Kaw Dehydrating Co. , Inc. v. Commissioner, 68 T. C. 379 (1977)

Accrued bonuses are not deductible if not constructively received by related taxpayers within 2½ months after the close of the taxable year.

Summary

Kaw Dehydrating Co. sought to deduct $61,739. 06 as accrued bonuses for two controlling shareholders in 1973. The IRS disallowed the deduction under Section 267 because the bonuses were not paid or constructively received within 2½ months after the tax year. The Tax Court held that the bonuses were not constructively received because they were merely discussed, not formally approved, and not credited to the shareholders' accounts until well after the grace period, thus disallowing the deduction.

Facts

Kaw Dehydrating Co. , an accrual basis corporation, discussed bonuses for its president and vice president, R. M. Bunten, Jr. and W. W. Bunten, at a board meeting on October 3, 1973. The bonuses were set at percentages of the company's profit but were not formally approved or credited to the Buntens' accounts until June 30, 1974. The company deducted these bonuses on its 1973 tax return, but the IRS disallowed the deduction because the bonuses were not paid or constructively received within 2½ months after the close of the 1973 tax year.

Procedural History

The IRS issued a statutory notice of deficiency to Kaw Dehydrating Co. for the 1973 tax year, disallowing the deduction of the bonuses. The company petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the IRS's determination and entered a decision for the respondent.

Issue(s)

1. Whether the bonuses claimed by Kaw Dehydrating Co. as deductions in 1973 were constructively received by R. M. Bunten, Jr. and W. W. Bunten within the period consisting of the taxable year and 2½ months after the close thereof.

Holding

1. No, because the bonuses were merely discussed and not formally approved or credited to the Buntens' accounts until well after the 2½ month period, thus failing to meet the constructive receipt requirements under Section 267.

Court's Reasoning

The court applied Section 267, which disallows deductions for unpaid expenses to

© 2025 SCOTUSreports.com. All rights reserved.

related taxpayers unless paid or constructively received within 2½ months after the close of the tax year. The court found that the bonuses were not constructively received because they were not credited to the Buntens' accounts until June 30, 1974, and no formal resolution or action was taken to approve them. The court noted that the minutes of the October 3, 1973, meeting only discussed the bonuses without definitive action, and the subsequent issuance of promissory notes in June 1974, with interest starting from that date, indicated that the bonuses were not available to the Buntens earlier. The court also considered the lack of payment of a similar bonus to another employee as further evidence that the bonuses were not constructively received. The court emphasized that constructive receipt is a factual determination and found the evidence insufficient to support the taxpayer's position.

Practical Implications

This decision underscores the importance of formal action and timely crediting of bonuses to related taxpayers' accounts to satisfy the constructive receipt requirements under Section 267. For similar cases, attorneys must ensure that bonuses are properly authorized and credited within the statutory period to secure deductions. This ruling affects how closely held corporations handle bonus payments to controlling shareholders, requiring strict adherence to formalities and timely accounting entries. The decision also has implications for tax planning, as it highlights the need for clear documentation and action to support deductions. Subsequent cases have continued to apply the principles established in Kaw Dehydrating, emphasizing the factual nature of constructive receipt determinations.

© 2025 SCOTUSreports.com. All rights reserved.