## *Hansen Baking Co. v. Commissioner, T.C. Memo. 1953-296*

A taxpayer can deduct compensation expenses when the obligation to pay becomes fixed, but must deduct expenses in the year they accrue, and cannot deduct payments discharging prior debts as losses.

### Summary

Hansen Baking Co. sought to deduct payments made in 1946 to the estate of its former president and to the rightful owner of its stock following a court order. The Tax Court addressed whether these payments constituted deductible business expenses or non-deductible dividends, and whether certain payments could be considered deductible losses. The court held that the $61,000 payment representing previously unpaid compensation to the former president was deductible. However, a $2,250 payment for salary owed to another deceased individual in 1929 was not deductible in 1946, as the obligation accrued much earlier. Finally, a $6,500 payment was deemed not a deductible loss.

### Facts

The case concerns payments made by Hansen Baking Co. in 1946 pursuant to a California court decree resolving a dispute over stock ownership and unpaid compensation. Albert Hansen was owed additional compensation of $61,000 for services rendered. Oscar Hansen, another individual, was owed $2,250 in unpaid salary from 1929. Oscar Hansen had also loaned the petitioner $5,000. Following litigation initiated by Virginia Hansen Vincent, who was found to be the rightful owner of the stock, the court ordered the company to make certain payments, including payments to the estate of Albert Hansen and to Virginia Hansen Vincent.

### Procedural History

The Commissioner of Internal Revenue disallowed certain deductions claimed by Hansen Baking Co. The company then petitioned the Tax Court for a redetermination of the deficiencies. The Tax Court reviewed the case to determine the deductibility of the payments under Section 23 of the Internal Revenue Code.

### Issue(s)

1. Whether the $61,000 payment in 1946 constitutes a deductible business expense as compensation for services rendered by Albert Hansen.

2. Whether the $2,250 payment in 1946 for unpaid salary to Oscar Hansen from 1929 is deductible as a business expense.

3. Whether the $6,500 payment in 1946 constitutes a deductible loss under Section 23(f) of the Internal Revenue Code.

 

## Holding

1. Yes, the $61,000 payment is deductible because it represented compensation for services rendered by Albert Hansen, and the obligation to pay became fixed in 1946.

2. No, the $2,250 payment is not deductible because the obligation to pay Oscar Hansen accrued in 1929, and the failure to pay it then does not make it deductible in 1946.

3. No, the $6,500 payment is not a deductible loss because the company failed to prove that it had previously paid this amount, and the current payment merely discharged an existing indebtedness.

## Court's Reasoning

Regarding the $61,000 payment, the court construed the California Superior Court's order as effectively creating a novation, where the company's obligation to pay compensation to Albert Hansen's estate and the estate's obligation to return dividends to Virginia Hansen Vincent were satisfied by the company paying Virginia Hansen Vincent directly. Thus, the payment was deemed compensation and deductible under Section 23(a)(1)(A), citing *Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115.

Regarding the $2,250 payment, the court found that the company was obligated to pay this amount in 1929 based on a resolution of its board of directors. The court noted that the absence of book entries was not decisive, citing *Texas Co. (South America) Ltd.*, 9 T. C. 78. Since the liability became fixed in 1929, it could not be deducted in 1946.

Regarding the $6,500 payment, the court held that the company failed to prove that it had previously paid this amount. The court stated, "There is nothing in the record which shows that the petitioner, in fact, paid the sum of $6,500 twice." The court concluded that the payment in 1946 discharged the company's indebtedness to Oscar Hansen and was not a deductible loss.

## Practical Implications

This case illustrates the importance of properly accounting for and paying obligations in the year they accrue to ensure deductibility. It clarifies that payments for past obligations, even if made later due to legal judgments, must be assessed for deductibility based on when the liability was initially incurred. The case also underscores the importance of maintaining accurate records and providing sufficient evidence to support claims for deductions, particularly in cases involving losses or complex financial transactions. This ruling provides guidance on the timing of deductions for compensation and liabilities, emphasizing the principle that liabilities must be fixed and determinable for a deduction to be allowed.

 