207 F.2d 586 (7th Cir. 1953)

An employer's contributions to a profit-sharing trust exceeding the amount specified in the pre-approved plan are not deductible as ordinary and necessary business expenses under Section 23(p)(1)(C) of the Internal Revenue Code.

Summary

The Produce Reporter Co. sought to deduct contributions made to its employees' profit-sharing trust that exceeded the 5% of net profits outlined in the trust agreement. The Tax Court disallowed the deduction, arguing that only payments called for by the predetermined formula in the approved plan were deductible under Section 23(p)(1)(C). The Seventh Circuit affirmed, holding that because the trust agreement clearly stipulated the contribution amount, excess payments were not part of the approved plan and thus not deductible. The court also found that contributions made to organizations involved in lobbying were not deductible.

Facts

Produce Reporter Co. established a profit-sharing trust for its employees. The trust agreement stipulated that contributions would be 5% of the company's net profits. In certain tax years, the company contributed more than this stipulated amount. The company also made contributions to organizations, a substantial part of whose activities involved lobbying.

Procedural History

The Commissioner of Internal Revenue disallowed the deductions for contributions exceeding the 5% limit and for contributions to organizations involved in lobbying. The Tax Court upheld the Commissioner's determination. Produce Reporter Co. appealed the Tax Court's decision to the Seventh Circuit Court of Appeals.

Issue(s)

1. Whether contributions to a profit-sharing trust exceeding the amount specified in the trust agreement are deductible under Section 23(p)(1)(C) of the Internal Revenue Code.
2. Whether contributions to organizations, a substantial part of whose activities involved lobbying, are deductible.
3. Whether the Commissioner's partial disallowance of additions to a reserve for bad debts was proper.

Holding

1. No, because only contributions made in accordance with the pre-approved plan's formula are deductible under Section 23(p)(1)(C).
2. No, because Treasury Regulations prohibit the deduction of expenditures for

© 2025 SCOTUSreports.com. All rights reserved.

lobbying purposes.
3. No, because the petitioner failed to demonstrate that the Commissioner's disallowance was improper and did not adequately demonstrate the appropriateness of their bad debt reserve calculations.

Court's Reasoning

The court reasoned that the trust agreement clearly specified the contribution amount as 5% of net profits. Any amount exceeding this was not made "to or under a * * * pension * * * plan" as described by the statute. The court distinguished this case from Commissioner v. Wooster Rubber Co., where the plan's terms were ambiguous. Here, the court found no ambiguity and no room for extrinsic evidence. The court noted, "[W]hether or not the trust here involved was required to have a definite formula, it had one; and that is the formula which was exceeded by the payments in controversy." The court also relied on Treasury Regulations to deny deductions for contributions to organizations involved in lobbying, giving the regulation the force of law per Textile Mills Securities Corporation v. Commissioner, 314 U.S. 326. Finally, the court sided with the Commissioner's judgment on the disallowance for bad debt reserves, citing the taxpayer's failure to provide sufficient evidence of past experience or future expectations regarding bad debts, emphasizing that "A method or formula that produces a reasonable addition to a bad debt reserve in one year, or a series of years, may be entirely out of tune with the circumstances of the year involved."

Practical Implications

This case emphasizes the importance of adhering to the specific terms of pre-approved employee benefit plans when claiming deductions for contributions. Employers cannot deduct contributions exceeding the formula outlined in the plan, even if the trust itself might not have been required to have such a strict formula. It also reinforces the rule that contributions to organizations engaged in substantial lobbying activities are not deductible, regardless of whether the lobbying relates to the employer's business. Further, it underscores the taxpayer's burden of proof to demonstrate the reasonableness of additions to bad debt reserves, necessitating the presentation of adequate evidence regarding past experiences and future expectations concerning potential bad debts.

© 2025 SCOTUSreports.com. All rights reserved.