16 T.C. 41 (1951)

For the purposes of determining eligibility for tax relief on back pay under Section 107(d) of the Internal Revenue Code, gross income from a business means total sales less the cost of goods sold, and does not allow for subtractions for other business expenses.

Summary

The Tax Court, on remand, addressed whether back pay received by the Langers and the Lindseys qualified for tax relief under Section 107(d) of the Internal Revenue Code. The court had to determine if the back pay was paid pursuant to a prior agreement and whether it exceeded 15% of the taxpayers' gross income. The court held that the back pay was indeed paid pursuant to a prior agreement. However, only the Langers met the 15% gross income threshold because the court determined that for businesses, gross income is defined as total sales less the cost of goods sold without subtracting other business expenses. The Lindseys' back pay, when calculated against this definition of gross income, did not exceed the 15% threshold.

Facts

R.L. Langer and C. Abbott Lindsey received back pay in 1944 and 1945 from the Commodore Hotel Company for services rendered in prior years. The payments were delayed due to the hotel's financial difficulties. The Langers operated the Clifton and Figueroa Hotels as joint ventures. The Lindseys operated the Commodore Cafe. The Commissioner of Internal Revenue disputed the taxpayers' eligibility for tax relief under Section 107(d) of the Internal Revenue Code, arguing that the back pay was not pursuant to a prior agreement and did not exceed 15% of their gross income.

Procedural History

The Tax Court initially ruled against the taxpayers. The Ninth Circuit Court of Appeals reversed, finding that the payment delays were due to circumstances similar to receivership, as required by Section 107(d)(2)(A). The case was remanded to the Tax Court to address the remaining issues, specifically whether the back pay was paid pursuant to prior agreement and the calculation of gross income for the 15% threshold.

Issue(s)

1. Whether the back pay received by R.L. Langer and C. Abbott Lindsey was paid pursuant to a prior agreement or legal obligation, as required by Treasury Regulations 111, Section 29.107-3.

2. Whether, for purposes of Section 107(d) of the Internal Revenue Code, gross income should be calculated as gross receipts less the cost of goods sold and other

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business expenses, or as gross receipts less only the cost of goods sold.

Holding

1. Yes, because the salaries were authorized in 1937 and the facts show that the Commodore Hotel Company failed to pay salaries from 1937 to 1942 because it was not able to do so, not because it was not liable to do so.

2. No, because the statute plainly says “gross income,” not “adjusted gross income.” The gross income from business means the total sales, less the cost of goods sold.

Court’s Reasoning

The court reasoned that the 1937 salary authorization was a continuing one, and the presumption is that services rendered after 1937 were not gratuitous. The 1944 authorization was a recognition of a pre-existing liability, not a retroactive authorization. The court cited California jurisprudence stating that if an officer is hired at a fixed salary and continues in the same employment after expiration of the term of his original hiring without a new contract, it is presumed that the parties intend the same compensation.

Regarding the definition of gross income, the court emphasized the plain language of the statute, which specifies

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