Sebring v. Commissioner, 93 T. C. 220 (1989)

Contributions to a reserve fund for future liabilities are not deductible as business expenses under Section 162; they are includable in income when earned.

Summary

Leslie Sebring, a bail bondsman, argued that his mandatory payments into a 'Build Up Fund' (BUF) for indemnifying sureties were deductible business expenses. The U. S. Tax Court held that these payments were not deductible under Section 162 as they were contributions to a reserve for future liabilities, not actual expenses. Furthermore, the court ruled that these funds, which Sebring earned and set aside as security, were includable in his income in the year they were earned, despite being held by the sureties.

Facts

Leslie Sebring operated as a bail bondsman and was required to pay a percentage of his fees into separate 'Build Up Fund' (BUF) accounts managed by his sureties (Peerless, Cotton, and Allied Insurance Companies). These payments were security for Sebring's promise to indemnify the sureties for any losses due to bond forfeitures. The funds were held in trust and could only be used to cover Sebring's liabilities under the agreements. During 1981 and 1982, no funds were drawn from the BUF accounts to cover liabilities, as Sebring paid these directly from other sources.

Procedural History

The Commissioner of Internal Revenue disallowed Sebring's deductions for BUF payments and included these amounts in his taxable income. Sebring petitioned the U. S. Tax Court, which ruled in favor of the Commissioner, holding that BUF payments were not deductible and were includable in Sebring's income.

Issue(s)

1. Whether payments into a BUF account, held as security for future liabilities, are deductible under Section 162 as business expenses.
2. Whether the funds paid into the BUF accounts are includable in the taxpayer's income.

Holding

1. No, because contributions to a reserve for future liabilities are not deductible as business expenses until an actual liability is satisfied from the reserve.
2. Yes, because the funds were earned by Sebring and set aside as security, they are includable in his income in the year they were earned.

© 2025 SCOTUSreports.com. All rights reserved.

Court’s Reasoning

The court applied the long-standing principle that contributions to reserves for future liabilities are not deductible until used to satisfy an actual liability. The court distinguished Sebring’s BUF payments from deductible expenses, noting that no liabilities were satisfied from the BUF accounts during the years in question. The court also rejected Sebring’s analogies to prepaid expenses and defined benefit plans, emphasizing that BUF payments had life beyond any one-year rule and were not payments to a defined benefit plan. The court cited cases like *Commercial Liquidation Co. v. Commissioner* and *Hradesky v. Commissioner* to support its conclusion that such reserve payments are not deductible. Additionally, the court found that the funds in the BUF accounts belonged to Sebring and were therefore includable in his income when earned, as per *United States v. Britt*.

Practical Implications

This decision clarifies that mandatory payments into reserve funds for future liabilities are not deductible business expenses under Section 162. Taxpayers must wait until an actual liability is satisfied from the reserve to claim a deduction. For bail bondsmen and similar professionals, this means planning for tax liabilities without the immediate benefit of deductions for reserve contributions. The ruling also affects how income is reported, as funds set aside as security must be included in income when earned, even if held by a third party. This case has been cited in subsequent rulings to affirm the non-deductibility of reserve contributions and has implications for various industries where reserves are commonly used.

© 2025 SCOTUSreports.com. All rights reserved.