Bennett Paper Corp. & Subsidiaries v. Commissioner, 78 T. C. 458 (1982)

Preopening expenses are not deductible until a business begins operations, and employee bonuses are not deductible until the liability is fixed and certain.

Summary

In Bennett Paper Corp. & Subsidiaries v. Commissioner, the Tax Court ruled on the deductibility of preopening expenses incurred by Commodores International Yacht Club, Inc. (CIYC), a subsidiary formed to operate a marina and yacht club, and the accrual of employee bonuses under Bennett Paper Corp. 's profit sharing plan. The court held that CIYC's preopening expenses were not deductible under Section 162(a) as it was not yet carrying on a trade or business. Additionally, the court determined that Bennett Paper Corp. could not deduct the full amount of employee bonuses accrued under its plan for 1974 because the liability was contingent on future conditions, thus not fixed by the end of the year.

Facts

Bennett Paper Corp. and its subsidiaries, including Maryland Heights Leasing, Inc. (MHL) and King Island, Inc. (KI), filed a consolidated return for 1974. KI operated a marina business, Pirate's Cove, which it sold in 1974. In August 1974, Concepts, Inc. , another subsidiary, formed CIYC to establish a new marina and yacht club. CIYC collected application fees in 1974 but did not open its facilities until 1975. Bennett Paper Corp. also had a profit sharing plan for employees, with bonuses dependent on quarterly and annual profits and continued employment. The company claimed deductions for CIYC's preopening expenses and the full amount of accrued bonuses on its 1974 return, which the IRS contested.

Procedural History

The IRS determined a deficiency in Bennett Paper Corp. 's 1974 federal income tax and disallowed the deductions for CIYC's preopening expenses and a portion of the accrued employee bonuses. Bennett Paper Corp. and its subsidiaries petitioned the United States Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether the preopening expenditures claimed by CIYC were incurred in the course of a trade or business under Section 162(a).
2. Whether Bennett Paper Corp. is entitled to a deduction in excess of the amount allowed by the Commissioner for liabilities incurred under its profit sharing plan.

Holding

1. No, because CIYC was not carrying on a trade or business in 1974; it had not yet commenced operations.

2. No, because the liability for the employee bonuses was not fixed by the end of 1974, being contingent on future conditions.

Court’s Reasoning

The court applied Section 162(a), which requires expenses to be incurred in carrying on a trade or business to be deductible. For CIYC, the court found that it was not yet operating a marina or yacht club in 1974, as it lacked facilities, members, and operational income. The court rejected the argument that KI’s activities could be attributed to CIYC for tax purposes, emphasizing that each corporate entity must be considered separately. The court cited *Richmond Television Corp. v. United States*, which established that preopening expenses are not deductible until a business functions as a going concern.

For the employee bonuses, the court relied on the all-events test for accrual method taxpayers, requiring that the liability be fixed and certain by the end of the tax year. Since the bonuses were contingent on employees remaining with the company until future payment dates, the liability was not fixed at year-end, and thus, the full amount could not be accrued and deducted in 1974.

Practical Implications

This decision underscores the importance of timing in tax deductions, particularly for new businesses. Taxpayers must wait until a business is operational to deduct preopening expenses, affecting cash flow planning for startups. The ruling also clarifies that for accrual method taxpayers, liabilities must be fixed and certain to be deductible, impacting how companies structure and account for employee compensation plans. Subsequent cases have followed this precedent, reinforcing the need for clear business operations before claiming deductions and careful structuring of contingent liabilities. Legal practitioners must advise clients on these principles to avoid disallowed deductions and potential tax deficiencies.

