18 T.C. 1001 (1952)

A taxpayer cannot deduct contributions to an employee pension trust by merely delivering a promissory note; actual payment in cash or its equivalent is required within the taxable year or the specified grace period.

Summary

Slaymaker Lock Company sought to deduct a contribution to its employee pension trust by issuing a promissory note. The Tax Court ruled that the mere issuance of a promissory note did not constitute 'payment' under the tax code, thus disallowing the deduction except for the portion actually paid within 60 days after the close of the taxable year. However, the court allowed deductions for expenses related to a recreation lodge provided for employees, finding them to be ordinary and necessary business expenses given the wartime labor market conditions. The case clarifies the requirements for deducting contributions to employee trusts and what constitutes a deductible 'ordinary and necessary' business expense.

Facts

Slaymaker Lock Company, an accrual-basis taxpayer, established an employee pension plan. On December 31, 1943, it delivered a demand negotiable promissory note to the pension trust for $54,326.30, representing its contribution to the fund. The trust agreement allowed contributions in cash, property or securities. The Commissioner approved the pension plan. Within 60 days of year-end, Slaymaker made a partial cash payment of $10,500. Later, it replaced the original note with another for $43,826.30, eventually paying off that note. During 1944 and 1945, Slaymaker purchased and improved a property conveyed to its foremen's association for employee recreation.

Procedural History

Slaymaker Lock Company deducted the full amount of the promissory note as a contribution to its employee pension plan for the 1943 tax year. It also deducted expenses related to the recreation lodge in 1944 and 1945. The Commissioner of Internal Revenue disallowed the deduction of the promissory note (except for the $10,500 paid within 60 days) and the recreation lodge expenses, resulting in a tax deficiency. Slaymaker petitioned the Tax Court for review.

Issue(s)

1. Whether the delivery of a demand negotiable promissory note to an employee pension fund constitutes a deductible payment under Section 23(p) of the Internal Revenue Code.
2. Whether expenses incurred for the purchase and improvement of a recreation lodge conveyed to an employee association are deductible as ordinary and necessary business expenses under Section 23(a) of the Internal Revenue

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Code.

Holding

1. No, because the delivery of a promissory note is not an actual payment as required by Section 23(p) of the Internal Revenue Code.
2. Yes, because the expenditures were reasonable and necessary to maintain employee morale and attract workers during wartime, thus qualifying as ordinary and necessary business expenses.

Court’s Reasoning

Regarding the promissory note, the court emphasized that deductions require strict adherence to the statute. Section 23(p) requires contributions to be ‘paid’ to be deductible. The court stated, “Where the definite word ‘paid’ is used in the statute, its ordinary and usual meaning is to liquidate a liability in cash.” The delivery of a promissory note, even a demand note, is merely a promise to pay, not actual payment. The court distinguished a check, which implies sufficient funds and immediate honoring by the bank, from a promissory note, which requires further action by the promissor. The court also rejected the argument that the note constituted an authorized payment in “property or securities”, holding that a note in the hands of the maker before delivery is not property. Regarding the recreation lodge, the court found that the expenditures were ordinary and necessary because they served a legitimate business purpose: attracting and retaining employees during a period of high wartime demand for labor. The court noted, “In order for expenditures to be ‘necessary’ in carrying on any trade or business it is sufficient if ‘there are also reasonably evident business ends to be served, and an intention to serve them appears adequately from the record.'”

Practical Implications

This case clarifies that for accrual-basis taxpayers to deduct contributions to employee benefit plans, they must make actual payments in cash or its equivalent (e.g., readily marketable securities) within the taxable year or the grace period provided by the tax code. A mere promise to pay, such as issuing a promissory note, is insufficient. The case also illustrates the broad interpretation courts may give to ‘ordinary and necessary’ business expenses, especially when there is a clear connection between the expense and a legitimate business purpose. Attorneys advising businesses on tax planning should counsel clients to ensure that contributions to employee benefit plans are actually funded with cash or its equivalent within the statutory timeframe. They can also use this case to support deductions of employee goodwill expenses by showing a direct link to improving business performance.

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