Lacy Contracting Co. v. Commissioner, 56 T. C. 464 (1971)

Accrual basis taxpayers cannot deduct bonuses accrued to related cash basis recipients unless paid within 2 1/2 months after the close of the taxable year or constructively received within that period.

Summary

Lacy Contracting Co. , on an accrual basis, sought to deduct bonuses accrued for its controlling shareholder, Lacy, who was on a cash basis. The bonuses were not paid until December, more than 2 1/2 months after the company's fiscal year-end. The court disallowed the deductions under IRC section 267(a)(2), ruling that the bonuses were neither paid nor constructively received within the required period. The decision hinged on Lacy's lack of a right to the specific bonus amount before September 15, emphasizing the distinction between power and right in applying the constructive receipt doctrine.

Facts

Lacy Contracting Co. , an accrual basis taxpayer, accrued bonuses for its fiscal years ending June 30, 1966, and June 30, 1967. Jerry H. Lacy, the company's president and majority shareholder, was on a cash basis. The company's board authorized total bonus amounts, but Lacy determined individual allocations, including his own, sometime in September. Bonuses were paid in December, outside the 2 1/2 month period after the fiscal year-end, and were not credited to Lacy's account before September 15.

Procedural History

The Commissioner of Internal Revenue disallowed Lacy Contracting Co. 's deductions for the accrued bonuses, leading to a deficiency determination. The company petitioned the U. S. Tax Court, which upheld the Commissioner's disallowance of the deductions.

Issue(s)

1. Whether the bonuses accrued by Lacy Contracting Co. were deductible under IRC section 267(a)(2) when paid to Lacy more than 2 1/2 months after the close of the company's taxable year.
2. Whether Lacy constructively received the bonuses within the required period under IRC section 267(a)(2).

Holding

1. No, because the bonuses were not paid within the required 2 1/2 month period after the close of the company's taxable year and Lacy did not have a right to a specific amount within that period.

2. No, because the bonuses were not constructively received by Lacy within the required period as he did not have a right to the specific amount until after September 15.

Court's Reasoning

The court applied IRC section 267(a)(2), which disallows deductions for expenses accrued to related parties unless paid within the taxpayer's taxable year and 2 1/2 months thereafter or included in the recipient's gross income within that period. The court found that Lacy's power to determine and draw his bonus did not equate to a right to receive it, as the specific amount was not determined until after the statutory period. The court distinguished between the power to draw funds and the right to receive them, emphasizing that only the latter triggers constructive receipt. The court also noted that the company's practice of paying bonuses in December further supported the conclusion that Lacy did not intend to receive his bonus earlier.

Practical Implications

This decision clarifies that accrual basis taxpayers must ensure bonuses to related cash basis recipients are either paid or constructively received within the statutory period to be deductible. Practitioners should advise clients to document the determination of bonus amounts and credit them to individual accounts before the end of the statutory period. The case also underscores the importance of distinguishing between a shareholder's power and right in corporate transactions, affecting how bonuses and similar payments are structured and timed. Subsequent cases have applied this ruling to various related party transactions, reinforcing the need for careful planning to avoid disallowed deductions.