33 T.C. 506 (1959)

Deferred compensation received after ceasing employment is considered business income for purposes of calculating a net operating loss if it is derived from a prior trade or business, and not to be offset by non-business deductions.

Summary

In 1949, the taxpayer, Joe Swisher, was awarded a bonus by General Motors, payable in installments. He left General Motors in 1950 but continued to receive bonus installments through 1954. He then operated an automobile dealership. When computing a net operating loss (NOL) for 1954 and carrying it back to 1952, Swisher treated the bonus income as non-business income, allowing him to offset it with non-business deductions. The IRS disagreed, classifying the bonus as business income, and the Tax Court upheld the IRS's determination. The court found that the bonus, although received after Swisher ceased his employment with General Motors, was still attributable to his past trade or business as an employee and thus constituted business income, restricting the use of non-business deductions to offset the income in the calculation of the net operating loss. The decision underscored the importance of the source of income when determining the availability of a net operating loss carryback.

Facts

Joe Swisher worked for General Motors for 23 years. In 1949, he was awarded a $10,000 bonus, to be paid in $2,000 annual installments beginning in 1950. Swisher left his employment with General Motors on January 15, 1950, and became an automobile dealer. He continued to receive the bonus payments through 1954. In his 1954 tax return, he reported the bonus income. However, in calculating his net operating loss for 1954, he treated the bonus as non-business income. The IRS determined that the bonus payments were business income and disallowed the offset by non-business deductions.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the taxpayers' income tax for 1952. The taxpayers then brought the case before the United States Tax Court, disputing the Commissioner's determination that the bonus payments were business income. The Tax Court ruled in favor of the Commissioner.

Issue(s)

1. Whether the $2,000 bonus payment received by the taxpayer in 1954 should be considered as gross income not derived from the taxpayer's trade or business for the purposes of determining the extent to which deductions not attributable to his trade or business may be taken into account in computing his net operating loss for 1954 to be carried back to 1952.

Holding

1. No, because the bonus payment was considered income attributable to the taxpayer's trade or business despite him no longer being employed by the same company.

Court's Reasoning

The Tax Court addressed the application of Section 172 of the Internal Revenue Code of 1954, which concerns net operating losses. The court focused on the definition of "trade or business" income and how it applied to the deferred compensation. The court cited existing precedent, including the regulations, which established that employment constitutes a trade or business. The court noted that the bonus was awarded to Swisher as compensation for his past services at General Motors. The court considered the language of the General Motors bonus plan. The bonus, according to the court, was part of the compensation paid to him by General Motors. The court considered it immaterial whether the services extended through 1954 or the bonus constituted deferred compensation for services performed in prior years. Therefore, the bonus was deemed business income, not subject to offset by non-business deductions in the NOL calculation. The court stated, "In our opinion income may be considered as income from the taxpayer's trade or business even though such business was not carried on in the year in question, so long as it is derived from a business which the petitioner had carried on in the past."

Practical Implications

This case is significant for its clarification on how deferred compensation is treated when calculating net operating losses, particularly when the income is received after the employment has ended. Attorneys and tax professionals should note that income received after leaving a business can still be considered income derived from that business, as long as it is tied to the prior employment. This has implications for how taxpayers structure compensation and how they calculate their taxes if a net operating loss is incurred. This case should inform analysis on what income is considered business income or non-business income for NOL calculation. Subsequent cases should consider this when determining whether to allow non-business deductions to offset income in NOL calculations. This case is good precedent for the IRS to classify income that stems from a prior business as business income.

