***Dunn & McCarthy, Inc. v. Commissioner, 139 F.2d 242 (1943)***

Business expenses can include payments made to protect a business's reputation and income, even if the payments are made on behalf of another party.

## Summary

The case revolves around whether a corporation could deduct payments made to cover the debts of its former president, who had committed suicide after borrowing from the company's top salesmen. The court held that the payments were deductible business expenses because they were made to preserve the loyalty of the salesmen and avoid negative customer reaction, thereby protecting the company's business and income. The court distinguished the payments from non-deductible personal expenses, emphasizing the business purpose and the potential harm to the company if the debts went unpaid.

## Facts

Dunn & McCarthy, Inc., a shoe manufacturer, faced a crisis when its president committed suicide, leaving a large amount of debt owed to the company's top salesmen. The president's estate was insolvent. The corporation decided to pay off the president's debts to the salesmen to maintain their loyalty and prevent a negative perception among customers, which could have damaged the business. These payments were in essence a voluntary act by the corporation.

## Procedural History

The Commissioner of Internal Revenue disallowed the corporation's deduction for the payments made to the salesmen. The Tax Court upheld the Commissioner's decision. The corporation appealed to the Second Circuit Court of Appeals.

## Issue(s)

1. Whether the payments made by Dunn & McCarthy, Inc. to cover its former president's debts constituted an ordinary and necessary business expense under Section 23(a) of the Internal Revenue Code.

## Holding

1. Yes, because the payments were made to protect the company's business reputation and employee loyalty, and they were therefore deductible as ordinary and necessary business expenses.

## Court's Reasoning

The court focused on the business purpose of the payments. It considered whether the payments were made to protect or preserve the company's business and income.

 

The court found the payments analogous to other deductible expenses, such as those made to settle claims against the company's officers to prevent harm to the business. The court reasoned that failing to pay the debts could have led to the loss of key employees and damage to customer relations. The court noted that the payments were intended to prevent a loss of business. The court emphasized that the corporation made the payments to prevent the loss of loyalty from its salesmen and to avoid an adverse reaction from customers. The court distinguished the case from situations where payments were made for personal reasons or to benefit the president personally.

## Practical Implications

This case illustrates the importance of demonstrating a clear business purpose when deducting expenses. It provides guidance on what constitutes an

 