick Hagner, the president and majority shareholder of Archbold-Hagner Instrument Laboratory, Inc., received a lump-sum payment in 1944 representing unpaid salaries from 1941-1943. The corporation’s primary assets were patents that the government classified as secret, restricting their use during the war. Hagner argued this delayed compensation qualified as “back pay” under Section 107(d) of the Internal Revenue Code, allowing him to spread the tax burden over the years the income was earned. The Tax Court agreed, finding the government’s restrictions analogous to a receivership, justifying back pay treatment.

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Facts

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Archbold-Hagner Instrument Laboratory, Inc. was formed to exploit Hagner’s patents. Hagner owned 75% of the stock and served as president. The corporation’s primary assets were patents related to national defense, which the government placed on a restricted list, preventing the corporation from manufacturing or licensing them without permission. From 1941 to 1943, Hagner worked extensively to adapt his inventions for the U.S. Navy, receiving only $400/month for expenses. In 1944, the government contracted with Mergenthaler Linotype Co. to produce sextants under one of Hagner’s patents and entered into a license agreement with Archbold-Hagner, resulting in a $39,559.50 payment to the company, $38,000 of which was immediately paid to Hagner as back salary.r

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Procedural History

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Hagner and his wife filed separate income tax returns for 1944, claiming the benefit of Section 107 of the Internal Revenue Code to prorate the back pay over the prior years. The Commissioner of Internal Revenue contested this treatment, leading to consolidated proceedings before the Tax Court.r

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Issue(s)

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Whether the $38,000 Hagner received in 1944 qualifies as “back pay” under Section 107(d) of the Internal Revenue Code, allowing him to allocate it over prior years for tax computation purposes, specifically under subsection (iv) regarding events similar in nature to bankruptcy, receivership, or lack of government funding.r

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Holding

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Yes, because the government’s restrictions on the corporation’s patents were analogous to a receivership, preventing the company from using its assets to generate income and pay Hagner’s salary, thus meeting the criteria for back pay treatment under Section 107(d)(2)(A)(iv).r

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Court’s Reasoning

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The court analyzed whether the circumstances delaying Hagner’s salary receipt were similar to those listed in Section 107(d)(2)(A)(i), (ii), and (iii). Since the situation didn’t involve bankruptcy, a dispute, or a governmental employer lacking

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funds, the court focused on subsection (iv), which allows proration for "any other event determined to be similar in nature." The court referenced its prior decisions in *Norbert J. Kenny, 4 T.C. 750*, and *James Newton Dean, 10 T.C. 672*, where government-imposed restrictions justified back pay treatment. Distinguishing those cases, the Tax Court found the restrictions in Hagner's case "more analogous to those in a receivership" because

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