Woodward v. Commissioner, 50 T. C. 982 (1968)

The term “an employment” under IRC Section 1301 refers to an arrangement for personal services to effect a particular result, and cannot be severed to meet the 80% rule for tax relief.

Summary

Walter L. Woodward, a consulting engineer, sought to apply IRC Section 1301’s long-term compensation tax relief for payments received in 1963 from a sewer project contract spanning multiple years. The Tax Court held that the contract constituted a single “employment” aimed at constructing a sewer system, not severable into multiple employments. Thus, Woodward did not meet the 80% compensation requirement for Section 1301 relief. Additionally, the court disallowed Woodward’s travel expense deductions due to lack of substantiation under IRC Section 274(d).

Facts

In 1956, Walter L. Woodward contracted with Lewiston Orchards Sewer District No. 1 to design and supervise the construction of a sewerage system and treatment plant for 7. 5% of the total cost. The contract outlined three phases: preliminary surveys, detailed plans post-voter approval, and construction supervision. Payments were structured as 2. 5% for preliminary work, 65% less the preliminary payment for detailed plans, and 35% for supervision. The project faced delays due to voter rejections in 1956 and 1959, but was approved in 1961. Woodward received payments in 1957, 1959, 1962, 1963, and 1964, totaling $94,322. 87 upon completion in May 1964.

Procedural History

Woodward filed for tax relief under IRC Section 1301 for 1963, treating payments received as long-term compensation. The IRS disallowed the application of Section 1301 and certain travel expense deductions. Woodward petitioned the Tax Court, which heard the case and issued a decision in favor of the Commissioner on September 30, 1968.

Issue(s)

1. Whether Woodward’s contract with the sewer district constituted a single “employment” under IRC Section 1301, or if it could be severed into multiple employments for the purpose of meeting the 80% rule.
2. Whether Woodward’s claimed travel and automobile expenses for 1963 and 1964 were substantiated adequately under IRC Section 274(d).

Holding

1. No, because the contract was an arrangement for personal services to effect one particular result – the construction of a sewerage system and treatment plant. The court rejected Woodward's attempts to sever the contract into multiple employments.
2. No, because Woodward failed to substantiate his travel and automobile expenses as required by IRC Section 274(d), relying on estimates and unsupported statements.

Court's Reasoning

The court interpreted "an employment" under IRC Section 1301 as a single project or result, not severable into parts to meet the 80% rule. The court relied on the legislative history and regulations which emphasized that the term relates to a particular project, not unrelated services. The contract's three phases were steps towards the same result, not separate employments. The court also noted that even if the contract were severable, the second employment post-voter approval would not meet the 36-month requirement. For the travel expenses, the court applied IRC Section 274(d), which requires substantiation by adequate records or corroborating evidence, overruling the Cohan rule for such expenses. Woodward's lack of records or evidence led to the disallowance of the deductions.

Practical Implications

This decision clarifies that for IRC Section 1301 to apply, a contract must be for a single project or result, not severable into multiple employments to meet the 80% rule. Taxpayers and practitioners must carefully consider the nature of a contract when planning to apply for long-term compensation tax relief. The decision also reinforces the strict substantiation requirements under IRC Section 274(d), requiring taxpayers to maintain detailed records of business expenses. Subsequent cases have followed this interpretation, impacting how long-term contracts are structured and documented for tax purposes. Practitioners should advise clients to keep meticulous records of all business expenses to avoid similar disallowances.