Truck and Equipment Corporation of Harrisonburg v. Commissioner of Internal Revenue, 98 T. C. 141 (1992)

The temporary regulation setting a 2 1/2-month period for the payment of accrued employee bonuses to avoid deferred compensation rules is valid and applies to foreseeable delays in payment.

Summary

Truck and Equipment Corporation challenged the IRS's disallowance of a $137,000 deduction for bonuses accrued but not paid within 2 1/2 months after the end of their fiscal year. The case hinged on the validity and application of a temporary regulation under section 404(b) of the Internal Revenue Code, which presumes that bonuses not paid within this period are subject to deferred compensation rules. The court upheld the regulation's validity, finding it consistent with legislative intent to address timing distortions between deductions and income inclusion. The court also ruled that the company's foreseeable cash flow issues did not exempt them from the regulation's application, thus the bonuses were subject to deferred compensation rules.

Facts

Truck and Equipment Corporation, a Mack truck dealer, accrued bonuses of $137,000 for its employees at the end of its fiscal year on January 31, 1986. These bonuses were intended as additional compensation for services rendered during the fiscal year but were paid in July and December of 1986, and partially in 1987. The company's policy was to pay bonuses when cash flow improved, typically in the summer. The IRS disallowed the deduction for these bonuses, asserting they were subject to deferred compensation rules under section 404 because they were not paid within 2 1/2 months after the fiscal year-end.

Procedural History

The IRS issued a statutory notice of deficiency to the company on May 17, 1989, disallowing the deduction for the bonuses. The company filed a petition with the United States Tax Court. The court heard the case and issued its opinion on February 6, 1992, upholding the validity of the temporary regulation and ruling that the company's bonuses were subject to deferred compensation rules.

Issue(s)

1. Whether section 1. 404(b)-1T, Temporary Income Tax Regs. , is a valid regulation.
2. Whether the company's yearend bonus payments method falls within an exception to the temporary regulation.

Holding

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1. Yes, because the temporary regulation is a reasonable implementation of the legislative intent to minimize timing distortions in deductions and income inclusion.
2. No, because the company failed to demonstrate that it was impracticable to pay the bonuses within the 2 1/2-month period and that such impracticability was unforeseeable at the end of the fiscal year.

Court's Reasoning

The court found that the temporary regulation was valid because it harmonized with the statute's purpose and legislative history. The regulation's 2 1/2-month rule was seen as a reasonable interpretation of Congress's intent to address timing issues in deferred compensation. The court applied the regulation to the company's bonus payments because the company could not rebut the presumption that the delay was foreseeable, given its established practice of paying bonuses later due to cash flow issues. The court emphasized that the regulation allowed for exceptions only when delays were both impracticable and unforeseeable, neither of which the company could prove.

Practical Implications

This decision clarifies that temporary regulations issued under section 404(b) are valid and enforceable, even if they establish bright-line rules like the 2 1/2-month period for bonus payments. Businesses using accrual accounting must be aware that bonuses accrued at year-end but not paid within this period are subject to deferred compensation rules unless they can demonstrate both impracticability and unforeseeability of the delay. This ruling may influence how companies structure their compensation plans to avoid similar disallowances and underscores the importance of timely payment of accrued bonuses to align with tax deductions. Subsequent cases have referenced this decision in upholding the validity of temporary regulations and applying the deferred compensation rules to similar situations.

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