Craft Plating & Finishing, Inc. v. Commissioner, 61 T. C. 51 (1973)

Checks do not constitute “money” under IRC Section 1375(f) if not treated as such by the corporation and shareholders, and bonuses can be constructively received even if not paid within 2. 5 months after the tax year.

Summary

In Craft Plating & Finishing, Inc. v. Commissioner, the court addressed whether checks issued by a Subchapter S corporation to its shareholders qualified as “money” under IRC Section 1375(f) and whether a bonus accrued to a shareholder-employee was constructively received within the required timeframe. The court ruled that the checks were not “money” because they were not treated as such by the corporation and shareholders, resulting in the distributions being taxable as dividends. Conversely, the court found that the bonus was constructively received, allowing the corporation to deduct it. This case highlights the importance of properly documenting and treating corporate distributions and the nuances of constructive receipt for tax purposes.

Facts

Craft Plating & Finishing, Inc. , a Subchapter S corporation until July 31, 1967, issued checks to its shareholders, C. D. Fountain and Charles E. Craft, in October 1967, representing their shares of the corporation’s undistributed taxable income for the fiscal year ending July 31, 1967. The checks were not cashed until October 1969 and were not recorded as cash disbursements but as notes payable. The corporation also authorized a $20,100 bonus to Craft in July 1968, which was recorded in an accrued bonus account but not paid within 2. 5 months after the fiscal year-end.

Procedural History

The Commissioner determined deficiencies in federal income tax for the shareholders and the corporation. The cases were consolidated for trial, briefs, and opinion. The Tax Court upheld the Commissioner’s determination that the checks did not constitute “money” under IRC Section 1375(f) and were taxable as dividends. However, the court allowed the corporation to deduct the bonus to Craft, finding it was constructively received.

Issue(s)

1. Whether the checks issued by Craft Plating & Finishing, Inc. to its shareholders constituted “money” under IRC Section 1375(f), and if not, whether they represent dividend income.
2. Whether Craft Plating & Finishing, Inc. could deduct a $20,100 bonus to Charles E. Craft, given that it was not paid within 2. 5 months after the close of the taxable year.

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Holding

1. No, because the checks were not treated as money by the corporation and shareholders; they were taxable as dividends.
2. Yes, because Craft constructively received the bonus within the taxable year.

Court's Reasoning

The court found that the checks did not constitute "money" under IRC Section 1375(f) because they were held for two years without being cashed, were not recorded as cash disbursements, and there were insufficient funds in the account to honor them when issued. The court cited Randall N. Clark, 58 T. C. 94 (1972), to support its holding that the checks were demand obligations and thus property, taxable as dividends. For the bonus issue, the court applied the doctrine of constructive receipt, finding that Craft had the authority to withdraw the funds and that the bonus was set aside in an account without restrictions, allowing the corporation to deduct it.

Practical Implications

This decision underscores the importance of proper documentation and treatment of corporate distributions for tax purposes. Corporations and shareholders must treat checks as cash and ensure they are negotiated in a timely manner to qualify as "money" under IRC Section 1375(f). For bonuses, the concept of constructive receipt is crucial, and corporations should ensure that bonuses are properly documented and accessible to employees to avoid disallowance of deductions. This case has influenced how similar cases involving Subchapter S corporations and shareholder-employee compensation are analyzed, emphasizing the need for clear policies and procedures regarding corporate distributions and bonuses.

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